

Mortensen, Jørgen

**Research Report**

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# CASE Network Studies & Analyses

## Economic Policy Coordination in the EMU: From Maastricht via SGP to the Fiscal Pact

Jorgen Mortensen

No. 459/2013

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al. Jana Pawła II 61, office 212, 01-031 Warsaw, Poland

tel.: (48 22) 206 29 00, 828 61 33, fax: (48 22) 206 29 01

e-mail: case@case-research.eu

<http://www.case-research.eu>



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**Jørgen Mortensen** CASE Fellow and associate Senior Research Fellow at the Brussels-based Centre for European Policy Studies (CEPS). He graduated in economics and statistics from the University in Copenhagen in 1963. After a brief period as administrator at the Central Statistical Office he took up a post as junior economist at the Organisation for Economic Co-operation and Development (OECD) in Paris. From 1973 to 1988 he was a senior economist (Head of Division) in the Directorate-General for Economic and Financial Affairs of the European Commission. Since 1989 he has been free-lance researcher, mainly associated with CEPS and now with CASE. Jørgen Mortensen has written or edited numerous research reports and books on issues as economic and social cohesion in the European Union, social and health policy issues, Social Europe, the financing of retirement provision, portability of pension rights, the role of intellectual capital in the economy, intangibles in business accounting and in the national economy, productivity and growth accounting. He has coordinated and participated in a large number of FP research projects and several studies on social policy and employment issues for the European Commission.

## **Abstract**

The present paper first takes a step backwards with an attempt to situate the adoption of this Treaty in discussion of the SGP and the “Maastricht criteria” (the criteria for EMU membership fixed in the Maastricht Treaty) in a longer perspective of the sharing of competences for macroeconomic policy making within the EU from the initial Treaty to the Maastricht Treaty and the Stability and Growth Pact (SGP). It then presents the main features of the Fiscal Treaty and its relation to the SGP and draws some conclusions as regards the importance and relevance of this new step in the process of economic policy coordination. It concludes that 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 already well identified in the Delors report in 1989 and regularly emphasised ever since and now 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.

## 1. Introduction

On 9 December 2011 at the European Council meeting, all 17 members of the Eurozone agreed on the basic outlines of a new intergovernmental treaty to put strict caps on government spending and borrowing, with penalties for countries deemed to violating the limits. Non-Eurozone countries except the United Kingdom indicated that they were prepared to join, subject to parliamentary vote. On 30 January 2012 European Council members except from United Kingdom and Czech Republic endorsed the final version of the fiscal pact at the European summit in Brussels. The Treaty entered into force on 1 January 2013 as it had been ratified by the necessary minimum of 12 Eurozone countries as stipulated in Article 14.

The present paper, which in the initial sections constitute extracts of Mortensen (2004), first takes a step backwards with an attempt to situate the adoption of this Treaty in discussion of the SGP and the “Maastricht criteria” (the criteria for EMU membership fixed in the Maastricht Treaty) in a longer perspective of the sharing of competences for macroeconomic policy making within the EU from the initial Treaty to the Maastricht Treaty and the Stability and Growth Pact (SGP). It then presents the main features of the Fiscal Treaty and its relation to the SGP and draws some conclusions as regards the importance and relevance of this new step in the process of economic policy coordination.

## 2. Policy coordination or policy competition?

Whereas the original Rome Treaty was overwhelmingly focussed on the creation of the customs union and the common agricultural policy (CAP) a mechanism for “soft coordination” of economic policy was created in the early 1960s through the creation in 1960 of a “Conjunctural Policy Committee” and in 1964 of a Medium-Term Economic Policy Committee and a Committee of Central Bank Governors. In practice the tasks facing these committees were not challenging: underlying economic growth was strong, unemployment was low, rates of inflation also low and external imbalances limited. The debates were mainly *ex post* presentations and debates of policy measures taken by the member states and were thus not liable to seriously influence the economic and monetary policy decisions at the EU level.

Following a conference of Heads of State and Government in the Hague in 1969, a committee under the chairmanship of Pierre Werner in June 1970 presented a plan for an Economic and Monetary Union and a more ambitious (prior) coordination of economic policy and proposed the creation of two new Community bodies: a Centre of Decision for Economic Policy and a Community System for Central Banks. This institutional innovation was however not retained by the Council, which, nevertheless, in March 1971 decided that economic and monetary union implied the transfer of competences for economic policy from the national to the Community level and to this end adopted the Werner Plan for EMU in stages.

However, just a few months after the adoption of the ambitious Werner Plan, the Bretton Woods system, which had been under heavy pressure for some time due in particular to the large external deficit of the United States, broke down definitively. In May 1971 the DM and the Guilder were disconnected from the US dollar and on 15 August the dollar-to-gold convertibility was suspended by order of President Nixon. During the course of the autumn the Benelux currencies, the lira and the yen were floated. In view of the chaotic situation in exchange markets and the large disparities within the EC with respect to the economic policy response to the new situation, the Council in November 1973 decided not to move forward to the second stage of the EMU. During the following months the first oil price increase added to the chaos and uncertainties concerning policy making both inside and outside the EC.

During the mid-1970s at least two attempts were made to reintroduce some degree of coordination of policy making within the EU:

- A report on the prospect for Economic and Monetary Union by a group of experts under the chairmanship of Robert Marjolin in 1975. The report argued that the failure to move to the second stage of EMU was due both to insufficient political will and to a misunderstanding of the nature and the conditions for a successful functioning of an EMU.
- A report on the role of public finances in European Integration by an expert group under MacDougal. This report argued in favour of a significant expansion of the budget of the EU notably by increasing the role of the EU's budget with respect to redistribution between member states.

However, a genuine move towards a certain degree of monetary coordination was made only with the creation of the European Monetary System in December 1978. During the following fifteen years the EMS showed a certain capacity to constitute a basis for implementation not only on monetary but also of budgetary policy, This was essentially due to the fact that



domestic policy of the member states for the first time after the breakdown of the Bretton Woods agreement was called upon to take explicit account of external constraints, in this case the observance of the limits for fluctuation of exchange rates within the EMS limits.

The creation of the EMS and the resulting constraints on domestic economic and monetary policy of the participating countries in no way was greeted with satisfaction by all camps. In fact, the ensuing limitation of the freedom of manoeuvre of domestic policy was considered a heresy by a number of influential economists around the world. It was argued by many that the EU in no way constituted an “optimal currency area”. With relatively low cross-frontier mobility of production factors the EU members states were, according to this school of thought, in the case of “asymmetric shocks” strongly in need for exchange rate flexibility. Without exchange rate flexibility, adjustment to supply and demand shocks would be more likely to result in unemployment or demand pressures and the EMS would therefore be likely to result in welfare losses in the longer run.

Even among the supporters of the original idea of Jean Monnet to use monetary union as a *tool* rather than a final objective for European integration<sup>1</sup> there was recognition that the EMS could only constitute an intermediate stage in the move towards full monetary union. Furthermore, there was increasing awareness that the original objectives of creating a customs union and a “level playing field” were far from being attained. The Commission, under the new President: Jacques Delors, therefore in 1985 launched a programme of mass elimination of remaining (non-tariff) barriers to the movement of goods, services, labour and capital within the internal market (called the 1992 programme due to the fact that the target was to eliminate these barriers in 1992 at the latest). This programme was adopted by the Council and the EC then launched a comprehensive legislative process leading to the adoption of almost 300 new directives forming the legal basis for ensuring a “level playing field” in a number of areas. Furthermore, at the beginning of 1986 Spain and Portugal entered into the EC and the extension of the EU single market legislation to the EFTA countries were initiated with the creation of the European Economic Area.

In April 1986, the Commission (under president Jacques Delors) asked a Group of experts to investigate the economic consequences of the decision to enlarge the Community to include Spain and Portugal and to create a market without internal frontiers by year 1992. The Report by the Group, chaired by Tommaso Padoa-Schioppa, then Deputy Director-General of the

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<sup>1</sup> Jean Monnet is supposed to have said that ‘L’Europe se fera par la monnaie’.

Banca d'Italia, was delivered in 1987 under the eloquent title: *Efficiency, Stability and Equity: A Strategy for the Evolution of the Economic System of the European Community.*<sup>2</sup>

The Report argued that:

- The 1992 programme implied a very strong action to improve the *efficiency of resource allocation*.
- The 1992 programme created a need for complementary action to foster macroeconomic stability. Specifically as regards *monetary stability*, the Group argued that the Programme implied a need for considering afresh the case for a strengthened monetary coordination.
- There were, according to the Group, serious risks of aggravation of regional imbalances. Reforms and development of Community *structural funds* were therefore appropriate.
- The 1992 programme enhanced the need for ensuring consistency between microeconomic and macroeconomic policy with *sustained impetus on both supply and demand sides* of the macroeconomic “equation”.

The Group argued that as monetary integration progressed, national budgets would also have to be subject to more intense common disciplines. However, the Report also argued (page 10) that *the decentralised model evident in the mature federations, where the capital market exerts some restraint on state borrowing, is more plausible in the long run than power sharing arrangements that have sometimes been considered*.

The Padoa-Schioppa Group on the other hand, warned against a ‘precipitate move’ in the direction of monetary union, arguing that further adaptation of attitudes and behaviour among private ‘agents’ as well as of political attitudes were required for monetary union to be a sufficiently low-risk proposition.

Nevertheless, less than a year after the publication of the Padoa-Schioppa Report, the European Council, in June 1988 in Hanover decided to examine the means of achieving economic and monetary union. The task of studying and proposing concrete stages leading towards EMU was entrusted to a committee chaired by the President of the Commission and

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<sup>2</sup> The members, in addition to Mr Padoa-Schioppa were : Michael Emerson, Mervyn King, Jean-Claude Milleron, Jean Paelinck, Lucas Papademos, Alfredo Pastor and Frits Scharpf. Paul Krugman presented a paper, published as an annex to the report and certain other experts contributed to the work of the Group.

with the participation of the central bank governors of the EC, one other member of the Commission and three experts. The Report was submitted in April 1989.

### **3. From the Delors Report to the Stability and Growth Pact**

#### **3.1. *The Delors Committee's outline for EMU***

The Report (here after called the Delors Report) provided, first, a brief review of past and present developments in economic and monetary integration in the Community, second, a detailed examination of the key aspects of the final stage of economic and monetary union and, third, a blueprint for the attainment of this union through a gradual approach.

As regards the basic features of economic and monetary union, the Delors Report did not diverge fundamentally from the Werner Report. In contrast to the latter, that saw macroeconomic policy coordination mainly as a way to increase the efficiency of demand management, the Delors Report was more concerned with defining Community procedures to ensure the fixing of upper limits to budget deficits and define the overall stance of fiscal policy in a medium-term framework. First and foremost, however, the Report recommended the establishment of a new Community institution of a status comparable to the existing ones: a European System of Central Banks. The Werner Report had proposed `a Community system for the central banks, but was much less specific than the Delors Report as to the status of this institution within the overall institutional framework. In sharp contrast to the Werner Report, moreover, the Delors Report did not propose a specific timetable for the initiation of the scheme nor for the transition to the subsequent stages of the process of creation of EMU.

Like the Padoa-Schioppa Report, the Delors Report considered the `principle of subsidiarity' (according to which the functions of higher levels of government should be as limited as possible and should be subsidiary to those of lower levels) an essential element in defining the appropriate distribution of power within the Community. It nevertheless expressed strong fears that `uncoordinated and divergent budgetary policies would undermine monetary stability and generate imbalances in the real and financial sectors of the Community'. Moreover, because the centrally-managed Community budget is likely to remain a very small part of total public sector spending and much of it will not be available for cyclical adjustments, `the task of setting a Community-wide fiscal policy stance will have to be performed through the coordination of national budgetary policies'. In fact, according to the Delors Committee, monetary policy alone cannot be expected to establish a fiscal/monetary policy mix appropriate for the preservation

of internal balance or for ensuring that the Community plays its part in the international adjustment process. In sharp contrast to the MacDougall Report, however, the Delors Report did not envisage any significant expansion of the Community's own budget even in the later stages of the EMU.

A key condition for moving to irrevocably-locked exchange rates (the third stage of EMU), according to the Committee, would be that the rules and procedures of the Community in the macroeconomic and budgetary field would become binding, implying that the Council of Ministers in cooperation with the European Parliament would have the authority to take directly-enforceable decisions with respect to national budgets, make discretionary changes in Community resources and apply terms and conditions to existing Community structural and regional policies. The latter would, however, according to the report, need to be further strengthened and their instruments and resources adapted to the needs of the economic and monetary union.

The Delors Committee's fear that market forces would not exert sufficient disciplinary influence upon national governments' borrowing was spelled out in detail in a background paper by Alexandre Lamfalussy. According to this paper, the fact that in federal states like the United States, Germany or Australia there are few constraints on the budgetary policies of sub-federal governments does not imply that such constraints will not be needed in the European Community. In fact, according to Lamfalussy, EC member states appear, by history and tradition, to exhibit much larger and persistent fiscal divergences than observed in federal states and it would not be wise to rely principally on the free functioning of financial markets to iron out any excessive differences in fiscal behaviour between member countries. Fiscal policy coordination, therefore, according to this paper, would appear to be 'a vital element of a European EMU and of the process towards it'.

A strong call for tight constraints on member states' freedom of action in budgetary policy was also put forward in a paper contributed by Karl-Otto Pöhl. According to this paper, whereas the national States would necessarily lose their monetary policy independence in a monetary union, they can quite easily retain certain responsibilities in the field of fiscal and economic policy, as is the case in every federation of States. However, in order to exclude any doubts about the cohesion of the monetary union from the outset and at the same time avoid an overburdening of monetary policy, it would be necessary to ensure conformity of action in fiscal and economic policy within the Community. This is because any lack of convergence that could give rise to expectations of parity changes would need to be "bridged" through interventions and interest rate measures on the national money markets in order to ensure the continuing existence of the monetary or exchange-rate union. Over time it will thus, according to Pöhl, be

necessary to allow for the necessary transfer of economic and fiscal policy responsibilities from national authorities to Community organs.

Transfer of fiscal authority to Community organs, according to Pöhl, though necessary, would not be a sufficient condition for the smooth functioning of a monetary union in the Community. The procedures of income formation would also have to be flexible enough to accommodate differing rates of increase in productivity or shifts in demand leading to divergences in regional developments. Even so, it will, he argued, be necessary to put in place a system of 'fiscal compensation' through a Community organ in favour of the structurally-weak member countries, compensating the latter 'for the burdens of adjustment associated with the definitive renouncement of devaluations as a means of maintaining their competitiveness'.

Although, as indicated above, the Delors Committee attached a high priority to the principle of subsidiarity, it argued that the approach to economic and monetary union must even more strictly respect the principle of parallelism between economic and monetary integration. Although temporary deviations from parallelism are part of the dynamic process of the Community, the Report said, material progress on the economic front would be necessary for further progress on the monetary front. The Report, thus, implicitly came out quite strongly against the idea of using monetary integration as an instrument in the process of economic (and political) integration.

Whereas the Delors Report on the whole turned out to be the expression of the views of central bank governors, other actors in the EMU game were not necessarily in support of further steps in the field of monetary integration. In fact, certain EU member governments, such as notably the UK government, suggested retaining the EMS as a key feature in support of the completed single market. In addition other experts were much less keen than the central bank governors in the Delors Committee to promote the idea of 'parallelism' between economic, monetary and budgetary integration.

In fact, even within the Commission services there was not full support of the main arguments in the Delors Report. Thus, an ECFIN opinion on the EMU published after the Delors Report argued that Monetary Union to be viable should be founded essentially (and only) on two basic principles: (i) no monetary financing of the budget deficits of member governments and (ii) no bail out of national government debt by the EU.

### **3.2. The Maastricht Treaty**

Despite the resistance of some Member States, the EC in 1990 started the process which would lead to the adoption of 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 the achievement of political union and with a view to the final stages of economic and monetary union. The final negotiations took place in Maastricht on 7 February 1992, giving rise to the creation of the European Central Bank and Treaty changes concerning also Justice and Home Affairs and external policy. With respect to EMU the Maastricht Treaty largely reflected the views of the Delors Committee.

The final Treaty thus, in *ARTICLE 4 a*, stipulated as follows:

*A European System of Central Banks (hereinafter referred to as 'ESCB') and a European Central Bank (hereinafter referred to as 'ECB') shall be established in accordance with the procedures laid down in this Treaty; they shall act within the limits of the powers conferred upon them by this Treaty and by the Statute of the ESCB and of the ECB ( hereinafter referred to as 'Statute of the ESCB') annexed thereto.'*

The details on the creation and functioning of the ECB were (as indicated) presented in a protocol. Another protocol specified the conditions which should be fulfilled by a member state in order to participate in the final stage of economic and monetary union that is the replacement of the national currency by the euro and acquiring the rights to become a full member of the ECB (the 'convergence criteria'). The protocol fixed the following convergence criteria:

1. That the average rate of inflation in the member state, observed over a period of one year before the examination, did not exceed by more than 1 ½ percentage point that of, at most, the three best performing member states;
2. That the member states was not the subject of an 'excessive deficit procedure' according to article 104c(6) of the Treaty;
3. That the member states for at least two years had respected the normal fluctuation margin within the EMS; and

4. That the average long-term interest rate had not exceeded by more than 2 percentage points that of, at most, the three best performing member states in terms of price stability.

When commenting on the results of the Maastricht IGC, the then Commissioner responsible for Economic and Financial Affairs, Henning Christophersen, stated that the Commission had been in favour of either no criteria at all or at least a higher degree of 'tolerance' for EMU membership. But at least one key member state (Germany) had insisted on the maintenance of such rigorous rules of the game in order to go forward to EMU. The Maastricht Treaty also fixed the time frame for moving to the final phase of EMU (article 109 j) in the following terms:

*Taking due account of the reports referred to in paragraph 1 and the opinion of the European Parliament referred to in paragraph 2, the Council, meeting in the composition of Heads of State or of Government, shall, acting by a qualified majority, not later than 31 December 1996:*

- *decide, on the basis of the recommendations of the Council referred to in paragraph 2, whether a majority of the Member States fulfil the necessary conditions for the adoption of a single currency;*
- *decide whether it is appropriate for the Community to enter the third stage, and if so*
- *set the date for the beginning of the third stage.*

*4. If by the end of 1997 the date for the beginning of the third stage has not been set, the third stage shall start on 1 January 1999. Before 1 July 1998, the Council, meeting in the composition of Heads of State or of Government, after a repetition of the procedure provided for in paragraphs 1 and 2, with the exception of the second indent of paragraph 2, taking into account the reports referred to in paragraph 1 and the opinion of the European Parliament, shall, acting by a qualified majority and on the basis of the recommendations of the Council referred to in paragraph 2, confirm which Member States fulfil the necessary conditions for the adoption of a single currency.*

### **3.3. The Stability and Growth Pact**

With the ultimate limit for passing to Stage 3 (1 January 1999) approaching, some member states became increasingly concerned with the possibility of irresponsible budgetary behaviour by governments once admitted in 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 final agreement on the text was reached on 7 July 1997 (see annex).

Broadly speaking, the SGP stipulates the need for observing the Maastricht criteria even after EMU membership and provides somewhat specific guidelines for the process of deciding whether an EMU member country runs an excessive deficit. The SGP, however, goes considerably beyond the Maastricht Treaty by giving the Council the competence 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' always to 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.

As presented by the Directorate-General for Economic and Financial Affairs of the European Commission, the Stability and Growth Pact (SGP) is the concrete EU answer to concerns on the continuation of budgetary discipline in Economic and Monetary Union (EMU). Adopted in 1997 as indicated above, the SGP strengthened the Treaty provisions on fiscal discipline in EMU foreseen by articles 99<sup>3</sup> and 104<sup>4</sup>, and the full provisions took effect when the euro was launched on 1 January 1999.

The principal concern of the SGP was to enforce fiscal discipline as a permanent feature of EMU. Safeguarding sound government finances was considered a means to strengthening the conditions for price stability and for strong and sustainable growth conducive to employment creation. However, it was also recognised that the loss of the exchange rate instrument in EMU would imply a greater role for automatic fiscal stabilisers at national level to help economies adjust to asymmetric shocks, and would make it "necessary to ensure that national budgetary policies support stability oriented monetary policies". This is the rationale behind the core commitment of the SGP, i.e. to set the "... medium-term objective of budgetary positions close to balance or in surplus..." which "... will allow all Member States to deal with normal cyclical fluctuations while keeping the government deficit within the reference value of 3% of GDP".

Formally, the SGP consists of three elements as follows:

- a political commitment by all parties involved in the SGP (Commission, Member States, Council) to the full and timely implementation of the budget surveillance process. These

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<sup>3</sup> <http://europa.eu/old-address.htm#anArt1>

<sup>4</sup> <http://europa.eu.int/eur-lex/en/treaties/selected/livre223.html#anArt6>



are contained in a Resolution<sup>5</sup> agreed by the Amsterdam European Council of 17 June 1997. This political commitment ensures that effective peer pressure is exerted on a Member State failing to live up to its commitments.

- preventive elements which through regular surveillance aim at preventing budget deficits going above the 3% reference value. To this end, Council Regulation 1466/97<sup>6</sup> reinforces the multilateral surveillance of budget positions and the co-ordination of economic policies. It foresees the submission by all Member States of stability and convergence programmes<sup>7</sup> which will be examined by the Council.
- dissuasive elements which in the event of the 3% reference value being breached, require Member States to take immediate corrective action and, if necessary, allow for the imposition of sanctions. These elements are contained in Council Regulation 1467/97<sup>8</sup> on speeding up and clarifying the implementation of the excessive deficit procedure<sup>9</sup>.

Besides this legal basis, the Code of Conduct on the content and format of the stability and convergence programmes, endorsed by the ECOFIN Council on 10 July 2001, incorporated the essential elements of Council Regulation 1466/97<sup>10</sup> into guidelines to assist the Member States in drawing up their programmes. It also aims at facilitating the examination of the programmes by the Commission, the Economic and Financial Committee and the Council.

The right of initiative in this procedure is attributed to the Commission.

### **3.4. Examination and monitoring of programmes**

In conformity with the SGP, the Council examined the original 1999 programmes. Since then the Council assesses the annual programme updates at the beginning of each year. This

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<sup>5</sup>[http://europa.eu.int/smartapi/cgi/sga\\_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31997Y0802\(01\)&model=guichett](http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31997Y0802(01)&model=guichett)

<sup>6</sup>[http://europa.eu.int/smartapi/cgi/sga\\_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31997R1466&model=guichett](http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31997R1466&model=guichett)

<sup>7</sup> [http://europa.eu.int/comm/economy\\_finance/about/activities/sgp/scp\\_en.htm](http://europa.eu.int/comm/economy_finance/about/activities/sgp/scp_en.htm)

<sup>8</sup>[http://europa.eu.int/smartapi/cgi/sga\\_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31997R1467&model=guichett](http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31997R1467&model=guichett)

<sup>9</sup> [http://europa.eu.int/comm/economy\\_finance/about/activities/sgp/edp\\_en.htm](http://europa.eu.int/comm/economy_finance/about/activities/sgp/edp_en.htm)

<sup>10</sup>[http://europa.eu.int/smartapi/cgi/sga\\_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31997R1466&model=guichett](http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31997R1466&model=guichett)

examination is based on assessments by the Commission and the Economic and Financial Committee and includes considerations as to:

- whether the medium-term budget objective in the programme provides for a safety margin to ensure the avoidance of an excessive deficit;
- whether the economic assumptions on which the programme is based are realistic;
- whether the measures being taken and/or proposed are sufficient to achieve the medium-term budgetary objective (and, for convergence programmes, to achieve sustained convergence);
- whether the content of the programme facilitates the closer co-ordination of economic policies;
- whether the economic policies of the Member State concerned are consistent with the broad economic policy guidelines;

On a recommendation from the Commission, and after consulting the Economic and Financial Committee, the Council delivers an opinion on each programme, and can invite the Member State concerned to strengthen it. The Council monitors the implementation of programmes and, to prevent an excessive deficit, can recommend to the Member State concerned to take adjustment measures. If subsequent monitoring suggests worsening budgetary divergence, the Council can recommend taking prompt corrective measures.

### **3.5. The Excessive Deficit Procedure (EDP)**

The Treaty (Article 104)<sup>11</sup> obliges Member States to avoid excessive budgetary deficits, defined by a reference value of 3% of GDP. Article 104 also sets out a procedure to be followed at Community level to identify and counter such excessive deficits, including the possibility of financial sanctions. To make this a more effective deterrent, the Stability and Growth Pact (SGP)<sup>12</sup> clarified and speeded up the excessive deficit procedure. The EDP refers to the procedure as specified by Council Regulation 1467/97<sup>13</sup> included in the SGP.

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<sup>11</sup> <http://europa.eu.int/eur-lex/en/treaties/selected/livre223.html#anArt6>

<sup>12</sup> [http://europa.eu.int/comm/economy\\_finance/about/activities/sgp/sgp\\_en.htm](http://europa.eu.int/comm/economy_finance/about/activities/sgp/sgp_en.htm)

<sup>13</sup> [http://europa.eu.int/smartapi/cgi/sga\\_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31997R1467&model=guichett](http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31997R1467&model=guichett)

### ***Identifying an excessive deficit and requesting the Member State to correct it***

The EDP sets out schedules and deadlines for the Council, following reports from and on the basis of opinions by the Commission and the Economic and Financial Committee, to reach a decision that an excessive deficit exists. Such a decision is taken within three months of the reporting deadlines for government finances of 1 March and 1 September each year established by Council. A government deficit exceeding the reference value of 3% of GDP is considered exceptional and temporary and not subject to sanctions when:

- It results from an unusual event outside the control of the Member State concerned and has a major impact on the financial position of the general government;
- It results from a severe economic downturn (if there is an annual fall of real GDP of at least 2%).

When it decides that an excessive deficit does exist, the Council makes recommendations to the Member State concerned and establishes a deadline of four months for effective corrective action to be taken. In the absence of special circumstances, such action is that which ensures completion of the correction of the excessive deficit in the year following its identification. If, after a progressive notice procedure, the Member State fails to comply with the Council's decisions, the Council normally decides to impose sanctions, at the latest, ten months after reporting of the data indicating an excessive deficit exists.

### ***Sanctions***

Sanctions first take the form of a non-interest-bearing deposit with the Commission. The amount of this deposit comprises a fixed component equal to 0.2% of GDP and a variable component linked to the size of the deficit. Each following year the Council may decide to intensify the sanctions by requiring an additional deposit, though the annual amount of deposits may not exceed the upper limit of 0.5% of GDP. A deposit is as a rule converted into a fine if, in the view of the Council, the excessive deficit has not been corrected after two years.

### ***Abrogation of sanctions***

The Council may decide to abrogate some or all of the sanctions, depending on the significance of the progress made by the participating Member State concerned in correcting the excessive deficit. The Council will abrogate all outstanding sanctions if the decision on the existence of an excessive deficit is itself abrogated. However, any fines already imposed are not reimbursable. Interest on the deposits lodged with the Commission, and the yield from

finances, are distributed among Member States without an excessive deficit, in proportion to their share in the total GNP of eligible Member States.

In reality the procedures outlined in the SGP and the EDP proved to be incapable of ensuring implementation of the rules in line with the original objectives. A first case of EDP emerged in 2002 with respect to Portugal. After some back-and-forth negotiations and re-estimation of budget deficits, the Portuguese government at the end of 2002 took further measures of budgetary consolidation and in its new assessment in February 2003 the Commission revised considerably downward the forecast budget deficits, which consequently were brought just below the 3% threshold for 2003 and expected to fall further in 2004.

However, already in late 2002 and early 2003 it became clear that first Germany and later France were in serious risk of running general government budget deficits in excess of the limits fixed in the Maastricht Treaty and in the SGP. In fact the Council, already in January 2003, decided that an excessive deficit existed in Germany and recommended that Germany “put an end to the present excessive deficit situation as rapidly as possible”. It noted the German government’s expressed resolve to deal with these issues and established a deadline of 21 May 2003 at the latest for the German government to take the measures required to ensuring that the rise in public debt be brought to a halt in 2003 and reversed thereafter.

As far as France was concerned, the Council on 3 June 2003 decided that an excessive deficit existed and adopted a recommendation that France put an end to this excessive-deficit situation before 3 October 2003 and achieve a significantly larger cyclically-adjusted deficit in 2003 than planned in June.

Since neither of the two governments had acted according to the Council recommendations, the Commission in October (France) and November (Germany) recommended that the Council proceed with the adoption of the sanctions envisaged in the SGP. Nevertheless, on 25 November when the Council took a vote on the Commission’s draft recommendations the required qualified majority for applying sanctions was not reached. However, the conclusions agreed to hold the excessive deficit procedure “in abeyance for the time being” and invited both France and Germany to “regularly report on the progress made in fulfilling the commitments to reduce the deficits”.

On 13 January 2004, the European Commission decided to challenge, before the European Court of Justice, the legality of the procedures under which (according to the Commission) the eurozone’s disciplinary rules on budget balances as determined by the Stability and Growth Pact (SGP) had been broken by the Council. This step was the Commission’s reaction to the Ecofin Council’s decision on 25 November 2003 not to apply sanctions on the German and

French governments for exceeding the limits to budget deficits as determined in the “excessive deficit procedures” provided for in the SGP. However, the Commission underlined that it would continue the conduct of economic and budgetary surveillance for all member states in the framework of the Treaty and the SGP and continue to monitor developments for countries in excessive deficit. It also announced that it would make new proposals for the strengthening of economic governance in the future, including proposals for improvements in the implementation of the SGP.

In its judgment of 13 July 2004 the Court of Justice clarified the powers of the Commission and the Council relating to the Excessive Deficit Procedure. It went a long way toward the Commission’s claims in so far as it annulled the conclusions adopted by the Council in which it held the EDP in “abeyance” and modified the recommendations previously made to it to Germany and France for correction of their excessive deficit.

The assessment by many observers that the Council, by not observing the rules laid down in Treaty article 104 and the Stability and Growth pact, had actually exerted a discretion not in compliance with these provisions had thus been largely confirmed by the Court.

The Court found first of all that, where the Commission recommends to the Council that it adopt decisions such as those at issue in the present case and the required majority is not achieved in the Council, a decision, even an implied one, does not exist for the purposes of the Treaty.

Consequently, the Court found that failure by the Council to adopt the decisions recommended by the Commission did not constitute an act challengeable by an action for annulment and it declared this part of the action to be inadmissible. The Court accordingly, as indicated, annulled the Council’s conclusions of 25 November 2003.

The Court of Justice, by stressing that the Council does not have the competence to depart from the rules laid down by the Treaty, provided a welcome clarification of the assignment of competences to the Commission and the Council as far as the Broad Economic Guidelines and the Excessive Deficit Procedure were concerned.

First of all, the Court stressed that only the Commission has the competence to make recommendations concerning the EDP. It does, however, recognise that there may be cases where the majority required for adopting a decision may not be achieved. However, in this case the Council can do nothing more than to take note of unilateral commitments of the member states concerned by the EDP.

Secondly, the Council does not have the competence to modify the recommendations without being prompted by the Commission. However, the Council's conclusions in this case were not preceded by Commission initiatives and, furthermore, they were adopted in accordance with the voting rules prescribed for a "decision to give notice".

The final outcome of this "case law" was therefore a certain strengthening of the power of the Commission and, notably, of the role of the Broad Economic Guidelines in the policy making apparatus of the EU. However, the Court also recognised that Council may not actually be in a position to achieve a qualified majority in support of any recommendation from the Commission. Consequently, in case the Council does not deliver the sanctions envisaged the whole EDP may remain a political process with only limited influence on national policy making.

### **3.6. The Commission's communication of 3 September 2004**

With the judgement as the starting position for a reconsideration of the application of Article 104 and the SGP, the Commission on 3 September 2004 adopted a communication on "strengthening economic governance and clarifying the implementation of the Stability and Growth Pact".<sup>14</sup>

This Communication examined firstly how the fiscal framework - and in particular the Stability and Growth Pact - could respond to the shortcomings experienced so far through greater emphasis to economic developments in recommendations and an increased focus on safeguarding the sustainability of public finances. Secondly, this Communication addressed how the instruments for EU economic governance could be better interlinked in order to enhance the contribution of fiscal policy to economic growth and support progress towards realising the Lisbon strategy. Thirdly, the Communication suggested possible improvements to the enforcement of the framework.

In developing this approach, the Commission stated explicitly taking into account the implications of the ruling of the European Court of Justice of 13 July that clarified the respective roles of the Commission and the Council in the application of the EU fiscal framework. The ruling also in the opinion of the Commission confirmed that a rules-based system is the best guarantee for commitments to be enforced and for all Member States to be treated equally.

The Commission then proposed to refocus the SGP by placing more emphasis on government debt and sustainability in the surveillance of budgetary positions. Furthermore it suggested to allow for more country-specific circumstances in defining the SGP medium-term deficit

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<sup>14</sup> COM(2004) 581 Final, 3.9.2004.

objective of “close to balance or in surplus” and, finally to consider the specific economic circumstances and developments in the implementation of the EDP. As stated in the Communication the Commission would in consultation with the Member States continue the work to elaborate these ideas and render them operational and then present legislative proposals to implement the new rules.

#### **4. The Lisbon strategy and the “three pillar approach”**

The new Commission installed in the autumn of 2004 faced the challenge of taking responsibility for the mid-term review of the Lisbon strategy and of formulating a stance with respect to the future of the Stability and Growth Pact. The status of the two policy issues are different, with the Lisbon strategy being essentially a common set of objectives to be pursued by member states within the framework of the Open Method of Coordination and the SGP being founded on the Treaty. However, at the level of EU policy making it was clearly not possible to fully disentangle the two sets of policy issues and the Commission apparently decided to focus mainly on the re-launching of the Lisbon strategy, leaving the SGP issues to be debated at the level of the presidency of the Council.

On 9 March 2005 Commission President Barroso in the European Parliament stressed that the first five years of Lisbon had not delivered the hoped-for results and that, in key areas from productivity to research and education spending, early school leavers or poverty the EU had barely managed to make progress on closing the gaps that existed in year 2000. He did not, however, announce any new initiatives aimed at accelerating the implementation of the Lisbon agenda.

As far as the SGP is concerned, the presidency in the run-up to the Spring-2005 Summit struggled to arrive at a consensus between the various antagonists, with France, Germany and Italy apparently aiming at an explicit agreement on the interpretation of the provisions while a number of other member states clearly opposed any modifications. The Commission did not express any official views on the SGP but in early March two key staff members of DG ECFIN in European Economy Occasional Paper No. 15, argued that the 3% ceiling on budget deficits should not only be preserved but the effectiveness of both the preventive and corrective elements of the Pact needed to be reinforced by stronger institutions, improved surveillance and transparency plus enhanced peer pressure and reliable, complete and timely statistics.

A new element in the puzzle emerged with the announcement in late 2004 that the Greek budget deficit in fact already by the time the Drachma joined the eurozone had been seriously under recorded and that, consequently, Greece ought to be the subject of an Excessive Deficit procedure as well.

After the 2004 enlargement, an EDP was initiated as regards Hungary and in 2008 as regards the United Kingdom. However, with the emergence of the financial crisis and the deterioration of budget balances in 2008-2009 a large number of EDPs were, in fact, launched on 18 February 2009 (France, Latvia, Ireland, Greece and Spain), on 13 May 2009 (Poland, Romania and Lithuania) on 7 October 2009 ((Austria, Belgium, Czech Republic, Italy, The Netherlands, Portugal, Slovenia and Slovakia) and on 12 May 2010 (Denmark and Cyprus) in all cases with a horizon of 2012-2016 for correction of the deficits.

Furthermore, faced with the implications of the financial and economic crisis and the increasing diversity of fiscal and monetary responses to the new challenges, the Commission and the Council already in 2010 initiated explorations of the path towards strengthening of the economic policy coordination and, in particular, the ways to ensure the most appropriate mix of the monetary policy and the financial stability mechanisms of the ECB and the budgetary policy of the Eurozone member states plus the monetary and budgetary policy decided and implemented by the non-eurozone Member States.

## 5. Towards a Banking Union?

In the Padoa-Schioppa Report, Paul Krugman, in a special contribution<sup>15</sup>, stressed that “the desire to prevent 1930s-style banking collapses has led nearly all nations to provide a safety net of deposit insurance, together with implicit guarantees that the government will bail out the banking system if necessary. He also underlined that the explicit and implicit guarantees of governments to the financial system are not unconditional and that they are backed by regulations on exposure and capitalization requirements that insure that bank equity is large enough to bear much of the responsibility of adverse outcomes. He then moved on the argue that integration on financial markets requires revision of the regulatory framework and that,

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<sup>15</sup> Krugman, Paul: *Economic Integration in Europe: Some Conceptual Issues* (Annex A to the Padoa-Schioppa Report).



without such a revision, capital flows will be motivated more by a search for loopholes than a search for real economic opportunities, and reduce the welfare instead of increasing it.

Furthermore Krugman argued that if fiscal problems make seignorage an important source of revenue, the problem is compounded so that a country that relies to a significant extent on inflation for revenue will offer a strong negative real return on its currency and a low real return on bank deposits. Although Krugman did not discuss in depth the additional complications and challenges in a full monetary union as the eurozone, he nevertheless ended up arguing for both a coordinated regulation of the banking system and for moves to achieving enhanced coordination of fiscal policies.

Not even the cautionary Krugman probably envisaged the huge expansion of financial institutions' balanced, the boosting of leverage and increase in cross-frontier capital movements following the liberalisation of the banking system in the United States and in other OECD countries. Nevertheless, the assumption of the capacity of efficient and transparent markets to auto-regulate themselves apparently did not resist to the challenge of the accelerated cross-frontier capital flows and the sub-prime bubble in the United States and a number of European Countries, inside and outside the eurozone.

The bursting of this bubble in 2007-2008 furthermore demonstrated that the traditional perceptions of macroeconomic policy as consisting of budgetary and monetary policy with the charge of finding the most appropriate mix of these two policy components would need to be complemented by a third component which could best be termed: financial and regulatory policy or, alternatively, capital market policy.

Faced with the risk of a number of bank failures as a result of the bursting of the bubble, the Federal Reserve in the United States undertook strong measures to stabilise the system and the European Union also took strong measure although of a somewhat different nature creating, in May 2010 a "European Financial Stability Facility". Its task was to manage the €780b of financial aid guarantees made necessary as debt-laden Euro members try to cope with the fall-out from the financial crisis. The EFSF is part of the wider European Financial Stabilisation Mechanism (EFSM). The fund, which provides temporary financial assistance, is supported by the 17 Euro members to the tune of €500b, with the remainder provided by the IMF. Germany is the single biggest guarantor, followed by France and Italy. Together, Germany and France provide 50% of the total guarantees.

The facility was boosted to €1 trillion to in October 2011 as part of the financial package agreed by Euro states in response to the sovereign debt crisis. The other two elements of the deal included the write-off of 50% of Greek debts, and the €106 billion recapitalisation of banks.

Nevertheless the Financial Stability Mechanism proved to be insufficient to cope with the increasing problems of sovereign debt for some of the European countries giving rise to enhanced pressures for stronger efforts of solidarity. However, some important eurozone countries firmly resisted any new solidarity measures without increasing common constraints on the national budgetary policy.

The European Council meeting on December 9, 2011 discussed the incorporation of aspects of a reinforced SGP rules<sup>7</sup> into the EU Treaties. Only the United Kingdom was openly opposed to the proposal, but 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 treaty change<sup>16</sup>. This gave rise to the adoption on 2 March 2012, by 25 Member States (in addition to the UK, the Czech Republic opted out) of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

In addition, however, the European Commission in September 2012 put forward a proposal for a “banking union” with the declared aim of placing the banking sector on “a more sound footing and restore confidence in the Euro as part of a longer term vision for economic and monetary integration”.<sup>17</sup> The two regulations proposed involve in particular the creation of a single supervisory mechanism for eurozone Member States and to be run by the European Central Bank. The subsequent debate has, however, raised an issue as to whether the creation of such an additional mechanism would require changing the Treaty. The creation of the banking union was therefore still pending in April 2013 while the Fiscal Stability Treaty, in fact, came into force in January 2013.

## 6. The Fiscal Stability Treaty

As strongly emphasised in the preambles of the Treaty, its main purpose is to introduce strict observance of the quantitative criteria in the Maastricht Treaty and the SCP and introduce more rigorous rules for budgetary discipline without modifying the 60% limit for public debt in proportion to nominal GDP.

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<sup>16</sup> For more see, for example, Broin, Peadar o: *The euro crisis: The fiscal treaty – an initial analysis*, Working Paper 5 of the Institute of International and European Affairs (Dublin 2012).

<sup>17</sup> European Commission: *A Roadmap towards a Banking Union*, Communication from the Commission to the European Parliament and the Council, COM(2012)510 Final 12 September 2012.T

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 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 on 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 Stability Treaty stipulates some more formal rules of governance and also, importantly in article 16 that within five years at most of the entry into force, on the basis of an assessment of the experience with its implementation, the necessary steps shall be taken with the aim of incorporating the substance of the Fiscal Treaty into the legal framework of the European Union.

The only really significant innovation due to the Fiscal Treaty is the assignment to the European Court of Justice of the responsibility of deciding to sanction a Member State for having an excessive deficit.

In addition, however, the Stability Treaty (in article 8) stipulates that where, on the basis of the Commission’s assessments, taking account of 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: Where, 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.

The inter-governmental nature of the Stability Treaty is also made evident by the fact that the Commission, despite its important role in the preparation of the 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 an “obligation” for the members to supporting the proposals or recommendations submitted by the European Commission where it considers that a eurozone Member States 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.

As indicated, for example, in the Report by the House of Lords’ European Union Committee<sup>18</sup> the Treaty raises a number of other questions, particularly concerning the relationship between it and the EU treaties and laws made under those treaties; and the proper role of EU institutions. It stresses that the history of the institutional development of the European Union is characterised by pragmatic flexibility and ‘finding a way’, suggesting that some of the rough legal edges of the proposed treaty will be softened over time. With the United Kingdom reducing its objection to the use of the EU institutions under the Treaty, it might be argued that this process is already underway. But even so, the lack of clarity about whether it is legitimate for the treaty to confer new functions on institutions of the European Union, and the extensive overlap between the provisions of this treaty and functions, which have already been imposed by EU legislation, is according to this Report, undesirable.

In a debate in the European University Institute the Stability Treaty has been characterised as a “legal monster” but the views of Miguel Maduro, professor of European Law at the EUI, were more “balanced”.<sup>19</sup> According to Maduro, the treaty has a political function and this is the value he assigned to this treaty. He, in fact, argued the Treaty has not been adopted because European political leaders genuinely believed that this is what the markets want to end the crisis but that they believed that this may have a political legitimating function with respect to the national public opinions, notably in Germany.

Another issue is, however, to what extent the 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

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<sup>18</sup> House of Lords’ European Union Committee

<http://www.publications.parliament.uk/pa/ld201012/ldselect/ldeucom/260/260.pdf>

<sup>19</sup> EUI Working Paper 2012/09

[http://cadmus.eui.eu/bitstream/handle/1814/21496/LAW\\_2012\\_09\\_Kocharov\\_ed.pdf](http://cadmus.eui.eu/bitstream/handle/1814/21496/LAW_2012_09_Kocharov_ed.pdf) )

“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”.

In considering these implications of the Stability Treaty, Andreas Maurer, in a working paper of the Italian Institute of International Affairs,<sup>20</sup> argues that the recent developments in reforming the Economic and Monetary Union (EMU) are problematic for three reasons. Firstly, the reforms strengthen cooperation among the governments of the Euro-17, while widely ignoring the parliamentary component and the more general issue of democratic legitimacy of the deepened EMU (DEMU). He stresses that neither the European Parliament nor the national parliaments are provided with a uniform or coordinated, reliable control mechanism whereby parliamentary oversight is combined with the possibility of political and legal sanctions against the decision-makers of the European Council, its President and the Eurogroup. And although the Lisbon Treaty explicitly holds that the European Council “shall not exercise legislative functions”, the heads of state and government increasingly step in to mandate the Commission with rather fixed sets of reform proposals for further policy-initiation and to ask their President to present proposals with a view to reform the EMU.

According to Maurer, the European Parliament is only informed of the results of the European Council meetings and Eurogroup summits, its President participates in the beginning of the meetings, and some of its Members of European Parliament (MEPs) get informal access to the negotiation table. But the Parliament at large remains a passive observer. The resulting democratic deficit is not compensated through national parliaments, since only a few of them are able to force their governments into both ex-ante and ex-post scrutiny.

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 interpretation by the Court of the provisions in Article 3 and, notably, how the Court will decide as regards 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

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<sup>20</sup> Maurer, Alfred : *From EMU to DEMU : The Democratic Legitimacy of the EU and the European Parliament IAI Working Paper 13/11, April 2013* : <http://www.iai.it/pdf/DocIAI/iaiw1311.pdf>

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 take full account of very "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 cannot be excluded that, in the end, the Court's decision will 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.

## 7. Conclusions

An institutional crisis in the European Union emerged in 2004 as the result of the ECOFIN Council's failure to "jump the obstacle" and take sanctions against France and Germany in accordance with the Excessive Deficit Procedure according to the 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 the full competence in the field of fiscal affairs and social policy to the national (or regional) governments.

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 to be completely independent policy instruments. There can be little doubt that a prospective building 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' concern with respect to

the long-term sustainability of budget balances of EU member states is therefore legitimate. Clearly this potential conflict was “forgotten” in the 1990s and the early years of 2000 but came out of hiding with the financial and economic crisis of 2007 and onwards.

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. While a large number of directives are adopted by the Council their implementation most often requires national legislative acts as well. However, there can be little doubt that assigning discretionary competences as regards public expenditure and taxation to the Council would run counter to the normal functioning of democratic institutions.

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 Stability Treaty do not involve any transfer of discretionary competence to the Council and consequently do not run counter to normal democratic functioning of the EU institutions. From the point of view of 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 appropriate trade-off between the need to ensure long-term consistency between budgetary and monetary policy and the respect for the principle of subsidiarity.

The entering into force of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union does not significantly modify the observations made above concerning the implications of the Maastricht Treaty and the Stability and Growth Pact assessed above. It does provide a slightly modified excessive deficit procedure and in sharp contrast to the Maastricht Treaty and the SGP stipulates a direct involvement of the European Court of Justice, attempting thus to fill the judicial vacuum recognised in the cancellation by

the Court 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 make an attempt to fill the legal void demonstrated by the excessive-deficit procedure against France and Germany. This procedure having been concluded by the cancellation by the European Court of Justice of the Council's decision to suspend the procedure, the future of the excessive-deficit procedure in fact depended upon the unlikely adoption by the Council of a Commission proposal to sanction a Member State in a situation of excessive deficit.

However, the transfer to the Court of Justice of 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 leaves serious questions open: On what criteria should the Court take this decision in case there is disagreement as regards the nature of the deficit and the route to be followed towards reduction of this deficit? Given the exceptionally large number of excessive-deficit procedures now under way (twenty), it may be legitimate to apprehend with some doubts the unfolding and outcome of these procedures from 2013 to 2016 and beyond.

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 already well identified in the Delors report in 1989, regularly emphasised ever since and now 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.



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