Solving the enforcement dilemma of the EU fiscal rules*


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- *To ensure a smooth functioning of the Economic and Monetary Union, the Stability and Growth Pact defines limits on national fiscal policies and encompasses the possibility to impose sanctions.*
- *This short piece explores the much under-examined issue of enforcement of the EU fiscal rules.*
- *In the ongoing reform debate, a more consistent recourse to financial sanctions under the Stability and Growth Pact is presented as counterweight to more flexible and tailor-made rules.*
- *At the same time, in light of past experience and in the absence of concrete changes to EU governance, many observers take a rather negative stance on the enforceability of EU fiscal rules.*
- *We clarify a number of crucial concepts with the aim to debunk the politically appealing but risky view that in the EU imposing sanctions on sovereigns is nearly impossible.*

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Introduction: Commitment versus enforceability

Like all rules-based systems, the effectiveness and credibility of the EU's Stability and Growth Pact has been predicated on two basic ideas: strong commitment of the participating parties and enforcement. Without them the whole architecture set out in the Maastricht Treaty would have been void from the start or, as the saying goes, the political tribute vice pays to virtue.

From the onset, commitment played an important role. Article 126 of the Treaty - one of the cornerstones of the Stability and Growth Pact - draws a clear red line with regard to legal enforcement. It explicitly excludes recourse to the main enforcement instrument under EU law - the infringement procedure - for the largest part of the excessive deficit procedure. In other words, the architects of the single currency area thought that member states should not be referred to the European Court of Justice, for running afoul of fiscal recommendations of the Council. In return, the European Council issued a resolution in June 1997, which includes the firm commitment by (i) the EU member states to respect the provisions of the SGP, and (ii) by the Council to a rigorous and timely implementation of all elements of the SGP.

However, the credibility of the political commitment took a first important blow in November 2003 when the Council resorted to a procedural trick to refrain from enforcing the rules upon Germany and France, and held the excessive deficit procedures launched against these two countries in abeyance. The action the Commission filed, following its role of 'Guardian of the Treaties', before the European Court of Justice against the Council proved ultimately unsuccessful, and failed to clarify the enforceability of fiscal policy rules (see Maher, 2004).

Since then, the public debate around the Stability and Growth Pact has been characterized by an overt dichotomy. The official line religiously highlights the rules-based nature of the Stability and Growth Pact and pledges equal treatment across countries. The informal view expresses serious doubts about whether the rules will ever be enforced subject to considerations of political opportunity. The informal view gained ground after repeated attempts to revive the spirit of the 1997 resolution of the European Council by strengthening the economic rationale of the Stability and Growth Pact did not bear significant fruits.[1]

For completeness, it is worth stressing that compliance with EU fiscal rules has not been dismal across the board. Since the Stability and Growth Pact entered into force in 1997, a large number of countries have followed a course that is perfectly in line with sound and sustainable public finances (see Larch et al. 2023). Some countries, by contrast, have run fiscal policies which clearly and repeatedly departed from the numerical constraints implied by the EU rules and, as a result, accumulated very high levels of government debt, which in the wake of major negative shocks gave rise to concerns of sustainability plus the realization that enforcement had been weak.

[1] The 2005 reform of the SGP encompassed a number of crucial innovations all of which were meant to make the rules economically more meaningful: (i) the structural budget balance became the key reference for fiscal adjustment and for a sound fiscal position in the medium term, differentiated across countries; (ii) more time for fiscal adjustment in the face of unexpected economic events and/or in exchange for structural reforms; and (iii) codification of 'other relevant factors' when assessing the existence of an EDP.

Is it really just politics, stupid?

Successive decisions by the Commission and the Council seemed to increasingly resign to the imperatives of politics by exercising greater forbearance or leniency especially when dealing with larger member states (see, for instance, Juncker's famous quote "because it is France").[2] More recently, in the context of the ongoing economic governance review, the informal view has moved to the front seat: Lack of compliance with the Pact is now officially presented as the result of unreasonably tight rules imposing unrealistic budgetary adjustments, especially on member states with high debt ratios, on account of the new macroeconomic environment.

The way out suggested by the Commission in its November 2022 orientations and reflected in the legislative reform proposal of 26 April this year is once more predicated on enhanced commitment, this time through ownership: the idea is that governments will eventually comply with reformed rules because they are expected to be directly involved in drawing up a bespoke and more realistic adjustment plan.[3]

As a concession to the original idea of a rules-based system, which is still dear to many member states, the Commission proposal also contains a promise to finally get serious about enforcement (a 'more stringent EU enforcement'). However, this part is much less developed and mainly based on a pledge rather than a solid plan.[4] In a nutshell, the Commission promises a more systematic activation of excessive deficit procedures, a more frequent use of financial sanctions by lowering of their amounts, reputational sanctions and a consistent recourse to macroeconomic conditionality mechanisms.

Many observers may take the lack of detail and strength of the Commission's proposals about enforcement under a reformed Pact as inevitable. It therefore bears recalling that the lack of actual enforcement witnessed so far does not reflect a lack of enforcement instruments.

First, one should stress that although Article 126(10) of the Treaty practically excludes the infringement procedure under the EDP, other legal remedies are available to prompt action and support the enforcement of the EU's fiscal rules. Two such remedies are the action for annulment (Article 263 of the Treaty) and the action for failure to act (Article 265 of the Treaty). Hence, while the architects of the SGP excluded the infringement procedure for deviations from the fiscal rules, they still very much cared about due process. Although the two remedies have not been exploited much thus far, there is room for a stronger judicial involvement in the implementation of the EU's fiscal governance. One may not want to go as far as Blanchard et al. (2021) who propose a setup in which judges of a new and dedicated section of the European Court of Justice would ultimately decide whether a country's fiscal policy was or was not in line with EU guidance. However, instruments are in place for the European Court of Justice to decide whether the SGP has been implemented in line with EU law or not. For instance, the Court could very well be expected to take a view on whether during the COVID-19 pandemic the so-called general escape clause was implemented in line with the relevant provisions or, for that matter, whether the excessive deficit procedure was applied as designed. As a matter of fact, the Commission regularly and rightly underscored that the escape clause did not suspend the Stability and Growth Pact. Moreover, the excessive deficit procedure was conceived to anchor budgetary policies over the medium term, not to push them immediately into consolidation. Since the 2005 reform of the Pact negative growth surprises have typically led to extensions of the adjustment process (see EFB, 2022).

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[2] EU gives budget leeway to France 'because it is France' - Juncker | Reuters.

[3] https://economy-finance.ec.europa.eu/system/files/2022-11/com_2022_583_1_en.pdf.

[4] The legislative reform proposal of the Commission of 26 April 2023 does not envisage any changes to the existing sanctions. The idea is to work with the current provisions by moderating the amounts of possible fines compared to the maximum set out in legislation.

Second, next to financial sanctions under the Stability and Growth Pact, conditionality arrangements making access to EU funds conditional upon compliance with the EU fiscal rules, have been strengthened over the years and apply to a wider range of budgetary instruments, most importantly structural funds.[5] These incentive structures usefully complement the punitive prongs of the enforcement mix, but their potential, with regard to fiscal governance and the enforcement of the Pact, remains largely unexploited.

Rather than blaming politics, we take the view that the lack of enforcement under the Stability and Growth Pact reflects a flaw in the evolution of the EU's economic governance framework: Available enforcements instruments are not used in spite of overt departures from the fiscal rules because there is no neutral advocate. We consider that the six and two-pack reforms passed in the aftermath of the global financial crisis, coupled with growing differences across Member States over the perceived value the Stability and Growth Pact, have affected the original division of roles between the Council and the Commission, with the latter turning into the dominant actor.[6] As a consequence, the current system increasingly blurs the line between technical assessment and the final decision on compliance, putting the Commission into a situations where it exercises political judgement while at the same time trying to act as neutral enforcer (see Dermine, 2022a). To be clear, the fact that the Commission has come to act as a 'genuine executive' is not *per se* problematic; it is inevitable and even welcome in the broader context of growing economic and political integration. The Covid pandemic first and the energy price hike thereafter have clearly underscored the importance of having a Commission that swiftly takes political initiatives. However, the clear downside of this *mélange des genres* is that the EU is effectively left without a crucial element of advocacy: if the 'Guardian of the Treaties' is not triggering available enforcement tools provided by the economic governance framework, the rules-based nature of EU fiscal rules is void.

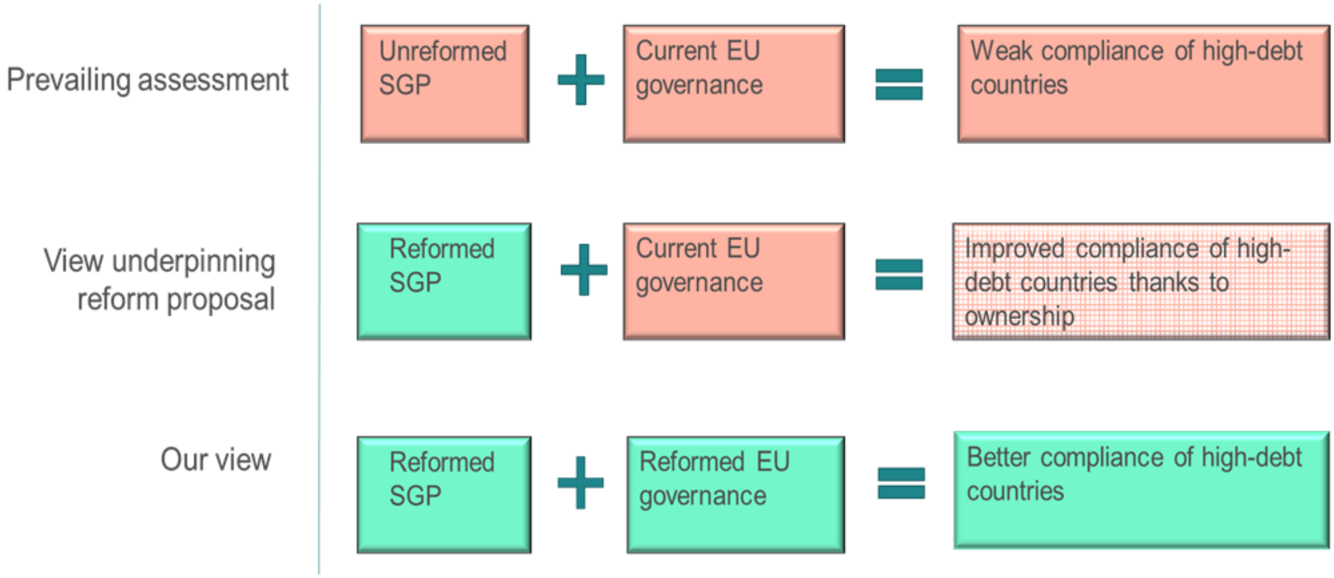
A possible way forward

As a consequence, we believe any attempt to improve enforcement of the Stability and Growth Pact must include meaningful efforts on the governance side to clarify the demarcation between technical assessment, political decisions and advocacy. This seems all the more necessary if fiscal governance is to become increasingly bilateral and country specific. In fact, the ongoing reform debate mainly revolves around the notion that the effectiveness of the EU fiscal framework hinges on the design of the rules and the involvement of the individual member states in defining the adjustment path. The EU dimension of fiscal governance remains largely untouched. We believe this notion underrates the importance of EU governance; we think that strengthening EU governance would increase the chances of achieving the desired result (see Diagram 1).

[5] Initially limited to the comparatively small group of countries eligible for cohesion fund money, conditionality now also covers most EU structural funds and therefore virtually all member states. Moreover, the role of the European Parliament in deliberating a suspension of EU funds has been clarified. The strengthened provisions have not been tested yet, because they entered into force in 2021 after the de facto suspension of the SGP via the severe economic downturn clause.

[6] Two particularly prominent innovations introduced with the six and two- pack reforms of the SGP are the reversed qualified majority voting for new financial sanctions and the comply-or-explain principle.

Diagram 1: Can the effectiveness of the EU fiscal rules be improved without adjusting EU governance?



We see two main avenues for reform aimed at increasing transparency. First, the double-hatting described above should be better addressed through a clearer separation between technical assessment and final decision-making. This could a *minima* be achieved through a clearer allocation of tasks within the Commission, for instance with stronger autonomy of the competent Commission services vis-a-vis the final decision-making at the level of the College. A more radical option would consist in taking the logic of delegation one step further and, following a template reminiscent of that of independent fiscal institutions, which the EU and the Commission have promoted at the national level, outsource parts of the technical assessment beyond the Commission, to an external expert body. The European Fiscal Board or an institutional aggregation of national independent fiscal institutions would then constitute the most obvious candidates.

Finally, stronger judicial involvement could contribute to enhance enforcement of the Pact and frame the action of the Commission, and the use of its discretion in that context. This would nonetheless require a more proactive use of the remedies available, and an overall relaxation of access conditions to the European Court of Justice. Most notably, such relaxation could be achieved through a broader understanding of challengeable acts, and a refined apprehension of the hard law/soft law divide, which would finally end the profound disconnect between the formal characterization of EU fiscal governance as a 'soft' governance framework lacking clear legal force and the much harder effects that its instruments (starting with the country-specific recommendations issued under the European Semester, or Commission's opinions on draft budgetary plans) actually produce, and the harmonizing dynamics they concretely set in motion (Dermine, 2022b).

Conclusions

Enforcement of EU fiscal rules is increasingly seen as difficult if not impossible. This view is reflective of actual experience with the implementation of the Stability and Growth Pact, not due to lack of legal instruments. Several legal instruments to ensure enforcement exist but are not being used, not least because EU governance arrangements have not been adapted to the changing political roles of EU institutions. With growing economic and political integration in the EU, the Commission naturally and inevitably morphed into a political player whose interests are not necessarily aligned with those of the original role of the 'Guardian of the Treaties'. This evolution needs to be acknowledged and addressed when assessing the enforceability of the EU fiscal rules in the context of the ongoing reform of the Stability and Growth Pact. In parallel, established practice of the European Court of Justice also deserves attention. Its currently narrow approach to its own jurisdiction prevents the Court from playing the role of guardian of EU law it could, and should, also embrace in the context of fiscal governance. ■

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