Intergovernmentalism and the reinforcement of the economic governance in the European Union: the Fiscal Compact

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Abstract

The deep economic and financial crisis that shook European countries starting from 2009 unveiled some flaws in the economic governance of the European Union and urged the EU and its Member States to start working on the establishment of a renewed legal framework, able to ensure a sufficient degree of financial stability and economic convergence in all member countries. The reinforcement of the economic governance of the EU has been achieved by means of both EU legal acts and intergovernmental actions. This paper focuses on one of the intergovernmental instruments adopted in the midst of the crisis, i.e. the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, which introduced, inter alia, some new rules concerning national budget policies. The adoption of such a Treaty gave rise to some legal concerns concerning the legitimacy of the choice for the intergovernmental path and its impact on the EU legal framework, which this paper aims to examine.
Summary

1. Introduction.
2. The Fiscal Compact: the introduction of new provisions concerning national budgetary policy.
3. The choice for an intergovernmental agreement: the feasibility of a EU law path.
   3.1. The reasons for an international agreement.
   3.2. The impact of the Fiscal Compact on the EU legal framework.

1. Introduction.

The creation of the Economic and Monetary Union (EMU) embodied a key step for the future of the European Union (EU), but also represented a significant challenge for both the EU and its Member States, since it implied the need of ensuring a stable economic environment, which is a vital requirement for a strong and stable single currency. As proven by the crisis, financial or economic instability in one country can quickly spread to other countries, given the high interdependence between national market economies within the EU. For this reasons, when the crisis broke out, the EU and its Member States soon started to work on the establishment of a renewed legal framework, capable of ensuring a sufficient degree of financial stability and economic convergence in all member countries. To this end, several instruments have been adopted, with a view of enhancing the regulation of all areas of policy directly relevant to the EMU: economic, monetary and fiscal policy.

With regard to fiscal policy, the revision of the legal framework started in 2011, with the adoption of a comprehensive reform of EU rules. The reference is to the ‘Six-Pack’, a set of EU law acts aiming at amending the Stability and Growth Pact and providing additional rules and tools for the control of national budgetary policies. Furthermore, in 2013, the ‘Two-pack’ entered into force, with a view of further strengthening fiscal and economic surveillance and introducing common rules for the monitoring and the evaluation of draft budgetary plans. In the meantime, Member States of the EU started negotiating an intergovernmental instrument aiming at developing a closer coordination of economic policies within the euro area and setting stricter rules concerning national budgetary policies. Such an instrument, the Treaty on Stability, Coordination and
Governance in the Economic and Monetary Union (whose budgetary-related part is also known as “Fiscal Compact”), entered into force on 1 January 2013.
The present article aims at analyzing the genesis of the Fiscal Compact and examining the legal issues arising from the choice of adopting it in the form of an intergovernmental agreement between some Member States.

2. The Fiscal Compact: the introduction of new provisions concerning national budgetary policy.

The Fiscal Compact starts from the premises that, in order to safeguard the stability of the euro area as a whole, it is necessary for governments to maintain sound and sustainable public finances and to prevent a general government deficit becoming excessive.
To this end, the Fiscal Compact envisaged, inter alia, a “balanced budget rule” and an automatic mechanism to take corrective action in case of significant deviations.
In particular, Article 3(a) of the Fiscal Compact, introduce the provision according to which the budgetary position of the general government of contracting parties shall be balanced or in surplus; it also provides detailed references to assess compliance with such a rule (see Article 3(b), (c), (d) and the introduction of a correction mechanism to be triggered in case of significant deviations (Article 3(e)).
Furthermore, Article 3(2) of the Fiscal Compact contains a provision according to which the balanced budget rule must be given effect in the national law of the contracting parties “through provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes”. It also provides for the obligation to introduce, at national level, the abovementioned correction mechanism, on the basis of common principles to be proposed by the European Commission.
Finally, Article 8 of the Fiscal Compact confers on the Court of Justice of the EU competence to check compliance by the contracting parties with their obligation to incorporate the new budgetary limits into national legislation, competence that includes the imposition of financial sanctions in case of infringement.
3. The choice for an intergovernmental agreement: the feasibility of a EU law path.

As it has been noted, most of the rules contained in the Fiscal Compact could have been adopted within the EU legal framework.

It is true that most of the decisions regarding public spending stay in the responsibility of national governments, since control over budgetary policy is considered a traditional attribute of national sovereignty. However, since decisions on national public finances can have a thorough impact throughout the Union, the establishment of the EMU required the introduction of certain constraints, in order to ensure a sound management of national public finances. In particular, a prohibition of excessive national deficit was envisaged, together with a control to be exercised by the Union, in the form of a specific procedure to detect and sanction significant deviations from set common values. The regulatory framework is based on Article 126 TFEU, according to which ‘Member States shall avoid excessive government deficits’. The task of monitoring compliance with that provision is entrusted to the Commission, which must verify whether the ratio of government deficit to gross domestic product (GDP) exceeds certain reference values.

The reference values are specified in Protocol No 12 on the excessive deficit procedure annexed to the Treaties (Article 1), which set them at 3% (ratio of government deficit to GDP) and 60% for (ratio of government debt to GDP).

According to Article 3(1)(b) of the Fiscal Compact, the balanced budget rule is considered to be respected ‘if the annual structural balance of the general government is at its country-specific medium-term objective, as defined in the revised Stability and Growth Pact, with a lower limit of a structural deficit of 0,5 % of the gross domestic product at market prices’. Furthermore, according to Article 3(1)(d), ‘where the ratio of the general government debt to gross domestic product at market prices is significantly below 60 % and where risks in terms of long-term sustainability of public finances are low, the lower limit […] can reach a structural deficit of at most 1,0 % of the gross domestic product at market prices’.

In the light of the above, it is apparent that the balanced budget rule could have been introduced in the EU legal system via a modification of Protocol No 12.

In that regard, it should also be noted that, according to Article 126(14) TFEU, the amendment of Protocol No 12 does not require the usual Treaty reform procedure, but a mere decision by the Council, acting unanimously. Such decision, if necessary, could have been adopted by means of enhanced cooperation, in order to exclude the Member States which did not wish to participate in it.
After introducing the new budgetary limits in the text of Protocol No 12, the second requirement provided for by the Fiscal Compact, i.e. the obligation to incorporate the balanced budget rule into national law and to introduce a correction mechanism, could have been achieved by means of an ordinary EU directive. Finally, with regard to the attribution to the Court of Justice of the competence to control the incorporation of the balanced budget rule in the national legal systems, the EU nature of such a rule would have per se ensured the competence of the Court, to be activated in the framework of an infringement procedure concerning the non transposition or incorrect transposition of the EU directive requiring the incorporation of the balanced budget rule into national law. However, the introduction of a type of jurisdictional control other than the ordinary one (for example from the point of view of the procedure or the sanctions) would have required a Treaty revision.

3.1. The reasons for an international agreement.

Considering that the rules introduced by the Fiscal Compact could have been adopted following an intra-EU path, it is necessary to examine the reasons that drove the Member States to opt for an intergovernmental instrument. During the discussions concerning the reinforcement of the economic governance in the EU, the German government has been strongly backing the option of introducing the new budgetary limits directly in the European Treaties. The reason was mainly a political one. Given the outcomes of the crisis and the increasing loss of trust towards European governments and Institutions, the German government was convinced of the necessity to give a strong signal of commitment towards financial stability in Europe. To that purpose, it proposed to incorporate the new budgetary limits in the EU Treaties, as a symbol of the importance, strength and rigidity of the new rules.

However, an amendment of the EU Treaties would have required a unanimous consent of Member States, but at the European Council meeting of 9 December 2011 the UK government denied its consent. The British veto was determined by the refusal of other Member States to accept the exclusion of the City of London from the application of some EU financial regulations, put forward by the Prime Minister David Cameron as a condition for the British consent.

The non-feasibility of a Treaty revision determined the decision of the Member States to abandon the EU framework and to envisage the adoption of an intergovernmental treaty. The option for an action in the framework of enhanced cooperation was not considered, presumably due to the abovementioned political will not to incorporate the new rules in
ordinary EU legislation, but in an act of higher level, as a powerful symbol of strong commitment.

Another reason might have been the determination to avoid the lengthy and onerous EU procedures that would have prevented the Member States from taking a quick action. In that respect, the intergovernmental framework offers a less demanding environment for decision-making, by giving the States a larger margin to manoeuvre, at least in the phase of negotiation and conclusion of the instrument: in particular, States can freely set the agenda of the negotiations and exclude countries who are unwilling to cooperate.

The only disadvantage of the intergovernmental path, at least in the case of traditional treaties, is that the agreement needs to undergo the process of national ratification, which might be problematic and delay the entry into force of the instrument. However, the parties of the Fiscal Compact tried to overcome this obstacle by deciding that the treaty could entered into force if ratified by 12 Eurozone countries.

3.2. The impact of the Fiscal Compact on the EU legal framework.

As seen, the reasons for adopting the Fiscal Compact as an intergovernmental instrument was exclusively grounded on political and practical reasons. However, such a choice gave raise to some legal issues, concerning the compliance of the new treaty provisions with some EU rules and principles.

From a theoretical point of view, EU Member States have the power to conclude international agreements between themselves. First of all, according to international law, parties of a multilateral treaty are allowed to conclude additional agreements among themselves, provided that, in doing so, they not infringe the rights of the parties not included. Secondly, according to EU law, Member States retain the power to act at international level in all fields not (yet) covered by an exclusive competence of the EU. This is confirmed by the fact that Member States have been concluding inter se agreements since the beginning of European integration. And even though the size of the phenomenon has decreased in the course of time, Member States still own such a power. However, when concluding international agreements, Member States must comply with the obligations that EU law imposes on them, meaning that all agreements concluded outside the EU Treaty framework must not jeopardise the application of EU law. Such a rule is a direct expression of the principle of primacy, that can be referred not only to domestic law provisions, but also to the legal instruments adopted by Member States in their international law capacity.
Aware of this, the contracting parties of the Fiscal Compact inserted in the text of the Treaty a specific provision aiming at reaffirming the primacy of EU law. In particular, Article 2 states that the treaty must be applied and interpreted ‘in conformity with the Treaties on which the European Union is founded […] and with European Union law’. Furthermore, the treaty applies ‘insofar as it is compatible with the Treaties on which the European Union is founded and with European Union law. It shall not encroach upon the competence of the Union to act in the area of the economic union’.

However, such a provision does not per se ensure the compatibility of the Fiscal Compact with EU law, but has a mere political value.

One of the first objections that was moved against the legality of the Fiscal Compact is the fact that it dangerously overlaps EU competences. In fact, it is undeniable that it intervenes in a sector which is widely covered by EU provisions, of both primary and secondary law. The reference is mainly to the new budgetary limits and to the provisions concerning the control and correction of excessive deficits. However, it has been affirmed that such rules do not represent a violation of EU competences, since the relevant provisions aim at strengthening the limits set by EU law, thus operating a mere reinforcement of the rules already existing.

Another problem is raised by the fact that the mechanisms for checking compliance with the new rules are put in the hands of European Institutions. For example, the European Commission is attributed the task of enforcing the balanced budget rule, setting deadlines for deficit corrections, proposing common principles for automatic correction mechanisms and monitoring compliance by the Member States (see Articles from 3 to 8 of the Fiscal Compact). The question is: are Member States allowed to do so? Is it possible for EU Members to attribute new tasks to European Institutions in the framework of an intergovernmental agreement?

In that regard, one could recall Article 13(2) TEU, according to which each Institution ‘shall act within the limits of the powers conferred on it in the Treaties, and in conformity with the procedures, conditions and objectives set out in them’. At a first glance, and on the basis of a strict interpretation of such a provision, it could be argued that an intergovernmental agreement cannot confer additional tasks on EU Institutions. Nonetheless, through a closer look at the case law of the Court of Justice, it is possible to identify some cases in which the judges have acknowledged the possibility to attribute to EU bodies functions to be performed in an intergovernmental framework (see joined cases C-181/91 and C-248/91 and case C-316/91). The issue has been recently dealt with by the Court of Justice in the Pringle case (case C-370/12), that concerned, inter alia, the role of European Institutions in the operation of the European Stability Mechanism (ESM). In its judgment, the Court confirmed that ‘Member States
are entitled, in areas which do not fall under the exclusive competence of the Union, to entrust tasks to the institutions, outside the framework of the Union, provided that ‘those tasks do not alter the essential character of the powers conferred on those institutions by the EU and FEU Treaties’. The Court did not offer detailed criteria to assess the respect of such a condition, nor did it elaborate on cases in which those tasks are to be performed in areas widely covered by EU provisions. It the ESM case, it merely legitimized the attribution of tasks to European Institutions by noting that they are asked to perform activities which are in line with their role within the EU legal system, taking into consideration also the aim of the ESM itself, which is to ensure the financial stability of the euro area.

The case of the Fiscal Compact is, indeed, very specific. The application of the Court’s loose reasoning might result in the conclusion that EU Institutions’ tasks within the Fiscal Compact are broadly consistent with their powers concerning economic governance. However, the impact of their involvement within areas which are, as in the case of the Fiscal Compact, so deeply interconnected with EU law has not been fully explored.

Even if acknowledging the legitimacy of such an involvement, few words must be devoted to the procedural aspects of deciding the attribution of tasks to EU Institutions in an intergovernmental agreement stipulated by some EU Members. In particular, a doubt arises as to whether the consent of all EU Member States is necessary to legitimize such an involvement.

To date, the issue has not been adequately addressed: the practice is quite relaxed on the matter, and also the case law of Court of Justice. The need of protection of the institutional acquis suggests the unavoidability of such a requirement, also as a guarantee for non-participating Member States that the EU legal order will not suffer any damage. One could argue that the criteria applied by the Court of Justice to assess the legitimacy of the attribution of new tasks to the EU Institutions represent a sufficient assurance. However, as seen, those criteria are not detailed enough and the judicial control would always intervene ex-post.

Apart from these two specific legal issues, the Fiscal Compact raised a more far-reaching question, directly dealing with the core principles of EU integration.

In the case of the Fiscal Compact, the intergovernmental path has been chosen due to the impossibility to amend the EU Treaties, as a result of the UK veto. This choice has been strongly criticized by a part of the legal scholarship, which pointed out how the legal framework of the EU cannot be set aside so easily. The EU Treaties provide for clear rules and specific procedures for their amendment requiring, *inter alia*, the unanimous consent of the Member States. Also, the Treaties contains provisions which
are meant to offer an intra-EU solution to those States which want to change the rules, but are facing a veto of other States: enhanced co-operation. During the summit of December 2011, an attempt was made to change the Treaty. Then, due to the UK opposition, the intergovernmental path was chosen, without even considering the possibility of making recourse to enhanced cooperation. It should be underlined that the provisions concerning Treaty revisions are expression of the principle according to which the rules of the game cannot not be altered unless all players agree, while the provisions on enhanced cooperation are meant to offer an alternative EU solution for the case in which some players want to change the rule and others do not. By adopting the Fiscal Compact, the contracting parties showed to believe that, if it is not possible to amend the EU Treaties due to the lack of unanimous consent, it is legitimate to pursue the desired aims through an intergovernmental path, without even attempting to stay inside the EU framework, and also involving EU Institutions in such a venture, without a formal consent by other Member States. It has been noted that such a scenario could be justified by the specific circumstances in which the EU meeting of December 2011 took place, i.e. the deep institutional, economical and financial crisis that Europe was facing and the need to quickly overcome it. In other words, an unorthodox path could be undertaken in a situation of urgency, to address problems that deeply affect the EU, in its very structure. If this view is accepted, however, it is necessary to explain how a treaty such as the Fiscal Compact, that did not contain many legal innovations and was supposed to enter into force one year after the December 2011 meeting, could give such a vital contribution.


As seen, the main reason to conclude the Fiscal Compact lied in the will to bypass the UK veto concerning a Treaty amendment and give a strong signal of commitment towards financial stability in the EU. However, the Fiscal Compact is just one of the intergovernmental instruments adopted by the Member States to deal with the crisis of the EMU. Other international agreements have been concluded, namely in order to establish financial assistance mechanisms meant to help Member States in difficulties. In that case, the reasons that led EU countries to resort to extra-EU solutions were directly connected to the architecture of the EMU and the policy choices that assisted its design, namely the decision not to devise an automatic insurance mechanism. Faced with shaky legal bases for EU law instruments, the inadequacy of EU financial resources and the reluctance of non-euro area countries to accept the disbursement of
EU money to save Eurozone countries, Member States opted for the intergovernmental path, making such a channel a sort of ‘ordinary’ instrument to cope with the outcomes of the crisis.

In all those cases, the conclusion of international agreements gave rise to many legal problems, most of which are still debated. The complexity of the phenomenon and its potential impact on the EU Treaty framework urged the doctrine to ask for those issues being dealt with in the next Treaty amendment. Undoubtedly, the constitutional nature of the problems involved fully justifies such a request.

In the meantime, the focus has been put on the incorporation of the new rules in the text of the EU Treaties. Such a need has recently been expressed in the Five Presidents' Report ‘Completing Europe's Economic and Monetary Union’ (report delivered in June 2015 by the President of the European Commission in cooperation with the Presidents of the Euro Summit, the Eurogroup, the ECB and the European Parliament). The Report sets a roadmap for completing the EMU, at the latest by 2025, by identifying a number of initiatives to be taken within specific timeframes. With regards to the intergovernmental instruments adopted during the crisis, the Report states: ‘[a]t the height of the crisis, far-reaching decisions had often to be taken in a rush, sometimes overnight. In several cases, intergovernmental solutions were chosen to speed up decisions or overcome opposition. Now is the time to review and consolidate our political construct – and to build the next stage of our Economic and Monetary Union’.

Article 16 of the Fiscal Compact already provides for a commitment of the contracting parties to insert its provisions in EU law, stating that, at most within five years, ‘the necessary steps shall be taken, in accordance with the Treaty on the European Union and the Treaty on the Functioning of the European Union, with the aim of incorporating the substance of this Treaty into the legal framework of the European Union’. Such a commitment is recalled in the Five Presidents’ Report, that put the integration of the Fiscal Compact among one of the immediate steps toward the completion of the EMU, i.e. in stage 1 of the roadmap (1 July 2015 - 30 June 2017).

So far, no specific action has been taken, since the focus has been put on other aspects of the EMU’s deepening. Some indications might emerge after June 2016, when the European Council will discuss the progress achieved in the roadmap and the further steps to be taken.
Selected bibliography


