

## **IMPOTENCY OF EU INSTITUTIONS REGARDING THE ENFORCEMENT OF STABILITY AND GROWTH PACT**

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## **1. INTRODUCTION**

There are not many issues in European law which would whip up so many controversial emotions among lawyers, politicians and especially economists at once. The Stability and Growth Pact (SGP) was criticized by many of them. Former President of The Commission Romano Prodi once stated: „I know very well, that the stability pact is stupid“<sup>1</sup>. Was Mr. Prodi wrong? Answer to this question will be one of the goals of this article. What I will discuss here is also the impotency and disability of EU institutions regarding the enforcement of SGP. I will bring brief legal and factual background of the problematic and then raise critical questions and remarks. This article is neither meant as an economic analysis nor political polemics.

## **2. OVERVIEW**

The legal background of the Pact is based in the Art. 99 – 104 EC<sup>2</sup>. These provisions of the Treaty accent the price stability and fiscal co-ordination of the EMU. The system could not be based on autonomous fiscal policy of member states and the surveillance of their budgetary discipline is absolute necessity. Brief description of the rules and procedures will be given in following chapter. The provisions of the Treaty are complemented by secondary legislation and acts: Council Regulation 1466/97<sup>3</sup> on the

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<sup>1</sup> Romano Prodi, Le Monde, 17th October 2002

<sup>2</sup> The Treaty establishing the European Community

<sup>3</sup> Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies OJ L 209, 2.8.1997

preventive procedure of Art. 99 EC, Council Regulation 1467/97<sup>4</sup> on speeding up and clarifying the implementation of the Excessive deficit procedure (description will be given in following chapter) and legally binding Resolution of the European Council from 17 June 1997. The mentioned acts were amended in 2005 as an outcome of the reform of the Pact.

### **3. RULES OF THE PACT**

The aim of this article is to criticise ineffectual enforcement of the Pact, hence I will not describe all the rules and procedures of the system and I will focus on its stumbling blocks.

The SGP is based on two dominating rules. Members' annual budget deficit shouldn't exceed 3% of the annual GDP and the amount of national debt shouldn't be higher than 60% of GDP or approaching that value. The basic idea came from German former prime-minister Theo Waigel in the middle of 90's. In mid 90's Germany was strong economy and monetary engine of the EU. The idea of surveillance on all participating states was the way how to ensure strict budgetary discipline among other members. How ironic could this fact seem will be clear in the end of this paper.

The process itself is monitored by the Commission and the ECOFIN<sup>5</sup>. All member states, those not participating in EMU included, have to forward regular reports and prognosis on the condition of their economy and measures connected with the fiscal policy. The Commission evaluates given data and if estimates that there is risk of real or potential breach of rules it is entitled to start the Excessive Deficit Procedure (EDP). EDP has three stages. The process begins with the opinion of the Commission on the risk forwarded to the Council. The Council then brings decision on the recommendation from the Commission by its qualified majority to the delinquent state. If there is no significant change in the performance of the state, the decision will be made public. The idea behind this step was probably to cause serious pressure on the state involved. If member state persists to fail to fulfil the criteria, the ECOFIN may decide to give notice to the member state and claim regular reports on taken measures.

The third stage, as the most problematic part, consists of serious actions against the delinquent state. It can be requested to make non-interest deposit reaching up to 0,5 % of its GDP. This deposit can be lately turned into non-refundable payment as sanction for the gross breach of the rules. In the

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<sup>4</sup> Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure OJ L 209, 2.8.1997

<sup>5</sup> Council of Ministers of Economy

history of the Pact this procedure never arrived at this final stage. Was one of the reasons impotence of institutions to act or rather vague regulation of the procedure in the Treaty?

I will discuss the answers on following case, which is the best example that can be found in the development of the SGP.

#### **4. GERMANY AND FRANCE IN THE ROLE OF OUTSIDERS OR WRECKERS?**

In 2003 the Council found the deficits in Germany and France excessive and started the EDP with the recommendation. Both countries were given one year to resolve their problems and correct the deficit situation. In the end of the year 2003 the Commission issued a recommendation to the Council stating that both countries had not yet taken any significant actions to cut the deficit. The Commission proposed to give both countries notice under Art. 104(9) to adopt measures to adjust the situation and reduce their deficits by 1 % and 0, 8 % of GDP respectively. The Council proved to be highly political body and there was real political deal happening among some of bigger member states. Germany and France, following the approach “Scratch my back and I will scratch yours”<sup>6</sup>, helped each other to avoid the award of legally binding decision requiring them to remedy unfavourable situation. This decision would probably bring the EDP to the last stage of sanctions and Germany and France were certainly aware of this fact. But what happened instead, was the adoption of spurious legal act called “conclusion”. Therein The Council expressed contentment with the public commitment of France and Germany to improve the situation and recommended to correct the deficit until 2005. The ECOFIN decided to hold up EDP and issued its will to monitor further behaviour of touched member states. While the Maastricht Treaty says countries should treat economic policy as a matter of common concern<sup>7</sup>, this was an example of extreme unilateralism.

The regulation of EMU a European law itself sustained significant defeat in this case. Considering that it was particularly Germany calling for strict fiscal rules in EMU the situation seems pretty ironic. This one was neither the first nor the only case of EDP that was started against a state. In 2002 there was recommendation issued by the ECOFIN against Ireland and Portugal having fiscal problems. The political pressure on those member states made them comply with the recommendation and tighten their fiscal policy, mainly at the costs of large budget cuts. This lay-out brings back to

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<sup>6</sup> There is qualified majority in the Council needed to adopt decision applying EDP, the delinquent state excluded. Also Great Britain and Italy helped to form the blocking minority in the Council.

<sup>7</sup> In the consolidated version it is Art. 99 of the Treaty Establishing European Community

memory famous Orwell's quote that could be easily paraphrased: "All the states are equal, but some of them are more equal."

In that moment the EMU found itself in the same position it would have been if the act had never been in force. This case could serve as dangerous precedent regarding the decision process not only within EMU, but in more areas of European law. From that moment it became more obvious that anything Europe's big governments sew together, the same governments can split at the seams. Eye-opening lesson, isn't it?

## **5. THE ECJ INVOLVED**

Obviously the Commission was not happy at all to see this outcome of the process. It raised a case in front of the ECJ and brought an action for annulment of the "conclusion" of ECOFIN. The Commission argued there was no legal basis for such legal act and challenged the Council for not adopting formal instruments recommended by the Commission. The Court in its judgement<sup>8</sup> agreed with the first argument, but there was great debate over the roles of both institutions regarding the decision making procedure within EDP and the outcome was the disagreement of the Court with the later issue<sup>9</sup>.

Following the arguments of the Commission the 'conclusion' to hold up EDP against Germany and France was annulled by reason of lack of legal basis for such a decision. On the other hand the Court stressed the leading role of the Council in the procedure. It agreed with the Council's argument that it has no legal obligation to adopt any act<sup>10</sup>. The Court declared the right of discretion lying exclusively in the hands of the Council. The Council is the institution bearing the responsibility for enforcing budgetary discipline<sup>11</sup>. Did the ruling of the Court mean victory of one of the institutions? And which one should it be? The Judgement was presented by both institutions as their own victory. But, by my opinion, there was nothing to celebrate in the Commission.

The Court here missed an opportunity to rule actively and bring tighter and stricter interpretation of vague rules. There were still many unanswered questions regarding the role of both institutions in the enforcement procedure. The weakest point was still the vulnerability in the crossfire of

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<sup>8</sup> Case C-27/04, Commission vs. Council, judgement of 13 July 2004

<sup>9</sup> More on analysis of the decision see D.Doukas, *The Frailty of the Stability and Growth Pact and the European Court of Justice: Much Ado about Nothing?* (2005) 32 *Legal Issues of Economic Integration* (The Hague: Kluwer Law International) 293-312

<sup>10</sup> Above note 7, paras 32-24, \*!

<sup>11</sup> *Ibid.*, 7, paras 76-79

political influences and pressures<sup>12</sup>. The impotency of ECJ opened doors for wider discussion about the structural reform of the Pact, which seemed truly dead by then.

## **6. THE REFORM OF THE PACT**

After above-discussed pathetic case of mightier member states' ignorance towards rules there was still a disagreement on the basic ideas and extent of the reformed Pact. There was rigour approach of smaller member states which had done rather well in consolidation of their fiscal policy in contrast with the laxity of big ones<sup>13</sup>. From today's perspective the statement of former vice-president of the Bundesbank Jürgen Stark, that the status quo would be the best solution<sup>14</sup> seems a little short-sighted.

After long struggle above the outcome of the negotiation, on 23 and 24 March 2005 the reformed Pact was signed by the Council<sup>15</sup>. Existing legislation was amended by Council Regulation 1055/2005 and Council Regulation 1056/2005<sup>16</sup>. The fact that it was again the political organ deciding about the new document didn't bring any great hope for the change<sup>17</sup>. And so it was. The review of the Pact was not based on any change of the 3% and 60% basic rules, neither was there any comment about the enforcement procedure, which was the burning issue. On contrary, the application of these rules became more flexible. What changed was the exceptional excess of deficit. Since then the member state may breach the rule of the Pact temporarily if there is annual fall of GDP more than 2%. Next reformed provision was the interpretation of so-called "other relevant

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<sup>12</sup> B. Dutzler, A.Hable, The ECJ and the Stability and Growth Pact – Just the beginning? (2005), *EIoP* Vol.9 Issue No.3, Page 15

<sup>13</sup> J.-V. Louis, The review of the stability and growth pact (2006) *Common market law review* 43: Page 85

<sup>14</sup> See the speech of Jürgen Stark, former – vice president of the Bundesbank *Manotsbericht*, one of the main actors and negotiators of the reformed Pact, "Die Büchse der Pandora", Jan. 2005, [http \[www.bundesbank.de/download/press/reden20050118\\_stark.pdf\]](http://www.bundesbank.de/download/press/reden20050118_stark.pdf)

<sup>15</sup> See Presidency Conclusion of the Brussels European Council, endorsing the Report of the Council of 20 March 2005 on "Improving the implementation of the Stability and Growth Pact" Annex II

<sup>16</sup> Council Regulation (EC) No. 1055 of 27 June 2005 amending Regulation (EC) No. 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, O.J.2005, L174/1; Council Regulation (EC) No. 1056 of 27 June 2005 amending Regulation (EC) No. 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, O.J. 2005, L 174/5

<sup>17</sup> See e.g. E.H.Buiter, How to reform the Stability and Growth pact, *European Bank for Reconstruction and Development* (2003)

factors” to be taken into account when assessing whether a deficit above 3% of GDP is excessive. In other words, if there is a reason to start Excessive Deficit Procedure. The old Pact referred to “other relevant factors” without specifying what these might be. By contrast, the new Pact provides an explicit and relatively long list of “other relevant factors” such as pension and structural reforms, investments for education, innovation and development. The immense will of bigger member states to make the Pact “highly equal” represents the incorporation of the expenses on unification of Germany, which happened more than 13 years before the Pact was reformed. (!!!). Do you think of G. Orwell once again now?

There were not only these ineffective changes brought by the reform. Member States are required to consolidate and strengthen their fiscal policy in periods of good economic growth. However, all the history of the system doesn't bring much confidence in such proclamations.

As a result of the reforms, member states have now wide room for manoeuvre when trying to escape EDP. The diction of excuses allows them to apply so-called creative accounting by hiding the majority of budgetary expenses behind so-called relevant factors. SGP became a public finance consolidation system during safe periods of economic growth. This idea is very much different from the one in the beginning of the process in 1997.

## **7. SOME CRITICAL REMARKS & CONCLUSION**

The reform in 2005 was other example of impotency of EU institutions to make functionless rules stricter and enforceable if their personal interests are at stake. The Pact still suffers from vague and uncertain terms. Free rules and the absence of automatic enforcement procedure don't mark colourful future for the document and the system based whereon. In 2005 the EMU missed an opportunity to make the Pact work for every one of involved state equally without any preferences and favours. By my opinion, if SGP will not get rid of the system “being its own judge” there won't be a way how to ensure long-term stability and efficiency of the system.

There are recent fears we are facing here. There is still apparent lack of states' personal responsibility for the stability of common currency. This lack of stability could, under certain circumstances, provoke European Central Bank to tighten up fiscal policy, e.g. by increasing the interest rates. This kind of measures would, by implication, influence economic growth and that would be a contrario to the fundamental idea of the system, maintenance of the stability. The flexibility of the Pact is does not directly means arbitrariness of parties concerned, but to avoid that, there would have to be more serious sense of responsibility of all authorities<sup>18</sup>.

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<sup>18</sup> J.-V. Louis, The review of the stability and growth pact (2006) Common market law review 43: Page 106

SGP is directed to another crisis. The economies of member states are weakened by global recession. In the beginning of November 2009 there were 20 of 27 member states in breach of the Pact. In the case of Greece estimated budget deficit for next year reaches 12% of its annual GDP<sup>19</sup>. There is no space for calls for stricter rules and unfortunately it seems that will not ever be.

Finally, are we able to answer the question: Was Romano Prodi wrong saying that the Pact is stupid? He was indeed. But the stumbling block here is not the Pact itself, but the performance of member states while applying it.

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<sup>19</sup> Revised Greek deficit figures caused outrage. A. Willis EUobserver.eu; <http://euobserver.com/9/28853>