CHAPTER V.I

The Impact of EMU Law on National Budgetary Freedom

An Inquiry into the Limits of State Sovereignty in Economic Policy Matters

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1 Introduction[1]

This paper explores the borderline between Community and national law in the area of economic policy and, notably, budgetary policy. To what extent does the Community framework for economic policy and, more particularly, the procedure for identifying and correcting excessive budgetary deficits, limit State sovereignty? It also looks at possibilities for further progress in economic-policy coordination, again with an emphasis on the sensitive area of fiscal prudence and Community impact on State budgets.

2 State of the law: economic union

2.1 Who is competent: monetary union versus economic union plus internal market

The law of the EMU is characterized by a major distinction: monetary union is based on the exclusive attribution of competences to the Community, whereas economic union is characterised by continued State sovereignty, to be exercised within a Community framework of rules and procedures. Thus, while Article 105 EC implies the transfer of former State powers to the Community, notably to the European System of Central Banks (ESCB), as a Community body,[2] Article 99 EC lies down the requirement of coordination of national policies in the economic sphere. Although the Treaty does not define monetary and economic, it is submitted that, among all the matters of government policy which may considered to be of an economic nature, those relating to the issue of money, the regulation of the currency, the central bank, the exchange rate, the payment systems and all appurtenant matters[3] can be taken

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[2] On the status under Community law of the European Central Bank (ECB) and the ESCB, see my inaugural address of 4 June 2003 *The European Central Bank in the European Constitutional Order* (Eleven International Publishing, Utrecht 2003), http://62.131.144.145/eleven/pdf/90-77596-01-1.pdf, and the judgment of the European Court of Justice (ECJ) of 10 July 2003 in Case C-11/00 *Commission* v. *ECB* [2003] ECR I-7147.

[3] The list of subject matters on which Member States are to consult the ECB, pursuant to Article 105(4) EC, cannot be considered indicative of the area of exclusive competence, as it contains, naturally, matters on which the ECB is to be consulted while there is no exclusive Community competence while, at the same time, it also extends into areas on which there would seem to be no State competence left, thus no possibility to draft legislation on which the ECB is to be consulted. By way if example: whereas statistics in the monetary and financial area, and financial sector supervision, are clearly examples of areas where the ECB has a role, but not an exclusive one, 'currency matters' and 'payments (...) systems' extend to competences such as the issue of money or the operation of payments systems in euro on

to be monetary matters. Other issues of economic policy, such as State (and regional sub-entities') budgets, industrial policy, employment policy, income and price policies (if still pursued), regional and environmental policies, et cetera, are economic in the sense of the word the Treaty attaches to it and, hence, predominantly national policies. While they remain in the national domain, the law of EMU and other Treaty provisions (on employment, the environment, regional policy et cetera) contain rules restricting the States' freedom to act.

Since EMU consists of three elements – (1) economic and (2) monetary union, both based on the completion of the (3) internal market (in financial products) –, the question of State versus Community competence under EMU goes beyond the distinction between 'economic' and 'monetary'. The internal market rules and those on the customs union also exert limitations on State economic policy-making: the borderless area where persons, goods, services and capital can move freely,[4] and the common regime vis-à-vis the outside[5] world have to be respected. This derives from the supremacy of Community law.[6] Competition policy for the internal market is an exclusive Community competence,[7] although national competition policies may be pursued (nowadays, mostly in line with the EU's competition rules) and National Competition Authorities (NCAs) and national courts are entrusted with enforcing Community competition law, alongside the Commission.[8] Capital and payments, as an internal market affair (Articles 56-60 EC), are generally considered shared competences,[9] but might more appropriately be considered at least partially an area of exclusive Community competence, since States can only exercise their powers within the confines of the far-reaching provisions which liberalise both intra-EU movements of capital and payments and those with third countries. These latter provisions might therefore better be classified as falling within the exclusive domain of the Community legislator.

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which the ESCB would seem to be the only authority left after the transition to Stage 3 of EMU. The somewhat confusing nature of the list in Council Decision 98/415/EC on the consultation of the European Central Bank by national authorities regarding draft legislative provisions [1998] OJ L 189/42) may be due to it being the successor to a similar decision in respect of the ECB's forerunner, the European Monetary Institute (EMI); see Article 5(2) of the Decision.

4 Article 14 EC.

5 Article 23 EC.

6 Case 6/64 *Costa* v. *ENEL* [1964] ECR 1141.

7 Articles 81 and 82 EC. See Article I-13(1)(b) of the Treaty establishing a Constitution for Europe (hereafter: European Constitution) [2004] OJ C 310, which classifies 'the establishment of the competition rules necessary for the functioning of the internal market' as an exclusive Union competence.

8 Council Regulation (EC) No. 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the EC Treaty [2004] OJ L 1/1.

9 See Article I-14(2)(a) of the European Constitution, which classifies the internal market as an area of shared competence between the Union and the Member States.

2.2 General economic policy coordination: principles, prohibitions, provisions and procedures

2.2.1 General: the four 'P's'

Economic union can best be described on the basis of Four 'P's':

1) the basic principles, laid down in Articles 4 and 98 EC;
2) the three fundamental prohibitions (Articles 101-103 EC);
3) the major provisions working these out (Articles 99 and 104, as well as Article 100 EC, which contains an additional, Community, power), and
4) the procedures established on the basis of the two former provisions: the multilateral surveillance procedure and the excessive deficit procedure (EDP).

National economic policies may thus be pursued within the restraints of certain prohibitions (see below) and of several procedures (see below), which implement the general obligation of coordination of these policies; see below. Furthermore, as outlined below, the Community may adopt economic policy measures of its own.

2.2.2 Principles

Article 4 EC contains the definitions of economic and monetary union. Its first paragraph defines economic union as follows:

> '(...) the adoption of an economic policy which is based on the close coordination of Member States' economic policies, on the internal market and on the definition of common objectives, and conducted in accordance with the principle of an open market economy with free competition.'

The first provision of the Title on Economic and monetary policy, Article 98 EC, then requires Member States ('shall') to conduct their economic policies with a view to contributing to the achievement of the objectives of the Community and in the context of the Broad Economic Policy Guidelines (BEPGs; see below). Both the Member States and the Community are to 'act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources'. Finally, they are to act in compliance with guiding principles that Article 4 EC sets out for EMU: stable prices, sound public finances and monetary conditions, and a sustainable balance of payments.[10]

[10] For Member States that have adopted the single currency, the requirement to be guided by the principle of a stable balance of payments seems somewhat awkward when this is seen as referring to their own balance of payments. It is submitted that, in a currency union, it is the union's balance of payments with the outside world, *i.e.* the other EU States and third countries, which is of importance.

The Treaty also requires Member States to ''regard their economic policies as a matter of common concern'. They 'shall coordinate them within the Council'.[11]

2.2.3 Prohibitions

The Treaty, based as it is on free market thinking, requires States to stand on their own when funding budgets: they are forbidden to rely on direct central bank credit[12] and on privileged means of finance from financial institutions.[13] Moreover, the Treaty makes clear that obligations undertaken by States are not automatically underwritten by fellow States, or by the Community: the so-called 'no bail-out' clause[14] implies that public authorities of EU States cannot rely on backing by the Community or by other States and have to repay their debts themselves. These provisions should ensure that States and their subdivisions fund themselves in the markets, apart from receiving tax receipts and, thus, are subject to the discipline of the financial markets.

2.2.4 Provisions and procedures

The Treaty lays down a procedure for the guidance of Member States' general economic policies. The Ecofin Council is to adopt annually broad economic policy guidelines on the basis of a recommendation from the Commission and after a discussion in the European Council. These BEPGs, which are in the form of a recommendation, are then communicated to the European Parliament (EP).[15] The Council monitors economic developments in each State and in the Community as a whole, including the consistency of economic policies with the BEPGs. It does so on the basis of Commission reports and '(i)n order to ensure closer coordination of economic policies and sustained convergence of the economic performance of the Member States'. Member States are to give the Commission information about 'important measures taken by them

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[11] Article 99(1) EC, referring to Article 98 EC.

[12] Indirect credit by way of secondary market purchases by central banks of government bonds has not been outlawed, as these financial instruments have a major role in central banks' operations to supply liquidity to the financial markets and, thereby, to influence interest rates. See the seventh and eighth recital of the preamble to, and Article 2(2) of Council Regulation No. 3603/93 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b(1) of the EC Treaty [1993] OJ L 332/1. Please note that Articles 104 and 104b EC have been renumbered Articles 101 and 103 EC, respectively, by the Treaty of Amsterdam (1997).

[13] See Articles 101 and 102 EC and the Regulation cited in the previous footnote as well as Council Regulation No. 3604/93 specifying definitions for the application of the prohibition of privileged access referred to in Article 104a of the EC Treaty [1993] OJ L 332/4. Please note that Article 104a EC has been renumbered Article 102 EC by the Treaty of Amsterdam.

[14] Article 103 EC.

[15] Article 99(2) EC.

in the field of their economic policy and such other information as they deem necessary'.[16]

On the basis of these Commission reports, the Council may make recommendations[17] to individual Member States should it be 'established (...) that the economic policies of [that] Member State are not consistent with the [BEPGs] or that they risk jeopardising the proper functioning of economic and monetary union'. Such recommendations may be made public by separate decision.[18]

> Decision-making under the multilateral surveillance procedure described here is by qualified majority voting (QMV), *i.e.* pursuant to the Treaty of Nice amendment to Article 205 EC, effective 1 January 2005.[19] Again, the EP is informed and the President of the Council 'may be invited to appear before the [EP] if the Council has made its recommendations public'.[20]

Thus far, a recommendation pursuant to the multilateral surveillance procedure has been adopted, and simultaneously published, only once (Ireland, 2001).[21] Article 99(4) EC also plays a role in the Excessive Deficit Procedure (EDP; see below).

Prior to the adoption of the single currency, the convergence criteria[22] acted (and, for non-participating Member States, still act) as an incentive towards better policy coordination. Furthermore, economic policy coordination should result from the separate employment policy guidelines[23] and may be the consequence of the application of the measures adopted to finance the convergence efforts of certain Member States.[24]

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[16] Article 99(3) EC. Note that the States are at liberty to decide which information to impart ('(...) as they deem necessary', emphasis added), which can be criticized from the perspective of effective Community oversight of compliance with their obligation to coordinate economic policies.

[17] For which the Commission is to submit a recommendation (Article 99(4) EC).

[18] Upon a proposal by the Commission (Article 99(4) EC). The difference between a Commission recommendation and a Commission proposal is, of course, that the Council can only deviate from the latter by unanimity (Article 250(1) EC).

[19] See the Protocol on the enlargement of the European Union attached to the EC Treaty.

[20] Article 99(4) EC.

[21] See Council Recommendation of 12 February 2001 with a view to ending the inconsistency with the broad guidelines of the economic policies in Ireland (2001/191/EC) [2001] OJ L 69/22 and Council Decision of 12 February 2001 making public the recommendation with a view tending the inconsistency with the broad guidelines of the economic policies in Ireland (2001/192/EC) [2001] OJ L 69/24.

[22] Article 121(1) EC and the Protocol No. 21 on the Convergence Criteria, annexed to the Treaty.

[23] Article 128(2) EC, which requires these guidelines to be consistent with the BEPGs adopted pursuant to Article 99(2) EC. On employment policies see, also, Articles 125-130 EC.

[24] See Council Regulation (EC) No. 1164/94 establishing a Cohesion Fund [1994] OJ L 130/1, replaced by Council Regulation (EC) No. 1084/2006 establishing a Cohesion Fund and repealing Regulation (EC) No. 1164/94 [2006] OJ L 210/79. See, also, Council Regulation (EC) No. 1083/2006 laying down general

2.2.5 Community policy measures

In an often forgotten additional provision, the Treaty gives the Community an economic policy competence of its own. Article 100(1) EC makes the Council competent to 'decide upon the measures appropriate to the economic situation'. Since the Treaty of Nice (2001), the Council, always acting on a proposal from the Commission, can act by QMV. Which measures may be adopted has not been specified. Although the competence is specifically (in particular) given for cases of scarcity (if severe difficulties arise in the supply of certain products), it is not limited to this kind of occurrence.

Article 100(2) EC institutes a Community financial assistance mechanism. The Council can activate this when a Member State is faced with severe difficulties caused by natural disasters or exceptional occurrences beyond its control.[25]

2.3 Fiscal policy framework: reasons, rules and procedure

National economic budgets are subject to a more stringent set of rules and procedures. These are based on the need to counter overspill of excessive government deficits in one Member State to the economy of another after the transition to a single currency with uniform interest rates across the monetary union. After all, economic subjects in, say, Finland and Ireland, should not see their cost of borrowing rise excessively because of the hunger for credit of the governments of, say, Germany and France. The latter's excessive demand for funding would crowd out private finance or, at least, exert an upward pressure on the interest rate to be paid by the private sector on their funding. This effect would be produced not only in the States whose Governments are eager for credit but also elsewhere in the currency union. Furthermore, with the convergence criteria having a one-off influence only, there are reasons to provide for a continuous scrutiny of Member State budgets in the face of an aging population, which will bring more spending requirements and less government income. These concerns explain why the non-participating Member States are subject to the budgetary policy framework, as well. As is well-known, the tests for adopting the single currency include the absence of an excessive

provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No. 1260/1999 [2006] OJ L 210/25.

[25] Article 100(2) EC, as amended by the Treaty of Nice. Decision-making is by QMV, as well. As in other instances of decision-making in the economic policy area, the EP is to be informed only of such assistance. For Member States outside the Euro zone, Articles 119 and 120 EC provide for the possibility of balance-of-payments assistance; see the fourth paragraph of each of these provisions and Article 122(6) EC.

deficit[26] but once in, a Member State cannot be expelled from monetary union, as entry is a one-way process.[27]

The fiscal policy framework entails a rule of budgetary restraint and procedures to ensure compliance, involving an assessment by the Commission and decision-making by the Council. The rule is given in the provision which entrusts the Commission with the fundamental task of overseeing State budgets.[28] It is to monitor the development of both budgets (current expenditure) and the stock of government debt with a view to identifying gross errors. Compliance with budgetary discipline is examined in particular on the basis of two criteria. One relates the planned or actual government deficit to Gross Domestic Product (GDP). The other relates government debt to GDP. The reference values against which the Commission has to evaluate the States' budgetary discipline are given in the EDP Protocol and are set at: 3% for the ratio of deficits to GDP and 60% for the ratio of accumulated debt to GDP.

Thus, both the current budget and the accumulation of debt as a result of financing past deficits are subject to Community review.

The Treaty does not set exact limits on these two variables, though. Rather, it requires the Commission to assess budgetary discipline on their basis but taking into account their development and the context, as well as other factors.

> As for the 3% deficit ratio, the Commission has to take into account whether:
> - 'the ratio has declined substantially and continuously and reached a level that comes close to the reference value';
> - 'or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value'.[29]
>
> Thus, when there is only a limited overshoot of the 3% mark, either a substantial and continuous fall in the level of the deficit or an exceptional and temporary transgression may be reason not to find the budget deficit excessive.
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> As for the 60% debt ratio, the Commission may conclude there is no trespassing the fiscal prudence rule when 'the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace'.

The Commission is to take into account whether the government deficit exceeds government investment expenditure, *i.e.* whether the golden rule is followed. This prescribes that a deficit should not be run to finance current expenditure

[26] This is one of the four economic convergence criteria. The other are price stability, the observance for two years of the normal fluctuation margins of the Exchange Rate Mechanism (ERM-II) and the convergence of long-term interest rate to those of the best-performing States in terms of inflation. See Article 121(1) EC. The legal convergence criterion (Articles 121 and 109 EC) requires that national legislation is compatible with (the EMU provisions of) the Treaty and with the ESCB Statute.

[27] See Protocol No. 24 to the EC Treaty on the transition to the third stage of economic and monetary union, which declares the transition irreversible.

[28] Article 104(2) EC.

[29] Article 104(2)(a), first and second indents, EC.

but may be incurred to finance investments which will repay themselves in the long run. Of course, this golden rule will lead to a discussion of the question which budget items qualify as current expenditure and which as investments. While funding the construction of a toll road is an easy example of the latter, the question whether expenditure for education also qualifies as investment is altogether more difficult to answer. '(A)ll other relevant factors are to be taken into account', notably the State's medium-term economic and budgetary position.

The Commission is thus given a free hand to be flexible on the reference values. Yet, it can also prepare a report on a State's finances when, notwithstanding fulfilment of the criteria, it considers there is a risk of an excessive deficit.[30]

The Treaty provides for a step-by-step procedure. It begins with a report by the Commission and may end with a published recommendation of the Council to the Member State whose deficit is considered excessive. For Member States which have adopted the euro, the measures can go further and could end with the imposition of a sanction, notably a fine.

The procedure is as follows:

1) the Commission prepares a report in case of a Member State not fulfilling the requirements under one or both of the criteria (Article 104(3) EC);
2) the Ecofin Committee[31] gives an opinion (Article 104(4) EC);
3) the Commission addresses an opinion to the Council (Article 104(5) EC)
4) the Council decides that an excessive deficit exits (Article 104(6) EC) and makes recommendation to the Member State concerned (Article 104(7)EC);
5) if no effective action has been taken in response to this recommendation within the time period laid down therein, the Council can make its recommendations public (Article 104(8) EC);
6) if a Member State persists in failing to put the Council's recommendations into practice, the Council may give notice to this Member State with a specified time-limit to remedy the situation, possibly requiring it to submit reports within a specific timetable to examine that State's adjustment efforts (Article 104(9) EC);
7) ultimately, the Council may impose sanctions or intensify those already applied (Article 104(11) EC).

The sanctions are the following:

1) requiring a Member State to publish additional information – specified by the Council – when issuing bonds and securities. This would put investors on alert that the State runs an excessive deficit and, probably, lead to

[30] Article 104(3), last sentence, EC.

[31] A high-level committee composed of representatives of the Member States, the Commission and the ECB with special preparatory tasks in the area of EMU and with the overall obligation to keep the economic and financial situation of the States and the Community under review and report to the Council and the Commission. See Article 114(2)-(4) EC.

a lesser status as a borrower,[32] thereby raising that State's borrowing costs. Therefore, it is a market conform mechanism to achieve compliance by the Member State concerned;

2) inviting the European Investment Bank (EIB) 'to reconsider its lending policy towards the Member State concerned'. This step is described with due deference to the EIB's separate legal personality. Due to the Ministers of Finance themselves being members of its Board of Governors and the latter's responsibility for laying down the EIB's credit policy,[33] it will mean a severance of further EIB lending;
3) requiring the State concerned 'to make a non-interest bearing deposit of an appropriate size with the Community' until the Council considers the deficit to have been corrected, or
4) imposing fines of an appropriate size.

It should be mentioned that, for Member States eligible for credit from the Cohesion Fund, a finding by the Council that an excessive deficit exits, already has an additional financial consequence, which does not hinge on the adoption of sanctions under Article 104(11) EC. Pursuant to the Regulation governing this Fund,[34] a

[32] As rating agencies will give its debt instruments a lower ranking.

[33] See Article 9(1) and (2) of the Statute of the EIB.

[34] Article 6 of Council Regulation (EC) No. 1164/94 of 16 May 1994 establishing a Cohesion Fund [2004] OJ L 130 reads as follows: ' (1) In the event of the Council deciding, in accordance with Article 104c (6) of the Treaty, that an excessive government deficit exists in a Member State, and if that decision is not abrogated in accordance with Article 104c (12) of the Treaty within one year or any other period specified for correcting the deficit in a recommendation under Article 104c (7), no new projects or, in the case of large multi-stage projects, no new stages of a project shall be financed from the Fund for that Member State. (2) Exceptionally, in the case of projects directly affecting more than one Member State, the Council, acting by a qualified majority on a recommendation from the Commission, may decide to defer suspension of financing. (3) Suspension of financing shall not take effect less than two years after the entry into force of the Treaty on European Union. (4) The suspension of financing shall cease when the Council, in accordance with Article 104c(12) EC, abrogates its decision adopted in accordance with Article 104c EC.'
See: http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!DocNumber&lg=en&type_doc=Regulation&an_doc=1994&nu_doc=1164. Please note that Article 104c EC has been renumbered Article 104 EC by the Treaty of Amsterdam. Since the workshop was held for which this paper was written, the aforementioned Regulation has been repealed. Article 4 of Council Regulation (EC) No. 1084/2006 of 11 July 2006 establishing a Cohesion Fund and repealing Regulation (EC) No. 1164/94 (OJ 2006, No. L 210/79), now reads as follows:
'Conditions applying to access to Fund assistance
(1) Assistance from the Fund shall be conditional on the following rules: (a) if the Council has decided in accordance with Article 104(6) of the EC Treaty that excessive government deficit exists in a beneficiary Member State, and (b) has established in accordance with Article 104(8) of the EC Treaty that the Member State concerned has not taken effective action in response to a Council recommendation made under Article 104(7) of the EC Treaty, it may decide to suspend either the totality or part of the

> finding of an excessive deficit, in time, leads to an end to further project funding in the State concerned. As only States whose GDP averages less than 90% of the Community average and which have a convergence programme are eligible for funding from the Cohesion Fund, this additional sanction only concerns the less wealthy States, notably Greece, Spain and Portugal and, previously, Ireland, which were the initial sole recipients of credits from the Cohesion Fund.[35]

Non-compliance with the budgetary rules cannot lead to judicial responsibility as with normal Community obligations. Since application of the budgetary rules was intended to be a political matter, access to the ECJ has been excluded in this respect.[36] Of course, the acts adopted (or the failure to adopt such acts) by the Commission and the Council under the Excessive Deficit Procedure (EDP) are subject to judicial review, as is the application of paragraph 11 on sanctions. Interestingly, Article 104(12) on the discontinuation of the EDP when a Member State has corrected its deficit is not excluded from ECJ scrutiny either. In practice, this does not broaden the scope for judicial review at the end of the procedure, since paragraph 12 refers to paragraphs 6-9 (excluded from direct review of compliance by the ECJ) and 11, and requires decision-making by the Council concerning the situation mirroring a finding of an excessive deficit. Thus, the European Court cannot interpret the provisions in such a way that the Council's decision-making on whether an excessive deficit has ceased to exist can be replaced by a finding by the ECJ.

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commitments from the Fund for the Member State concerned with effect from 1 January of the year following the decision to suspend. (2) If the Council establishes that the Member State concerned has taken the necessary corrective action, it shall decide, without delay, to lift the suspension of the commitments concerned. At the same time, the Council shall decide, on a proposal from the Commission, to re-budget the suspended commitment in accordance with the procedure set out in the Interinstitutional Agreement of 17 May 2006 between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management OJ C 139, 14.6.2006, p. 1. (3) The Council shall take the decisions referred to in paragraphs 1 and 2 by qualified majority on a proposal from the Commission.'

The main provisions on the Cohesion Fund have been integrated into the provisions governing the European Regional Development Fund and the European Social Fund. See Council Regulation (EC) No. 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No. 1260/1999 [2006] OJ L 210/25).

35 See Article 2 of Regulation 1164/94. The currently applicable text is Article 5(2) of Regulation 1083/2006, which reads as follows: 'The Member States eligible for funding from the Cohesion Fund shall be those whose gross national income (GNI) per capita, measured in purchasing power parities and calculated on the basis of Community figures for the period 2001 to 2003, is less than 90% of the average GNI of the EU-25 and which have a programme for meeting the economic convergence conditions referred to in Article 104 of the EC Treaty.'

36 Article 104(10) EC excludes application of Articles 226 and 227 EC as regards paragraphs 1 to 9.

2.4 Application to all Member States with special rules for Euro zone members

The rules on budgetary restraint were motivated by the transition to monetary union. Yet, they apply to all Member States. Since the transition to Stage 3 of EMU, they are all required to ('shall') avoid excessive government deficits by virtue of Article 104(1) EC. Only the United Kingdom has secured an outsider's position[37] as it continues to be bound by the lesser requirement of endeavouring to avoid excessive government deficits (Article 116(4) EC, to which all Member States had been subject during Stage 2 of EMU (1994-1998)).

Nevertheless, there is a clear distinction between the participating Member States (for brevity's sake: the 'ins') and the non-participating Member States (the 'outs'). The procedure provided for to ensure compliance with the fiscal policy requirements ends with a published recommendation by the Council in case of States outside the Euro area, whereas for States fully participating in EMU, further steps are foreseen, possibly leading to sanctions.

This is provided for by Article 122(3) EC, which exempts States with a derogation from applicability of, *inter alia*, Article 104(9) and (11) EC, the provisions on a notice and sanctions.[38]

Article 122(5) EC provides that the voting rights of Member States with a derogation are suspended in the Council when it takes decisions pursuant to the provisions that are not applicable to them. Thus, only Member States of the Euro zone are possibly subject to a notice and to sanctions which are decided by their fellow full members of EMU.

As a final point in this description of the EDP, it should be noted that the Member State concerned participates in the decision-making in the Council on whether it runs an excessive deficit, but any further decisions in respect of this State (from recommendations to sanctions and the ultimate abrogation of any measures adopted when its budgetary situation has been corrected) are taken without its vote[39]. Thus, it faces scrutiny from its peers without formal influence. Of course, as we have seen in November 2003, States can muster 'friends' to vote against measures that are unwelcome, especially when promising these other States to vote against any measures to be imposed in respect of them. This completely undermines the EDP's effectiveness.

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[37] See paragraph 6 of the UK Opt-out Protocol. Note that Denmark, although an opt-out State, is not in the same position: as all States with a derogation (to which Denmark is equated thanks to its exemption; see paragraph 2 of the Danish Opt-out Protocol), Denmark is subject to Article 104(1) EC.

[38] As said before, the exemption for the UK derives not from Article 122 EC but from its Opt-out Protocol, attached to the Treaty of Maastricht. See: http://www.eurotreaties.com/maastrichtprotocols.pdf at p. 33.

[39] Article 104(12) EC.

2.5 Stability and Growth Pact

2.5.1 Original texts

The Stability and Growth Pact (SGP) contains additional constraints for States' fiscal policies. Originally, the SGP consisted of a Resolution of the European Council and two Regulations. The Resolution[40] contains the basic points of agreement adopted in addition to the Treaty obligations on budgetary discipline. It lays down the political agreement of strengthening budgetary discipline, contains a commitment of Member States to achieve budgetary balance or surplus, invites States to make Council recommendations public, contains the Commission's commitment to present timely reports as well as the Council's commitments

1) to see to it that deficits are rectified not later than one year after their identification;
2) to impose a non-interest-bearing deposit whenever a sanction is applied, and
3) to convert this deposit into a fine after two years (unless the deficit is corrected).

Regulations 1466/97 and 1467/97 then set out the specifics. Regulation 1466/97 was adopted on the basis of Article 99 EC and is referred to as the preventive arm of the SGP.[41] It contains the obligation for Member States to submit stability ('ins') or convergence ('outs') programmes to the Council and the Commission each year. In these documents, the Member States present a balanced-budget (or: surplus) objective and policy measures to achieve this objective. The Regulation also establishes a procedure for examining these programmes and for monitoring their implementation, possibly resulting in recommendations by the Council based on Article 99(4) EC by way of early warning against an excessive deficit in case of significant divergence of a State's budgetary position from the medium-term objective.[42]

Regulation 1467/97, as the corrective arm of the SGP,[43] restricts the discretionary powers under Article 104 EC as:

1) it defines an excessive deficit as 'exceptional and temporary' (*i.e.* 'acceptable' in the sense of Article 104(2)(a) EC) when either resulting from an unusual event outside the control of the State concerned or resulting from

[40] Resolution of the European Council on the Stability and Growth Pact [1997] OJ C 236/1.

[41] 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 [1997] OJ L 209/1.

[42] See Article 6(2) and 10(2) of Regulation 1466/97.

[43] Council Regulation (EC) No. 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure [1997] OJ L 209/6.

a severe economic downturn (that is, when GDP falls at least 2% in a single year);

2) it lays down the time-paths for the application of the excessive deficit procedure, introducing a three-month period for the establishment of an excessive deficit (Article 104(6) EC) and the simultaneous adoption of a recommendation (Article 104(7) EC), a deadline of four months for the State's effective action and the usual correction of such a deficit in the year following its identification,[44] as well as a two-month period between a notice (Article 104(9) EC) and the application of sanctions (Article 104(11) EC);
3) it establishes when the excessive deficit procedure is to be interrupted;
4) it sets out the specifics of the sanctioning by laying down that, in principle, a non-interest-bearing deposit is to be required and by establishing a method for calculating such a deposit (fixed and variable components, ceiling), and
5) it lays down that the deposit is to be lodged with the Commission; interest proceeds and possible fines are to be distributed among the 'ins' without an excessive deficit.

First assessment of the limits of State action – provisions studied thus far

By way of interim assessment, we may draw the following conclusions as to the limits of State sovereignty under EMU law. Apart from the complete transfer of sovereignty in the monetary area – where the limits of the Community competences and the extent to which they are exercised may still leave scope for State action, *e.g.* in the areas of payments and external representation; these matters are beyond the scope of the present study –, in the field of economic policy, the primary emphasis is on the States' freedom to pursue action. Nevertheless, the States are subject to a strongly worded embedment of their own economic policies in a Community framework since they are required to pursue them with a view to attaining Community objectives and in the context of Community guidelines. Also, the multilateral surveillance procedure for monitoring adherence to these guidelines, although these are couched in a mere recommendation, provides for a continuous oversight of State policies by the Commission and the Council, possibly leading to public rebuke (recommendations). Furthermore, strict prohibitions which, as is usual in other areas of Community law, are overseen by the Commission, and the possibility of Community measures, to be adopted by the Council provide further evidence of the fact that the freedom of Member States to pursue their own policies may, in principle, be markedly curtailed.

This is even more so in the specific area of budgetary policy. The aforementioned principles, prohibitions, guidelines and procedure also cover the subject matter of budgets but additional rules apply. These special rules on budgetary discipline set a clear framework and provide for a Community response with increased strictness and scrutiny as a Member State deviates further from fiscal prudence. Of course, the Commission's weakened role compared to the predom-

[44] See Article 3(3) and (4) of Regulation 1467/97 in its original form.

inant procedures in the Treaty, with only a power to recommend rather than to propose – the exception being the publication of a recommendation pursuant to Article 99(4) EC – protects State sovereignty, as does the requirement of QMV in the Council where peers are unlikely to 'condemn' peers. However, the original SGP implied a major restriction on State budgetary policies, as it required adherence to a stricter norm than the Treaty set (budgetary balance or surplus over time, instead of 'mere' absence of an excessive deficit) according to well-defined procedural steps to correct deviations from self-imposed policy measures to achieve a sound budgetary situation (set out in annual stability or convergence programmes). The ultimate prospect of deviant States channelling funds to their fellow participants in monetary union (who were to receive the proceeds of non-interest bearing deposits as well as any fines paid to the Community) implied a major restriction of State freedom in the area of budgetary policy[45].

2.5.2 2005 amendments

Resuming our description of the SGP, and before going into the experience with practical application of the rules studied, one has to conclude that the 2005 revision had mixed consequences for the interplay between Community and State competences. In some respects, it marked a strengthening while, in other respects its constituted a major loosening of the norms.

The SGP now consists, apart from the three documents described before, of two additional documents and two revisions of the 1997 regulations. The European Council has endorsed an Ecofin Council Report on improving the functioning of the SGP after its 2003 near-collapse (see below). This Report,[46] and a Code of Conduct on the stability and convergence programmes,[47] improving their quality and comparability, now also form part of the SGP.

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[45] For another assessment of the SGP's impact, see Amtenbrink, F., and J. de Haan, 'Economic Governance in the European Union: Fiscal Policy Discipline Versus Flexibility' *CML Rev* 2003, 40, p. 1075.

[46] Ecofin Council Report of 28 March 2005 'Improving the implementation of the Stability and Growth Pact – Council Report to the European Council –', Annex II to the Presidency Conclusions of the Brussels European Council of 22 and 23 March 2005, http://www.eu2005.lu/en/actualites/conseil/2005/03/23conseileuropen/ceconcl.pdf, and http://europa.eu.int/rapid/pressReleasesAction.do?reference=DOC/05/1&fo.

[47] Code of Conduct on the content and format of stability and convergence programmes, latest version endorsed by the Ecofin Council on 11 October 2005, http://www.europa.eu.int/comm/economy_finance/about/activities/sgp/codeofconduct_en.pdf.

The amendment to Regulation 1466/97 entails the following elements,[48] each of which is accompanied by a brief assessment of its impact on 'strengthening' or 'weakening' the SGP[49]:

1) it allows for 'country-specific' differentiated medium-term objectives for budgetary positions, diverging from 'close to balance or surplus position' (a clear weakening of the general overall budgetary surplus objective; RS);
2) it requires that these differentiated objectives provide a safety margin with respect to the 3% deficit ratio, 'ensure rapid progress towards sustainability' and, 'taking this into account, allow room for budgetary manoeuvre, considering in particular the needs for public investment'(a mixture of strengthening [first 2 elements] and weakening [last element]; RS);
3) it requires that, for States that have adopted the euro and participants in ERM-II, the specific objective lies between –1% of GDP and balance or surplus 'in cyclically adjusted terms, net of one-off and temporary measures' (a strengthening for (aspiring) Euro zone members; RS);
4) it provides for revision of a State's medium-term budgetary objective in case of major structural reform and in any case every four years (this seems to undermine the fixed nature of the objective, making it a moving target; RS);
5) it requires stability and convergence programmes to be detailed and quantitative (a strengthening of the requirements in comparison to the previous text; RS);
6) it requires reasons to be given for deviations from the adjustment path towards the medium-term budgetary objective(a strengthening of the preventive arm of the SGP; RS), and
7) it introduces a 0.5% of GDP benchmark for annual improvements in the budgetary situation on the adjustment path towards the medium-term budgetary objective, allowing for stronger adjustment in economically good, and more limited adjustment in economically bad times (a more quantitative approach than before but with cyclical variability; RS).

The amendment to Regulation 1467/97 entails a general loosening of the time-limits contained therein.[50] Based on the idea of 'enhanc(ing) the governance and the national ownership of the fiscal framework by strengthening the

[48] Council Regulation (EC) No. 1055/2005 amending Regulation (EC) No. 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [2005] OJ L 174/1.

[49] For an extensive description of the changes, see 'The reform of the Stability and Growth Pact' *ECB's Monthly Bulletin* 2005, p. 59, http://www.ecb.int/pub/pdf/mobu/mb200508en.pdf#search=%22The%20reform%20of%20the%20Stability%20and%20Growth%20Pact%20ECB%20Monthly%20Bulletin%20August%202005%22.

[50] Council Regulation (EC) No. 1056/2005 amending Regulation (EC) No. 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure [2005] OJ L 174/5.

economic underpinnings and the effectiveness of the Pact'.[51] and emphasizing peer support and peer pressure, while announcing that the Commission and the Council will 'act in close and constructive cooperation in the process of economic and fiscal surveillance, in order to guarantee certainty and effectiveness in the rules of the Pact.'[52] Regulation 1056/2005

1) allows to consider exceptional an excess of the reference value when it is due to 'a protracted period of very low annual GDP volume growth relative to [the State's growth] potential';
2) specifies other relevant factors to be taken into account which include, among many others, the budgetary burden of development assistance and the costs of Europe's unification (which may be an implied reference to the costly German unification, as well);
3) lays emphasis on the fiscal consolidation efforts in good times as an element to be taken into account by the Commission when preparing its report under Article 104(3) EC;
4) requires the Commission and the Council to pay due regard to pension reforms which introduce a mandatory, fully-funded pillar of a pension system;
5) extends the time periods for applying the excessive deficit procedure, whereby the year after identification remains the period for correction but deadlines have been extended for Ecofin Council action (4 instead of 3 months after reporting of the excessive deficit, and 2 instead of 1 months after establishing that a State has not taken effective action in response to its recommendation) and for State remedial action (6 instead of 4 months from an Ecofin Council recommendation and 4 instead of 2 months for taking effective action after an Ecofin Council notice); these extensions are clearly visible in the British Annex which accommodates the different UK budgetary year (March-April);
6) also, just as the SGP's preventive arm, as amended, establishes a minimum annual improvement of at least 0.5% of GDP as a benchmark for correction of the excessive deficit;
7) permits the Council, upon Commission recommendation, to adopt a revised notice which may extend the deadline for deficit correction if (a) effective action has been taken and (b) unexpected adverse economic events with major unfavourable consequences for government finances have occurred since the first notice, and
8) replaces the references to old numbering in the EU and EC Treaties.

It may be clear from the above that Regulation 1056/2005 contains only loosening of the SGP, with one major exception: the objective benchmark for budgetary corrections of 0.5% of GDP per year. As already remarked, the

[51] Recital No. 2 of the preamble to Regulation 1056/2005. See, also, recital No. 2 of the preamble to Regulation 1055/2005.

[52] Recital No. 3 of the preamble to Regulation 1056/2005.

requirement that correcting an excessive deficit should be completed within one year of its identification (unless there are special circumstances) has been maintained.[53] Coupled with the 0.5% of GDP benchmark, this means that deficits beyond 3.5% of GDP may have to be corrected within 12 months and, if they are not, the Member State has not met the efforts minimally required (*i.e.*, the 0.5% annual improvement).

The stated aim of the revised SGP is the 'prompt correction of an excessive deficit' in a procedure that 'should remain simple, transparent and equitable.'[54] As the legislator considered when amending the SGP in 2005: 'The Stability and Growth Pact has proven its usefulness in anchoring fiscal discipline, thereby contributing to a high degree of macroeconomic stability with low inflation and low interest rates, which is necessary to induce sustainable growth and employment creation.'[55]

Second assessment of the limits of State action – provisions studied thus far

At this juncture, it is possible, to state that the conclusions as to the limits on State action given above, need adaptation. The new texts governing budgetary discipline have widened the scope for State action considerably albeit not evenly: some strictness has also been adduced. When one considers the national ownership of budgetary rules and the many instances in which the surveillance thereof is to take special circumstances into account – ranging from a protracted period of very low annual GDP volume growth relative to the State's growth potential to the costs of development assistance and of European (including German) unification,[56] and pension reform – as well as the increased periods over which budgetary corrections can be spread out, the assessment of the revised SGP must be that States have won and the coordination of economic policies at Union level has lost. The abandoning of the same medium-term objective for all Member States[57] is a major setback from a coordination point of

[53] Article 3(4) of Regulation 1467/97, both prior to and after amendment.

[54] Recital No. 5 of the preamble to Regulation 1056/2005.

[55] Recital No. 1 of the preamble to Regulation 1055/2005 and recital No. 1 of the preamble to Regulation 1055/2005.

[56] Article 2(3) of Regulation 1467/97, as amended by Regulation 1056/2005, reads as follows: 'In that context, special consideration shall be given to budgetary efforts towards increasing or maintaining at a high level financial contributions to fostering international solidarity and to achieving European policy goals, notably the unification of Europe if it has a detrimental effect on the growth and fiscal burden of a Member State. A balanced overall assessment shall encompass all these factors.'

[57] Also criticized by Amtenbrink, F., and J. de Haan, 'Reforming the Stability and Growth Pact' *EL Rev* 2006, 31 (3) p. 408. The Commission, in its first assessment of the application of the revised SGP (Commission of the European Communities 'Communication from the Commission to the Council and the European Parliament: Public Finances in EMU 2006 – The first year of the revised Stability and Growth Pact, COM(2006) 304, http://eur-lex.europa.eu/LexUriServ/site/en/com/2006/com2006_0304en01.pdf), specifies that there are now '(c)ountry-specific medium-term budgetary objectives' which 'reflect economic fundamentals and national strategies (...)'. It continues to note that Member

view as the amended SGP now seems to acknowledge heterogeneity of economic policies and developments instead of convergence within the EU. Even the increased severity which can be discerned in the prescribed quantitative nature of the stability (or convergence) programmes, the need for justification of deviations thereof and the required safety margin with respect to the 3% norm do not diminish the conclusion that budgetary policy coordination has been weakened thanks to the 2005 amendments to the SGP.[58] Yet, the picture is not clear-cut across the board: for States that have adopted the single currency and for States that are serious in their plans to do so, the norm has been relatively[59] raised to between '–1% of GDP and balance or surplus', whereas the other 'outs' may continue to run budget deficits near 3% of GDP.

States 'with a relatively high risk to fiscal sustainability (high debt, low potential growth) have medium-term budgetary objectives of balance or a small surplus. Member States with low debt and high potential growth prospects aim for a deficit of up to 1% of GDP, allowing room for budgetary manoeuvre, while stabilising the debt at prudent values.' As First Deputy Governor Eva Srejber of Sveriges Riksbank (the Swedish central bank) remarked in a speech on the renewed SGP ('Greater budgetary discipline in the EU through transparency and national ownership') before a breakfast seminar at Ernst & Young on 26 September 2006, a split has been made between Member States, those with high debt levels being required to aim for a stricter medium-term objective than those with lower debt levels. See: http://www.riksbank.com/templates/Page.aspx?id=22608.

58 For terse remarks on the revised texts, see the ECB's Opinions. In both its Opinion of 3 June 2005 at the request of the Council of the European Union on a proposal for a Council regulation amending Regulation (EC) No. 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (COM(2005) 154) (CON/2005/18) (2005/C 144/11) [2005] OJ C 144/17, and its Opinion of 3 June 2005 at the request of the Council of the European Union on a proposal for a Council regulation amending Regulation (EC) No. 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure (COM(2005) 155 final, Brussels, 20.04.2005) (CON/2005/17) [2005] OJ C 144/10 and [2005] OJ C 144/16, the ECB remarks: 'Sound fiscal policies are fundamental to the success of economic and monetary union (EMU). They are prerequisites for macroeconomic stability, growth and cohesion in the euro area. The fiscal framework enshrined in the Treaty and in the Stability and Growth Pact is a cornerstone of EMU and thus key to anchoring expectations of fiscal discipline. This rules-based framework, which aims to secure sustainable public finances while allowing the smoothing of output fluctuations through the operation of automatic stabilisers, needs to remain clear, simple and enforceable. Compliance with these principles will also facilitate transparency and equal treatment in the implementation of the framework.' The ECB stated its preference for an amendment that is as limited as possible to Regulation (EC) No. 1467/97. It concluded that 'A rigorous and consistent implementation of the surveillance procedures (EDP) would be conducive to prudent fiscal policies.'

59 That is, in relation to their peers who wish to remain outside the monetary union. Of course, when compared to the overall objective of the SGP as drafted in 1997, the norm for the '(pre-)ins'' has been lowered, as well. Please note, in this context, that all Member States except the United Kingdom and Denmark are Treaty-bound to introduce the single currency and to work towards the necessary convergence.

3 Practical experience with the EDP and the SGP

3.1 EDP and SGP experience

The application of the EDP, which encompasses the application of the SGP as this only reinforces the procedures laid down in Articles 99 and 104 EC, shows that, in practice, there is less severity for Member States than would be possible under the law. First of all, a majority of Member States has been subject to findings of an excessive deficit[60] since 1999.[61] This means that, among the twelve Euro zone States, only six, *i.e.* Belgium, Spain, Ireland, Luxemburg, Austria and Finland, have not seen the excessive deficit procedure being opened in respect of them. Among all 25 States, these six plus Denmark and Sweden, as well as the Baltic States and Slovenia, *i.e.* a total of twelve, have not seen this procedure initiated. One may conclude that the level of compliance with the Treaty rules has been rather low. Of course, the recession in several States or low economic growth prevailing elsewhere, is in part accountable for this. This does not diminish the finding of low compliance since the EDP and the SGP were intended to prevent fiscal imbalances over time although, lately, the emphasis has been on the economic cycle rather than on a specific year. Second, some States have had serious and long-lasting problems of compliance with the EDP. Notably, Germany, France, Portugal (which remedied its first breach only to fall back into an excessive deficit sometime later) and, worst of all, Greece, have had major problems in this respect. They clearly could not remedy their fiscal deficits for years on end.

3.2 Stand-off in 2003

The most important practical observation to be made, of course, is that the proposed application of the rules in respect of France and Germany failed to materialize in November 2003. Germany had first managed to see a previous step in the procedure not taken in its respect. On 12 February 2002, the Council, unanimously, decided not to act upon a Commission recommendation for an early warning in respect of the German deficit, in view of the commitments undertaken by Germany.[62] Later that same year, the Commission

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[60] See http://www.europa.eu.int/comm/economy_finance/about/activities/sgp/procedures_en.htm.

[61] This year is taken as a yardstick since previous findings of excessive deficits were abrogated when, in the run-up to the transition to Stage 3 of EMU, most Member States were successful in bringing their deficits within the limits of the EDP. (The SGP only took effect on the first day of Stage 3.). The question whether the Council and the Commission followed too lenient an approach when applying the criteria at the time, and the subsequent revealing of fraud in the Greek figures, are not discussed further here.

[62] Statement by the Council (ECOFIN) on the budgetary situation of Germany, 12 February 2002 (SN 1382/1/02 REV 1).

had to initiate the EDP for Germany,[63] leading to the finding of an excessive deficit on 21 January 2003, when an early warning was also given to France.[64] The Council later found that France, indeed, did run an excessive deficit.[65] When, ultimately, the Commission submitted recommendations to take decisions pursuant to Article 104(8) EC in respect of both States, the Council could not muster the necessary majorities and, instead, issued a statement which concluded that the EDP was held in abeyance in respect of them. The Council relied on public commitments by both France and Germany to reduce their deficits to within the acceptable range (*i.e.* below 3% of GDP). The Council's statement included recommendations that the Commission had recommended it to adopt formally and invited each State to regularly report on progress in implementing these. Thus, an informal procedure was chosen instead of a formal one. Critics dubbed this the death of the SGP.[66]

3.3 ECJ judgment in 2004

The Commission took the Council to Court for this blatant failure to proceed with the EDP along the self-imposed line of the SGP. The EU executive attacked the decision not to adopt the formal instruments it had submitted and the conclusions the Council had adopted instead. The ECJ[67] held that the adoption of a decision under Article 104(8) EC - the publication of its previous recommendations – , and (9) – the giving of a notice – , requires a two-third majority in the Council, excluding the vote of the State in respect of which the decisions are taken.[68]

It should be repeated that the voting rights of the Member States with a derogation are suspended in respect of Article 104(9) and (11) EC.[69] Thus, the 'outs' do not participate in a Council vote on a notice but do take part in the voting earlier on in the procedure. This point was important in the assessment of the legality of the Council's acts, as will be explained below.

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[63] Council Decision of 21 January 2003 on the existence of an excessive deficit in Germany – Application of Article 104(6) of the Treaty establishing the European Community (2003/89/EC) [2003] OJ L 34/16.

[64] Council Recommendation with a view to giving an early warning to France in order to prevent the occurrence of an excessive deficit (2003/90/EC) [2003] OJ L 34/18.

[65] Council Decision of 3 June 2003 on the existence of an excessive deficit in France — application of Article 104(6) of the Treaty establishing the European Community (2003/487/EC) [2003] OJ L 165/29.

[66] See Begg, I., and W. Schelkle, 'The Pact is Dead: Long Live The Pact' *Nat. Inst. Econ. Rev.* 2004, 189, p. 86, http://ner.sagepub.com/cgi/reprint/189/1/86. See, also, Europe and the Euro – the death of the Stability pact', *The Economist* 396 (8352) 45, 27 November 2003.

[67] Case C-27/04 *Commission* v. *Council* [2004] ECR I-6649. See Maher, I., 'Economic policy coordination and the European Court: excessive deficits and ECOFIN discretion' *EL Rev* 2004, p. 831.

[68] See Article 104(13) EC.

[69] Article 122(3) and (5) EC. A similar exclusion of the voting rights of the United Kingdom prevails pursuant to Paragraph 5 of the UK Opt-out Protocol (see *supra* § 2.4).

The Court acknowledged the intention of the legislator for urgent action because of the seriousness of an excessive deficit in Stage 3 but found that there is no rule that expiry of the time limits precludes adoption of acts that the Commission has recommended it to take. Otherwise, the whole procedure would have to be recommenced.[70] Thus, the challenge of the Council's behaviour under Article 230 was rejected[71]. Although Regulation 1467/97 only permits the procedure to be held in abeyance when a Member State complies either with a recommendation under Article 104(7) or with a notice under Article 104(9) EC[72], the EDP can also be held in abeyance on the practical basis of insufficient votes in favour of the recommended measures. The ECJ helpfully reminded the Commission that it can challenge a failure to act under Article 232 EC. So, it seems that the Commission's choice of a legal basis for its challenge (challenging an act, rather than failure to act) led to the partial loss of its case.

Partial, since the Court did find for the Commission in that it annulled the Council's conclusions.[73] The ECJ found that the conditional suspension of the EDP, which was based on the commitments undertaken by France and Germany, went beyond a mere practical stop to the procedure because there were insufficient votes for adoption of the recommended acts.[74] Also, the Council had made resumption of the EDP dependent on the assessment of the manner in which the two States has fulfilled their unilateral commitments and, thus, not on their following up recommendations under Article 104(7) EC.[75] The Council had effectively altered its previous recommendations, *e.g.* by lengthening the period given for correction of the excessive budget deficits[76]. All this led the Court to find that the conclusions had legal effects[77] and, thus, were subject to judicial review.

The ECJ mentioned 'the importance that the framers of the Treaty attach to the observance of budgetary discipline' and sought to interpret the rules so as to ensure their full effectiveness[78]. It emphasized that the EDP is a procedure in stages which have to be followed and contains a strict framework of deadlines[79]. Although the Council has a discretion to adopt measures, it 'cannot break free from the rules laid down by Article 104 EC and those which it set itself in Regulation 1467/97.'[80] Since the Council had held the procedure in abeyance beyond

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70 Paragraph 33 of the judgment.

71 Paragraph 34 of the judgment.

72 See Article 9. The amendments to this provision introduced by Regulation 2005/1056 do not alter this.

73 See the *Financial Times*' editorial comment on 14 July 2004: 'Solomonic ruling on stability pact'.

74 Paragraph 47 of the judgment.

75 Paragraph 48 of the judgment.

76 Paragraph 49 of the judgment.

77 Paragraph 50 of the judgment.

78 Paragraph 74 of the judgment.

79 Paragraphs 77-78 of the judgment.

80 Paragraph 81 of the judgment.

one of the precise conditions which the SGP provides for[81] and since it had modified its previous recommendations without a fresh recommendation from the Commission to that effect[82], the recommendations contained in the Council's conclusions had been adopted unlawfully. The Court made special mention of the fact that the Council had adopted its conclusions without the votes of the 'outs' (Article 104(9) EC) whereas the appropriate procedure for adopting or amending recommendations should have included them (Article 104(7) EC)[83]. The ECJ specifically did not express a view on whether the Council would have been under a legal obligation to adopt a decision when a Member State persists in failing to put its recommendations in practice as this question was not at issue[84].

A third assessment of the measure of freedom of States in their budgetary policies

When assessing the position of the Member States on the basis of practical experience, including the ECJ's judgment in Case C-27/04, one can only conclude that the States have much more leeway than would appear to be the case on the basis of the legal texts alone. The practical difficulty of applying sanctions, or even of putting Member States under permanent surveillance of Community institutions proves that State sovereignty is more tenacious than considered in Maastricht and in Amsterdam. This may be explained by three main reasons.

First, it is partially a reflection of the way the oversight of fiscal prudence and economic-policy coordination in general, have been organized. The institutional weakness of the Treaty rules on EMU in the economic field contains the seeds of the current state of affairs.[85] With the Council acting through peer group pressure and the Commission being obliged to act almost exclusively by way of recommendation, a better outcome cannot be expected. The Council, even when competent to act by QMV, will be inclined to be reticent when subjecting its members to scrutiny, considering that what happens to one State today, can happen to another tomorrow.[86] Especially, the disinclination by larger Member States to submit to the Council's authority has meant that recommendations are avoided (Germany, 2002) or not followed up according to the proper sequence of stages (Germany, France, 2003). The only published recommendation adopted

[81] Paragraphs 83-90 of the judgment.

[82] Paragraphs 91-94 of the judgment.

[83] Paragraph 95 of the judgment.

[84] Paragraph 90 of the judgment.

[85] Amtenbrink, F. and J. de Haan, *op. cit.*, at p. 404 state that '(t)he conscious choice by the Member States at the time of the drafting of the Treaty on European Union and thereafter to effectively leave economic policy in the national sphere has resulted in a half-hearted solution incapable of preventing the emergence of excessive deficits in the Member States'. They deplore the application of the open method of coordination and a system of peer review.

[86] This disinclination to apply the EDP and the SGP makes Eva Srejber of Sveriges Riksbank remark that 'peer pressure' has become 'peer protection'. See her above referred speech on the renewed SGP.

under the multilateral surveillance procedure, rather than the EDP, concerned Ireland in respect of its budgetary policy for 2001 which the Council thought was pro-cyclical and threatened to overheat the booming Gaelic Tiger's economy.[87]

Second, the weak enforcement and, thereby, the wide scope for State's to act, is due to the political climate and the lack of enthusiasm for European integration shown by State politicians. The past couple of years, a marked tendency to reject common approaches and multilateral solutions and to fall back on national instincts can be discerned. It shows in many policy areas and culminated in the fierce stand-off about the voting rules in the European Constitution and the lackluster defence of this texts by politicians whom the public usually perceived as bashing Brussels when the Constitution was put to a vote[88]. When, during 2003, French politicians stated that they will not subject their budgets to unelected bureaucrats or foreign statisticians,[89] meaning the Commission and their fellow members of the Council, they could hardly expect their electorate to support a text which would continue and strengthen the Union whose institutions they publicly scorn. This state of affairs may also explain why the Commission is reluctant to enforce compliance with EMU rules more than it does.[90] Thus, a political 'climate' which is unfavourable to European solutions – and, perhaps, even the prevailing attitudes in society where a backlash against 'other-

[87] See Council Recommendation of 12 February 2001 with a view to ending the inconsistency with the broad guidelines of the economic policies in Ireland (2001/191/EC) [2001] OJ L 69/22, published in consequence of Council Decision of 12 February 2001 making public the recommendation with a view to ending the inconsistency with the broad guidelines of the economic policies in Ireland (2001/192/EC) [2001] OJ L 69/24.

[88] With the notable exception of Spain, where the Government pulled out a major show of support for the Constitution.

[89] Jean-Pierre Raffarin, the French Prime Minister at the time, is quoted by *Le Monde* of 6 September 2003 as having said on French television channel TF1 on Thursday 4 September: «*Mon premier devoir, c'est l'emploi et non pas d'aller rendre des équations comptables et de faire des problèmes de mathématiques pour que tel ou tel bureau, dans tel ou tel pays soit satisfait*» (which translates roughly as follows: 'My first duty is employment and not having to submit accounting equations or solve mathematical problems to please this or that office in one or another country'). The reference to 'heartless 'accountants in Brussels'' can also be found in the recent speech by Eva Srejber of Sveriges Riksbank referred to above, where she says that 'instead of national leadership towards clear objectives we have seen the opposite – the political exploitation of the gap between the national and European level. The requirements of the Pact are blamed on heartless 'accountants in Brussels' (...).'

[90] To give an example from the area of monetary union: the Swedish self-made opt-out which keeps this Member State outside monetary union without such exclusion having a Treaty basis, is founded on non-compliance with two convergence criteria (compatibility of national law with EMU rules and membership of ERM-II). Non-compliance with Article 109 which requires compatibility of national law with the EMU rules as from the date of establishment of the ESCB (*i.e.*, 1 July 1998) could be brought before the ECJ.

ness' can be perceived – may be held, at least partially, accountable for the lack of application of the rules on economic policy and budgets.[91]

Third, the absence of compliance with the budgetary rules and, thereby, the large measure of State freedom of action in practice, may be due to a general trend towards the Open Method of Coordination as the preferred option to work together in the European Union. This method is a bottom-up manner of coordination, consisting of exchanging information, comparing notes, establishing best practices and evaluating actual performance. It stands in opposition to a more formal and top-down approach to coordination. The recent inclination to follow this form of cooperation has spread from the areas where it is the best manner to start (*i.e.*, policy areas where there are no, or new, Community competences) to the longtime Community responsibility of coordinating economic policy,[92] and that during a period in which this coordination was to underpin the single currency.[93]

4 European Constitution

4.1 Amendments to economic union texts

The European Constitution[94], as adopted on 29 October 2004 in Rome (I), would, if and when it entered into force, have contributed to a slight strengthening of economic union governance. While its main characteristics would remain unchanged, the Constitution would have permitted the Commission, rather than the Council, to adopt an early warning in case of (the threat of) an excessive deficit[95]. A similar role was to be given to the Commission in case of divergence of a Member State's economic policies from the BEPGs or when these risk to jeopardize the proper functioning of EMU[96]. The Constitution would have given the Commission one other increased power in the EDP – namely to propose rather than to recommend to the Council to establish that an excessive deficit exists[97] –, and would have included the possibility for increased

[91] This state of affairs was very well summed up by Munchau. W., in his contribution 'Euro zone Pettiness is Preventing Policymaking' in the *Financial Times* of 26 June 2006, when 'Yet European policymakers continue to have a predominantly small-country mindset. They are obsessed with small-country issues and they have petty, small-country fights.'

[92] Coordination of Member State's economic policies has been among the Council's main tasks since 1958.

[93] Perhaps, this inclination to follow the OMC also reflects the underlying aversion of European integration, so that the third reason given is merely a sign of the second.

[94] Treaty establishing a Constitution for Europe [2004] OJ C 310/1.

[95] Article III-184(5) European Constitution.

[96] Article III-179(4) European Constitution.

[97] Article III-184(6) European Constitution. The division of competence adopted in Maastricht, with Commission recommendations for the adoption of a Council recommendation in respect of a Member State, both under the multilateral surveillance procedure and under the EDP, would remain in place (see

coordination among the Euro area States[98]. Apart from other elements, such as the ranking of coordination of economic policy as an intermediate class between exclusive and shared competences[99], and the ill-advised and badly-drafted exit clause[100], economic policy would be affected by two other elements of the Constitution, the institutional set-up of a ministerial group of the 'ins' and the allotment of voting rights.

The Eurogroup, the convening of the Ministers of Economic Affairs and Finance of the 'ins' only, would have been given constitutional status and its members would elect a president for two and a halve years[101] but it would not have any decision-making power. This would remain with the ECOFIN Council albeit, as now, with the exclusion of voting rights for the 'outs'[102]. This last element of alteration to economic governance is discussed in the following section.

4.2 Voting rules

Voting rules would have been changed. Whereas, nowadays, all Member States take part in the EDP, while the State whose deficit is at issue does not have the right to vote after the initial finding of an excessive deficit, under the Constitution only 'ins' would participate in votes in respect of fellow participants in the currency union, with 'outs' – of course together with 'ins' – voting only in respect of their peers. It should be remembered that, both currently and under the Constitution, sanctions can only be applied to full members of the Euro area and that decision-making in respect of such sanctions is limited to those that can potentially be subjected to them. This means that the Constitution's innovation would have been the exclusion of participation of 'out'

Articles III-179(4) and III-184(6) and (7) European Constitution), just as the peculiar and undemocratic procedure of secret recommendations that the Council is to decide specifically to publish (in the case of the multilateral surveillance procedure on the basis of a Commission proposal (Article 99(4) EC versus Article 104(8) and (12), respectively Article III-179(4) versus Article III-184(6), (7) and (8) European Constitution). The Constitution failed to enact the procedure that is already followed in practice and which, under the SGP, is recommended by the European Council, namely of immediate publication of Council recommendations to Member States.

98 Articles III-179(2) and III-197(2)(b) European Constitution.

99 See Article I-15(1) European Constitution.

100 Article I-60 European Constitution, which implies an open-ended option to leave the Union without proper regulation of the necessary arrangements for relinquishing the single currency. For a critical review of the Constitution from an EMU perspective, including capital and payments and monetary union, see Smits, R., 'The European Constitution and EMU: An Appraisal' *CML Rev* 2005, 42, p. 425.

101 Protocol No. 12 on the Eurogroup [2004] OJ C 340/341, http://eur-lex.europa.eu/LexUriServ/site/en/oj/2004/c_310/c_31020041216en03410341.pdf.

102 Article III-197(2) and (4) European Constitution.

Member States from decision-making on economic policy[103] and on all decisions concerning budgetary discipline in respect of 'ins'.

4.3 Missed opportunity

In view of the limited alterations and only slight improvements to the governance structure of economic union, the Constitution can be considered a missed opportunity. There are several reasons which should have led the authors of the Constitution to adopt stronger rules: (1) the acute absence of compliance with the basic rules underlying the adoption of the single currency, (2) the blatant abuse of confidence in respect of the provision of data on which both to base economic policy decisions and to asses convergence,[104] (3) the public perception of the SGP as dead and (4) States, especially large Member States, deciding for themselves whether to comply with budgetary rules or not.

Those responsible for the adoption of the Constitution might have foreseen that the public, when asked to approve the Constitution, would not be convinced that the advanced state of organization that this title implies, would be suitable for 'a bunch of States behaving badly'. This is not to say that the Constitution was not a worthy project, or that it should have been dubbed otherwise[105] but, rather, that the Union should have been endowed with a more spirited set of rules on which to base the economic governance of the Union in the future.

4.4 Prospects

With the prospects of the European Constitution adopted in its current form being dim, and the idea of splitting the more innovative and 'technical' matters from the bulk of the Treaty meaning that the rules on EMU will not be altered at all, there is no improvement of the economic governance of Europe on the horizon. Only if the Constitution were to be redrafted in a truly forward looking manner could one expect a better functioning set of rules for economic policy making. This would require, on the part of the Union, the acceptance of more limited competences in certain areas[106] and, on the part of

[103] This is because of a similar exclusion of the 'outs' from voting in respect of the adoption of special parts of the BEPG addressed to 'ins' and in respect of the monitoring of compliance with these. See Article I-15(1), Article III-179(2) and (4), Article III-184(6), (7), (8) and (11), as well as Article III-197(2)(a) and (b), and (4) European Constitution.

[104] Notably in the case of Greece. This should have led to a strengthening of the obligation to submit data on which the current text of Article 99(3) *in fine* is remarkably lenient to State preferences and practice. However, Article III-179(3) *in fine* is phrased similarly. See: http://europa.eu/constitution/en/ptoc37_en.htm#a224.

[105] After all, irrespective of the adoption of the Treaty establishing a Constitution for Europe, the EU does have a constitution, albeit one dispersed over the many basic Treaty texts as interpreted by the ECJ.

[106] As I have proposed before, the European Union does not need a whole list of competences in 'adjacent' areas (enumerated in Chapter III of Title III of the European Constitution) but strong powers in the

the States, a clear recognition that monetary union implies giving up that part of sovereignty (*i.e.* competence) which is so closely connected with the sharing of the single currency that keeping it 'national' in name is not serving their interests nor a worthy objective to pursue. The recent unnerving resurface of desires to abandon the single currency and of studies of the likelihood of its demise should have spurred politicians into action to save the fruits of 50 years of integration instead of succumbing to the popular mood.

5 Proposals for strengthening economic union

5.1 Within the current context

Without a great chance of the Constitution being rewritten, and adopted, in this manner, this part of the paper looks at other, more limited, venues of achieving better economic policy coordination and, more importantly, of realizing an outcome that serves the citizens' interests. The next, more imaginative, section gives ideas for change beyond the current legal context.

5.1.1 Statistical data gathering and review

Without going into the details of the arrangements, it would seem that a more independent status for the European Statistical Office,[107] and the possibility of having non-political outsiders decide on the necessary data, and their quality, would be possible within the current context. Institutional arrangements to put Eurostat at an even further distance from the Commission which, after all, is a political body, and the possibility of having independent experts decide on the appropriateness of statistical data submitted by the States could help underpin European economic policy making and budgetary scrutiny[108]. In plain words, this would assist the Commission and the Council in countering State cheating. An equitable, non-discriminatory application of the same rules across the Member States could also be ensured.[109]

main domains of federal government: internal market, including competition policy; single currency and economic governance; customs union and external affairs, including foreign and defence policy, with – for each of these domains – a clear instruction to pursue interests of peace, the rule of law, and global development, stable prices, effective market functioning, a clean and sustainable environment, proper energy supply and conservation, and 'social market' solidarity.

[107] Eurostat is one of the Commission's services.

[108] See the editorial in the *Financial Times* of 19 October 2004: 'Independence for EU statisticians' which ends as follows: 'If independent statistics are the guarantor of Euro zone stability, there is surely a case for making Eurostat independent and subject to a non-partisan auditing body, perhaps akin to the US Congressional Budget Office, with overall accountability to the directly elected European Parliament.'

[109] In its first assessment of the revised SGP, the Commission also mentions 'improved statistical governance' as crucial for the effective implementation of the fiscal framework. See Commission of the

5.1.2 'Agreed overruling': the case of Germany in 2006

The present-day arrangements can be applied in a manner which is acceptable to the States. If a government agrees in advance to a Commission monitoring of its budgetary policies, perhaps also in order to strengthen its own resolve to tackle persistent deficits against domestic special-interest's pressures, the prospect of moving beyond the stage of Article 104(8) EC comes close. While, previously, only Greece had been subject to a formal notice (Article 104(9) EC)[110], the new 'Grand Coalition' government of Germany has agreed to a notice being adopted in its respect.[111] Although cynics may say this is only due to the fact that the prospects of further steps is far off – the German budgetary situation being on the path to convergence and compliance within the foreseeable future[112] – it should be clear that, legally, a river has been crossed when the largest Member State is subject to the one but last step in the EDP.

5.1.3 Intensified application of Article 100(1) EC

A possible way forward would be to make more use of the competence to adopt Community measures. Article 100(1) EC has only been applied in the field of energy: the Community's international obligations to maintain sufficient oil reserves are implemented by a directive based on this

European Communities 'Communication from the Commission to the Council and the European Parliament: Public Finances in EMU 2006 – The First Year of the Revised Stability and Growth Pact' COM(2006) 304.

[110] Council Decision giving notice to Greece, in accordance with Article 104(9) of the EC Treaty, to take measures for the deficit reduction judged necessary in order to remedy the situation of excessive deficit (2005/441/EC) [2005] OJ L 153/29.

[111] See Council Decision giving notice to Germany, in accordance with Article 104(9) of the Treaty establishing the European Community, to take measures for the deficit reduction judged necessary in order to remedy the situation of excessive deficit (2006/344/EC) [2006] OJ L 126/20.

[112] See the Commission's assessment of the German Government's actions to remedy the excessive deficit ('Communication from the Commission to the Council: Assessment of the action taken by Germany in response to the Council decision of 14 March 2006, in accordance with Article 104(9) of the Treaty, for the deficit reduction judged necessary in order to remedy the situation of excessive deficit' SEC(2006) 990, http://ec.europa.eu/economy_finance/about/activities/sgp/edp/edp_de19072006.pdf. This document concludes: 'On current information, it appears that Germany has taken action representing adequate progress towards the correction of the excessive deficit within the time limits set by the Council, namely by 2007 at the latest.'

provision.[113] The Commission's recent Green Paper on Energy[114] encompasses a proposal to introduce similar requirements in respect of gas.[115] It may be useful to explore further possibilities of making use of Article 100(1) EC which, as indicated before, requires only QMV for the Council, on a Commission proposal, to adopt 'the measures appropriate to the economic situation'.[116] The provision clearly goes beyond the authors' intention to give a Treaty basis for the oil stocks legislation. It may be used to adopt measures (regulations, directives, decisions or recommendations) of economic policy. Although the context makes clear that budgetary surveillance and coordination of economic policies are to be dealt with under Articles 99 and 104 EC, respectively, Article 100 EC may be invoked to implement Community-wide measures on energy supply and conservation, rather than on merely coordinating Member States' supply policies, to introduce Community-wide incentives for certain economic activities, or to adopt Community measures to foster education, as an investment into full utilization of human potential, thereby fostering growth.

5.1.4 Acceptance of Union pre-emption of fiscal parameters (*Wellink* doctrine)

A further step within the current context would be the acceptance by the States that, while they remain fully sovereign in deciding their budget items, they have lost sovereignty in respect of the size of their budget deficits. This would be counter-intuitive for States which, through their representatives in the Council, have recently emphasized the 'national ownership' of budgetary rules and 'brought back home' some powers previously held by the Community bodies to oversee their compliance with the fiscal norms, and which are to adopt different long-term budgetary objectives. Yet, such an open acknowledgement by State politicians might help avoid a continuous wrangle

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[113] Directive 68/414/EEC of 20 December 1968 imposing an obligation on Member States of the European Economic Community to maintain minimum stocks of crude oil and/or petroleum products [1968] OJ L 308, at p. 14, as amended by Directive 72/425/EEC [1972] OJ L 291/154; repealed with effect from 31 December 1999; see Article 2 of the next amending legal instrument and by Council Directive 98/93/EC of 14 December 1998 amending Directive 68/414/EEC imposing an obligation on Member States of the EEC to maintain minimum stocks of crude oil and/or petroleum products [1998] OJ L 358/100, http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:31998L0093:EN:HTML.

[114] Commission of the European Communities 'Green Paper: A European Strategy for Sustainable, Competitive and Secure Energy' COM(2006) 105, http://www.europa.eu.int/comm/energy/green-paper-energy/doc/2006_03_08_gp_document_en.pdf.

[115] Energy Green Paper (2006), at p. 9: 'This could, *inter alia*, include **a new legislative proposal concerning gas stocks** to ensure that the EU can react to shorter term emergency gas supply disruptions in a manner that ensures solidarity between Member States, whilst taking account of the different potential for storage in different parts of the EU.' (bold in original; RS).

[116] To which the Treaty adds: ', in particular if severe difficulties arise in the supply of certain products'.

with Community bodies. I refer to the 2003 Annual Report of the Dutch Central Bank in which its President observed[117]:

'Where national monetary sovereignty in Europe has been transferred to the European Central Bank, the pendant – in order to avoid conflicts between monetary and fiscal policies – is the limitation of national budget deficits and the agreement, measured over the cycle, to reduce the deficit close to zero or to realise a surplus. In essence, this comes down to a partial transfer of national fiscal sovereignty. The partial nature of the transfer should be stressed; the transfer of sovereignty relates solely to the balance of revenues and expenditures, and not to their level or composition.'

It is submitted that a clear recognition of this – limited but essential – transfer of sovereignty as regards the balance between budgetary revenue and expenditure would serve the single currency and the credibility of State policies. Thus, acceptance of what may be called the Wellink doctrine,[118] which only implies a reinterpretation of existing obligations, could underpin economic policy coordination within the current legal context.

5.1.5 Aligned decision-making on economic policy – policy mix proposals by EEAG

Finally, the Council and the ECB may wish to align their policies better within the current legal context by following a recent proposal by the European Economic Advisory Group (EEAG)[119]. In the analysis of this body of independent economic advisors, linked with the Ifo Institute for Economic Research in Munich (D),[120] the current imbalances in the European economy are partially due to a wrong mix between fiscal and monetary policies. While, rightly, not proposing coordination of actual policy decisions, as such would undermine the ECB's independence,[121] they argue for a longer-term perspec-

[117] Annual Report over 2003 of De Nederlandsche Bank, pp. 26-27, http://www.dnb.nl/dnb/bin/doc/ar03_tcm13-39878.pdf. The central bank's Governor continues somewhat later as follows: 'Seen from the more technical viewpoint of a central bank, the situation is crystal clear. If a number of countries transfer monetary sovereignty to a supranational body, that should also apply for that part of fiscal policy which directly influences monetary policy. If that proves impossible, fiscal policy in the Member States should be limited in such a way that no conflicts can arise with monetary policy.'

[118] Dr. Wellink being the President whose words are quoted in the text and in the previous footnote.

[119] Report on the European Economy 2006, March 2006, http://www.cesifo-group.de/pls/guestci/download/EEAG%20Report%202006/EEAG-2006.pdf.

[120] See: http://www.cesifo-group.de/portal/page?_pageid=36,34586&_dad=portal&_schema=PORTAL.

[121] On the protracted public row over policy coordination between the ECB and the Eurogroup, see 'Euro zone Ministers Urge ECB to Limit Rate Rises amid Fears on Exports' in the *Financial Times* of 8 June 2006, 'Juncker Willing to Serve on if Liaison with ECB Improves' in the *Financial Times* of 9 June 2006, 'ECB Chief Fends off Politicians' Demands for More Dialogue' in the *Financial Times* of 9 September 2006 'Trichet Warns off the Politicians' in the *Financial Times* of 9/10 September 2006

tive under which the ECB would link monetary policy reform – consisting of a loosening of the inflation target – to a re-establishment of fiscal discipline.[122] Without going into the economic merits of this proposal, it can be said to be possible within the current legal context to place such a monetary policy reward on a certain fiscal policy stance by the governments, if this were to help to achieve a better performance for the European economy.

5.2 Outside the current context

5.2.1 Stronger role for the Commission as overseer of fiscal prudence

The most effective way to achieve better fiscal policy coordination would be to make the Commission the sole arbiter of observance of the budgetary rules. If it were to oversee compliance, the question of large States considering decision-making in the Council as a hostile act would not arise. Of course, their adversity would then be directed against the Commission. But the guardian of the Treaty is used to this role and well versed in it. Its decisions would, of course, be subject to Court scrutiny, just as Council decisions are. Moreover, the European Parliament could control the Commission's stance as the latter is directly responsible towards the former institution.[123] Thus, democratic oversight of a State's budgetary policy would be ensured at two levels: in the national parliament and in the EP. Of course, the European Parliament would only 'control' the Commission's oversight which, itself, would be limited to upholding the fiscal framework, and not extend to the individual items of State budgets. Such an arrangement would also increase the transparency of decision-making: the current possibility of giving recommendations behind closed doors would be abolished, and should be abolished anyway. It is clear that this proposal would require a political turnaround and completely rewritten rules.

5.2.2 *Républiqueeuropéenne* proposals: EP sets limits for States' budgets

Even further down the line is the proposed institutional arrangement by Stefan Collignon.[124] It would make the BEPGs into a *loi-cadre* which would set the basic guidelines for economic policy and a Europe-wide

and, finally, 'Eurogroup Chief Urges End to Currency Squabbles' in the *Financial Times* of 11 September 2006.

[122] Report on the European Economy, March 2006, http://www.cesifo-group.de/pls/guestci/download/EEAG%20Report%202006/EEAG-2006.pdf, at p. 36.

[123] Article 201 EC.

[124] Collignon, S., *Vive la république européenne* (Éditions de La Martinière, Paris 2004), http://www.stefan-collignon.de.

budgetary deficit that would be apportioned among the Member States.[125] Although such an arrangement may be considered wild in current circumstances (it was written before the '*non*' and the '*nee*' against the European Constitution), its attractiveness lies in thinking through the consequences of EMU and in sketching a structure which we could at least borrow elements from. The idea of setting overall budgetary limits and then filling these in by a separate round of decision-making has roots in arrangements at State level and sounds familiar for those who accept that budget-line sovereignty is retained but budget-size sovereignty has been relinquished with the adoption of the single currency. Also, the idea is reminiscent of original thinking on EMU, in the first effort towards its realization in the 1970s.[126]

5.2.3 New voting arrangements excluding deficit States

Although not as far-reaching as the previous two options, another one would probably help alleviate the lack of enforcement of budgetary restraint rules by the Council. It has been suggested[127] to bar the Member States with a deficit from voting in the Excessive Deficit Procedure. This might help to make the Council effective as the institution entrusted with deciding whether an excessive deficit exists and with overseeing its correction. But, also in view of the fact that many States run excessive deficits, this may mean that only a very few fiscally prudent States decide on the steps that their fellow members of the Council need to take, which is politically as unacceptable a solution as making the Commission the ultimate arbiter of budgetary correctness. In any case, this approach could also only be based on a Treaty amendment.

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[125] Collignon, *op. cit.*, at pp. 186 *et seq.*

[126] See the Werner Report on establishing EMU in stages, which departed from a stronger central authority for economic policy, even though warning against excessive centralization. See the Report to the Council and the Commission on the realization by stages of economic and monetary union in the Community, Luxembourg, 8 October 1970, http://ec.europa.eu/economy_finance/emu_history/documentation/chapter5/19701008en72realisationbystage.PDF. The Resolution of the Council and the Representatives of the Governments of the Member States on the achievement by stages of economic and monetary union in the Community of 22 March 1971 stated that 'the main economic policy decisions will be taken at Community level, and therefore (that) the necessary powers will be transferred from the national to Community level.' It continues as follows: '(...) as regards budgetary policy proper, the margins within which the main items of all the public budgets must be situated shall be determined at Community level, with particular reference to the variation in their sizes, the extent of the balances and the methods of financing and using the latter (...)', http://www.ena.lu/mce.cfm.

[127] See Irlenbusch, B., U. Leopold-Wildburger, J. Schutze and M. Sutter 'Voting in EMU – An Experimental Study of Institutional Innovation and the Role of Communication in the Stability and Growth Pact', *JCMS* 2003, 41, p. 645, cited by Amtenbrink, F., and de J., Haan, *op. cit.*

6 Conclusions

It will be apparent by now that we have seen three degrees of limitations of State sovereignty. The first two relate to the state of affairs when the law is considered in isolation. Before the 2005 amendments to the SGP, the States could be said to be clearly subject to major constraints in both their general economic policy making, since they are subject to an obligation to pursue Community objectives while their policies are contained in a Community framework and, specifically, in their fiscal policies, under the Treaty itself and the additional requirements of the SGP. Also, the market conform rules on central bank funding and public access to the financial sector, applicable since 1994, marked a break with the past for many Member States. Since the 2005 amendments, the picture has not changed basically but the room for manoeuvre in the budgetary area has been significantly increased, with objectives no longer shared across the Union and diversified from State to State, with (actual and prospective) Euro area members supposed to maintain higher standards (*i.e.* lower budget deficits) than other Member States. The third assessment can only relate to practice as it has unfolded up till now and does not include the short experience with the loosened SGP since 2005. Here, we see a dichotomy between the rules and their application. The institutional weakness of the economic policy framework, the political adversity towards 'things European' and the attractiveness of the Open Method of Coordination which was introduced even where a more effective form of policy alignment is called for – by the Treaty and by the requirements of monetary union – can be cited as reasons for this. Of course, the economic cycle did not help. Yet, that is hardly an explanation as the rules were meant to reduce deficits in good times as well as bad and the conclusion that they have not (sufficiently) been complied with[128] is blatant in view of the figures and the persistence with which they have been (too far) in the red. To sum it all up: States are subject to major restrictions in the economic policy area but often choose to neglect this and to bend, or amend, the rules when it suits them.

7 Recommendations

7.1 Testing some suggested improvements and preparing for future Treaty changes

By way of first recommendation, I propose to put some of the improvements suggested above, both within and outside the current legal context, on the agenda and subject them to discussion. This will focus the debate

[128] The EEAG notes that the EDP has only functioned in respect of the Netherlands. See its Report on the European Economy 2006, http://www.cesifo-group.de/pls/guestci/download/EEAG%20Report%202006/EEAG-2006.pdf p. 33.

on the alterations which may be successful. It may also help the authors of new Treaty (or: Constitution) provisions to prepare arrangements that are economically sound, legally transparent, workable and politically lasting.

7.2 Single representation of EU at international level

Although not in the immediate context of the issues discussed in this paper, it should be remembered that, in the area of EMU, the representation of the EU at the international level is underdeveloped. This situation should be remedied. Not because of some overly zealous attitude for legal rectitude[129] but because the Union's interests are not properly defended when its representation is dispersed and the advocacy of its policies is divided among State actors who, by definition, are not inclined to take the Community perspective on matters at hand. Since reform of the IMF is on the agenda,[130] the time to act is now. One may expect the United States, Japan, India and China, to mention only a few of the interested parties, to argue for single EU representation, or at least for a single EMU voice at the table. But one cannot expect these other nations to do our bidding and to reflect a true concern for adequate representation of Europe. Rather, they may be inclined to accept a fragmentation of its voice as the outcome of negotiations which may envelop other aspects of international economic relations than a restructuring of the IMF. Also, a single voice abroad[131] will help focus on coordination within.

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[129] Although I would submit that the current state of affairs is wholly inadequate in view of the case law. See my thesis, 'The European Central Bank – Institutional Aspects', *ICLQ*, 1996, 45 (2) p. 319, notably chapter 6. For a similar view, see the contribution by (at present) ECB Executive Board Member Lorenzo Bini Smaghi, 'A Single EU Seat in the IMF?' *JCMS* 2004, 42, p. 229. On this issue, see, also, 'Euro zone 'Needs Bigger IMF Role', interview with Lorenzo Bini Smaghi in the *Financial Times*, 29 March 2006, 'Almunia Plots Voice for Euro' *European Voice*, 20-26 April 2006, http://www.europeanvoice.com/; 'Trichet Says IMF Representation Progressing', http://www.*CentralBankNews.com*, 4 September 2006.

[130] See the speech by Mervyn King, Governor of the Bank of England at the Indian Council for Research on International Economic Relations (ICRIER) in New Delhi, India, on Monday, 20 February 2006, 'Reform of the International Monetary Fund', http://www.bankofengland.co.uk/publications/speeches/2006/speech267.pdf.

[131] This would include representation in informal groupings such as the G8.

7.3 Further inroads into national law: payments

By way of other, this time domestic, aside, the reader is reminded of the fact that internal payment systems regulation is an underdeveloped area of EMU law, as well. There are recent legislative initiatives[132] and the need for a truly single payments area is stressed, time and again, by the ECB.[133] This means that payments will be an area of new rules and joint action this decade, implying more inroads into areas of the law which have, up till now, remained national, even for States whose monetary sovereignty has been transferred to the Community level. Changes in this field are long overdue.

7.4 Correcting EMU's basic division and fulfilling EMU's potential

In the areas of external relations and payments, as well as in economic policy coordination, a new emphasis on developing rules and fostering compliance with these is called for. The adoption of rules on payments for the single currency area[134] and a development towards joint action with respect to 'the Euro's place in the international monetary system'[135] will focus the minds on the unfulfilled potential of EMU to serve its citizens' interests. A proper economic governance structure will correct the basic division – some might say: fault line – of EMU. It is submitted that a stronger role for the Commission in fiscal policy compliance and methods to ensure that the European Parliament is involved in the Union's overall economic policy stance should be the ultimate objectives. Closer to the present – some might say: more down to earth –, it is recommended that we take a new look at the existing provisions and agree that sharing a single currency implies sharing responsibility for adequate but prudent budgets. These require honest accounting, overseen by independent statisticians, the agreed overruling of one's position in the Council, as Germany has finally been willing to accept, and innovative use of the sole power for the Community to adopt its own economic policy measures. While agnostic on whether the alignment of policies resulting in a better monetary/fiscal policy mix is

[132] See the Commission of the European Communities 'Proposal for a Directive of the European Parliament and of the Council on Payment Services in the Internal Market and Amending Directives 97/7/EC, 2000/12/EC and 2002/65/EC', COM(2005) 603 final. Brussels, 1.12.2005, in the context of its ideas for a New Legal Framework for Payments in the Internal Market, http://www.europa.eu.int/comm/internal_market/payments/docs/framework/com_2005_603_en.pdf.

[133] See the ECB's 4th Progress Report on a Single European Payments Area (SEPA), http://www.ecb.int/pub/pdf/other/singleeuropaymentsarea200602en.pdf.

[134] Note that the Commission and the ECB do not agree whether the rules for the single payments area and SEPA itself should extend to the entire EU or be confined to the Euro area. But see the Joint statement from the European Commission and the European Central Bank of 4 May 2006 on the Single Euro Payments Area, http://www.ecb.int/press/pr/date/2006/html/pr060504_1.en.html.

[135] A quote from Article III-196(1) of the European Constitution.

economically sound advice, I do profess to know that it would be within the limits of central bank independence[136] and in line with the intentions underlying the Treaty rules on mutual representation between the ECB and the Council.[137] To me, these or other suggested improvements would provide a welcome change to the current tune mixed by Euro-pessimism and national reflexes. They would also signal that the European Union is willing, and able, to put its own house in order so that it is well-positioned to contribute to meeting the major global challenges: achieving the Millennium Development Goals, countering global warming, organizing efficient and sustainable use of energy from reliable sources, facing the economic effects of globalization, bringing peace to worn-torn areas and bridging cultural and religious differences. Thus, strengthening its economic governance, while definitively strongly recommended for its own sake, would have benefits beyond Europe.

[136] Article 108 EC and Article 7 ESCB Statute.

[137] And the Commission: Article 113(1) and (2) EC (Article III-383(1) and (2) of the European Constitution).