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THE CRISIS OF THE ECONOMIC AND MONETARY UNION AND ITS SOLUTION (OR DISSOLUTION?)

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Abstract: *Both parts of the institution of "economic and monetary union" are constructed in different ways within European law. The economic part is built upon the decentralized structure of the European Union as a "community of states"; the monetary union is based upon the delegation of monetary powers from individual states – their central banks – to the Union level. Serious crises of functioning of such a model brought up the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. TSCG is part of a gradual strategy of the centralization of budgetary policy at the level of the European Union. This strategy is built upon presumption that effective functioning of the monetary union must be supported by a central budget and central, or centralized, budgetary policy.*

Keywords: *Economic and monetary union, budget policy, Treaty on Stability, Coordination and Governance in the Economic and Monetary Union*

BACKGROUND

The Economic and Monetary Union was instituted within EU law under the Treaty Establishing the European Community. It resulted from changes incorporated in this source of primary law of the European Communities by the Maastricht Treaty which became effective on November 1, 1993. The provisions dealing with the Economic and Monetary Union, without any major changes, were included as Articles 119-144 in the Treaty on the Functioning of the European Union ("TFEU"), as amended by the Lisbon Treaty, which became effective on December 1, 2009.

Although the primary law of the EU consistently uses the phrase "economic and monetary union" *("union économique et monétaire", "Wirtschafts-und-Währungsunion")*, this description is not completely true. Monetary policy has been uniform within those EU Members participating in the monetary union. However, the economic policy of the EU Member States has been declared as a matter of common interest even though it has been supervised and coordinated by the Council and the Commission in its basic directions. Unlike monetary unification, the economic part of the unification process has not been completed yet. Thus the term "monetary union" designates an actually existing concept, whilst the completion of the economic union would require many steps to be taken at the economic and legal levels. Both parts of the institution of "economic and monetary union" are constructed in different ways within European law. The economic part is built upon the de-

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centralized structure of the European Union as a "community of states"; the monetary union is based upon the delegation of monetary powers from individual states – their central banks – to the Union level. Regardless of the different composition of either part, the EC Treaty endeavoured to achieve their legal unification in the concept of "economic and monetary union" through the directed and coordinated division of powers between the Member States and EU Institutions in the course of the preparation of the third stage of the economic and monetary union. However, this legal conception resulted in the creation of an internal opposition in the sense of a centripetal force of monetary, credit and interest policies, and a centrifugal effect of economic and budgetary policies. In addition, these two opposing types of effect remain unsupported by constitutional legislation in individual EU Member States. These antinomies are not only preserved in the valid wording of the TFEU, but are confirmed through incorporating the monetary policy of Member States which have the euro as currency into the set of exclusive delegated powers under Art. 3 TFEU, and incorporating monetary policies into coordinated powers under Art. 5 TFEU.

LEGAL ORIGIN OF THE CRISIS

Serious concerns with respect to the fulfilment of convergence criteria in the budgetary area were expressed as early as on the date of the commencement of the third stage of the economic and monetary union in the first wave of the EU Member States on January 1, 1999. Whilst the public budget deficit of 3% to GDP represented no serious problem, some states – particularly Belgium and Italy – failed to fulfil the parameter of a 60% to GDP threshold for the deficit of public funds in the area of general government debt.

The first reason for the crisis is that the convergence criteria were interpreted rather extensively from the very beginning of the third stage of the economic and monetary union. An inadequate emphasis was laid on the wording of the EC Treaty under which the tendency of the public debt to decline was relevant; however, even the declining trend proved to be unsustainable.

State	**Public budgets deficit to GDPratio in % 1998**
Belgium	2.1
Finland	0.9
France	**3.0**
Ireland	0.9
Italy	2.7
Luxemburg	surplus 1.7
Germany	2.7
Netherlands	1.4
Portugal	2.5
Austria	2.5
Spain	2.6

Source: European Central Bank

State	**Public debt to GDP ratio in % 1998**
Belgium	**122.2**
Finland	55.8
France	58.0
Ireland	**66.3**
Italy	**121.6**
Luxemburg	47.6
Germany	45.2
Netherlands	49.2
Portugal	**62.0**
Austria	**66.1**
Spain	**68.8**

Source: European Central Bank

THE CRISIS OF 2003–2004

The Stability and Growth Pact was intended to sustain fiscal discipline. The Pact proved its usefulness in the course of strengthening fiscal discipline; undoubtedly, it contributed to the high standard of macroeconomic stability in the EU. Nevertheless, it was subjected to a serious crisis in 2003 and 2004, which led to the reform of the Stability and Growth Pact, including the amendment of relevant EC Regulations in 2005. The crisis of the Stability and Growth Pact was started by the decision of the Council of the EU of November 25, 2003, to not apply sanctions against France and Germany for breach of the budgetary rules of the Stability and Growth Pact. Criticism of that decision of the Council was aimed particularly at the fact that such an approach created a precedent for any further violations of the EU rules as such. On the other hand, many economists recognized that France and Germany acted as a sort of "engine" of the European economy. Thus they expressed a certain understanding for such leniency with respect to the budgetary problems of both countries. Subsequently, the European Commission in its capacity as guardian of legality brought an action as a matter of principle against the decision of the Council. The subject of the action was a proposal to annul acts of the Council of November 25, 2003, namely its decision to adopt against the French Republic and the Federal Republic of Germany no formal instruments contained in recommendations of the Commission under Art. 104 (8) and (9) of the EC Treaty, as amended by the Nice Treaty, becoming effective on February 1, 2003 ("TEC"), and as amended by conclusions regarding these Member States adopted in reaction to the recommendations submitted by the Council in accordance with Art. 104 (7) TEC, and for consideration of new measures to reduce the deficit in order to improve the situation caused by the excessive deficit. The application to institute proceedings was filed by the EC Commission on January 27, 2004 under Article 230 TEC as an action for annulment of an act of the Community in order to examine the legality of the acts of the EU Council of November 25, 2003. The EU Council decided not to take any formal measures in the sense of the Stability and Growth Pact ("Pact") against the French Republic and the Federal Republic of Germany; such measures would have consisted of imposing sanctions upon these Member States – participants in the third stage of the economic and monetary union which had failed to observe the budgetary rules of the euro area. The Commission in its action requested that the Court of Justice annul the decision of the Council on its non-acceptance of formal instruments contained in the recommendations of the Commission under Art. 104 (8) and (9) TEC, and that the Court of Justice repeal the conclusions of the Council in those parts leading to the suspension of the procedure applicable to excessive deficit, and that it repeal the use of measures not regulated by the Treaty and the change of recommendations adopted by the Council under Art. 104 (7) TEC.

The European Court of Justice delivered its judgment in the case on July 13, 2004,[1] by which it refused the application for the annulment of the challenged decision of the Council as inadmissible. The Court concluded that, where the Council had not adopted the acts

[1] Judgment of the European Court of Justice in case C-27/04 Commission of the European Communities v. Council of the European Union.

recommended by the Commission against France and Germany for their violation of the budgetary discipline of the euro area, such a situation might not be challenged by an action for annulment of an act of the Community in the meaning of Art. 230 TEC, but it should have been challenged by an action for failure of an EU Institution to act in the sense of Art. 232 TEC. The Council, in the case under consideration, should have decided, under the recommendation of the Commission, by a two-third's majority vote of its members, excluding the members of the states concerned. If the Commission recommended to the Council to adopt a decision under Art. 104 (8) and (9) TEC and the required majority was not reached, no decision in the sense of this Article was in fact adopted. The existence of an excessive deficit in the third stage of the economic and monetary union was a serious issue requiring that immediate steps be taken by all parties concerned. Although certain time-limits were set and must be preserved, it made no difference regarding the fact that the expiry of the set time-limits did not preclude the Council from adopting the acts recommended by the Commission. These time-limits are intended to ensure expeditious and effective implementation of the excessive deficit procedure. It would therefore contradict this objective for expiry of the deadlines to result in the lapse of the Council's power to adopt the acts recommended by the Commission in the course of that procedure. Such a lapse would require that the procedure be recommenced where appropriate. On the other hand, the European Court of Justice accepted the application of the European Commission for the annulment of the conclusions of the EU Council. The European Court of Justice declared the conclusions of the Council applicable to the French Republic and the Federal Republic of Germany respectively as unlawful; the Court ordered their annulment in so far as they contain a decision to hold the excessive deficit procedure in abeyance and a decision modifying the recommendations previously adopted by the Council under Art. 104 (7) TEC. The European Court of Justice concluded that it had been settled case-law that an action for annulment must be available in the case of all measures adopted by the institutions, whatever their nature or form, which are intended to have legal effects. In the present case, the purpose was to establish whether the Council's conclusions were intended to have such effects. The Court stated that the conclusions of the Council were aimed at establishing such legal effects at least in so far as they held in abeyance the procedure applicable to excessive deficit and in fact changed the recommendations adopted earlier by the Council under Art. 104 (7) TEC.

The decision of the European Court of Justice appears to be a compromise. The Court refused the action against the Council for its decision not to implement the sanctioning instruments against France and Germany due to its procedural inadmissibility. The Court declared as unlawful the conclusions of the Council which are on the border between a political declaration and a legal act of the EC.[2] Despite its overall outcome the described judgment of the European Court of Justice has been of key significance. It is the first substantial decision of the Court of Justice on the interpretation of that part of Community law which deals with the European economic and monetary union and the use of the euro in a wider context. At the same time the judgment was a significant impetus for the development of the Stability and Growth Pact.

[2] TOMÁŠEK, M. Nad rozsudkem Evropského soudního dvora ve věci dodržování Paktu stability a růstu. *Právní forum.* 2004, č. 6.

The Council of the EU adopted a report entitled "Improving the implementation of the Stability and Growth Pact" on March 20, 2005. The objective of the report was to improve the management of the budgetary framework and the responsibility of Member States for the budgetary framework through the enhancement of economic foundations and the efficiency of the Pact in its preventive and sanctioning part. Another objective of this report was to ensure the long-term sustainability of public funds, to support the growth and to avoid excessive indebtedness of future generations. Member States, the Council and the Commission reaffirmed their commitment to implement the Treaty on the EC and the Stability and Growth Pact efficiently, timely and with mutual support; they confirmed their intention to closely and effectively cooperate in the process of economic and fiscal supervision aimed at ensuring the stability and effectiveness of the Pact rules. This was how the reform of the Pact and related regulations were adopted in 2005.

In the area of prevention it was determined that a mid-term objective in the Union with regard to economic and budgetary diversity should be differentiated in respect of individual Member States so that the diversity of economic and budgetary positions and development could be respected along with the fiscal risks for the sustainability of public funds reflecting potential demographic changes. The mid-term objective for individual Member States may differ from the balanced or surplus budget. There would be defined limits for mid-term budgetary objectives for the euro area and ERM 2 Member States which would be set for particular countries in net budget cycles net of any one-off or temporary measures. A more symmetric approach to fiscal policy was introduced in the course of the cycle through the enhancement of budgetary discipline in more favourable periods so that the procyclical policy could be avoided and the mid-term budgetary objective could be attained. Observance of the mid-term budgetary objective should enable the Member States to adapt more easily to common cyclical fluctuations when keeping the deficit of public funds under the recommended value of 3% of GDP and to ensure speedy progress towards sustainability of public funds. This should create space for more relaxed budget disposal, in particular regarding public investments. In order to enhance the pro-growth oriented conception of the Pact, significant structural reforms bringing long-term savings of costs, including costs achieved by increasing potential growth, which have a detectable impact upon the long-term sustainability of public funds, should be taken into consideration when defining the regulation of gradually attaining the mid-term budgetary objective of states which have not observed it yet. In order to prevent obstacles for structural reforms from unambiguously improving the long-term sustainability of public funds, special attention should be paid to pension reforms introducing a multiple-pillar system containing a mandatory fully funded pillar; such pension reforms tend to result in a short-term deterioration of public funds during the implementing period.

Rapid adjustment of an excessive deficit should be the main principle within the procedure applicable in the area of sanction in case of an excessive deficit. The procedure should remain simple, transparent and just. It was decided to revise the conception of an exceptional excess of recommended parameters caused by a rapid economic decline. The economic diversity in the European Union should be considered in this respect. All budgetary assessments made within the excessive deficit procedure should include careful consideration of a small excess of recommended parameters which would reflect the implementation of the pension system introducing a multiple-pillar system which includes the

mandatory fully funded pillar, since the implementation of such reforms results in a short-term deterioration of the budgetary situation, but while the long-term sustainability of public funds is evidently improving. Considering the question of whether the excessive deficit has been adjusted, the Commission and the Council should assess in particular the development of deficit data within the excessive deficit procedure, taking into account the net expenditures regarding the reform of the publicly administered pillar. Procedural time-limits for a decision of the Council within the framework of the excessive deficit procedure have been extended so that the Member States could better incorporate measures in their national budgetary process and could prepare a more coherent set of measures. It is necessary that Member States having excessive deficits and intending to adjust them quickly, adopt effective measures and reach a yearly minimum fiscal improvement of their cyclically-adjusted net budget balance without any impact of one-off or temporary measures. As a reference value, countries with an excessive deficit would have to reach a yearly minimum fiscal effort in the cyclically-adjusted net balance and net of one-off and temporary measures.

CONSEQUENCES OF THE EUROPEAN DEBT CRISIS

The consequences of the crisis of the Stability and Growth Pact between 2003 and 2004 and its subsequent reforms in 2005 were soon confronted with the European debt crisis. This crisis significantly deteriorated the debt situation in many euro area Member States, which required finding new legal instruments for its solution. The main instruments are as follows:

– The Reform of the Stability and Growth Pact of 2011; and
– The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) of 2012.

A/ Reform of the Stability and Growth Pact

The Stability and Growth Pact was significantly modified by Regulation (EU) No. 1173/2011 on the effective enforcement of budgetary surveillance in the euro area. The Regulation is part of the so-called *six-pack*; a sanction in the form of an interest-free deposit in the amount of 0.2% GDP is imposed only upon those euro area states which are monitored within the excessive deficit procedure. The decision on imposing such a sanction is adopted by the Council upon recommendation by the Commission unless a qualified majority of Member States votes against it. This is a vote by so called "reversed qualified majority". If, under Art. 126 (8) TFEU, the Council concludes that a Member State which is subject to the excessive deficit procedure and in reaction to the recommendation of the Council (under Art. 126 (7) TFEU) has failed to adopt efficient measures to adjust the excessive deficit, a fine is usually imposed on the Member State in the amount of 0.2% GDP upon recommendation of the Commission.

A vote on imposing a sanction under this Regulation is also taken by the reverse qualified majority. Member States that are not members of the euro area may not have sanctions in the form of either a financial deposit or a fine imposed. In the case of recipients of support from the Cohesion Fund (who include non euro area members), their failure

to observe recommendations within the excessive deficit procedure may not lead to stopping payments from this Fund (under Art. 4 (1) of Regulation No. 1084/2006 establishing a Cohesion Fund and repealing Regulation (EC) No 1164/94, whose legal basis is Art. 126 (8) TFEU).

The *six-pack* has introduced new provisions relating to the debt criterion of the Stability and Growth Pact. Now it is possible to open the excessive deficit procedure upon the debt criterion. The excessive deficit procedure may be launched against a Member State in the event that the Member State's public debt exceeds its GDP by 60% and this excess is not diminished by at least 1/20 a year (in average during three years) and even if the State's budgetary deficit is below 3% of GDP.

The decision is made after all relevant factors have been considered in particular regarding the impact of the economic cycle on the rate of diminishing the debt. Member States against which the excessive deficit procedure was launched before the effect of the *six-pack* have been provided with the term of three years for their fulfilment of so-called rule of one twentieth and for adjustment of their excessive deficit. However, a Member State must show considerable progress in this respect.

B/ The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG)

Art. 2 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union ("Fiscal Compact") clearly suggests that the Treaty is not aimed at restructuring the powers of the Union and Member States in the area of economic and monetary union. It has no ambition to transfer coordinated powers in the budgetary area in the meaning of Art. 5 TFEU for example to the area of shared powers under Art. 4 TFEU, or even to the area of exclusive powers, i.e. to raise them the same level as currency powers under Art. 3 TFEU. The Treaty may not do it. Such transfer would have to be a result of the revision of establishing treaties at an intergovernmental conference and relevant ratification procedures in individual Member States. Art. 119 TFEU provides that activities of Member States and of the Union in the meaning of Art. 3 of the Treaty of the European Union (TEU) encompass the implementation of economic policy based upon close coordination of economic policies of Member States, the internal market and the defining of common goals; such economic policy should be implemented in compliance with the principle of open market economy and free economic competition. Paragraph (3) of the same Article states that these activities include the observance of the following principles: stable prices, sound public finances and currency conditions and sustainable payment balance. Art. 126 (1) TFEU provides that Member States should avoid excessive government deficits. The rules stipulated in Art. 126 TFEU (originally Art. 104 of the Treaty on the European Community – TEC) were clarified and enhanced by the Stability and Growth Pact created particularly by the resolution of the European Council of June 17, 1997, and by Regulations No. 1466/97 and No. 1467/97 as amended.

TSCG is part of a gradual strategy of the centralization of budgetary policy at the level of the European Union. This strategy is built upon presumption that effective functioning of the monetary union must be supported by a central budget and central, or centralized,

budgetary policy. The European Union has a central budget; however, it appears to be rather weak. Its enhancement in the direction towards uniform currency can be seen in the construction of the European Stability Mechanism. The centralization of budgetary policy can be identified in the strengthening of the position of the European Commission. It should be noted that recently the Commission has decided many times to suspend the drawing of Union financial means for states which have failed to fulfil the criteria of budgetary policy. The mechanism of sanctions of the fiscal pact clearly follows the tendency of more powers of the Commission in the process of budgetary sanctions. Since its beginning and after the reform in 2005, the sanction mechanism of the Stability and Growth Pact has been a reflection of certain "gentleman agreements" considered to serve as coordinating instruments of economic policies in the outset of the economic monetary union. In accordance with well-known saying that gentleman agreements are not agreements and those making them are not gentlemen at all, the EU Institutions resorted to a more determined action. Within the intention of the above-mentioned judgment of the ESJ, i.e. where necessary the Member State concerned may be compelled to diminish the deficit ascertained, the mechanism of a reverse majority has been instituted; this means that a vote by the reversed qualified majority is *de facto* taken in the Council when adjustment measures are to be adopted within the excessive deficit procedure under Art. 126 TFEU.

Where the Commission as a general guardian of legality ascertains that the rule of 3% deficit has been violated by a Member State, the process of sanctioning may be launched against such State. The proposal of the Commission may be reversed by a qualified majority vote taken by the Council with the opinion of the State concerned being disregarded. Unlike in the past, when the imposition of a sanction must have been supported by an affirmative vote of a qualified majority of Member States, today the qualified majority disagreement is required for the proposed sanction to not be imposed. This procedure of the reversed qualified majority has been suspected of avoiding the fundamental EU treaties, namely that a certain "voting cartel" outside the EU treaties has been formed. The "voting cartel" is to rely on votes of the member of the euro area. Each state is assigned a certain weight of votes, for example depending on the size of population, etc. Today the proposal of the Commission may be rejected by 74% of all votes. Germany and France together have 27% of votes. A similar mechanism of the reversed majority has been adopted within secondary legislation (Regulation /EU/ No. 1173/2011 on the effective enforcement of budgetary surveillance in the euro area) in relation to the latest amendment of the Stability and Growth Pact. The principle of a reversed majority stipulated in Art. 7 TSCG clearly strengthens the role of the Commission in the process of compelling Member States to diminish their budgetary deficits. This undoubtedly gives rise to a question of whether the extent of enhancement of the role of the Commission has, or has not, gone beyond the limits permitted by primary law. However, it should be repeated that the reverse majority principle has existed in the valid law of the EU. There has been no information on any actions filed with the Court of Justice challenging the validity of such a principle due to its conflict with primary law.

While mentioning any potential involvement of the Court of Justice of the EU, it should be noted that its willingness to decide issues relating to the coordinated policies within budgetary responsibility has never been extensive. This was seen particularly in the above-mentioned case C-27/04 Commission of the European Communities v. Council of the European Union from July 13, 2004. the TSCG involves the Court of Justice of the EU in the

mechanism of imposing sanctions for exceeding the determined budgetary deficit in its Art. 8 within the system of concluding a *special agreement* between Member States in the meaning of Art. 273 TFEU, which does not intervene in the powers of the EU Institutions and Union policies defined by the establishing treaties. Contracting States, under Art. 8 (1) TSCG, are obliged to file an action with the Court of Justice of the EU if the Commission concludes in its report that any Contracting State has failed to comply with Art. 3(2) TSCG. It should be emphasized in this context that in such cases the Commission, under Art. 273 TFEU, may not be a party filing an action with the Court. On the other hand, the Commission is considered as a general guardian of legality; its position under Art. 8 TSCG may be regarded as proportionate and in compliance with the overall tendency of the strengthening of its role in the process of budgetary sanctions. Opponents of the TSCG point to excessive subjection of Member States to legal opinions of the Commission in regard of their right to raise a claim in the *special agreement* proceedings. Such doubts are difficult to be refuted as relevant implementing legislation has not been passed.

THE GOLDEN RULE

The rules stipulated in Art. 126 TFEU, or its Protocol (12) on the excessive deficit procedure, are more stringent as a result of the application of the basic principle of the Fiscal Compact, the so-called "Golden Rule". The Golden Rule stipulates that public budgets and Contracting States must be balanced or with a surplus. The Golden Rule is presumed to be observed even if an annual structural deficit of public budgets has been lower than 0.5% GDP in market prices. This is a more stringent rule than that already applicable, stipulated in the revised Stability and Growth Pact setting the limit of 3% GDP in market prices. On the other hand, in the case of the TSCG this is a structural balance, i.e. net of any impacts of economic cycles, one-off and temporary measures, whilst in the case of the Stability and Growth Pact the deficit is aggregate, i.e. both structural and cyclical. Another requirement for the observance of the Golden Rule is that the structural balance (or the deficit in the maximum amount of 0.5% GDP) corresponds with the so-called country-specific medium-term objective (MTO). This medium-term objective was newly defined in the revised Stability and Growth Pact, namely in Art. 2a of Regulation (EC) No. 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, as amended by Regulation (EU) No. 1175/2011 of November 16, 2011. Under Art. 9(1) of the revised Regulation No. 1466/97, the Council, within its multiple supervision authority under Art. 121 TFEU and on the basis of evaluation by the Commission and the Economic and Financial Committee, is to review the medium-term objectives submitted by Member States within the convergence criteria; the Council considers whether the route chosen for the attainment of the MTO is appropriate. The Commission may, under the above-mentioned Regulation, issue a warning notice; should the serious situation be persistent, the Member State concerned would receive a recommendation from the Council to adopt adjustment measures under Art. 121 TFEU.

The following definitions are relevant under Art. 126 TFEU and Protocol No. 12:

- "government" means general government, that is a central government, regional or local government and social security funds, to the exclusion of commercial operations, as defined in the European System of Integrated Economic Accounts;

- "deficit" means net borrowing as defined in the European System of Integrated Economic Accounts;
- "investment" means gross fixed capital formation as defined in the European System of Integrated Economic Accounts;
- "debt" means total gross debt at nominal value outstanding at the end of the year and consolidated between and within the sectors of general government as defined in the first bullet point.

Art. 3 of the Fiscal Compact provides for rules for balanced budgets, forming the nucleus of the whole TSCG; Contracting States will have to implement the rules within their national law. However, it should be noted that most of the duties regulated in Art. 3 have already been applicable in the EU Member States under the revised Stability and Growth Pact. The substance of the regulation in the TSCG, and its main difference from the Stability and Growth Pact, has been that the Contracting States will have to provide for a so-called debt brake in their national legislation primarily at the constitutional level. The observance of the debt brake rules will be subject to control by the Court of Justice of the EU (Art. 8 TSCG. The Contracting States will ensure rapid convergence towards their respective medium-term objective. Under Art. 3 (2) (a) of the amended Regulation (EC) No. 1466/97, every participating state submits to the Council and the Commission its medium-term budgetary objective and its mode of gradual attainment. Under the TSCG, the time-frame for such a convergence will be proposed by the European Commission "*taking into consideration country-specific sustainability risks.*" It should be noted that, although the Commission should only "propose" the schedule of convergence, such competence of the Commission results neither from the amended Regulation nor from any other legislative act of the EU. The evaluation of progress towards, and respect for, the medium-term objective will be based on an overall assessment with the structural balance as reference, including an analysis of expenditure net of discretionary revenue measures. According to the explanatory report on the draft Regulation (EU) No. 1175/2011, discretionary measures with respect to revenue should serve as compensation for increasing expenditures exceeding their cautiously planned medium-term growth. Under the principle of cautious fiscal policy, a yearly increase of expenditures should not be higher than the cautiously planned rate of GDP growth. Overall assessment is defined in detail in Art. 5 (1) of the amended Regulation (EC) No. 1466/1997. Similarly to Regulation (EC) No. 1466/97, the determination of so-called structural balance may appear to be problematic. The calculation itself of the structural balance is subject to many partial uncertainties; as such it remains in essence a specific estimate. Restrictions and limitations of the concept of structural deficit are not the substance of debates over the TSCG. Nevertheless, related issues cannot be avoided, such as the estimate of potential gross product and the subsequent extent of the gap in the outcome; the most frequently used methods include the method of production function analysis or various statistical smoothing (e.g. the Hodrick-Prescott filter, applied also by the Commission). Needless to say, the two methods need not generate fully identical data. It may be quite important what items in the public budgets are selected and assigned for consideration with respect to their cyclical performance. Sensitivity of public expenditures to economic cycles in some countries has been so negligible that it is assigned a zero value in practical computation. In other countries, on the other hand, the sensitivity of data to the output gap caused by the impact of an economic

cycle has been quite high (Denmark, Sweden and the Netherlands). The TSCG stipulates that the Contracting States may deviate from their respective medium-term objective only temporarily and only in exceptional circumstances, as defined in the definition clause of Art. 3 (3) (b). This definition corresponds to the definition in the fourth subparagraph of Art. 6 (3) of Regulation (EC) No. 1466/97, as amended by Regulation (EU) No. 1175/2011 from November 16, 2011.

Where the debt-GDP ratio in market prices is substantially lower than 60%, which is the criterion contained in Protocol (12) on the excessive deficit procedure, the structural deficit may attain a maximum value of 1% in market prices without violating the Golden Rule. However, the fundamental requirement is a low risk for the long-term sustainability of public finances. Should a serious deviation from a medium-term objective be ascertained, or deviation from the path to its gradual achievement, the corrective mechanism will be automatically set in motion; the mechanism includes a duty of the Contracting State concerned to adjust the deviation within a particular period of time. Criteria for considering the seriousness of deviation are stipulated in Art. 6 (3) of Regulation (EC) No. 1466/97, as amended by Regulation (EU) No. 1175/2011. Besides the scope of deviation the criteria include the development of net expenditures or an unusual event outside the control of the Contracting State.

Art. 3 TSCG stipulates an obligation to incorporate rules in national legislation for balanced budgets and methods for their enforcement under paragraph (1); a one-year implementation period is set to start running after the entry into force of the TSCG. Contracting States are to implement these rules through provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes. It is up to each Contracting State what legal force for such provisions it chooses for the implementation of these rules, whether constitutional or lower level, but either of these must fulfil the set requirements. The Contracting States are further obliged to put the automatic correction mechanism in place at their national level on the basis of the common principles proposed by the European Commission. There is an model list of common principles covering the nature, size and time-frame of the corrective action to be undertaken, including cases of exceptional circumstances, and the role and independence of the institutions responsible at the national level for monitoring compliance with the rules set out in paragraph 1. Similar to proposing the time-frame for convergence under paragraph 1, the proposing of common rules for the correction mechanisms represents a new role for the Commission (although it is not genuine authority in the sense of executive competence) which is not established by any provision of the law of the EU.

Since the process of adoption of Government revenues and expenditures belongs to the sovereign powers of Member States, traditionally performed by national Parliaments, and it could be intervened by automatically activated correction mechanisms under the common principles, the TSCG stipulates that such a correction mechanism must fully respect the prerogatives of the national Parliaments.

Art. 4 TSCG imposes an obligation upon the Contracting States to reduce the debt-GDP ratio at an average rate of 1/20 per year in the event that the debt-GDP ratio in market prices exceeds the 60 % reference value referred to in Article 1 of the Protocol (No 12) on the excessive deficit, complementing Art. 126 (2) TFEU. The extent of reducing the exces-

sive deficit by one twentieth per year is stipulated in EU secondary legislation (Regulation (EC) No. 1467/97, as amended by Council Regulation (EU) No. 1177/2011). The debt-GDP ratio of 60% in market prices is the bench-mark set in Art. 1 of the Protocol (12) obliging the Member States to immediately and regularly notify the Commission of the envisioned and actual deficit and the volume of their debt. The Commission is charged with monitoring the development of public debt in accordance with Art. 126 TFEU. Should their public debt exceed the set referential rate, the Contracting States are obliged to reduce such debt. The rate of reduction is determined by the referential value of 1/20 per year. However, this is only a recommended value. The details of the reduction of public budgets are set in Regulation (EC) No. 1467/97, as amended by Council Regulation (EU) No. 1177/2011; they provide that the requirement relating to the debt criteria be considered fulfilled if the budgetary projection of the Commission indicates that the required adjustment of the ratio could be achieved during a three-year period, including the two years following the last year when the data have become available. The debt-GDP ratio is considered to be being reduced at a sufficient and satisfactory rate approximating the reference value if the difference from the reference value has been reduced by 1/20 a year on average during the previous three years, which is the recommended value; changes during the previous three years for which data are available are taken into account. The rate of adjustment of an excessive debt may be considered as sufficient if the ratio indicator of the public debt (in % of GDP) was reduced during the last three years by 1/20 of its excess over the reference value. It is essential in this respect that the value of 1/20 determines the average rate of reduction during three subsequent years and that the reduction applies to the excess over the reference value, not to the reduction of an overall public debt. Although the TSCG does not make the Union legislation more stringent in this regard, it cannot be excluded that potential amendments it passes in the future to ensure the implementation of other TSCG provisions would not lead to a more stringent application or regulation of the rules and to shifts with respect to the numbers used as reference values.

Under Art. 5 TSCG the adjustment of the budgetary deficit is not sufficient by itself to ensure durable and sustainable economic growth. Contracting States subject to an excessive deficit procedure under the Treaties on which the European Union is founded have a new obligation imposed on them, namely to put a *budgetary and economic partnership programme* in place, including a detailed description of the structural reforms which must be launched and implemented to ensure an effective and durable correction of their excessive deficit. It is obvious that the aim of such a measure is to ensure a systematic monitoring of the economic situation in Member States - Contracting Parties against which the excessive deficit procedure has been instituted. There is a pending question as to what way the procedure would be linked with the existing mechanisms for reporting and evaluating within an excessive deficit procedure[3], excessive imbalance procedures[4], and pro-

[3] Art. 126 TFEU, Protocol (12) on an excessive deficit procedure and Regulation (EC) No. 1466/97, as amended by Regulation (EU) No. 1175/2011.

[4] Regulation (EU) No 1176/2011 of the European Parliament and of The Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances and Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area.

cedures within the European semester. Details with respect to interconnection of monitoring and the existing mechanisms, along with the definition of the content of such programs, should be determined through new EU secondary legislation. The provision imposes a duty on a Contracting State subject to the excessive deficit procedure to launch the *budgetary and economic partnership programme,* including a detailed description of the structural reforms to be introduced and implemented in order to attain an efficient and durable correction of their excessive deficit. It refers to the excessive deficit procedure in the meaning of Art. 126 TFEU and Protocol (12) on the excessive deficit procedure; but at the same time it imposes additional obligations on the State concerned in the form of launching the *programme*. In addition, it defines the competences of the Commission and the Council beyond the limits of EU law for the approval of the *programme*.

It should be emphasized that the *budgetary and economic partnership programme* is a new legal institution introduced by the TSCG; the Stability and Growth Pact, as amended, does not (and logically may not as yet) regulate the powers of the Commission and the Council to approve the programmes. The mechanism triggering the obligation to launch the *budgetary and economic partnership programme* may be the decision of the Council on the existence of an excessive deficit under Art. 126 TFEU. Such obligation would not be activated automatically in a case of exceeding the set reference value for a deficit of public budgets. Art. 126 TFEU, along with Regulation (EC) No. 1466/97, as amended by Regulation (EU) No. 1175/2011, describe the circumstances to be taken into consideration in decision-making with respect to excessive deficits. When a vote on excessive deficits is taken in the Council, the vote cast by the state whose deficit is subject to the vote is disregarded.

VOTING ON SANCTIONS

Under the TSCG the euro area Member States are obliged in essentially all cases in the Council to support the proposals and recommendations submitted by the Commission against any euro area Member State having violated the deficit criterion (3% GDP) within the excessive deficit procedure. This does not apply to those cases where a qualified majority of euro area Contracting Parties, calculated by analogy under relevant provisions of Treaties, casts a negative vote. The position of a Member State concerned is disregarded. The consequence of such a contractual obligation of the EU Member States adopted outside the establishing Treaties of the Union is to institute a reverse qualified majority vote already existing in EU secondary legislation in the so-called *six-pack*. However, the mechanism in this case should apply to decision making in the Council directly under Art. 126 TFEU, namely according to its paragraphs 6, 7, 8, 9, 11 and 12. The mode of voting by so-called reverse qualified majority is considered by some theoreticians as "*new procedure, and one that does not exist in the EU Treaties* [...] *which is purporting to alter institutional provisions in the EU Treaties outside the Article 48 TEU treaty change process* [...]".[5] This type of voting by a reverse qualified majority may in such cases give rise to connotations

[5] O'BROIN, P. *The Euro Crisis: The Fiscal Treaty – An Initial Analysis*. Institute of International and European Affairs: 2012. Retrieved from http://www.iiea.com/blogosphere/the-fiscal-treaty—an-initial-analysis.

of implied delegation of powers which has no backing in EU primary law. This is also one of the reasons why the Czech Republic has been rather reserved regarding the TSCG. Nevertheless, this type of vote has been submitted for consideration by constitutional courts in two of the most significant EU Member States. The French Constitutional Council only states in its decision that it is just a more stringent form of vote already existing in the Council.[6] Similarly, in its judgment the Constitutional Court of the Federal Republic of Germany finds the objection raised as irrelevant since the EU Institutions acquire no competences which may intrude in the national budgetary sovereignty.[7]

Provisions of Treaties relevant for the calculation of a qualified majority in cases where not all Members of the Council take part in a vote, which are applied to the calculation of a qualified majority of the members of the euro area, are stipulated in Art. 238 TFEU, with reservation of voting under Protocol (36) on transitional provisions. Art. 3 of this Protocol stipulates that by October 31, 2014, or March 31, 2017 where a Member States so requests, a count of 255 votes must be achieved in order to express the affirmative position of Member States regarding a decision submitted by the Commission towards a vote in the Council. The votes of Member States are respectively assigned a certain weight. Any member of the Council may apply for a check to be made to ensure that the Member States comprising the qualified majority represent at least 62 % of the total population of the Union. If this proves not to be the case, the act is not adopted. Where a vote is taken only within the euro area by its Members the qualified majority is determined as the same rate of weighted votes (the fraction of 255 votes out of the total number of votes, 346, makes 74%) and possibly the same percentage of the total number of the euro area Member State population (62%). Considering the existing number of euro area Members, 17, and that in order to achieve a qualified majority in the negative vote on proposals submitted by the Commission or recommendations submitted by the Council, a minimum of 74% of votes of the euro area Members, without the Member concerned (its position being disregarded),[8] it would be necessary for at least nine euro area Member States and possibly 62% of their total population (exclusive the Member State concerned) to express a negative position.

ENFORCEMENT

The enforceability of the Golden Rule contained in Art. 3 TSCG must be ensured to make it meaningful. Therefore there is a provision for a review of the observance of the

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[6] Décision n° 2012-653 DC du 9 août 2012 sur la question de savoir si l'autorisation de ratifier le traité sur la stabilité, la coordination et la gouvernance au sein de l'Union économique et monétaire, signé à Bruxelles le 2 mars 2012, doit être précédée d'une révision de la Constitution, Journal officiel du 11 août 2012, p. 13283

[7] BVerfG, 2 BvR 1390/12 vom 12.9.2012, Absatz-Nr. (1–319).

[8] This type of vote is considered in detail in an analysis of Regulation (EU) No. 1173/2011 on the effective enforcement of budgetary surveillance in the euro area; this Regulation created the frame within which a vote by reverse qualified majority, disregarding the vote of the Council member representing the Member State concerned, was used for the first time. The analysis was prepared by the British House of Lords. Commenting on Art. 8 of the Regulation governing the vote taken in the Council, the analysis states: "Only the Member States of the euro area, other than the state on which sanctions would be imposed, may vote. A Qualified Majority must comprise at least 55% of the voting states, representing at least 65% of the total population of the voting states". Retrieved from: htttp://www.publications.parliament.uk/pa/ld201011/ldselect/ldeucom/124/12406.htm#note113.

Rule and possible imposition of sanctions for its default by the Court of Justice of the EU. Art. 273 TFEU stipulates that the Court has jurisdiction over cases arising under a *special agreement* between the parties. Under the German doctrine[9] Art. 273 TFEU serves mainly to protect the autonomy of the EU legal system against international law. Three main requirements can be identified for the Article to be applied: (1) a dispute must be between Member States of the EU (there is no jurisdiction of the Court of Justice over cases between Member States and third countries); (2) a link between the dispute and the subject-matter of Union Treaties; (3) the *special agreement* or clause must be effective, i.e. it must be in compliance with general rules of public international law and with the rules and principles of European law. The link between the dispute and the subject-matter of Union Treaties may be interpreted quite liberally; this should be sufficient where a relationship between the dispute on the one hand and the tasks and objectives of the Union on the other can be ascertained. Proceedings under a *special agreement* between the parties under Art. 273 TFEU may be instituted in disputes not dealing with the application of EU law itself but having a clear relationship thereto. Disputes must be related to the subject-matter of the establishing Treaties but not to the Treaties themselves. Disputes between Member States over rights and obligations resulting directly from the establishing Treaties are determined in proceedings for an action for infringement of the Treaties under Art. 263 TFEU. The existence of such an institution linked with Art. 344 TFEU creates an objective limitation giving rise to the conclusion that proceedings under Art. 273 TFEU may deal only with areas indirectly linked with EU law.

Considering the first requirement, an action to the Court of Justice may be brought only by one or more EU Member States that are parties to the Fiscal Compact and only against another EU Member State as party to the TSCG. Thus these cases are "disputes between EU Member States". From the perspective of Art. 273 TFEU, this qualification remains unchanged even when considering the role assigned to the Commission under which the Commission is requested by the Contracting States to submit a report on implementing obligations set in Art. 3 (2) TSCG in national legal systems of the Contracting Parties. The report forms the basis on which one or more Contracting Parties may raise their claims in the Court of Justice should any Party fail to fulfil such obligations. The construction that Contracting Parties agree to act, i.e. to file an action with the Court of Justice on the basis of the Commission's report, indirectly strengthens the position of the Commission without its express determination in EU primary law. The requirement that a dispute should be related to the subject-matter of the establishing Treaties may be considered as fulfilled since obligations potentially forming a cause of the dispute result from, and further complement, the obligations imposed by EU law (in particular by the revised Stability and Growth Pact[10]); their tie to the definition of the Union policies is explicit even in the definition of the scope of the TSCG. Finally, considering the third requirement, it may be presumed that Art. 8 TSCG represents an efficient arbitration clause, i.e. a *special agreement* between the Contracting Parties within the meaning of Art. 273 TFEU, which is to be con-

[9] See CALLIES, CH., RUFFERT, M. *Kommentar zu EU-Vertrag und EG-Vertrag*. 2nd ed. Luchterhand 2002, pp. 2138–2139. VON DER GROEBEN, H., SCHWARZE L. Kommentar zum Vertrag über die Europäische Union und zur Gründung der Europäischen Gemeinschaften. 6th ed. *Nomos Verlagsgesellschaft.* 2003, Vol. 4, pp. 576–579.
[10] Regulation (EC) No. 1466/97, as amended by Regulation (EU) No. 1175/2011.

cluded in the international law capacity of the EU Member States without interfering in the competences of the EU Institutions and Union policies set by the establishing Treaties.

Proceedings before the Court of Justice against a Contracting Party may be instituted should the Party have failed to comply with its obligations under Art. 3 (2) TSCG. These obligations are as follows: (a) to transpose, not later than within one year after the TSCG comes into force, into its national law rules stipulated in Art. 3 (1) TSCG (the Golden Rule or the Rule of Fiscal Responsibility); and (b) to put in place an automatic mechanism to take corrective action under the common principles proposed by the Commission. Although Art. 3(2) expressly speaks only about the transposition of the fiscal responsibility rule into national legal systems, the provision should, in the light of Art. 8 (1), be interpreted in such a way that a review by the Court of Justice covers an obligation to adhere to the rules during their existence. Such judicial review would otherwise lose its meaning.

A judgment of the Court of Justice is binding on parties to the proceedings; they are obliged to accept measures determined necessary for ensuring their compliance with the judgment within a time-limit set by the Court of Justice. The TSCG allows for imposing financial sanctions on Contracting Parties should their failure to comply with the requirements of Art. 3(2) TSCG persist; the aim of the sanctions is to ensure efficient enforcement of the obligations. The imposition of sanction is to be decided by the Court of Justice in its capacity as arbitrator in a *special agreement* procedure in the meaning of Art. 273 TFEU. Requirements for imposing the sanctions have been conceived by analogy to proceedings for infringement of Treaties under Art. 260 TFEU. Autonomous sanction proceedings are presumed; under Art. 273 TFEU, they may be instituted by any Contracting Party if the Party, having considered the issue by itself or relying on the evaluation of the Commission, believes that any other Contracting Party has failed to adopt measures necessary for ensuring compliance with the judgement of the Court of Justice. Sanction proceedings may be commenced only after the Court of Justice has decided in a proceeding that a particular Contracting Party had failed to comply with the requirements of Art. 3 TSCG. In such a case, Contracting Parties are entitled, but not obliged, to institute the sanction proceedings; it is their respective discretion whether they do so or not. A generally reserved approach of Member States to bring actions before the Court of Justice against other Member States for the latter's undue transposition of EU law may play a certain role; such an approach is caused primarily by concerns that good bilateral inter-state relations might be thereby disturbed.

From the perspective of Art. 273 TFEU, sanction proceedings may also be considered a dispute between Contracting Parties. The dispute subsists in whether the Contracting Party concerned has fulfilled its obligations resulting from the prior judgment of the Court of Justice. A *special agreement* procedure does not in its nature preclude imposition of sanctions, since its objective should be to terminate unlawful acts or state, and not only to declare that such acts or state continue. Art. 273 TFEU is not an exception in this respect. The only requirement is that a possibility to impose sanctions is agreed by the Contracting Parties (in their international law capacity) in their *special agreement* or clause.

A Contracting Party, in its application for instituting the proceeding, proposes the type and amount of financial sanction under those criteria set by the Commission in Art. 260 TFEU. The reference to this Article may not be understood as its direct application, which is excluded in the case of the TSCG, but as a provision in the *special agreement* that the

Contracting Parties in their application, and the Court of Justice in its adjudication, would proceed in the imposition of financial sanctions by analogy to the methodology used in proceedings for infringement of the Union Treaties. The TSCG presumes the same types of financial sanctions to be imposed as those applicable to infringement proceedings. If the Court of Justice finds that the Party concerned has failed to comply with its judgment, the Court may impose upon the Party a lump sum or penalty payment in an amount adequate to the circumstances, which would not exceed 0.1% of its GDP. Where the euro is the currency of the Contracting Party the sanction paid becomes revenue of the European Stability Mechanism. Sanctions paid by non-euro Contracting Parties become part of the general budget of the Union. The reason for such a difference in the regime of payment is that parties to the Agreement of the European Stability Mechanism are only those countries with a euro currency. Particularly in their case it is desirable that financial sanctions imposed upon them for their violation of fiscal discipline become revenue of that Mechanism, as its main objective is to enhance the stability of the euro area (i.e. these means are tied to a certain extent).

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European law must follow a certain dynamism induced by objective economic needs. It must not turn into being a brake of such dynamism. The preservation and success of the euro in international contexts has become an ultimate interest of the EU providing that the EU intends to preserve its future competitiveness in respect of countries such as the USA, China, Japan, Russia or Australia. The practice of the last ten years has clearly suggested that the existing model of the economic and monetary union is far from being sustainable. A path to greater cohesion of budgetary policies appears to be unavoidable. Moreover, the International Monetary Fund calls on the European Union to introduce a uniform budgetary policy. However, exigent economic needs may not be a reason for twisting, or even violating, primary law. This is why the TSCG presumes certain amendments to primary law; however, their adoption requires adequate time to be set, spanning an inter-governmental conference and due ratification processes.