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(Re)newing economic governance in the EU: History repeating?

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On November 9, 2022, after conducting a year-long debate (the debate had been originally launched in February 2020, but then re-launched after the COVID-19 pandemic on October 2021), the European Commission proposed an overhaul of the European Union's (EU) economic governance framework. If eventually pursued, this will be the third overhaul of the framework since its original adoption 25 years ago. How have these changes affected or will affect the *modus operandi* of the EU?

This post first lays out the existing economic governance framework of the EU before looking at the proposals made by the Commission.

The existing framework

The economic governance framework of the EU is included in primary and secondary EU, and international, legislation:

- Articles 126 and 140 TFEU;
- Protocol No 12 to the EU Treaties;
- the Stability and Growth Pact (SGP), which consists of European Council Resolution 97/C 236/01, and Regulations 1466/97 ('preventive arm') and 1467/97 ('corrective arm');

- the 'Six-Pack', which consists of Directive 2011/85/EU and Regulations 1173/2011, 1174/2011, 1175/2011, 1176/2011, and 1177/2011;
- the 'Two-Pack', which consists of Regulations 472/2013 and 473/2013
- the 2012 Treaty on Stability, Coordination and Governance (TSCG).

Article 126 TFEU stipulates that Member States should avoid deficits and sets out the Excessive Deficit Procedure (EDP). Article 140 TFEU includes four convergence criteria (price stability, sustainability of government finances, exchange-rate stability, convergence of long-term interest rates) for evaluating when Member States are in a position to join the Eurozone (all EU Member States must do so except Denmark, which has an opt-out under Protocol No 16). Protocol No 12 further specifies the EDP and sets, *inter alia*, the targets of 3% of the Gross Domestic Product (GDP) for the deficit and 60% of GDP for the debt of all Member States.

The SGP, originally enacted in 1997, further specified the above provisions of primary EU legislation, with the European Council Resolution including commitments by Member States, the Commission, and the Council to act accordingly in the case of an excessive deficit. Its preventive arm outlines the Stability Programs (for Eurozone Member States) and Convergence Programs (for non-Eurozone Member States) and the details of Member States' medium-term budgetary objectives (MTBO). The corrective arm delineates the EDP, including when an excessive deficit is considered 'exceptional and temporary'.

At the first sign of political impact on the framework, the preventive and corrective arms of the SGP were amended in 2005 (Regulations 1055/2005 and 1056/2005), with the staunch support of both Germany and France, two Member States against whom only two years prior an EDP had been initiated by the Commission which was then voted down by the Council. The amendments resulted in relaxing the EDP criteria, in the removal of the automatic character of the EDP, and in providing more room for intergovernmental (and political) bargaining.

After the beginning of the Eurozone crisis in 2010, the European Council created a "Task Force" to re-evaluate the EU's economic governance framework, which proposed, among others, the enhancement of the SGP and its governance and oversight provisions (it also proposed the creation of what would later become the European Stability Mechanism). The legislative result was the so-called 'Six-Pack', which considerably strengthened the SGP (Regulations 1175/2011 and 1177/2011 amended 1466/97 and 1467/97 respectively), and introduced multiple additional safeguards, obligations, and procedures, including new sanctions (especially for the medium and long term), and setting a stricter framework especially for Eurozone Member States (Regulations 1173/2011 and 1174/2011 are exclusively for them).

Changes introduced through the above included strengthening of fines (e.g., under the EDP), the transformation of the MTBO to the 3-year Medium-Term Budgetary Framework (MTBF), the introduction of the Excessive Imbalance Procedure (EIP) and the alert mechanism scoreboard related to macroeconomic imbalances (the Macroeconomic Imbalance Procedure), the reduction rate of 1/20 annually for when debt to GDP ratio exceeds 60%, the "European Semester for Economic Policy Coordination," which was originally focused nearly exclusively on providing a single timetable and framework of economic coordination between EU Member States. From 2015 onwards, however, the European Semester has begun to encompass multiple other EU policy areas (e.g., policies on employment and social inclusion). Perhaps the most important change, from an institutional point of view, was the widespread introduction of reverse qualified majority voting related to most of the above – i.e., when voting in the Council, a Commission proposal to impose a fine, find an excessive deficit, etc., is deemed adopted by the Council, unless a qualified majority in the Council rejects it within 10 days. This not only reinstated, but further augmented the automatic character of the EDP, which had faded after the 2005 amendments.

The aforementioned reforms were complemented in 2013 by the Two-Pack and the TSCG. The Two-Pack Regulations apply only to Eurozone Member States and, *inter alia*, establish an enhanced surveillance procedure for Member States under or threatened by financial difficulties. Further, they integrate the structural adjustment programs upon which financial assistance by the EU is contingent, and the relevant conditionality oversight by EU institutions and the IMF, within the EU legal framework (through the concept of Macroeconomic Adjustment Programs or MAPs). For the first time, they also stipulate that budgetary plans of the Eurozone Member States are submitted to and evaluated by the Commission and the Eurogroup ahead of becoming binding at the national level. Both the Commission and the Eurogroup can request changes to those budgetary plans, if necessary.

The TSCG is an international (not an EU) agreement between all EU Member States, with some parts applying only to Eurozone Member States. It includes the Fiscal Compact (Title III). Based on an idea originating from a joint French and German letter to the European Council President during the December 2011 European Council meeting, the TSCG included the recognition of the Eurozone summit as an official (but informal) meeting, the numerical values for considering a budget as balanced, and the obligation for each Member State to adopt a permanently or constitutionally legally-binding budgetary automatic correction mechanism or 'golden rule' for when budgetary deviations from the MTBF occur. This was based on Germany's *Schuldenbremse* (German for 'debt brake') implemented in 2009 – the first by a Eurozone Member State.

Issues and the Commission's proposals

The existing framework enhanced the depoliticization, enforcement, and strictness of economic coordination framework, especially in the Eurozone. It established new procedures, reinforced sanctions, introduced a more medium/long-term focus through attention to macroeconomic imbalances, and augmented the authority of the Commission – a largely technocratic institution – against the Council, limiting the ability of Member States to impact decisions. However, the complexity of the framework, including the sheer number of different legal acts that concern different subsets of Member States and involve multiple processes, increased exponentially, making the framework increasingly complex.

In addition, the ability of the supranational level to influence an ever-increasing number of aspects of economic policy of Member States, often prior to even the national level (oversight of budgetary plans of Eurozone Member States by the Commission and the Eurogroup), progressively restricted national governments' ability to act independently. This, coupled with the boost of authority of the Commission and the extremely limited role of the European Parliament across all the above acts, which is mostly confined to a "dialogue" with relevant institutions, may raise considerable issues related to legitimacy and accountability. Finally, the near-exclusive focus on fiscal discipline, lacking in emphasis on growth or the potentially adverse consequences of exactly such a focus on fiscal discipline on it, especially in times of crisis, created a rigid and unidimensional system that, among others, disproportionately impacted Member States with already high levels of debt.

So, what are the main changes proposed by the Commission in November 2022? It recognizes that the framework has become complex and difficult to apply. The guiding principle is an emphasis on growth and debt sustainability, with a focus on the medium and longer terms (macroeconomic imbalances), and a differentiation between Member States. The primary amendment is gearing surveillance and enforcement towards a risk-based approach, incorporating reforms and investments, along with fiscal objectives, into the Member States' programs, placing the primary emphasis on debt sustainability, and moving to a single operational fiscal indicator: nationally financed net primary expenditure (expenditure of discretionary revenue measures, excluding interest expenditure and cyclical unemployment expenditure).

The Commission proposes a single program for each Member State, titled "Medium-Term Fiscal-Structural Plans" (MTFSP), which would merge the Stability and Convergence Programs and the National Reform Programs of Member States into one (the latter include the alignment of Member States' policies with the EU's strategy for growth and jobs, and are submitted under the European Semester), and would translate into annual spending ceilings. It would be binding for at least 4 years, with the possibility of earlier revisions only in case of objective circumstances and after validation by the EU (frequent revisions are to be avoided).

In terms of debt, the Commission proposes enhancing the debt aspect of the EDP (the deficit aspect and the EIP are maintained), albeit differentiating (e.g., the Six-Pack and TSCG 1/20 reduction rule) between Member States, in light of their vastly different fiscal and debt positions to avoid jeopardizing growth. The Commission also proposes the introduction of a new enforcement tool leading to a stricter adjustment path in case a Member State that has submitted a more gradual adjustment path but has failed to adhere to its commitments.

History repeating or a truly new framework?

The Commission's proposals seem to be more of a step in the right direction rather than an overhaul of the economic governance framework of the EU; definitely, a shorter step compared to the major modifications occurring after the Eurozone crisis. Despite such fact, the proposals do appear to address some dysfunctionalities of the existing EU economic governance framework. The merging of the multiple different programs of Member States to one, simplifies the multiple existing processes, commitments, etc., enhances transparency and facilitates surveillance, since it is much easier to have a single document that includes all policies than multiple ones.

The shift of focus to debt sustainability and a long-term, risk-based, differentiated approach to the rules and monitoring processes, modernizes the rules by which Member States must abide, more effectively corresponding to the structure of the modern financial system. This shift allows for better ownership of the commitments by the Member States themselves, since these commitments, along with the corresponding targets, are much more realistic and dependent on the situation of each Member State. In turn, many of the dangers associated with the previous system, largely based on a "one-size-fits-all" paradigm, can be avoided.

In line with previous modifications, the proposed reinforcement of sanctions, the increasingly binding nature of the commitments undertaken by Member States, and the strengthening of the EDP's debt aspect while the deficit aspect and the EIP are maintained, lead to an increase in the ability at the EU level to influence Member States' economic and budgetary processes, limiting even further their fiscal autonomy. This, by itself, but also combined with the lack of any meaningful or even substantial input by the European Parliament (which was already the case in the existing framework), may, in turn, raise concerns regarding democratic governance, especially regarding legitimacy and accountability. It is worth noting that, despite the fact that budgetary and fiscal processes are (at) the core of the modern democratic state, the proposal of the Commission does not at all include the European Parliament in any of its modifications. This seems in line with the existing framework, whereby most legal acts have been approved by the European Parliament, but contain minimal (if any) input of it in the decision-making processes. To ensure better legitimacy and accountability, consistent with modern democratic governance principles, this is an area where improvements could be undertaken, both in the existing framework but also in the proposals of the Commission.