The two pack on economic governance: an initial analysis

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Abstract

The adoption of the two pack in May 2013 temporarily brings to a close a set of reforms to the Stability and Growth Pact which began in 2010.

These two regulations further strengthen EU monitoring of national budgets by completing the European Semester, reinforcing the Excessive Deficit Procedure and creating a surveillance mechanism for member states facing financial difficulties.

The particularly long legislative process for their adoption has led to more transparency and may bring more guarantees for member states receiving conditional assistance. Yet it failed to deliver the growth and social objectives sought by left-wing and liberal political groups.

An assessment of the two pack’s contribution to ‘austerity policies’, however, should also take into account the legal framework in which it has developed, which has largely determined some of its main features.

Even so, there is still room for policy choices by European institutions, on the one hand, and by member states on the other, as long as their economic health means that they are not subject to surveillance and corrective EU mechanisms.
Introduction

The adoption of the ‘two pack’ in May 2013 marks – at least temporarily – the end of a series of major reforms to the Stability and Growth Pact which began in 2010. The attention of the EU legislator should now focus on other areas, as outlined in the Commission’s *Blueprint* for the completion of a ‘deep and genuine Economic and Monetary Union’ (European Commission 2012b).

However, at a time of gloomy outlooks for most EU economies, there is overall scepticism about the effectiveness of the Union’s remedies, often associated with ‘austerity’. Doubts about the current fiscal consolidation policies can be heard at national, European and even international level, in political and in academic fora (Krugmann 2012; Blanchard and Leigh 2013).

The regulations in question have not been exempt from such criticism. Like its predecessors, the two pack aims to further strengthen EU surveillance of national budgets, following three main approaches.

Firstly, it completes the European Semester, enabling the Commission and the Council to examine member states’ budgets before their approval by national parliaments. Secondly, the Excessive Deficit Procedure (EDP) is enhanced, with closer monitoring by the Commission and tighter reporting requirements. Thirdly, a new mechanism of ‘enhanced surveillance’ is created for member states facing financial instability; this increases in line with the severity of the difficulties encountered.

This paper aims to provide a first analysis of this new piece of legislation.

The two pack adds to a very complex set of rules governing EU coordination of national economic policies, the so-called European economic governance, as will be seen in part 1. The content of the two regulations will be examined in part 2, recalling the particularly long legislative process for their adoption and highlighting the amendments added by the Parliament and the Council to the original Commission proposal. Part 3 will then provide a critical assessment

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of the two texts, trying to answer the following questions: is the two pack ‘austerity-oriented’, and why, and to what extent do these new rules modify member states’ room for manoeuvre? Short concluding remarks will follow.
1. The new European economic governance – situation at the beginning of 2012

‘Economic governance’ usually refers to the economic pillar of Economic and Monetary Union (EMU) or, more simply, the common rules governing EU member states’ economic policies. Unlike monetary policy, which has been transferred to EU level\(^2\), the definition and implementation of economic policies have been largely left to member states. EU rules mainly consist in coordination of these national policies\(^3\) and monitoring of national budgets.\(^4\)

At the heart of this budgetary surveillance lies the Stability and Growth Pact (SGP), a set of rules defining a mechanism requiring member states to respect two parameters: a maximum debt level and a deficit-to-GDP ratio. As is well-known, these have been capped respectively at 60% and 3% of GDP. In practice, a monitoring procedure was established to avoid excessive deficits (preventive arm of SGP)\(^5\) and, in cases where a member state incurs an excessive deficit, another procedure was created to correct it (corrective arm of the SGP)\(^6\).

From 2008 onwards, the financial and then economic crisis emphasised the shortcomings of the system: failing statistical supervision, narrow macroeconomic supervision, ineffective prevention mechanism, weak corrective measures, lack of last resort mechanism (Hallerberg \textit{et al.} 2012: 11; De Gregorio Merino 2012: 1644). To address these problems, a set of reforms was gradually adopted from the spring of 2010, using both Community and international law, and which can be summarised as follows:\(^7\)

Firstly, after a set of insufficient bilateral loans to Greece, two bail-out funds were created. Their function is to provide financial assistance to member states no longer able to finance themselves on the financial markets due to the excessively high premium risks requested. The European Financial Stability Mechanism (EFSM) and the European Financial Stability Facility (EFSF) were created in 2010 for a limited duration and could provide €60 bn and €440 bn respectively. In 2012, after a Treaty revision, the Treaty establishing a European Stability Mechanism (ESM) replaced these with a permanent

\(^2\) Art. 3, c TFEU.
\(^3\) Art. 121 TFEU.
\(^4\) Art. 126 TFEU.
\(^7\) For a detailed description, see Allemand and Martucci (2012) and Degryse (2012).
mechanism. The financial assistance provided by the ESM can take the form of credit lines, assistance for the re-capitalisation of financial institutions, purchase of sovereign bonds on the primary or secondary market and the granting of loans.8

Once the immediate threat of a member state’s default has passed, a reinforced framework has to be set up in order to prevent such situations. The most visible innovation was probably the creation of the European Semester, in June 2010. The Semester mostly consists of the integration and synchronisation of existing procedures9 in order to provide the EU with a ‘global economic coordination’ tool.10 It aims to rationalise these macroeconomic coordination mechanisms and bring them together in the first six months of every year. At the end of this European Semester, in June/July, recommendations are made, which member states have to translate into policy action, notably when preparing their budgets for the next year. The first European Semester was launched in January 2011.11

Another major step was the adoption of the ‘six pack’12 in December 2011. Unlike the Semester, which mostly deals with procedures, the six pack adds substantive provisions to the governance system. Its main provisions aim at reinforcing the governance system by:

- strengthening the preventive and the corrective arms of the Stability and Growth Pact, notably by giving renewed attention to the debt criterion and by adding an expenditure rule and a debt reduction benchmark;
- adding reporting requirements for member states and enhancing their statistical systems;
- extending multilateral surveillance to non-budgetary elements. A mechanism to detect, prevent and correct macroeconomic imbalances is created;

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9. The three ‘pillars’ brought together under the Semester are Europe 2020, the Stability and Growth Pact and the Macroeconomic Imbalances Procedure.
11. However, it became legally binding only in November 2011 when the six-pack, in which it was enshrined, was adopted. Cf. Hallerberg et al. 2012: 17.
– ensuring effective surveillance by generalising sanctions for euro area member states in case of non-compliance with EU recommendations and making them quasi-automatic thanks to ‘reverse qualified majority voting’ (RQMV).

Finally, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), signed in March 2012 by 25 member states, aims to internalise budgetary surveillance by requiring member states to transpose into national law – preferably at constitutional level – the requirement to have a balanced budget.\(^{13}\)

To sum up, the structure of the EU economic governance at the beginning of 2012 can be simplified as follows:\(^{14}\)

– a six-months timeline (European Semester) from January to June during which member states exchange information with EU institutions. At the end of this cycle they are given guidance which they should implement at national level during the second half of the year (national semester), particularly in order to prepare and approve their national budgets. However, only recommendations concerning fiscal policy and macroeconomic imbalances are binding.

– To ensure the implementation of these recommendations, stricter surveillance procedures exist for member states at risk of incurring excessive deficits (preventive part of the SGP), already incurring excessive deficits (corrective part of the SGP) or facing macroeconomic imbalances (excessive macroeconomic imbalance procedure). These may be triggered at almost any time of the year, whenever a member state fails to remain within certain parameters, and may lead to sanctions in case of non-compliance by a euro area member state.

– A permanent bail-out fund for member states experiencing liquidity or solvency problems and therefore no longer able to borrow on financial markets;

– National rules (preferably constitutional) requiring a balanced budget.

\(^{13}\) One should also add the euro-plus pact, signed in March 2011 by euro area member states and Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania. This ‘political commitment’ aims to enhance policy coordination between those member states; compliance with its provisions is assessed within the Semester framework.

\(^{14}\) On the problems ensuing from the overlapping of EU, international and soft law, and the variable geometries created by such a system, see Pisani-Ferry et al. (2012).
2. The two pack, from the Commission's proposal to the current version

In November 2011, as the sovereign debt crisis was reaching a new peak, the Commission unveiled a new package of measures aiming at strengthening the existing governance mechanism. It contained two draft regulations on budgetary surveillance of the euro area member states and a discussion document (Green Paper) on stability bonds, putting forward three options for the joint issuance of debt in the euro area (European Commission 2011).

Commissioner Olli Rehn explained the rationale of presenting these three documents together by stating that 'any step in the further sharing of risk would have to be balanced by provisions that ensure sustainable public finances and minimise the moral hazard' (Rehn 2012). The report issued at the end of the public consultation concludes that the results obtained are 'a useful process for further reflection about stability bonds' (European Commission 2012c: 14) but no further steps seem to have been undertaken since then until the MEP raised the issue again (see below).

It is not our purpose, however, to go further into this topic. We shall therefore concentrate on the two regulation proposals, analysing the original Commission draft, the legislative process and the amended version’s main features.

2.1 The Commission’s proposal

As briefly recalled above, the European Semester sets out a common timeline during the six first months of each year, leading to country-specific recommendations, which member states shall implement from June/July onwards, particularly when preparing their national budgets. Regulation 473/2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficits of the member states in the euro area (hereafter ‘Regulation on budgetary plans’) aims firstly to coordinate these national budgetary processes, which take place in the second half of the year. Secondly, it aims to assess national budgets’ conformity with the recommendations received at the end of the European semester. Thirdly, it reinforces the Excessive Deficit Procedure.
For this purpose, the following provisions apply:

- Between 15 and 30 April, member states shall publish a medium-term fiscal plan, a document which completes their stability programmes and mainly targets national audiences.\(^{15}\)

- By 15 October they shall publish their draft budget laws and a draft budgetary plan for the next year. This latter document, which is submitted to the Commission and the Eurogroup (the finance ministers of euro area member states), contains the main data in the draft budget laws and gives details of the budgetary measures member states intend to take in order to meet the Council recommendations issued in June/July.\(^{16}\)

- In case of ‘particularly serious non-compliance’ of the draft budgetary plan with the recommendations received, the Commission shall request a revised version within three weeks.\(^{17}\) Otherwise, it may deliver an opinion before 30 November.\(^{18}\) The Eurogroup publishes an assessment of the Commission’s opinion.\(^{19}\)

- Member states are invited to take this opinion into account in their budget laws, which they shall approve before 31 December.\(^{20}\) Non-compliance with the Commission’s opinion shall be considered by the Commission and the Council as an aggravating factor when deciding whether to establish an Excessive Deficit Procedure or, at a later stage, to impose a fine.\(^{21}\)

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15. Reg. 473/2013, art. 4(1). For ease of use, reference is made, where possible, to the final version of the texts.

16. Ibidem, art. 4(2); 4(3); 6(2). Examining the same standard document instead of 17 different budgetary laws should make the Commission’s assessment easier.

17. Ibidem, art. 7(2).

18. Ibidem, art. 7(1). In the final version the Commission must adopt an opinion on every budgetary plan.

19. Ibidem, art. 7(5).


– All these documents shall be based on forecasts established by an independent body.\textsuperscript{22}
– Also, as already stated in the euro-plus pact, in the six pack and the TSCG, the Regulation on budgetary plans reiterates that member states must include a requirement for compliance with the obligation to have a balanced budget in their national law, preferably at constitutional level.\textsuperscript{23}

The second part (chapter four) of the regulation sets out ‘closer monitoring’ for member states subject to the Excessive Deficit Procedure, thus completing the mechanism provided by regulation 1467/97.\textsuperscript{24} Member states in excessive deficit will be subject to tighter reporting requirements including periodical reports.\textsuperscript{25} In addition, at the Commission’s request they shall carry out an independent audit of their public accounts and provide any additional information requested.\textsuperscript{26} Finally, the Commission can intervene earlier, in cases where there is a risk that the deficit will not be corrected within the time period indicated.\textsuperscript{27}

Figure 2  Excessive Deficit Procedure as modified by the two pack

\begin{itemize}
\item Art. 126(6) TFEU
\begin{itemize}
\item Decision that an excessive deficit exists
\item Recommendation to take action within deadline
\item Non-interest bearing deposit
\end{itemize}
\end{itemize}

\begin{itemize}
\item Art. 126(7) TFEU
\begin{itemize}
\item MS report on action taken
\item Comprehensive assessment
\item Economic partnership programme (or corrective action plan)
\item Semestrial reporting
\item If risk of non-compliance within the deadline
\item new recommendation
\end{itemize}
\end{itemize}

\begin{itemize}
\item Art. 126(8) TFEU
\begin{itemize}
\item Public recommendation
\item Fine
\end{itemize}
\end{itemize}

\begin{itemize}
\item Art. 126(9) TFEU
\begin{itemize}
\item Decision establishing inadequate action
\item Notice to take measures within deadline
\item MS report on action taken
\item Comprehensive assessment
\item Quarterly reporting
\item If risk of non-compliance within the deadline
\item new recommendation
\end{itemize}
\end{itemize}

\begin{itemize}
\item Art. 126(11) TFEU
\begin{itemize}
\item Sanction (fine)
\end{itemize}
\end{itemize}

Source: author.

\textsuperscript{22} Ibidem, art. 4(4); 5.
\textsuperscript{23} Ibidem, art. 5(1)a. However, in the final version this obligation is only implicit.
\textsuperscript{24} At the date of entry into force of the Regulation, 20 member states were in an Excessive Deficit Procedure (of which 16 euro area member states,) which makes it the normal situation for the majority of the EU.
\textsuperscript{25} Ibidem, art. 10(2)-10(5).
\textsuperscript{26} Ibidem, art. 10(6).
\textsuperscript{27} Ibidem, art. 11.
Regulation 472/2013 on the strengthening of economic and budgetary surveillance of member states in the euro area experiencing or threatened with serious difficulties with respect to their financial stability (hereafter ‘Regulation on strengthened surveillance’) has two goals.

Firstly, it aims to prevent contagion from member states facing financial difficulties, and to avoid situations such as those of Portugal or Ireland, where a country procrastinates before seeking financial assistance with the result that the bail-out finally requested is higher than it need have been. With this aim, it allows EU institutions to intervene earlier by requiring all necessary information and indicating reform measures.

Secondly, as regard member states under financial assistance, the regulation aims to attach economic policy conditions to this assistance (granted outside the EU framework), consistent with the existing surveillance mechanisms foreseen by EU Law.

The first point concerns member states facing or threatened with financial instability, and those receiving financial assistance on a precautionary basis from other member states, European bail-out funds or international institutions. The regulation, developing a mechanism already outlined in EFSF and ESM guidelines, establishes that the Commission may decide to make these member states subject to ‘enhanced surveillance’. This entails an obligation to adopt measures, the same ‘closer monitoring’ as that foreseen for member states in an Excessive Deficit Procedure (see above), tighter reporting requirements and review missions by the Commission. Should the Commission consider that these measures are not sufficient, it can propose that Council adopt a recommendation to seek financial assistance.

The second point concerns precisely those member states seeking financial assistance from other member states, the EFSF, the ESM or the IMF. The regulation on enhanced surveillance overlaps here with provisions contained in the EFSF and ESM treaties, concerning the procedure for granting financial assistance. In practice, in addition to the Memorandum of Understanding foreseen by these treaties, the member state concerned shall draft a Macroeconomic Adjustment Programme, containing measures aiming at ‘reestablishing a sound and sustainable economic and financial situation and restoring the member state’s capacity to finance itself fully on the financial markets’. After it has been approved by the Commission and the Council, the member state shall implement the programme subject to Commission, ECB and IMF monitoring.

30. Ibidem, art. 3(1)-3(5).
31. Ibidem, art. 3(7).
32. Ibidem, art. 7(1).
This creates a kind of ‘emergency procedure’ which entails a situation of limited sovereignty for the member state, combined with a very strict surveillance procedure. On the other hand, all other surveillance mechanisms (European Semester, Excessive Deficit Procedure, Excessive Imbalance Procedure) are temporarily suspended in order to avoid a duplication of reporting obligations. Non-compliance with the adjustment programme can entail the suspension of payments of certain EU funds to the country concerned. Once all the instalments of the assistance have been delivered, the member state shall be subject to a ‘post programme surveillance’ until 75% of the assistance has been repaid.

### 2.2 The legislative process

Whilst most legislation concerning economic governance issues takes on average nine to ten months to finalise (European Parliament 2013), about one year and a half was needed for the two pack to be adopted.

On February 2012, three months after publication of the proposal, the Danish Minister for Economic Affairs, then chairing the rotating presidency, could proudly announce that a political agreement in the Council had been reached between member states within the Council. The amendments put forward only slightly modified the Commission’s proposal.

The Parliament’s position was much longer to adopt. From the beginning, left-wing political groups saw the proposals as another typical example of Commission initiatives ‘focusing only on the austerity and the discipline side’. Their main aim, therefore, was to counterbalance the general purpose of the two texts by introducing provisions focusing more on growth. The PPE’s main amendments, on the other hand, aimed to embed in the two pack as many elements of the recently approved TSCG as possible, in order to neutralise this intergovernmental treaty by embedding its content into EU law. In total, more than 500 amendments were put forward.

In May 2012, an agreement was finally reached in the Economic and Monetary Affairs Committee. On the day of the vote, however, the socialist group asked for it to be postponed, arguing that changes in the EU’s political landscape required a radical revision of certain provisions. The texts were approved anyway but only by a narrow majority. Therefore it was decided to postpone opening the negotiations with the Council and to first have a plenary vote on both proposals in order to provide the Parliament negotiators with a strong

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37. François Hollande had been elected the week before (6th May 2012).
mandate. The June plenary session finally approved both texts, opening the way for trilogue negotiations\textsuperscript{38} with member states.

From July 2012, seven trilogue meetings were held. Some member states proved particularly reluctant to include in the two pack references to a shared issuance of sovereign debt, or to use these texts to promote growth and investments. In mid-December, talks were suspended, particularly at the request of Socialist, Liberal and Green MEPs. In February 2013, the Commission undertook to set up an expert group to examine the issue of a redemption fund (a form of joint debt issuance) and the introduction of eurobills. This allowed the negotiations to resume and a compromise was finally reached a few days later.\textsuperscript{39} The Parliament was able to adopt the final texts by a large majority at the first reading in March\textsuperscript{40}, paving the way to the definitive Council approval two months later.

### 2.3 The amended version’s main features

The main changes to the Commission’s proposal can be classified in three groups. The details can be seen in the tables annexed.

The first set of changes aim to improve the transparency of the processes. Firstly, the European Parliament shall be better informed: the competent committee can invite top EU officials for an exchange of views over the issues at stake (the so-called ‘economic dialogue’, first set out by the six pack). In the case of member states subject to an adjustment programme, this invitation can be extended to IMF and ECB representatives, so that the ‘troika’ can be asked to report to the European Parliament. Moreover, national parliaments can also take that initiative. Secondly, several documents shall be made public (list of financial instruments entailing enhanced surveillance, preparatory work leading to a recommendation to seek financial assistance, macroeconomic adjustment programmes). Thirdly, the reasons underpinning certain Commission decisions shall be made explicit (request to submit a revised draft budgetary plan, methodology used for its forecasts, macroeconomic scenario used to assess a government’s debt sustainability). Lastly, the power to define the content of the regular reports submitted by member states subject to an Excessive Deficit Procedure will be delegated to the Commission and is subject to strict conditions.

Another group of amendments aims to ensure that the new proposals will not hinder economic growth. Member states shall assess in their draft budgetary plans the expected impact of budgetary measures on growth, as

\textsuperscript{38}These are informal tripartite meetings between representatives of the Parliament, the Council and the Commission, in order to facilitate the reaching of an acceptable agreement, enabling adoption of the text at the first reading. Among the shortcomings of this procedure however, is its lack of transparency.

\textsuperscript{39}European Parliament, Economic governance two pack background note, 4.3.2013.

\textsuperscript{40}The main political groups called for a positive vote (PPE, S&D, ALDE, Greens/EFA); GUE/NGL and EFD voted against; ECR abstained. Cf. European Parliament, Annex to the Plenary Session minutes of proceedings, 12.03.2012.
will the Commission in its global assessment of these plans. Attention is also paid to the relationship between investment and growth: in their medium-term budgetary plans, member states shall indicate the expected economic return on investments having significant budgetary impact. The regulation on budgetary plans also states that the Commission shall examine how to make productive public investments compatible with the current stability and growth pact. Moreover, all documents submitted by member states in the framework of the ‘completed’ European Semester (medium-term budgetary plans, draft budgetary plans) or of enhanced surveillance shall be consistent with the attainment of the Europe 2020 targets, and must sometimes explicitly indicate how they contribute to the EU strategy for growth and jobs.

However, the main demand of the left-wing and liberal groups, namely some form of debt mutualisation, found no place in the regulations. Instead, a document was attached to the Parliament’s final text in which the Commission undertakes to set up an expert group to examine the issue in more depth. This group will present a report by March 2014, which in turn could lead to legislative proposals before the end of this Commission’s mandate.

The third set of changes concerns the respect of social and labour rights. Reference is made in both regulations to Article 152 TFEU on the role of social partners; to article 28 of the EU Charter of Fundamental Rights on the right to collective bargaining and action; and to Article 9 TFEU, according to which social objectives must underpin every Union policy. More significantly, in the Regulation on enhanced surveillance, the involvement of social partners is made mandatory at every step of a member state’s request for financial assistance, notably when it drafts a macroeconomic adjustment programme. Also, in this sort of case, fiscal consolidation efforts shall ensure sufficient means for fundamental policies, such as education and healthcare.

There are two notable amendments to the Regulation on budgetary plans transposing TSCG provisions. One concerns the so-called economic partnership programmes, to be prepared by member states subject to an Excessive Deficit Procedure and which contain a detailed description of the structural reforms they commit to undertake, in order to ensure a sustainable correction of their deficits. The other one requires member states to inform the Commission and the Eurogroup of their public debt issuance plans. The original Commission proposal contained another TSCG provision, namely that the balanced budget rule should be enshrined in national law. This has been radically amended. Indeed, in the final version the obligation to enshrine this rule in national law is no longer mentioned, but can only be deduced from the wording of the provision.

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41. Statement by the European Commission. Annex to the legislative resolution, European Parliament document A7–0173/2012. In addition to the redemption fund, this annex also contains undertakings on a softening of the SGP as well as other short term actions outlined in the above mentioned Blueprint.

42. Reg. 473/2013, art. 8. See also TSCG, art. 5.

43. Reg. 473/2013, art. 9. See also TSCG, art. 6.

44. Ibidem, art. 5(1)a.
All in all, these amendments are of varying importance. The final texts certainly take a big step towards more transparency and openness. Yet references to ‘accountability’ – made loudly by all political groups – are probably exaggerated, since any form of accountability is lacking in this case (except for the minor amendment concerning the delegated power of the Commission). Economic dialogue, for instance, remains a mere exchange of views, which the Commission’s or other institutions’ top officials are invited to attend.

As concerns growth, two of the most relevant provisions have been neutralised, namely that concerning the redemption fund and that on the need to balance productive public investment with fiscal discipline objectives within the current SGP. In fact, the only concession to left-wing demands was an undertaking from the Commission to examine the feasibility of such reforms and to present the results of its enquiry at a later date.

A number of amendments then, notably the many references to Europe 2020 or to Treaty articles concerning social rights, may seem redundant: all Union acts are, in any case, supposed to be consistent with the treaties.

However, certain amendments relating to the macroeconomic adjustment programmes could be more significant. Member states asking for financial assistance will have to agree on a Memorandum of Understanding – drawn up outside the EU framework – and draft a Macroeconomic adjustment programme – which is now foreseen by secondary EU Law. The relationship between the two documents is still not totally clear, but what is certain is that they will coexist and they must be consistent with each other. Hence, it is likely that the guarantees brought to the Macroeconomic adjustment programme (involvement of social partners, taking account of national practices and institutions relating to the setting of wages, etc) will be reflected in the content of the Memorandum.

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45. Cf. ESM Treaty, art. 13.
3. Critical assessment

Like all measures concerning economic governance, the two pack has been fiercely criticised for being too ‘austerity-oriented’. Having described the main features of this new piece of legislation, it is worth examining whether this criticism is justified, and how much room for manoeuvre is left to member states to set their own policy priorities.

3.1 Austerity-oriented measures?

As described above, while monetary policy has been transferred to EU-level, the Union still has very limited competence over national economic policies, except as regards budgetary matters. Therefore one should not ask the two pack or other governance provisions to achieve what current EU law cannot deliver, that is to put the same emphasis on measures concerning growth, employment or social issues as it does on budgetary measures.

The regulation on budgetary plans, unsurprisingly, reflects this ‘physiological’ asymmetry: the ex-post surveillance of national budgets and the strengthening of the Excessive Deficit Procedure are rules pertaining to fiscal discipline, the only area in which the EU has binding powers.

That was precisely the most important criticism from the left-wing parliamentary groups of the European Parliament. Hence, their main aim has been to provide a counterbalance to the original draft – albeit with limited success, as has been explained.

Having said that, once the legal framework has been put in place, there is still room for policy choices by the EU institutions. In this respect, the Annual Growth Survey (AGS) is of major importance as it sets the annual priorities which will be later translated into country-specific recommendations. The 2013 AGS takes a clear stance, setting budgetary adjustment as its first priority: ‘Fiscal consolidation may have a negative impact on growth in the short term (...) the alternative scenario of postponing fiscal adjustment would prove much more costly’ (European Commission 2012a: 3-4).
One should not think that this is the only possible course of action. Indeed, the fiscal rules which must be respected by EU member states offer a degree of flexibility, which can be used depending on the political will of the Commission or the Council.

The launching of an Excessive Deficit Procedure, for instance, must take into account ‘exceptional circumstances’ defined as the result of ‘an unusual event outside the control of the member states’. Similarly, once this procedure has been launched, additional time can still be granted to correct the deficit in case of ‘unexpected adverse economic events with major unfavourable consequences for government finances’, and the same mitigating factor will be considered when deciding whether to permit a deviation from a member state’s medium-term objective under the TSCG. In a word, there is still room for political bargaining, as recently shown in the cases of Spain, France, the Netherlands, Poland and Portugal, in which cases the Commission has suggested extending the deadline for correcting the excessive deficit (European Commission 2013c).

It is still unclear whether the regulation on strengthened surveillance will allow the same political discretion.

One of the goals of the regulation is to bring the conditionality attached to financial assistance, granted outside the framework of the Treaties, into line with EU provisions, and to enshrine this conditionality in EU law. So far, conditionality understood as fiscal consolidation has been the way to reconcile the granting of financial assistance with the no bail-out clause (Art. 125 TFEU). This reasoning has been supported by the Court of Justice in Pringle, which examines the compatibility of the ESM Treaty with Article 125 TFEU. ‘The aim of Article 125 TFEU, says the Court, is to ensure that the member states follow a sound budgetary policy’, as their borrowing costs are only determined by the logic of the market. Hence, financial assistance is forbidden when ‘the incentive of the recipient member state to conduct a sound budgetary policy is diminished’. Therefore, Article 125 TFEU does not prohibit the granting of financial assistance, as long as the member state receiving assistance remains responsible for its commitments to its creditors and provided that the conditions attached to the assistance are such as to prompt that member state to implement a sound budgetary policy.
That is why, in all countries under financial assistance, conditionality includes large-scale fiscal consolidation programmes.

As shown above, the amended version of the regulation on strengthened surveillance may offer certain guarantees for member states drafting macro-economic adjustment programmes in order to receive financial assistance (the programmes shall ensure sufficient means for education and healthcare; social partners and civil society organisations will be involved; etc.) but these will hardly overturn the conditionality’s *raison d’être*.

### 3.2 How much room for manoeuvre for member states?

In this framework, member states’ room for manoeuvre is directly proportional to their economic health, or more precisely to their respect of certain criteria such as their public debt and deficit ratios, and several other indicators used to detect macroeconomic imbalances.\(^{53}\) In a normal situation, i.e. when all these parameters are respected, they enjoy maximum latitude. However, non-compliance triggers corrective mechanisms which gradually reduce member states’ leeway (figure 3). How does the two pack modify this situation?

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\(^{53}\) See Reg. 1176/2011, art. 4; and European Commission (2012d).
A member state fulfilling all the requirements shall report in April, in the framework of the European Semester, and then implement the recommendations received at the end of the surveillance cycle. The two pack adds further reporting requirements in April and October each year. The latter (draft budgetary plan) is particularly important as it is the basis for a Commission opinion, which must be taken into account when preparing its budget for the next year.

Whatever one may think of the moment chosen for the Commission’s intervention, its opinion should in theory only give an indication of the consistency of national budgets with the recommendations received in June/July. With one major difference: the Commission is no longer examining a multiannual programme, as was the case for the Stability/Convergence Programme or the National Reform Programme submitted early in the year, but a very precise yearly document, containing detailed indications on government revenue and expenditure broken down by function (education, healthcare, employment, etc.). One may wonder whether the Commission will assess only the respect of budgetary objectives, or even the way in which member states plan to reach these objectives. In other words: to what extent will the Commission have a say on resource allocation between different functions, therefore interfering with national (not strictly budgetary) policy choices?

This opinion will, in any case, most probably have a relatively low impact as long as a member state respects the main indicators cited above. However, this might not be the case if it is at risk of an Excessive Deficit Procedure. As clearly stated in the regulation on budgetary plans, ‘the extent to which the member state concerned has taken into account the Commission’s opinion’ shall have an impact on the decision as to whether to make a member state subject to an EDP, or even to impose a fine. Hence, the worse the member state’s economic situation, the more binding will be the Commission’s opinion.

A member state which is subject to an Excessive Deficit Procedure must, according to the normal semester requirements, take action to bring its deficit under the 3% ceiling and report regularly to the Commission on the action taken. In cases of ineffective action, fines can be imposed at several stages of the procedure (see figure 2 above). The major innovation of the two pack, in addition to the extra reporting requirements and the possibility for the Commission to intervene earlier when there is a risk of non-compliance, is the obligation on member states to submit an economic partnership programme. The difference compared to the normal reporting foreseen

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54. Indeed although member states’ sovereignty as regards budgetary matters was already limited by the need to respect EU obligations, the Commission’s opinion intervenes at a crucial moment compared with the previous situation, when compliance with budgetary recommendations was controlled a posteriori. Given the importance of the budget approval for national parliaments, the Commission’s opinion could be seen as encroaching on national parliaments’ original function.

55. Reg. 473/2013, Art. 6(3). To be compared with the contents of the stability and convergence programmes, see Reg. 1466/97, art. 3; 7(2).


57. Reg. 473/2013, art. 9.
in cases of excessive deficit is that this document focuses on the structural reforms needed to ensure a lasting correction of the deficit. These will clearly coincide with those recommended at the end of the European Semester and in the November opinion on the draft budgetary plans.

A member state’s leeway is further reduced when the Commission decides to make it subject to enhanced surveillance. As seen above, this entails not only closer monitoring and tighter reporting requirements but also the obligation to adopt ‘measures aimed at addressing the sources or potential sources of difficulties’, taking into account all guidance received previously. Its fragile financial position and the will to avoid the next step will probably be decisive in the member state’s compliance.

Indeed, should these measures be considered insufficient, the Council can recommend it to seek financial assistance and may decide to make its recommendation public. However, as soon as this news becomes public, the markets will demand such high risk premiums that the member state concerned will have no choice but to seek financial assistance. 58

Once a member state requests financial assistance (reaching the bottom stage in figure 3 above), its room for manoeuvre is seriously limited: it is close to a ‘sub-sovereignty’ situation.

The financial assistance is provided in exchange for economic policies agreed on with its creditors, and is disbursed in several tranches. Whenever the member state does not comply with its commitments, the financial help is interrupted. To avoid a duplication of reporting obligations, all on-going surveillance procedures are suspended: the macroeconomic adjustment programme includes and develops all previous recommendations.

The point is that financial assistance granted in exchange for conditionality entails measures which go beyond purely budgetary matters and concern all areas of economic policy. 59 Now that this system has been embedded in EU Law, it remains to be seen how it will be made compatible with the sharing of competences foreseen by the Treaties. 60


60. Following the Court’s judgment in Pringle, according to which the conditionality prescribed in exchange for financial assistance ‘is not an instrument of coordination’ (para 111), the recitals of the two pack seem to suggest Article 121 TFEU as a legal basis for the Council’s power to adopt macroeconomic adjustment programmes. See de Witte and Beukers (2013) 837.
Conclusion

The European Parliament had rightly noticed the importance of this new piece of legislation. The two regulations extend the European Semester beyond the publication of country-specific recommendations in June/July; they reinforce the monitoring of member states under the Excessive Deficit Procedure; and they introduce a new surveillance procedure for member states facing financial difficulties, which is proportional to the gravity of the country’s situation.

The particularly long legislative process managed to bring more openness and transparency to the new mechanisms. Also, the social guarantees attached to the drafting of macroeconomic adjustment programmes could prove very beneficial for member states requesting financial assistance. What is certain, however, is that the objective of counterbalancing the initial proposals with provisions focusing on growth is far from having been reached.

When assessing the two pack by measuring its contribution to ‘austerity policies’, one should take into account two factors. Firstly, the legal framework in which these regulations were developed cannot be ignored. This may help to explain the imbalance between budgetary and growth objectives, or the strong link between conditions attached to financial help and budgetary consolidation. Secondly, there is, even so, still room for political choices by the EU institutions, meaning that the course of action currently followed is not the only possible one. As to the member states, their room for manoeuvre is directly proportional to their economic health.

Both regulations entered into force on 30 May 2013. Euro area member states must adapt their national budgetary process to the common budgetary timeline this year, and submit their first draft budgetary plans by 31 October. Euro area member states subject to an Excessive Deficit Procedure at the time of the entry into force of these regulations shall also submit their first periodical report by this date and then every six or three months. Only one of them – Belgium – could also have to draft an economic partnership programme. Ireland, Portugal, Greece, and Cyprus, which are subject to financial assistance programmes, are formally exempted from excessive deficit reporting.

61. i.e. 12 out of 17 Euro area member states, namely Austria, Belgium, Cyprus, France, Greece, Ireland, Italy, The Netherlands, Portugal, Slovenia, Slovakia and Spain.
The following months will probably bring an answer to many of the questions left open by this short analysis. These include the following:

How will the Commission interpret its new power to give an opinion on member states’ draft budgetary plans? How deep an assessment will it give of national policy choices on resource allocation or how far will it push the limits of its budgetary competence?

The two pack takes up provisions from two international treaties, namely the TSCG and the ESM Treaty. Will this situation provide more clarity and legal certainty or the opposite?

To what extent will the regulation on enhanced surveillance modify the functioning and the contents of the conditional assistance granted by European bail-out funds? Does it open a new route for challenging macroeconomic adjustment programmes before the Court of Justice?
Bibliography

Annex: Amendments to the Commission's proposal

Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of member states in the euro area experiencing or threatened with serious difficulties with respect to their financial stability

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### Growth, Europe 2020

| Rec. 4 | Macroeconomic adjustment programmes shall be consistent with national reform programmes in the context of the Europe 2020 strategy. |
| / | Abrogation of former recital 7 concerning the suspension of certain EU funds in case of non-compliance with macroeconomic adjustment programmes. |
| Art. 19c | By 1 January 2014, the EC shall publish a report on the application of this regulation, which includes an assessment of its contribution to the achievement of Europe 2020. |
| Art. 3(1) | Member states under enhanced surveillance shall adopt measures in line with the recommendations addressed to them concerning their (SCP and) NRP. |
| Art. 7(1) | The draft macroeconomic adjustment programme shall take into account the national reform programme of the member state concerned. |

### Social rights

| Rec. 2 | Reference to art. 9 TFEU: social objectives must underpin every Union’s policy. |
| Rec. 11 | Member states should involve social partners and civil society in every step of financial assistance programmes. |
| Art. 1(4) | The regulation shall take into account the role of social partners and the right to collective bargaining and action. |
| Art. 7(1) | The draft macroeconomic adjustment programme shall take into account the practices and institutions of wage formation of the member state concerned. |
| Art. 8 | Member states shall seek the views of social partners and civil society organisations when preparing a macroeconomic adjustment programme. |
| Art. 7(7) | Macroeconomic adjustment programmes shall take into account the need to ensure sufficient means for fundamental policies such as education and healthcare. |

### Various

| Art. 9 | Member states shall take measures aiming to reinforce the efficiency of tax collection and fight against tax fraud and tax evasion. |
| Art. 14(1) | The extension of the duration of the post-programme surveillance is adopted by reversed qualified majority voting in the Council. |
| Art. 14(4) | The recommendations of corrective measures to a member state under post-programme surveillance are adopted by reversed qualified majority voting in the Council. |
| Art. 1(1)a, 2(1), 3(6), 7(5) | Closer attention is paid to spill-over effects. |

### Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the member states in the euro area

#### Transparency, publicity

<p>| Art. 7(2) | The Commission shall motivate its request to submit a revised draft budgetary plan. |
| Art. 5(2) | The public bodies shall provide public assessments with respect to national fiscal rules. |
| Art. 7(3) | The Commission must present its opinion on member states’ draft budgetary plans to the European Parliament upon request. |
| Art. 7(4) | The Commission shall make explicit the methodology (including economic models) of its forecasts. |</p>
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