EU Regulation

MONITORING OF BUDGET POLICY AND STRENGTHENING THE DEFICIT PROCEDURE

cep Centrum für Europäische Politik

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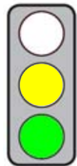
KEY ISSUES

Objective of the Regulation: The Commission intends to intensify the surveillance of national EU budget policy and to develop the deficit procedure.

Parties affected: All euro states.



Pros: (1) The requirement that euro states must use independent macroeconomic forecasts during budget planning prevents the circumvention of the stability rules by means of creative accounting.

(2) The Commission's right to monitor the due implementation of a Council recommendation to reduce deficits is reasonable, but it will only take full effect where the Council is actually willing to impose the financial sanctions provided for by the deficit procedure; it is questionable whether this will happen.

Cons: The obligation of euro states to transpose European budget rules into national law transcends – irrespective of their economic appropriateness – the competency of the EU to monitor budgetary discipline.

CONTENT

Title

Proposal COM(2011) 821 of 23 November 2011 for a **Regulation** of the European Parliament and the Council **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

Brief Summary

- **Background and target**

  The Commission wishes to intensify budgetary surveillance in euro states by complementing the Stability and Growth Pact [in particular Regulations (EC) No. 1466/97, 1467/97 and 1173/2011] with additional provisions. The additional provisions are to:
  – recover the confidence of capital markets in financially instable euro states;
  – avoid future debt crises and
  – eliminate the concerns of several States regarding eurobonds.

- **Publication of national budgetary plans**
  – By the 15 April of every year, euro states must publish their national budgetary plans for the three years that follow ("medium-term budgetary framework") [Art. 3 (1) in conjunction with Art. 9 (1) Directive 2011/85/EU)].
  – These plans must be based on "independent macroeconomic forecasts" [Art. 3 (1)].
  Macroeconomic forecasts are estimations of the future development of macroeconomic figures, such as economic growth and unemployment.
  – The national budgetary plans must be in line with the figures in the Stability Programme [Art. 3 (1)].
  The "Stability Programmes" (Art. 3 et sqq. Regulation (EC) No. 1466/97) are part of the budgetary policy surveillance within the framework of the Stability and Growth Pact. Euro states are obliged to submit such programmes annually no later than April. Therein they must present the national budgetary plans of the subsequent three years. The Commission and the Council will review the Stability Programmes. If a programme is not in line with the requirements of the Stability and Growth Pact, the Council "recommends" that the euro state concerned revises it [Art. 5 Regulation (EC) No. 1466/97].

- **Publication of national draft budget laws and the "draft budgetary plan"**
  – Euro states must publish annually and by 15 October at the latest:
    - the drafts of national budget laws and the macroeconomic forecast on which they are based [Art. 3 (2)] and
    - the "draft budgetary plan" [Art. 5 (1)].
  – The *draft budgetary plan* is to contain updated information [Art. 5 (3)] on the "Stability Programme" already submitted in April. Any deviations from the "Stability Programme" must be explained [Art. 5 (4)].
  – The *draft budgetary plan* is also to set out how the Council Recommendation to revise the Stability Programme is to be transposed into national law (Art. 121 TFEU).

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- In the case of "particularly serious non-compliance" of the *draft budgetary plan* with the budgetary policy obligations laid down in the Stability and Growth Pact, the Commission shall "request" a revision of the plan [Art. 5 (5)].
  - Where the *draft budgetary plan* continues to infringe the obligations laid down in the Stability and Growth Pact, even after the request for revision, the Commission make a statement as to the *draft budgetary plan* [Art. 6 (1)].
  - Where the *draft budgetary plan* continues to infringe the obligations laid down in the Stability and Growth Pact, even after the Commission has issued its statement [Art. 9 (1)], the Council is to "take this into account" when deciding:
    - whether or not a deficit procedure is opened (Art. 126 (6) TFEU) and
    - whether or not the opening of a deficit procedure is related to a non-interest-bearing deposit [Art. 5 Regulation (EU) No. 1173/2011].
- The euro states adopt and publish their budgetary rules for the subsequent year annually by 31 December at the latest [Art. 3 (3)].

► **Implementation of European budgetary rules in national law**
The euro states must stipulate compliance with their "medium-term budgetary objective" in their national law, "preferably" in their constitutions [Art. 4 (1)].
The "medium-term budgetary objective" is a budgetary policy obligation laid down in the Stability and Growth Pact, according to which, the deficit in cyclically adjusted terms, net of one-off and temporary measures must not exceed 1% of GDP (Art. 2a Regulation (EC) No. 1466/97, cp. CEP Analysis).

► **Additional reporting obligations in the deficit procedure ("Closer Monitoring")**
- Euro states which are subject to a deficit procedure (Art. 126 (6) TFEU) must provide the following additional information to the Commission [Art. 7 (3)]:
  - a "comprehensive assessment" of the in-year budgetary execution for the general government and its sub-sectors;
  - the budgetary impact of the in-year expenditure and revenues decisions which were discretionary, i.e. not statutorily required;
  - the target values of the expenditures and revenues; and
  - the adopted and envisaged measures for achieving said targets.
- Euro states which have received a Council recommendation to reduce their excessive deficits (Art. 126 (7) TFEU) must report on a half-yearly basis [Art. 7 (4)]. The first report must also contain the "financial risks" resulting from government-owned entities and government contracts [Art. 7 (2)].
- Euro states which fail to fully comply with the first Council recommendation ("notice of default", Art. 126 (9) TFEU) must report on a quarterly basis [Art. 7 (5)]. They must also set out whether and how they have implemented the Council Recommendation.
- The Commission may oblige euro states to (Art. 7 (6) lit. a and b):
  - "in coordination" with national supreme audit institutions (for Germany: *Bundesgerichtshof*) carry out an "independent audit" of the national accounts of the general government assessing their "reliability, completeness and accuracy"; and
  - provide "additional information" for the purpose of monitoring the progress of reducing the excessive deficit.

► **Impact on euro states at risk of non-compliance with their obligation to implement the Council Recommendation**
- On the basis of the information provided, the Commission assesses whether or not a due implementation of the Council Recommendation to reduce excessive deficits is at risk [Art. 8 (1)].
- Where the Commission finds that a due implementation of the Council Recommendation to reduce an excessive deficit is at risk, it makes a recommendation to the euro state concerned. Therein it requests the euro state to adopt further measures to achieve an implementation in due time [Art. 8 (2)].
- The Commission's recommendation is published [Art. 8 (2)].
- The Commission assesses whether a euro state has complied with the Commission recommendation [Art. 8 (5)]. It takes this into account when assessing whether a euro state has succeeded in implementing a Council Recommendation to reduce excessive deficit [Art. 9 (3)].
- Where the Commission finds that a euro state has failed to implement the Council Recommendation [Art. 9 (3)], the Council may impose sanctions [Art. 6 Regulation (EU) No. 1173/2011 on the effective enforcement of budgetary surveillance in the euro area].

Statement on Subsidiarity by the Commission

The Commission does not address the issue of subsidiarity.

Policy Context

The Regulation Proposal is part of a legislative package by the Commission on improved growth, economic policy governance and stability in the euro area. This also includes a Regulation Proposal on measures for financially instable euro states [COM(2011) 819; see CEP Policy Brief], the annual growth report 2012 [COM(2011) 815] and a Green Paper on eurobonds [COM(2011) 818; see CEP Policy Brief]. The two Regulation Proposals ("two-pack") are follow-ups of the "six-pack" [Regulations (EU) Nos. 1173/2011, 1174/2011, 1175/2011, 1176/2011, 1177/2011; Directive 2011/85/EU] on the reform of the Stability and Growth Pact (see CEP Analysis).
The incorporation of a "medium-term budgetary objective" in national law as already agreed upon in the Fiscal Pact (Art. 3 of the draft) is to be also established under EU law by the Regulation.

Legislative Procedure

23 November 2011	Adoption by Commission
30 November 2011	Debate in the Council
11 June 2012	1st Hearing in the European Parliament

Options for Influencing the Political Process

Leading Directorate General:	DG Economic and Financial Affairs
Committees of the European Parliament:	Economic and Monetary Affairs (leading), rapporteur: Elisa Ferreira (S&D Group, PT);
Committees of the German Bundestag:	Budget (leading), Committee for Affairs of the European Union, Finance Committee
Decision mode in the Council :	Qualified majority (only euro states have the right to vote, Art. 136 (2) TFEU)

Formalities

Legislative competency:	Art. 136 in conjunction with Art. 121 (6) TFEU (budgetary discipline and coordination of economic policies)
Form of legislative competency:	Coordination of economic policies (Art. 5 (1) TFEU)
Legislative procedure:	Art. 294 TFEU (ordinary legislative procedure)

ASSESSMENT

Economic Impact Assessment

Ordoliberal Assessment

Amongst other things, the aim of the Regulation is to ensure that the obligations stipulated under the Stability and Growth pact are taken into account already in the planning of national budgets. It is, however, questionable whether this can be achieved through a publication of the budgets in mid-April. Euro states must anyway present their budgets in Stability Programmes and convey them to the Commission in April. The Commission publishes them and assesses whether they are in line with the rules of the Stability and Growth Pact. An additional national publication does not create any added value.
Macro-economic forecasts, in particular for economic growth, have a strong impact on the budgetary deficit within the framework of the Stability and Growth Pact: Where a euro state expects high economic growth, this gives it more financial leeway, since increased growth increases tax revenues. In previous years, several Member States have deliberately assumed overly optimistic forecasts. Thus the obligations laid down in the Stability and Growth Pact were formally complied with in planning national budgets, but in fact the actual budgetary deficit was too high. **The rule to use independent forecasts in budget planning** eliminates this loophole and thus **impedes the circumvention of stability rules by means of creative accounting**.
The obligation to publish budget drafts and the *draft budgetary plan* in October enables the Commission to assess the degree to which euro states comply with the rules of the Stability and Growth Pact.
In the case of "particularly serious non-compliance" of the *draft budgetary plan* with the rules of the Stability and Growth Pact, the Commission asks the euro state concerned to revise the planning. However, whether or not the euro states follow such a request from the Commission strongly depends on whether the Council will be willing in future to sanction infringements of the Stability and Growth Pact.
The Council's blocking power laid down under primary law raises concerns that in future euro states might – as was the case in the past – prevent sanctions from being imposed through political bartering in the Council (cp. CEP Analysis). In order to prevent this, the TFEU would have to be amended. To date, Member States have not been willing to do so.
Moreover, the obligation to publish the draft budget act ensures that the draft sent to the Commission which is discussed in the national parliament is identical.
The new reporting requirements enable the Commission to identify at an earlier stage a euro state's non-compliance with the Council Recommendation to reduce excessive deficits.

The euro states' obligation to lay down the medium-term budget objective of not exceeding the public deficit of 1% of the GDP even reinforces the inadequate measures regarding excessive state deficits. A strict compliance could, however, fail, due to the fact that the medium-term objective approach is to complex, difficult to understand and open to different interpretations: it is based on a structural deficit, i.e. in cyclically adjusted terms, net of one-off measures and moreover depends on the potential growth of the euro state concerned.

The Commission's right to monitor the due implementation of a Council Recommendation to reduce the deficit can strengthen budgetary discipline. However**, it will only take full effect if the Council is really willing to impose the financial sanctions** proposed by the deficit procedure. **It is questionable whether this might happen**.

Legal Assessment

Competency

The EU may adopt measures aimed at reinforcing the coordination and monitoring of the budgetary discipline of euro states (Art. 136 TFEU). Moreover, it may coordinate, monitor and evaluate the economic policies of all Member States and deliver country-specific recommendations (Art. 121 TFEU). The proposed new reporting obligation of euro states and the surveillance powers of the Commission are parts thereof.

EU competency to monitor the budgetary discipline of euro states (Art. 136 TFEU) **does not – irrespective of its economic appropriateness – comprise the right to oblige euro states to transpose European budget requirements** in the form of compliance with the "medium-term budgetary objective" **in national law** [Art. 4 (1)]. For Art. 136 TFEU has a very limited scope: it empowers the EU to adopt special rules for euro states within the scope of Art. 121 TFEU (coordination of economic policies) and Art. 126 TFEU (procedure in the case of excessive deficits). However, neither Art. 121 TFEU nor Art. 126 TFEU provides for a provision that obliges Member States to comply with national budgetary rules. As the primary law does not contain any power to prescribe legally binding budget rules to Member States, this cannot be achieved for euro states through Art. 136 TFEU either. The provision of Art. 4 (1) can be based at most on the rounding competency of Art. 352 TFEU, which is, however, subject to unanimity in the Council.

With regard to the Fiscal Pact, a similar wording is used to that found in Art. 4 (1), but here the competency problem is not at stake.

Subsidiarity

As the proposed measures are based on a non-exclusive competency (see CEP Policy Brief), they must be compatible with the principle of subsidiarity (Art. 5 (3) TEC). For an individual euro state, a lackadaisical budget policy might make sense, but from a European point of view, it is harmful. Budgetary self-control therefore does not suffice, as has been demonstrated in the past. A stricter surveillance of euro states at EU level, as proposed by the Regulation, is unproblematic in terms of subsidiarity.

Proportionality

The measures to strengthen budgetary policy surveillance are necessary in order to identify any non-compliance of euro states with the rules of the Stability and Growth Pact at an early stage.

Compatibility with EU Law

Unproblematic apart from the incompatibility of Art. 4 (1) with the competency basis (see competency).

Compatibility with German Law

Unproblematic.

Conclusion

The rule that euro states must use independent economic forecasts prevents euro states from circumventing the stability rules by means of creative accounting. The Commission's right to monitor the due implementation of a Council recommendation to reduce deficits is reasonable, but it will only take full effect if the Council is really willing to impose the financial sanctions provided for by the deficit procedure. The proposed obligation of euro states to transpose European budget rules into their binding national laws transcends – irrespective of their economic appropriateness – the competency of the EU to monitor budgetary discipline (Art. 136 TFEU) and therefore constitutes an infringement of competency.

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