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**European Fiscal Compact as a spur for governments
to maintain sound and sustainable public finances.**

Talking about the economic crisis in Europe, the so called ‘European sovereign debt crisis’ (also referred as the Eurozone crisis) is an ongoing problem which most Member States of the European Union (further referred as the EU) have been dealing with. Resulted from a combination of complex factors, it is claimed that the landmark – apart from easy credit conditions in a period of 2002–2008 that encouraged high-risk lending and borrowing practices – was the monetary union among the Eurozone without the fiscal one.¹ While the setting of central bank interest rates and monetary easing was determined by the European Central Bank, taxation and government spending remained mostly under the control of national governments. Despite the fact that in 1992 Members of the EU signed the Maastricht Treaty pledging to limit their deficit spending and debt levels, the very idea to let the EU coordinate the fiscal policies of Member States conceived in the late 1990s. Notwithstanding, the Stability and Growth Pact² – an agreement reached in order to facilitate and maintain the stability of the Economic and Monetary Union (EMU), has occurred to be unenforceable instrument and has not prevented the financial crisis among the Eurozone. What was said to cure the crisis, was – according to the abovementioned - the stricter fiscal regulation. This paper intends to shed some light on the issue.

Background.

It was in 2007 when the idea of fiscal union – in order to ensure prudent fiscal policies across all Member States – was proposed.³ It was regarded as a natural step towards European integration (leading to complete economic union). In 2010 such an action of legislative nature was the solution to European sovereign debt crisis that many prescribed as a necessary one.⁴

Since 2010 numerous proposals to reform rules of the Stability and Growth Pact (in such a way as to make fiscal policy coordination stronger) were put forward. Presented by the EU Commission, the so-called ‘Six-pack’ contained legislative proposals on economic governance related to regulations and guidelines for both the fiscal policy and the macroeconomic imbalances. Subsequent to acceptance

¹ See: M. Ziemba, *Kryzys w strefie euro – geneza zjawiska*, „Zarządzanie i Finanse”, no 4/12, 2012.

² Based primarily on Articles 121 and 126 of the Treaty on the Functioning of the EU. See: Resolution of the European Council on the Stability and Growth Pact". Eur-Lex.europa. 17.06.1997.

³ J.C. Trichet (23.10.2007), *Building Europe in a globalised world*, European Central Bank.

⁴ S. Hamilton (12.05.2010), *King Says Crisis Shows It's 'Very Clear' That Euro Area Needs Fiscal Union*, “Bloomberg”.

made by the European Parliament on the 28th of September 2011, Member States have adopted six legal acts. Those are:

- (1) Regulation of the European Parliament and the Council amending Regulation (EC) No 1466/97 on the strengthening of budgetary surveillance and coordination of economic policies,
- (2) Council Regulation amending Regulation (EC) No 1467/97 regarding speeding up and clarifying the implementation of the excessive deficit,
- (3) Regulation of the European Parliament and Council Directive on the effective enforcement of budgetary surveillance in the euro area,
- (4) Directive of the Council on the requirements for the fiscal framework of the Member States,
- (5) Regulation of the European Parliament and of the Council on the prevention and correction of macroeconomic imbalances and
- (6) Regulation of the European Parliament and of the Council on enforcement action to correct excessive macroeconomic imbalances in the euro area.

Apart from above, in the end of 2011, the creation of a fiscal union across the Eurozone was vowed by a few countries, especially France and Germany. Such an union was said to contain strict and enforceable fiscal rules and automatic penalties embedded in the EU treaties.⁵ German chancellor – Angela Merkel – also took the view that the European Commission and the Court of Justice of the EU should act as a supervisory authority playing a significant role in ensuring that countries fulfil their obligations.⁶

At the European Council meeting in December 2011 the basic outlines of a new intergovernmental treaty were accepted by all Eurozone countries. Although there was a plan to change the whole existing European Union treaties – in order to impose new fiscal policy, it was blocked by the Great Britain.⁷

Nevertheless, at the European summit in Brussels, after several weeks of negotiations, on 30th of January 2012, European Union leaders (except from those from United Kingdom and Czech Republic) endorsed the final version of The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, known as the Fiscal Compact (further referred as the FC or the Treaty).

Signed on the 2nd of March 2012, the Treaty came into force on the 1st of January 2013, after having been ratified by 12 countries using euro as a currency. While the Treaty was left open to accession by any Member State, above cited condition was met when Finland has submitted its instrument of ratification on the 21st of December 2012.⁸ After ratification of the Treaty, a Signatory

⁵ H. Pidd (2.12.2011), *Angela Merkel vows to create 'fiscal union' across eurozone*, "London: Guardian".

⁶ *Ibidem*.

⁷ The British prime minister demanded the City of London to be excluded from future financial regulations, including the proposed EU financial transaction tax. See: A. Faiola (9.12.2011), *23 European Union leaders agree to fiscal curbs, but Britain blocks broad deal*, "Washington Post".

⁸ See: *'Fiscal compact' entered into force on 1 January 2013.*, website of european-council.europa.eu. 1.01.2013.

State is said to have another year, until the 1st of January 2014, to implement a balanced budget rule in their binding legislation.

Although the FC is not a formal part of the EU law, the idea to incorporate it as soon as possible into the existing European Union treaties is contractual. The necessary steps should be taken within next five years.⁹

Content.

The FC does not include self-exercising provisions. Quite the opposite, it imposes on the contracting states obligation to apply the rules that are contained in the Treaty. First and in the same time the most important rule is to keep in balance or even in surplus the budgetary position of a Contracting Party. To assure the common usage of the Treaty, there is a legal definition of the abovementioned condition – the budget is considered to be in balance when a country comply with its country-specific medium-term objective, as defined in the revised Stability and Growth Pact with the restrictions that structural deficit of a country should be lower than 0,5% of the gross domestic product at market prices. What is of vital importance at this point, the European Commission has been empowered to evaluate such convergence, taking into consideration country-specific sustainability risks.

According to the article 3.2 all abovementioned rules should be adopted in the Member States within a year since the Treaty enters into force. The implementation of the provisions should be conducted by means of legal acts of binding force and permanent character, preferably constitutional or otherwise guaranteed to be fully respected and adhered to the national budgetary processes.

The Treaty stipulates also an obligation for the Contracting Parties to create a special procedure in case when not all rules are appropriately performed (so called correction mechanism). In the event of significant observed deviations from the medium-term objective or the adjustment path towards it, this mechanism is deemed to be triggered automatically. As is commonly known, the main reason for the excessive debts of the governments is boundless issuance of the financial instruments (mainly bonds). To protect the countries from themselves, the Treaty according to the article 6 imposes on them an obligation to report ex ante on their public debt issuance plans to the Council of the EU and to the European Commission. This measure is considered to enhance coordination of the planning of future debt issuance and to enable to rethink the matter. As a result, according to the article 1.1, such regulation should foster the budgetary discipline. Worth-mentioning is that this obligation is stipulated without consequence for the Contracting Parties (*lex imperfecta*). On the other hand, the Council of the EU cannot oppose to the decision of a particular country and its prerogative is just of the informational nature.

⁹*Ibidem.*

According to the article 8, the European Commission is invited to present in due time to the Contracting Parties a report on provisions adopted by each of them and in due time. If the European Commission, after having given the Contracting Party concerned the opportunity to submit its observations concludes in its report that such Contracting Party has failed to comply with the rules or that it is in delay with its implementation, the matter will be brought to the Court of Justice of the EU by one or more Contracting Parties. Where a Contracting Party considers, independently of the Commission's report, that another Contracting has fail to implement the rules in due time, it may also bring the matter to the Court of Justice. In both cases, the judgement of the Court of Justice is binding on the parties to the proceedings. The Contracting Party should take necessary measures to comply with the judgement within the period determined by the Court of Justice.

Where, on the basis of its own assessment or that of the European Commission, a Contracting Party considers that another Contracting Party has not taken the necessary measures to comply with the abovementioned judgement of the Court of Justice, it may bring the case before the Court of Justice and request the imposition of financial sanctions due to article 260 of the Treaty on the Functioning of the EU. If the Court of Justice finds that the Contracting Party concerned has not complied with its judgement, it may impose on it a lump sum or a penalty payment appropriate in the circumstances that should not exceed 0,1 % of its gross domestic product. The amounts imposed on a Contracting Party whose currency is the euro should be payable to the European Stability Mechanism. In other cases, payments should be made to the general budget of the EU.

Heads of the Member States of the euro area meet at least twice a year for the so-called summit of the Euro zone, which also involves the European Commission and the President of the European Central Bank. As far as polish perspective is concerned, it is of great importance to stress, that when appropriate and at least once a year, leaders of the States from outside the Eurozone, which have ratified the Treaty, are entitled to participate in the summits. According to the article 12, the monetary competence of the summit is not binding hence it may only result in non-binding suggestions and conclusions. It can therefore be concluded that monetary policy in the sphere of competence covered by the EU (both no exclusive and exclusive) the Fiscal Compact does not affect the competence of EU and is compatible with European Union law.¹⁰

It is also worth mentioning, the European Parliament and the national Parliaments of the participating Member States shall cooperate in the field of budgetary policies and other matters covered by the Treaty. For this purpose, they will establish a body of representatives from the relevant committee of the European Parliament and the national parliaments. This authority will decide on its own structure.

¹⁰ See: C. Mik, *Opinia w sprawie zgodności tzw. traktatu fiskalnego z prawem Unii Europejskiej oraz trybu jego ratyfikacji*, „Zeszyty prawnicze” no 1(33) 2012, p. 87.

Evaluation.

The FC is an international agreement concluded between the majority of European Union Members. As the Lisbon Reform Treaty principle eliminated the international agreements between the Member States from the catalogue of integration measures, thus, provided for by the Treaty on the Functioning of the EU (further referred as TFEU), it is without binding force. the EU because. Therefore, the FC should be regarded as a spontaneous agreement between the parties. Simultaneously, as it has been mentioned before, the FC's preamble states the intention of the parties to incorporate its provisions to the founding treaties of EU as soon as possible. Many lawyers state, that all fiscal proposals included in the Treaty were covered in the form of an international agreement because of one simple reason: there are reasonable doubts whether these regulations are in compliance with the EU law. Particularly, many experts indicate that provisions of the Treaty contain more stringent solutions than those in the TFEU, because they introduce constraints not included in the FC (article 3 and 7).¹¹ Subsequently, admission to the entry into force of the Treaty only in the fiscal relations between 12 contracting parties (Article 14 p. 2) is also arguable. All these doubts and the circumstances of the Treaty's conclusion indicate, that this international agreement possesses a specific and relevant position in the history of European integration.

Many politicians indicate, that since Poland is not a member of the Eurozone, it should not ratify the Treaty. They state (which is true), that this agreement was intended to implement fiscal solutions in regard to the countries which use Euro as their currency. In their opinion, Treaty (above all the procedures of control) breaches fundamental constitutional principles i.e. the competences of parliament and government regarding the implementation of budget and its control. Some experts also emphasize, that the budget act is an important, fundamental political and economic act of the polish parliament and the transfer of decision-making powers on the outside violates important verdicts of Constitutional Court. In the most radical statements, opposition politicians suggest that the Fiscal Compact substantially breaches polish fiscal independence. Therefore, the Treaty was recently a subject of a complaint to the polish Constitutional Court.

According to the article 14 p. 3 this Treaty shall apply from the date of entry into force to the Contracting Parties whose currency is the euro. Treaty states explicitly: it applies only to the countries – Members of the Eurozone. Rights of the countries, which are simultaneously parties of this agreement but do not belong to the euro zone, are exhaustively listed in article 12 p. 3 which provides them with the abovementioned possibility to participate in the Euro zone summit.

Therefore, as long as Poland is not a member of the Eurozone, the Fiscal Compact cannot be viewed as unconstitutional since it does not impose any obligation. It may certainly become more controversial at the time of polish access to the euro zone. Nevertheless, presently the FC gives Poland only a simple right to take part in the discussion during the informal summits of Eurozone countries.

¹¹ See: *Ibidem*, p. 98.

As far as political context is concerned, the ratification of this Treaty seems to be more attractive than refusal. It must be emphasized, that this agreement does not bind Poland to implement Euro as its currency in any way. This decision still depends on the independent authority of the parliament. Concurrently, it provides Polish Prime Minister with a right to participate in the meetings, which will be certainly of vital importance for the future of the entire European Union.

Many economists believe, that current crisis does not derive from the lack of financial (budgetary) discipline as it happened in Greece or Cyprus. They indicate, that budget deficits are in fact not the cause of the crisis, but its effect. The main causes are overly rigid labour market, lack of adequate supervision of credit in individual countries, the growing indebtedness of the private sector and the lack of a central bank that could buy government bonds during the panic. Some believe that countries should combat the crisis with efficient counter-cyclical fiscal policy. It means, that governments are to prevent indebtedness at the time of financial prosperity and to conduct liberal fiscal policy at the time of crisis. Therefore, according to their opinions, European Union shall not combat the crisis through the FC since it imposes a severe budgetary discipline. Consequently, these countries will be prohibited from taking a loan and it will inevitably result in further deterioration of the country economy. They emphasize that this is the nature of the market economy: circulation of money is necessary for its operation, expenditures result in revenues which in turn generate further expenditure. Therefore any break of this chain will beyond any doubt cause crisis and decline of national income.¹² Concluding, according to these perspective, countries should combat the crisis by providing economy with a substantial amount of money hence the Fiscal Compact is an inappropriate solution to the situation.

On the other hand, there are many economists who believe that the idea of the FC is adequate. They point out, that financial crisis may be overcome only if all countries of Eurozone will be bound to conduct strict fiscal policy. These experts believe, that wisely dispensed debt situation serves as a stabilizer and prohibits countries from the complete bankruptcy. In their opinion, it is the only way to restore appropriate condition of economy. Moreover, the Treaty will enable the EU to control countries which do not comply with fiscal discipline (i.e. falsify statistics) and consequently expose the entire Eurozone to the further risk of economy's deterioration. In their opinion, wealthier countries from the EU may support poorer countries only if they possess an appropriate mechanism of control which is provided by the Treaty.

The outcome of the FC is unpredictable. Undoubtedly it bears an idea that may result in healing the status of national budgets but no one can answer whether it manages to do so. What is certain is that for the Member States was advisable to take serious steps rather than sweep the Eurozone crisis under the carpet.

¹² J. Żyżyński, *Pakt fiskalny – siła nonsensu*, blog of Jerzy Żyżyński (Member of Polish Parliament): <http://jerzyzyzynski.info/category/aktualnosci/> (18.03.2013)