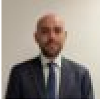
Strengthening Economic Protectionism in the Union

verfassungsblog.de/the-eu-fiscal-rules/



Marco Bevilacqua
06 May 2024

The Reform of the EU Fiscal Rules

The reform of European economic governance has been in the air for quite some time, but it was not until 2023 that the Commission put forward the most substantial development since the Maastricht Treaty. In April 2024, the European Parliament, along with the Council, approved all three legislative proposals. These measures strengthen European economic security by protecting the sustainability of the Union's debt. Without examining the legislations' details, this blog post reveals a propensity within EU economic governance towards neo-protectionism of the EU's financial interests. In particular, while this neo-protectionist leaning questions the relationship between the Union and the Member States, the transition (from the coordination to executive centralisation) strengthens the connection between the spending conditionality mechanism and the protection of the Union budget. In that way, the security of the Union's financial and economic interests is in turn strengthening the overall security and strategic autonomy of the EU.

The "breadcrumb trail" towards European economic security

In the last fifteen years, European economic governance has undergone many significant changes, including the widespread adoption of provisions which are directly applicable to Member States' legal systems, testifying to the priority within the EU to harmonise Member States' legislation in said area. If the Fiscal Compact of 2012 marked the end of the sovereign debt phenomenon, 2020 could be seen as the beginning of an era in which European public debt sustainability is of primary importance.

On 26 April 2023, the European Commission presented a new package of measures aimed at supplementing existing EU economic governance rules – and in particular at reforming the multilateral European budget – by repealing Council Regulation (EC) No. 1466/97 and amending Council Regulation (EC) No. 1467/97 (which regulate the Stability and Growth Pact mechanism) and Council Directive 2011/85/UE, of which only the former was agreed on by the Council and Parliament last February.

Almost exactly one year later, the European Parliament has just approved its own proposal under ordinary legislative procedure with some significant amendments, mostly with regard to the provisions that will replace Council Regulation (EC) No. 1466/97. Just a few days after the MEPs' vote, the Council also approved the package "in the wording which corresponds to the Parliament's position".

Compared to the proposed version of 2023, instead of debt sustainability, the European Parliament has decided to emphasise the importance of putting at the core of the economic governance framework sound and sustainable public finances and sustainable and inclusive growth (Recital 6 of the Regulation of 2024 that will repeal the one of 1997), in light of the equal treatment principle among Member States.

Moreover, the EP added some more recitals in order to clarify the connection between the coordination of domestic economic policies and the appropriate level of public investment (Recital 7). This linkage becomes more evident in light of the implementation of financing instruments such as the cohesion policy funds, which are crucial to achieving the main goal of reducing debt ratios and deficits laid down in the legislative package.

National plan governance for European budget sustainability

Let's take a deep dive into the package itself. Firstly, the previous version of Regulation (EU) No. 1466/97 only refers in general terms to monitoring of Member States' progress. On the contrary, the annexes to the aforementioned Regulation on monitoring mechanism will introduce specific provisions on the functioning of the "control account" corresponding to a debit record when "the actual net expenditure in the Member State in a given year is above the net expenditure path set by the Council". The implemented control system that will be applied to the national plans is strictly related to the consequent sanction mechanism – already provided for in the previous Regulation (EU) No. 1467/97 – which has been modified to impose fines to a limited extent (in particular, from 0,2% of National GDP to 0,05%). Even though this may appear to lessen the deterrence of sanctions on Member States, the philosophy of sound and prudent management is still implemented through instruments that discourage and impede a budgetary policy which risks excessively increasing public financial instability. For these reasons, these mechanisms are capable of taking precedence even in respect of other European regulations.

This reduction in the pressure of sanctions is accompanied by the introduction – in this regard, consider the amendments to Council Directive No. 2011/85/UE – of independent fiscal institutions established by national laws and entrusted with the task of overseeing, including *ex-post* evaluations, the macroeconomic and budgetary forecasts for annual and multiannual fiscal planning (Recital 12 of the approved EP text). As one can easily observe, the three legislations are deeply interconnected.

Said approach to the security and protection of the Union's financial interests and its budget acts in two ways. On the one hand, economic security is directly related to the application of the anti-corruption regulatory framework. On the other hand, the protection of the Union budget will continue to work by employing a top-down model based on tools to ensure debt sustainability, which is not so different from the mentioned preventive arm of SGP. Although national, medium-term fiscal-structural plans are framed as "the cornerstone of the economic governance framework of the Union" (Recital 10 of the EP's proposal), and the Commission is empowered "to ensure compliance" (Recital 12) with the provisions of the proposal that will repeal Regulation (UE) No. 1466/97. Moreover, Member States are explicitly required to bring their legal systems into line with the principles set out in Article 2 TEU, otherwise they will not be able, among other restrictions, to access the resources allocated by the Multiannual Financial Framework, as well as other funds (see Recital 7).

The package of fiscal measures under examination is the outcome of a process initiated in 2020 through the adoption of a specific regulation to ensure that domestic legal systems are brought into line with the principles and values expressed in Article 2 of TEU. In other words, it results from the positive experimentation that has occurred in the constancy of the approval of the Recovery and Resilience Facility (RRF) of 2021 and the relative national recovery and resilience plans (NRRPs). In this context, the European Commission is now evaluating the targets and milestones that each national policy maker intends to achieve within Member States' domestic economic and financial plans, in line with EU public debt management criteria. In this regard, Next Generation EU and REPowerEU plans imply a potential shift in the balance between the Commission and Member States through the standardization of national plans for budget provisions on reducing public debt levels.

With the expansion of the European Commission's spending powers, attributed to the enlargement of the Union budget established by the RRF, the need has emerged to ensure that "every euro and every cent is spent for its proper purpose and in line with the rule of law principles".

The approval of the new fiscal rules will entail the replacement of national budget laws with medium-term fiscal-structural plans covering a period of four or five years. The first versions of them should be prepared by September 2024. The additions of the MEPs to strengthen the principle of coordination between the European executive and the Member States within the public budget management will not be sufficient to undermine the power of review and control which the Commission will be able to exercise in the light of the recently approved package of fiscal rules.

In addition, the new measures will enable the Commission to introduce standard mechanisms to make national budgets accountable both *ex ante* and *ex post* during the European Semester. More specifically, the preventive arm of the Stability and Growth Pact will be replaced by a negotiated one-to-one mechanism between the Commission and the Member State to plan a spending programme in light of the expansion of EU competences,

as an expression of a potentially protectionist sentiment, especially in economic sectors. In this regard, the technical dialogue (Article 13 of the Regulation that will repeal No. 1466/97) is aimed at ensuring that the national medium-term fiscal-structural plan complies with the requirements for national medium-term fiscal-structural plans, such as the containment of net expenditure (Articles 13 and 15).

A keyword in this rather rapid evolutionary process is clearly *protection*, where national budgetary plans, placed within the EU budget, can be framed as European public goods and are protected from the threat to European economic security of domestic deficits.

The intertwined relationship between economic protection and economic security

Regulation (EU) No. 1466/1997 was amended in 2011 with specifications on the medium-term objective by Member States in their stability programmes, which "shall ensure the sustainability of public finances or a rapid progress towards such sustainability while allowing room for budgetary manoeuvre, considering in particular the need for public investment" (Article 2a of the consolidated version). This is about to change with the repealed Regulation of 2024 under the EP's version, because of the replacement of the SGP preventive arm with the "reference trajectory" which will be applied with the same thresholds as in the past (i.e. when national debt exceeds 60% of GDP or 3% of GDP with regards to deficit levels). In addition, in order to ensure and safeguard debt sustainability, the trajectory is no longer proposed by Member States but instead by the Commission itself as a tool to frame dialogue with Member States.

This centralisation of the source of executive coordination on the management of domestic public debt appears to make the connection between debt sustainability and economic protectionism more evident in order to secure the Union's financial interests. In this regard, security and protection aren't a dichotomy; they are complementary in helping the Commission bolster Europe's economic security capacity.

This could attest to the transition from the coordination approach, embedded in paragraph 3 of Article 2 TFEU, to the implementation of security policies easily extended to issues of protecting EU economic and financial interests. Moreover, this shift strengthens the connection between the above mentioned spending conditionality mechanism and the *protection* of the Union budget.

While the European Commission is currently trying to strengthen an independent economic position of the Union towards strategic autonomy (which might even be defined as economic sovereignty), remnants of internal conflicts between the EU and Member States still remain (e.g. the well-known decision of Karlsruhe's Constitutional Court on the Quantitative Easing mechanism).

It remains to be seen what impact the results of the upcoming EU Parliament elections will have on this process, but it would be highly challenging to deviate now from the pathway set down by the current Commission.

References

↑**1** I am grateful to Professor Marta Simoncini for her valuable comments on an earlier draft; I am solely responsible for any mistakes or inaccuracies.

References

LICENSED UNDER CC BY-SA 4.0

EXPORT METADATA

Marc21 XMLMODSDublin CoreOAI PMH 2.0

SUGGESTED CITATION Bevilacqua, Marco: *The Reform of the EU Fiscal Rules: Strengthening Economic Protectionism in the Union, VerfBlog,* 2024/5/06, https://verfassungsblog.de/the-eu-fiscal-rules/, DOI: 10.59704/867c9adde4a75138.

Explore posts related to this:

LICENSED UNDER CC BY-SA 4.0