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EXCESSIVE DEFICIT PROCEDURE: PAST, PRESENT, PERFECT?

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Abstract

The Economic and Monetary Union combines a single monetary policy with decentralised economic, especially fiscal policies under the responsibility of Member States. From the Treaty of Maastricht the EU is trying to optimise the specific institutions of one-armed European economic governance – with more or less success. The excessive deficit procedure is an elementary part of the system. The study focuses on the changes and criticism of the procedure paying particular attention to public debt and the sanctions that may be imposed.

Key words: *excessive deficit procedure, European economic governance, debt reduction benchmark, European Court of Auditors*

INTRODUCTION

The excessive deficit procedure (EDP) is an almost 30-year-old legal institution in EU law. This action can be launched by the decision of Council (recommended by the European Commission) against any EU Member State (MS) that exceeds the budgetary deficit and /or debt ceiling regulated in the Treaty on the Functioning of the European Union Article 126, Protocol No 12 annexed to TFEU and in the EU's Stability and Growth Pact *(1997).*[1] The study is based on the research of rules of the procedure, their changes, the related jurisprudence and some literature (including by reviews of the European Court of Auditors and the State Audit Office of Hungary). The scope of our studies does not provide full coverage of them. It focuses on the problems raised by the procedure, trying to systematise them. Even its rules have been changed several times, the Commission has relaunched a public debate on the review of EU economic

[1] The main provisions of EDP are laid down in Article 126 TFEU (thus Articles 119 and 120 TFEU are also linked to the procedure theoretically – as general rules of economic policy cooperation). Besides, Protocols 12, 13, 15 and 16 and Declaration 30 are related to the procedure at the level of primary law. The secondary legal framework for the EDP are the provisions of Regulation (EC) 1467/96, Regulation (EC) 479/2009 on reporting obligations of Member States. In addition, the sanctions for euro area MSs are governed by Regulation (EU) 1173/2011 and the correction of their excessive deficits is governed by Regulation (EU) 472/2013.

governance in 2021 October raising many questions to answer until 2023. This shows not only the timeliness of the study, but also the still existing contradictions in the procedure. The results of research are based on the use of legal historical method, comparative law and case law analysis.

1. RIGHT TO EXIST? REASONS OF REGULATION

The emerging internal market has amplified externalities between Member States' economies. Furthermore, the Treaty of Maastricht set the *objective of economic and monetary union*. From the Treaty of Maastricht monetary policy became an exclusive competence of the EU in the eurozone. Besides, other segments of economic policy, especially fiscal policy remained the competence of Member States. This led to *one-armed economic governance* at both EU and national level, which carries financial risks. If a euro-area Member State does not pursue a discipline fiscal policy, national overspending is no longer constrained by the risk of devaluation of the national currency. Why? The risks of increasing debt would spill over, spread across euro area Member States mitigating its negative economic effects (like increasing interest rate, devaluation of currency). Beside the overspending and "*moral hazardous*" behaviour of Member States, the so-called asymmetric economic shocks cannot be satisfactorily managed, either. *Asymmetric economic shocks* have different effects in Member States, countries can react and want respond to such shocks in different way (regarding budgetary resources and economic stabilization tools). Furthermore, the growing interdependence of Member States may increase the *spillover effect* of economic shocks on other Member States. All these economic contexts, and the legal principles of subsidiarity and proportionality also underpin the need for intervention at EU level. But how?!

2. MAJOR CHANGES, BASIC REASONS

A basic premise of the research is that, the changes in regulation have been driven by the macroeconomic challenges faced by Member States and the European economy. Nevertheless, this was also influenced by conflicts of interest, political bargaining and the different capacity of Member States to act. This unit of the study focuses only on the main changes.

The Treaty of Maastricht (accepted in 1991, entered into force in 1994) *re-regulated*[2] the rules of the multilateral surveillance of national budget (as a preventive arm) and laid down the rules of excessive deficit procedure (corrective

[2] The secondary legislation on multilateral surveillance was laid down in Council Decision 90/141/EEC. It was supplemented and incorporated into primary law by the Treaty of Maastricht. The Commission's examination under this procedure also covered the budgetary situation of the Member States, as a precursor to the excessive deficit procedure.

arm) in the primary law. The Council regulations of Stability and *Growth Pact*[3] accepted in 1997 regulated detailed rules for budgetary surveillance and the EDP. In the framework of excessive deficit procedure, the Commission shall examine compliance with budgetary discipline in the Member States on the basis of the following *criteria*:

- ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds 3%, unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value, or alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value;
- the ratio of government debt to GDP exceeds 60%, unless the ratio is sufficiently diminishing and approaching this reference *value at a satisfactory pace.*[4]

The fiscal element of the convergence criteria, set at the initiative of Germany, aimed to ensure the sustainability of fiscal policy, which remained the competence of Member States. The reference values were based on the average of the Member States' budgetary statistics at the time (1991) with the aim of maintaining them. However, there were more countries with high ratio of debt (e.g. 129.4% of GDP in Belgium, 101.4% of GDP in Italy in 1991) and their deficit was also above reference values (6.5% and 10.1% of GDP).

The euro was introduced in 1999 not on the basis of the reference values set out in the Treaty's protocol, but on the basis of whether a Member State was subject to EDP. When the decision was taken in May 1998 on which Member States could introduce the euro (01.01.1999), two countries were allowed to enter the final stage of economic and monetary union where gross public debt exceeded 100% of GDP: Belgium and Italy. When Greece (in 2001) became eligible to enter the eurozone, the Greek debt ratio was also above 100% *of GDP.*[5] At least in the case of the Greeks, a political compromise has been reached to expand the euro area.

Although a fiscal consolidation process took place in the European economies in the second half of the 1990s, an economic downturn began in 2000, which has left its mark on government deficits and debts. In 2005, the amendment of the Pact officially aimed at improving the implementation of the Pact, actually weakened the fiscal rules allowing to slow down the fiscal correction, avoiding the imposition of sanctions (by widening the scope of exceptions). The 2005 reform of the SGP introduced the structural balance as one of the targets that

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[3] Council Regulation (EC) 1466/97; Council Regulation (EC) 1467/97; Resolution of the European Council of 17 June 1997 on the Stability and Growth Pact. OJ C 236, 2.8.1997. p. 1.

[4] The Treaty text has not changed since then. See: Article 126 (1) TFEU. The reference values are specified in the Protocol on the excessive deficit procedure annexed to the Treaties.

[5] http://publikaciotar.repozitorium.uni-bge.hu/1048/1/Ferkelt-B..pdf (16.11.2022.)

Member States under the EDP must achieve in order to correct an excessive deficit situation.

There were *political and economic reasons beyond the amendments*. By 2003, the Council had already made recommendations to several Member States (like Ireland, Portugal) to correct their budgets, but in the case of Germany and France, despite the existence of excessive deficits, the Commission's proposal was not voted by the Council, and the procedure was closed for these two Member States. Politically, the Council decision is partly due to the strong German and French lobby, but also to the forced and discriminatory solidarity of other Member States, as the debate on the EU budget was taking place in parallel. The economic reason of the laxation of rules is that fiscal convergence criteria are difficult to fulfil – especially in a recession. Government measures to stimulate economic growth have a negative impact on the government deficit and debt. The Commission successfully brought an action before the *Court of Justice of the European Union,*[6] which led to continuing EDP against Germany and France. When sanctions could have been imposed against these countries, the rules of the procedure were instead weakened by the 2005 amendments.

What were the consequences of the 2005 amendments? The more the fiscal rules are relaxed the less relief they provide. As a result, the relevant actors and the central banks of the Eurosystem face greater demands and challenges. Furthermore, the Commission and the Council got considerably more scope for discretion and flexibility in the interpretation *of regulation than earlier.*[7]

The second – bigger – wave of EDP reforms was triggered by the financial and then economic crisis that escalated in 2008. The crisis had highlighted the weaknesses of financial policy at the time: lax financial market regulation, uncontrolled and irresponsible lending policies by the banking sector and rising indebtedness in both the private and public sectors. The stimulus measures necessitated by the crisis were putting additional strains on public finances, jeopardising their medium and long-term sustainability. This has called for a rethinking of the budgetary framework and structural reforms – not just at national, but also at European governmental level.

The need to strengthen the economic union has led to the creation of a multi-pillar surveillance system in 2010-2011 bringing together the different segments of economic policy coordination in the European Union. The first, reformed pillar is the European economic and budgetary policy coordination

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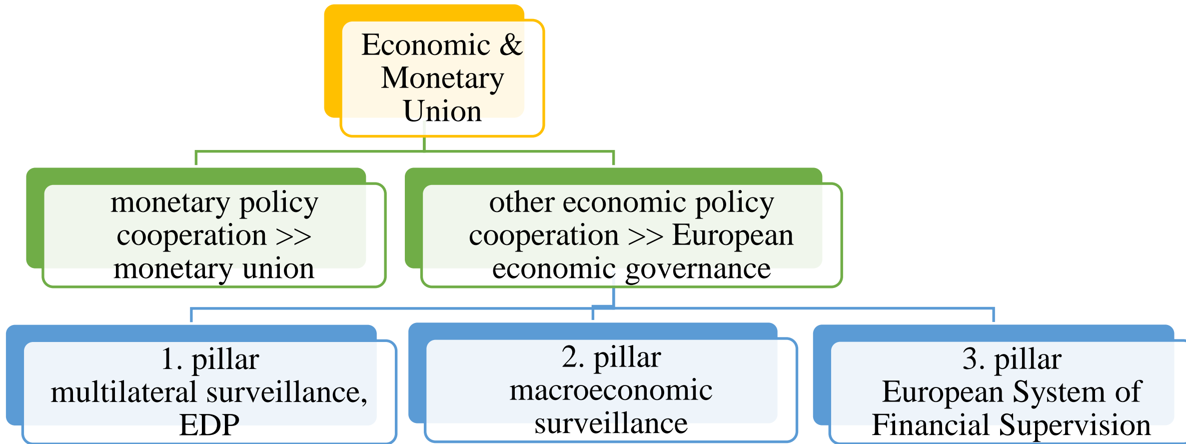
[6] Case C-27/04 Commission of the European Communities v Council of the European Union. About the case: Angyal, Zoltán: Európai ítélet. A túlzott hiány esetén követendő eljárás menete a közösségi jogban: az Európai Bíróság ítélete a Bizottság kontra Tanács ügyben. Európai Tükör, 2004/8. p. 76–92.

[7] Franz-Christoph Zeitler: What remains of the Stability and Growth Pact? Speech of the Member of the Executive Board of the Deutsche Bundesbank, Salzburg, 2005. https://www.bis.org/review/r050901j.pdf (10.11.2022.)

based on the rules of Stability and Growth Pact. The second new pillar is macroeconomic surveillance, and the third is the European System of Financial Supervision *(see Figure 1).*[8]

Figure 1.
Segments of economic policy cooperation in the EU



Source: own compillation

What has been changed by the reform relating to the EDP? The *European Semester* interlinks the annual mechanisms of economic governance related to the first two pillars from 2011. Under the EDP, euro area Member States are required to prepare stability programmes, other Member States are required to prepare convergence programmes by 1 April each year and to report deficit and debt data twice a year (before 01.04. and 01.10.). The programmes, data and corrective actions taken by Member States under the procedure are now assessed in the framework of the European Semester.

To facilitate a more disciplined fiscal policy, the possible cases in which *financial sanctions* (like non-interest-bearing deposit, fine) can be imposed on a euro area MS have been broadened and the rules for imposing them have been *tightened.*[9] The introduction of the reverse decision-making mechanism could facilitate the entry into force of the Commission's proposal to impose sanctions, as a qualified majority in the Council is required not to impose sanction (supporting the proposal) but to reject it.

[8] For further detailes see Kálmán, János: Az Európai Unió pénzügyi felügyeleti rendszere. In Kálmán, János (szerk.): A pénzügyi jog alapintézményei, 2022, HVG-ORAC, Budapest, 635–661. and Kálmán, János: Pénzügyi szolgáltatások igazgatása, in Lapsánszky, András (szerk.): Szakigazgatásaink, 2020, Wolters Kluwer, Budapest, 576–596.

[9] Sanctions for euro area Member States are governed by Regulation (EU) 1173/2011 of the European Parliament and of the Council.

Specific problems have also arisen: the *falsification of statistical data*. The shortcomings of the Stability and Growth Pact so far have been caused not only by weaknesses in the rules but also by inconsistencies in the application of the existing rules. Not the only example, but a typical one, is Greece's misreporting of public finances, which was already untrue before introduction of the euro (2001) and during the economic crisis (in 2009, the 3.7% budget deficit reported by the Greek government was actually 15.4% *of GDP).*[10] This is why from 2012 the Council, acting on a recommendation by the Commission, may decide to impose a fine on a euro area MS that intentionally or by serious negligence misrepresents deficit and debt data relevant for the application of (multilateral surveillance and) excessive deficit procedure.

Due to the crisis, more attention has been paid to public debt. The concept of debt diminishing at a satisfactory pace (when the state debt is higher than 60% of GDP) was operationalised through the *debt-reduction benchmark*.

The *Fiscal Compact*, signed in 2012 by 25 *Member States*[11] (as an international treaty!), sets out additional provisions on budget balances and debt above the reference value for participating Member States (see the regulation relating to mandatory balanced budget rule, benchmark for government debt reduction, reporting public debt issuance plan). A commitment by the euro area countries directly linked to the EDP to support proposals or recommendations from the European Commission to the ECOFIN Council if a euro area country breaches the deficit criterion, unless this is opposed by a qualified majority of the other euro area countries. This provision is expected to increase the automaticity of the excessive deficit procedure related to breaches of the *deficit criterion.*[12] The treaty has also had the effect of transposition of the balanced budget rule (and public debt limit) into national law, preferably at *constitutional level.*[13] Finally, it is important to note that the Pactum does not set any obligations for participating Member States outside the euro area (e.g. Romania, Hungary). The Pact highlights the limited and divergent willingness of Member States to cooperate, leading to multi-speed integration.

The so-called '*Two-Pack*', adopted in 2013, aimed to further strengthen the reformed economic governance framework for euro area Member States (!). Regulation (EU) 473/2013 of the European Parliament and of the Council incorporates into the European Semester a system of ex-ante monitoring and assessment of the annual budgetary plans of euro area Member States on the basis of the so-called common budgetary roadmap, and sets out additional rules for euro

[10] Szűcs Tamás: Politikai dimenziók. Gazdasági kormányzás az Európai Bizottság nézőpontjából. Európai Tükör, 2011/2. 23.

[11] The United Kingdom and the Czech Republic did not sign the treaty.

[12] https://www.ecb.europa.eu/pub/pdf/other/mb201203_focus12.en.pdf (04.11.2022.)

[13] The European Court of Justice has been empowered to impose financial sanctions of up to 0,1% of GDP to ensure compliance with the obligation of transposition.

area countries under the excessive deficit procedure. If the Council decides that an excessive deficit exists, the euro-area MS is required to prepare an *economic partnership programme* in addition to *reporting* on the measures taken under the Council recommendation. The *Commission* is empowered to make a *recommendation* directly to the MS if it considers that the compliance with the deadline to correct the *excessive deficit*[14] is at risk. Regulation (EU) 472/2013 of the European Parliament and of the Council introduces rules for *enhanced surveillance*, macroeconomic adjustment programme and post-programme surveillance. If a MS is placed under enhanced surveillance because requests financial assistance (credit) from one or several other Member States, third countries, the ESM or the IMF, it shall prepare a *macroeconomic adjustment programme*, which exempts the country from the obligation to prepare stability programme, macroeconomic adjustment programme and to report on correction measures, it remains outside the European Semester. If the EU was also involved in providing the loan, after the disbursement period, the MS will be subject to *post-programme surveillance* until at least 75% of the *loan has been repaid.*[15] Under post-programme surveillance the general rules come back into force. To sum up, the Commission's power have been strengthened, as it got the right to give an ex-ante opinion on draft budgets (in the European Semester) for euro area Member States and to make recommendations in the EDP. However, the extension of reporting and programming obligations for euro area Member States reduces transparency and increases the administrative burden on them.

3. CRITICS AND RECOMMENDATIONS

The comments on the excessive deficit procedure are organised thematically, according to subjectively chosen criteria, sometimes with a view to possible changes.

3.1. Assessment procedure

The European Court of Auditors (ECA) examined the Commission's implementation of the excessive deficit procedure between 2008 and 2015, focusing on six Member States and defined conclusions and a number of specific recommendations addressed to the Commission. The ECA found that, although detailed procedures and guidelines exist for most areas of the Commission's data collection and analysis and its assessment of compliance with the rules on budgetary discipline, there are problems with the implementation of these tasks. What has been lacking is consistency and transparency in the application of those rules. The ECA recommended to the Commission to enhance its quality assessment procedures and better document its work, maximise transparency and

[14] Article 126 (7), (9) TFEU.
[15] Regulation (EU) 472/2013 of the European Parliament and of the Council.

promote the involvement of national fiscal councils to confirm the national data used in the Commission's analyses.

The country-specific recommendations addressed to Member States are often regrouped, making it difficult to compare progress over the years and implementation of recommendations. The criteria and rationale for selecting recommendations are not clearly documented, prioritisation is not clearly *explained*[16] *(e.g. corruption).*[17]

3.2. Control of Public Debt

According to the European *Court of Auditors*[18] the excessive deficit procedure continues to over-emphasise the criterion of deficit rather than debt. Why does it carry risks? A high debt level impairs the stabilising role of fiscal policy even in respect of short-term growth stimuli. This is because an expansionary fiscal policy has less impact in an environment of high deficit and debt levels than in an economy with structurally sound public finances. Low government debt has a positive correlation *to growth*[19] because of the resultant boost in confidence, lower tax burden, possibly greater involvement and efficiency of the private *sector.*[20] Period of low interest rates until 2021 have significantly reduced the interest burden on general government.
The drivers behind debt dynamics are the *primary balance,*[21] *the snowball effect*[22] and the stock-flow *adjustment.*[23] The evolution of the debt-to-GDP ratio can therefore be broken down by the respective impact of those three drivers. In 2022, the challenge is a significant snowball effect resulting from a combination of a large initial stock of debt, low or negative nominal GDP growth and episodes of

[16] European Court of Auditors: Special Report 16/2020, p. 48–52.

[17] Állami Számvevőszék: Elemzés az Európai Bizottság 2004–2020. között a tagállamokról készített értékeléseiről 2. rész: Összehasonlító elemzés. 2020. október. (*State Audit Office of Hungary)* *https://www.asz.hu/storage/files/files/elemzesek/2020/elemzes_20042020_2_20201002.pdf?download=true (30.09.2022).*

[18] European Court of Auditors: Special Report 10/2016, p. 12.

[19] European Central Bank: Public Finances and Long-Term Growth in Europe – Evidence from a Panel Data Analysis. ECB Working Paper 246/2003. https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp246.pdf?9fc3689ef8dd20d85867f8b601f0e035 (30.10.2022.)

[20] Franz-Christoph Zeitler: What remains of the Stability and Growth Pact? Speech of the Member of the Executive Board of the Deutsche Bundesbank, Salzburg, 2005. https://www.bis.org/review/r050901j.pdf (10.11.2022)

[21] The primary balance is the budget balance net of interest payments on general government debt, so it indicates the amount of new debt created by the government.

[22] The snowball effect is the effect on public debt accumulation arising from the differential between the interest paid on public debt and the nominal GDP growth rate.

[23] The stock-flow adjustment groups all changes in public debt that cannot be explained by the deficit (e.g. changes in the value of debt denominated in foreign currency).

high interest rates. Medium- and long-term challenge is that high public debt also places a burden on future generations in ageing societies.

The analysis of the European Court of Auditors suggests that the EDP is potentially effective at keeping debt within limits, although a high initial level of debt may hamper the effectiveness of the procedure in keeping the debt-to-GDP ratio *under control.*[24]

The study stresses that it would be necessary to differentiate between Member States according to their level of public debt (e.g. between less, moderately or heavily indebted Member States) and to adjust the debt reduction benchmark accordingly, but strictly. Our conclusion is confirmed by the Commission's experience that in some heavily indebted countries, the debt reduction benchmark has required a particularly significant *fiscal effort.*[25] It is interesting to note that the debt levels of euro area Member States are higher than those of non-euro area Member States (see Figure 1., 2.) although they are subject to closer budgetary surveillance.

Figure 1.

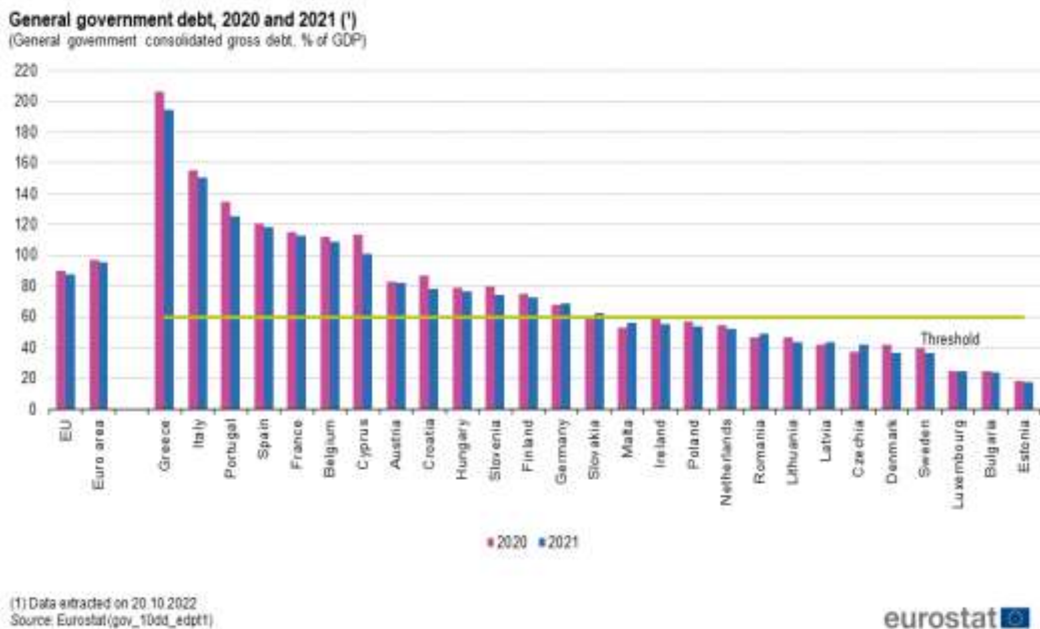
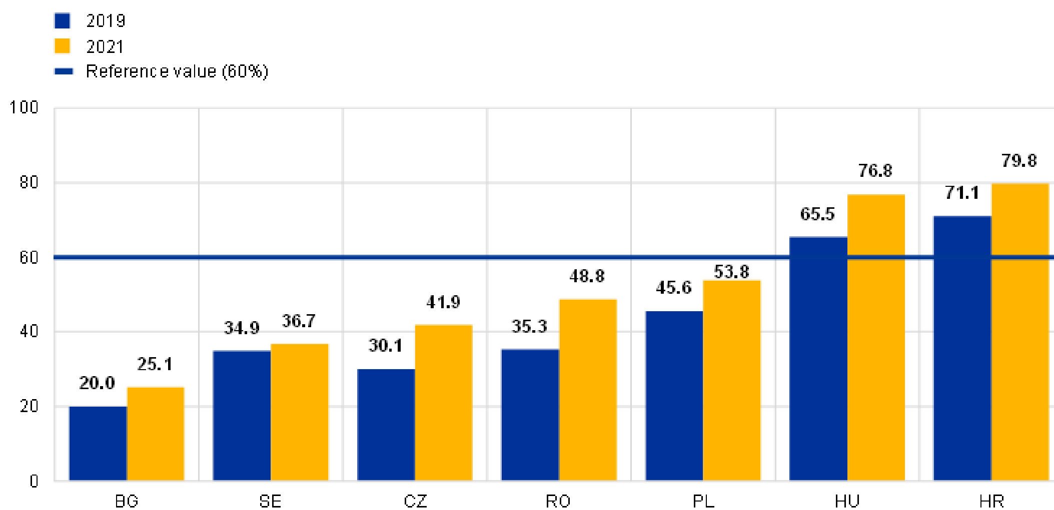


Figure 2.
General government gross debt

[24] European Court of Auditors: Special Report 10/2016, p. 72.
[25] COM(2020) 55 final, p. 7.



Source: *Eurostat*[26]

At the end of the first quarter of 2022, the highest ratios of government debt to GDP were recorded in Greece (189.3%). In six other euro area Member States government debt was above 100% of GDP: Italy (152.6%), Portugal (127.0%), Spain (117.7%), France (114.4%), Belgium (107.9%) and Cyprus (104.9%). The lowest government debt rate was in Estonia (17.6%), Luxembourg (22.3%) and Bulgaria *(22.9%).*[27]

3.2.1. Case of Romania

At the time of publication of this study, only Romania is subject to an excessive deficit procedure *(Cîrmaciu Diana, 2021, p. 68)*, even the government debt rate is under the reference value. What was the background?

Romania has been under consecutive Significant Deviation Procedures (SDP) under the preventive arm of the Stability and Growth Pact since spring 2017 as a consequence of the significant deviation by Romania from its medium-term budgetary objective (MTO) in 2016. In 2018 Romania registered a general government deficit of 2.9% of GDP, while debt stood at 35.0% *of GDP.*[28] Based on the Fiscal Strategy, Romania's general government deficit is planned to have increased to 3.8% of GDP in 2019. The Commission considered that this was well above and not close to the Treaty reference value of 3% of GDP and is also not exceptional, as it neither results from an unusual event nor from a severe

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[26] https://www.ecb.europa.eu/pub/convergence/html/ecb.cr202206~e0fe4e1874.en.html (10.11.2022).

[27] https://ec.europa.eu/eurostat/documents/2995521/14644644/2-21072022-AP-EN.pdf/ce72169d-1c4a-076c-d9da-4e87577a18dd?t=1658388869931 (10.11.2022).

[28] About the Romanian fiscal system see detailed: Ramona Ciobanu–Zoltán Varga: Romanian and Hungarian Fiscal Systems. Regulations and Fiscal Apparatus. Transilvania University of Brasov. Bulletin. Series VII: Social Sciences, Law 2020. 13 (62) pp. 307–317.

economic downturn. The excess over the reference value was not temporary, as the Commission 2020 winter forecast, extended for fiscal variables, projects a general government deficit of 4.0% of GDP in 2019, 4.9% in 2020 and 6.9% in 2021. According to the Commission report 2020, Romania faced high fiscal sustainability risks in the medium and long term, driven by high fiscal deficits and costs of aging. Assuming no-policy change, it was projected to breach the 60% *debit rule in 2025.*[29] Overall, on 3 April 2020, the Council decided that an excessive deficit existed in Romania because of a budget deficit above the reference value planned for 2019. The Commission considered in 2021 that the excessive deficit procedure should be kept in abeyance at this stage on the basis of the projected achievement of the required headline deficit *target in 2021.*[30]

The general escape clause of the Stability and Growth Pact has been active since March 2020. According to the general escape clause, a deviation from the medium-term budgetary objective or from the appropriate adjustment path towards may be allowed for Member States, during both the assessment and the implementation of Stability or Convergence Programmes. In the corrective arm of the Pact (EDP), the clause will allow an extension of the deadline for the Member States to correct their excessive deficits under the excessive deficit procedure, provided those Member States take effective action as recommended by the Council.

In its communication of 3 March 2021 entitled 'One year since the outbreak of COVID-19: fiscal policy response', the Commission set out its view that the decision on the deactivation or continued application of the general escape clause should be taken as an overall assessment of the state of the economy, with the level of economic activity in the Union or euro area compared to pre-crisis levels (end of 2019) as a key quantitative criterion. Heightened uncertainty and strong downside risks to the economic outlook in the context of war in Europe, unprecedented energy price hikes and continued supply-chain disturbances warrant the extension of the general escape clause of the Stability and Growth *Pact through 2023.*[31]

[29] COM(2020) 68 final, p. 8.
[30] COM(2021) 915 final, p. 7.
[31] Council Recommendation of 12 July 2022 on the 2022 national reform Programme of Hungary and delivering a Council opinion on the 2022 Convergence programme of Hungary. OJ C 334, 1.9.2022, p. 136–145.

In 2022 the deficit criterion is not fulfilled by 17 Member States (exceeded the deficit reference value in 2021 or plan to exceed it *in 2022),*[32] *and 5 MSs*[33] have not met the debt criterion *in 2021.* [34] The Commission announced in its Communication of 2 *March 2022,*[35] that that it would not propose the opening of new excessive deficit procedures in spring 2022 as the COVID-19 pandemic continued to have an extraordinary macroeconomic and fiscal impact that, together with the invasion of Ukraine by Russia, created exceptional uncertainty, including for designing a detailed fiscal adjustment path.

The question may arise: should the existence of a budget deficit of more than 3% of GDP be taken into account with the same rigour in countries with low public debt?

The *State Audit Office of Hungary considers* that the Commission has not given sufficient weight to the compliance with the debt benchmark in case of Romania and Czech Republic when compared with the assessment of Portugal, which had a debt ratio above 120%, twice the benchmark, and has not been able to reduce it significantly over the period 2011–2020, but has also made limited progress in fiscal policy according to the *Commission's assessment.*[36]

3.3. Legal actions relating to EDP

The Treaty requires Member States to avoid excessive government deficits. It is important to stress that according to Article 126 (10) TFEU, the excessive deficit procedure under primary law does not include infringement proceedings against Member States (Articles 258 and 259 TFEU). In case of breach, the Council can apply negative legal consequences under a specific (excessive deficit) procedure. The question arises whether Member States obligations regulated under secondary law (e.g. reporting) can be enforced under the *infringement procedure* or whether they are also covered by the prohibition of the Treaty.

The European Court of Auditors is clearly of the opinion that in the latter cases an infringement procedure can be launched. In its Special Report No 10/2016, it recommends that the Commission should more strictly enforce the rules on Member States' reporting and should always make clear in the assessments whether the Member States have fulfilled their reporting obligation. According to the ECA, Commission should make use of the possibility to launch

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[32] Belgium, Bulgaria, Czechia, Germany, Estonia, Greece, Spain, France, Italy, Latvia, Lithuania, Hungary, Malta, Austria, Poland, Slovenia and Slovakia.
[33] Belgium, France, Italy, Hungary and Finland.
[34] COM(2022) 630 final.
[35] COM(2022) 85 final.
[36] Állami Számvevőszék: Elemzés az Európai Bizottság 2004–2020. között a tagállamokról készített értékeléseiről 2. rész: Összehasonlító elemzés. 2020. október. (*State Audit Office of Hungary)* *https://www.asz.hu/storage/files/files/elemzesek/2020/elemzes_20042020_2_20201002.pdf?download=true* *(30.09.2022).*

infringement procedures when Member States do not comply with their reporting *obligations.*[37]

It is clear from the text of the Treaty that *annulment proceedings* in respect of EU acts and *judicial review of an infringement by omission* may be initiated in the framework of the excessive deficit procedure.

However, the Council's country-specific recommendations, which encourage Member States to undertake structural reforms among other things, are not binding and cannot be enforced by legal acts. The following proposal by the Court of Auditors was therefore rightly disputed by the Commission: "the Commission shall strengthen the monitoring of the implementation of agreed structural reforms, including making full use of its powers to ensure Member States meet *their commitments."*[38] In its response, the Commission pointed out that structural reforms are neither binding nor enforceable, thus the Commission is unable to influence or boost their implementation.

3.4. Sanctions

In the framework of EDP the Council may decide to apply one or more of the following measures:

- to require the Member State concerned to publish additional information, to be specified by the Council, before issuing bonds and securities,
- to invite the European Investment Bank to reconsider its lending policy towards the Member State concerned,
- to require the Member State concerned to make a non-interest-bearing deposit of an appropriate size with the Union until the excessive deficit has, in the view of the Council, been corrected,
- to impose fines.

As mentioned above, the 2011 reforms have strengthened sanctions against Member States that do not comply with recommendations, and have eased the conditions for imposing them. The introduction of the reverse decision-making mechanism could facilitate the entry into force of the Commission's proposal to impose sanctions.

Due to the 2011 reform (called "Six Pack"), the Council is entitled to impose a non-interest-bearing deposit if it decides that an excessive deficit exists in a MS, acting under Article 126 (6) TFEU. It is therefore entitled to impose sanction from the start of the procedure (!) in two cases. If the excessive deficit exists in a MS which has lodged an interest-bearing deposit with the Commission in the framework of the multilateral surveillance before the EDP, and when the Commission has identified particularly serious non-compliance with the budgetary policy obligations laid down *in the SGP.*[39]

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[37] European Court of Auditors, Special Report 10/2016, p. 82.

[38] European Court of Auditors, Special Report 10/2016, p. 13.

[39] Article 5 of Regulation (EU) 1173/2011 of the European Parliament and of the Council.

Until the reforms of 2011, whenever the Council decided to apply sanctions to a participating MS (having failed to take appropriate action on several times) in accordance with Article 126 (11) TFEU, a non-interest-bearing deposit shall, as a rule, be required. From 2011 a fine shall be applied (not a non-interest-bearing *deposit).*[40] The amount of the fine shall comprise a fixed component equal to 0,2% of GDP, and a variable *component.*[41] The fine cannot exceed 0,5% of GDP. It may be noted that Article 1(11) of Regulation 1177/2011/EU is contradictory to Article 6 of the Regulation *1176/2011/EU,*[42] which sets the amount of the fine at 0,2% of GDP ignoring the variable element rule.

Despite the tighter regulation, since the EDP's inception, no sanctions have *been applied.*[43] According to the ECA, "*while sanctions are also useful as a deterrent, not applying them when Member States fail to fulfil their commitment to budgetary discipline brings the risk that they will be perceived as a tool unlikely to be used. This would undermine their credibility and effectiveness, and hence that of the EDP as a whole. Indeed, although the imposition of sanctions is not the real aim, a system devoid of sanctions is one that relies on nothing more than moral suasion, in which case, unless the Commission can win the Member States' cooperation, the EDP is bound to be ineffective.*"[44] For this reason, the ECA recommends that the Commission should recommend that the Council step up the procedure and apply sanctions when there is evidence that a Member State has not complied with EDP recommendations and therefore has failed to fulfil its commitment to budgetary discipline under the Treaty. The The Commission did not accept the recommendation as the stepping-up of the EDP and the imposition of sanctions are governed by clear legal rules and processes which the Commission is bound to follow. The Commission will continue to recommend the Council to impose sanctions where appropriate in line with the *legislation.*[45]

The application of sanctions is controversial. Many stress its ultima ratio nature. However, it is sometimes even argued that an incentive-based system

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[40] Article 1(11) of Regulation (EU) 1177/2011 of the Council.

[41] The variable component shall amount to one tenth of the absolute value of the difference between the balance as a percentage of GDP in the preceding year and either the reference value for government balance or, if non-compliance with budgetary discipline includes the debt criterion, the government balance as a percentage of GDP that should have been achieved in the same year according to the notice issued under Article 126(9) TFEU.

[42] Regulation (EU) 1176/2011 of the European Parliament and of the Council.

[43] The EDP can be stepped up, it occured only once, for Belgium. Hungary was already subject to proceedings in the year of its accession to the EU (2004) and the partial suspension of the Fund was provided for in Council Decision 2012/156/EU with effect from 1 January 2013. However, as the Hungarian government had taken the necessary corrective measures in 2012, the suspension was lifted in 2012 and was not effectively applied from 2013. The excessive deficit procedure was lifted for Hungary in 2013. See: Csűrös, Gabriella: Uniós pénzügyek. Az európai integráció fejlődésének pénzügyi jogi vizsgálata. HVG-ORAC, Budapest, 2015.

[44] European Court of Auditors, Special Report 10/2016, p. 73,83.

[45] European Court of Auditors, Special Report 10/2016, p. 106.

should be introduced instead, as the use of financial sanctions against a Member State in a difficult budgetary situation is not a rational course of action.

3.4.1. Conditionality of sanctions

There is a tendency to attach conditions to EU funding. The roots of this go back to 1994, when the Regulation (EC) 1164/94 establishing the Cohesion Fund not only obliged Member States to prepare stability or convergence programmes, but also made it possible to suspend financial assistance from the Fund if a Member State failed to take the necessary measures to correct its excessive deficit within the deadline.

By 2014, the rules had been significantly extended to cover more funds, more Member States and more procedures, with more complex criteria. The conditions (ex ante, ex post and macroeconomic) for ESB funds[46] under the 2014-2020 EU budget[47] are now set for all Member States and have become broader and more complex, reinforcing the mechanisms of the multilateral surveillance, excessive deficit procedure and macroeconomic imbalance procedure. It is also covers Member States that benefit from EU-related lending.

From 2021 European Recovery and Reconstruction Instrument funding has also been linked to the European economic governance measures, so the Council is empowered to decide to suspend a total of €1,040,873 million in EU supports, reinforcing compliance with non-binding recommendations in the context of economic governance. Interestingly, although not directly related to the EDP, Regulation (EU, Euratom) 2020/2092 of the European Parliament and the Council links every (!) EU funding and EU-related lendings to the rule of law (all budgetary support and EU-related loans may be suspended).

Consequently, in areas where the EU cannot accept binding legislation, but only recommendations (economic policy, e.g. tax policy and employment policy, and protection the rule of law), the EU uses the withdrawal of its support as a negative incentive. Earlier it was mentioned that the Commission is unable to influence or boost the implementation of country specific recommendations. They have therefore effectively turned the system upside down and made it a fundamental objective to enforce non-binding EU economic policy recommendations. This was done not by classical regulatory measures, but by the

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[46] The European Structural Investment Funds are the funds for cohesion policy (European Regional Development Fund, European Social Fund and Cohesion Fund) and, within agricultural policy, the rural development fund (European Agricultural Fund for Rural Development) and the European Maritime and Fisheries Fund. These account for around 44% of the EU budget for 2014-2020.

[47] About the budgetary regulation of the European Union see detailed: Fábián, Klaudia–Varga, Zoltán: Az Európai Unió költségvetési szabályozásáról. PUBLICATIONES UNIVERSITATIS MISKOLCINENSIS SECTIO JURIDICA ET POLITICA Sectio juridica et Politica, Tomus 1/2021. pp. 81-115.; Halász, Zsolt: Az Európai Unió költségvetésének szabályozása. Budapest, Pázmány Press, 2018.

governance method of financing, using the possibility of suspending aid as a negative financial incentive.

CONCLUSIONS

Recent reforms to the EU fiscal framework (the 'Six-pack' in 2011 and 'Two-pack' in 2013) were made with the aim of achieving and maintaining the soundness of public finances. Relating to EDP, the reforms introduced complementary rules, an early-warning mechanism and a range of new monitoring and surveillance tools; they also strengthened sanctions and eased the conditions for imposing them. Detailed regulation has become complicated, hampering the transparency of the regime and making it difficult to apply.

The budget balance and debt-to-GDP ratio are the two Treaty indicators to assess the budgetary position of a Member State. However, under the procedure, the Commission puts more emphasis on the evolution of the government deficit, without taking due account of the different levels of government debt in Member States.

In connection with the procedure, the EU has several instruments to enforce the application of the legislation by Member States. Since the introduction of the procedure, no sanctions have actually been applied (once with the prospect of sanctions). It shows the ultiam ratio nature of sanctions.

While in 2010 all but three Member States (Luxembourg, Norway, Estonia) were subject to an excessive deficit procedure (EDP), from mid-2019 to April 2020 no Member State was subject to such a procedure. It may justify the dissuasive effect of the restrictions adopted from 2011. Though, the European Court of Auditors oppinion is that, the EDP has not proved fully effective as a corrective mechanism.

Events in recent years (Covid 19 pandemic, war in Ukraine) have had a significant negative impact on the European economy and the budgets of Member States. How has the process respond to all this? From 23 March 2020 the general escape clause of the Stability and Growth Pact has been activated until the end of 2023. The challenge for the future will therefore be how Member States in budgetary difficulties can return to a disciplined fiscal policy, also with regard to the rules of excessive deficit procedure.

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