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The New Governance of EU Fiscal Discipline

THE NEW GOVERNANCE OF EU FISCAL DISCIPLINE

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Introduction

In the Spring of 2013, a period of sustained legislative activity to strengthen European Union (EU) economic governance came to an end, and with it, the terms ‘six pack’ and ‘two pack’ entered an already full European lexicon. Comprising a total of seven regulations and one directive, the ‘six pack’ and ‘two pack’ have been visible symbols of the EU’s attempt to respond to an economic crisis which began with the financial crisis of 2008 and later developed into a sovereign debt crisis. With such a heightened legislative activity has come a rhetorical reconstruction of the EU’s governance response as one marking the return or revival of the ‘Community’ method,¹ in an area where European policymaking had seemingly left the Community method behind.²

The Community method is often treated as a synonym for rules-based governance as the product of EU legislative intervention in which ‘supranational’ actors have the leading if not decisive role.³ This definition draws additional strength from an explicit or implicit opposition between the Community method and those forms of EU governance typically

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² Dermot Hodson, Governing the Euro Area in Good Times and Bad (Oxford: Oxford University Press, 2011).

described as more ‘intergovernmental’ in nature, including the institutions and methods associated with policy coordination through the ‘open’ method of coordination (OMC). With its origins in the economic policy provisions of the Treaty on the Functioning of the European Union—particularly Article 121 TFEU—and later extended into the employment and social fields, the open method exerts influence on domestic policy through common EU guidelines, benchmarks and recommendations combined with national reporting, monitoring and surveillance, and peer review.

The apparent dichotomy and rivalry between a ‘supranational’ Community method and an ‘intergovernmental’ open method is dramatized in the context of the response to the economic crisis. Accordingly, in its diagnosis of the mistakes and flaws in the design of EMU, the European Commission has drawn attention both to the apparent weakness of the tools of policy coordination in the economic sphere—surveillance, recommendations and peer review—while also highlighting the absence of respect for the rules of the Stability and Growth Pact (SGP) and an unwillingness to impose sanctions for their breach. On this analysis, we might be forgiven for thinking that the path towards strengthened economic governance is one that departs from policy coordination via the open method and arrives at stronger rules-based and sanction-enforcing governance via the Community method. Or to put it another way, after a decade of experimentation with ‘soft’ law, it is apparently now time for ‘hard’ law to reassert itself.

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This article suggests an alternative reading of the trajectory of EU economic governance based on three related claims. The first claim is that, to the extent that the response to the crisis represents a heightening of rules-based governance, the Community method encounters rivalry in the form of extra-EU legal solutions, most visibility in the adoption of the Treaty on Stability, Coordination and Governance (TSCG) and the European Stability Mechanism (ESM) Treaty, and less visibly in the Memorandums of Understanding (MoUs) which render financial assistance to states conditional on a range of domestic economic and public administration reforms. Such responses also illustrate the plurality of, and interplay between, sites of normativity rather than the monopoly of the EU legal order typically implied by the Community’ method. The second claim is that, even inasmuch as there has been a strong EU legislative response to the crisis, characterizing that response as the invocation of the Community method and rules-based governance both fails to adequately capture the contemporary institutional dynamics of EU rule-making, and, downplays the capacity of the EU legislative process to produce something other than rules and hierarchy. Rather, the institutions and processes of policy coordination have been institutionalized in the reformed legislative framework. The third claim is that changes in EU economic governance cannot meaningfully be understood as mere switches from ‘soft’ to ‘hard’ law; from intergovernmentalism to supranationalism; or from the ‘open’ method to the ‘Community’ method. Rather, and building on their coexistence prior to the crisis, rules-based and coordination-based governance techniques form ‘hybrid’ normative grids and accountability frameworks. Focusing in particular on the steps taken to strengthen ‘fiscal governance’, the interaction between the Community method and the open method will be evidenced. The article concludes that the attempt to increase the governance capacity of the EU is not a zero sum game in which rules-based and coordination-based governance are simply rivals to one another. Indeed, the response to the economic crisis is a manifestation of broader trends towards pluralisation and differentiation in the forms and instruments of EU governance.8 The yoking of different

forms of governance together into hybrid forms creates new challenges for legality and legitimacy and for the identity of ‘European’ law.

**Going Outside: Extra-EU Responses to the Crisis**

If the ‘Community’ method is to have any meaning, then it must at least refer to the idea that cooperation between Member States takes place with the legal structures and processes of the European Union as the successor to the original Communities. Yet the response to the crisis evidences obvious departures from the Community method particularly though the two international treaties – the ESM Treaty and the TSCG – which have been adopted by groups of EU states outside of the treaty and legislative structures of the EU. Less obvious but no less difficult to reconcile with the Community method are the instruments through which financial stabilization support is rendered conditional on significant economic and public administration reforms. Based partly on EU executive acts – implementing decisions – and partly on contractual obligations entered into between EU states and international organizations – the normative matrix which creates duties and obligations for recipient states does not derive from the classic exercise of rule-making powers by the EU legislator.

**The ‘Fiscal Compact’ Treaty**

Notwithstanding efforts to create a stronger legislative framework for EU economic governance through the ‘six pack’ and later ‘two pack’, a Franco-German initiative sought a revision to the EU treaties to enforce fiscal discipline through a ‘fiscal compact’ with national implementation of a ‘balanced-budget’ rule as its centre-piece. In the face

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9 This paper is not directly concerned with either the wisdom or effects of balanced-budget rules. However evidence from the experience of other jurisdictions does highlight the problematic nature of such rules, particularly in the absence of a stronger federal budget which can offset the procyclical effects of balanced-budget rules. See Randall C. Henning and Martin Kessler, ‘Fiscal Federalism: US History for Architects of Europe’s Fiscal Union’, Peterson Institute for International Economics Working Paper No. 2012-1.
of UK opposition to a treaty amendment, the decision was taken for 25 EU states to adopt the fiscal compact via an international treaty – the TSCG.10

In its aim of tightening fiscal discipline, the TSCG clearly overlaps with the SGP as amended by the ‘six pack’. Thus, the obligation to have a balanced budget is met when the annual structural balance meets a Member State’s medium-term budgetary objective (MTO), with a structural deficit of no more than 0.5% GDP (rising to 1% where the debt ratio is below 60% GDP). The MTO is the key benchmark within the ‘preventative’ arm of the SGP. The TSCG also seeks to strengthen the ‘corrective arm’ of the SGP by speeding up reduction of public debt by a Member State with public debt in excess of 60% of GDP and through agreement to a ‘budgetary and economic partnership programme’ of domestic reforms to be monitored through the structures and processes of surveillance described further below. There is no obvious reason why such a tightening of the rules could not have been achieved within the legislative framework of the SGP, including taking advantage of the post-Lisbon power to adopt rules applicable only to Eurozone state as is the case with the ‘two pack’. Indeed, the use of extra-EU instruments to amplify obligations under EU law not only evades the institutions and processes which have evolved for norm-production within EU law but risks creating conflicts and tensions between these different sources of normativity.

What is particularly novel about the TSCG is that the balanced budget rule is to be embedded and enforced within national law. As regards embedding the rule, whereas the regulations which form the SGP are directly applicable and so do not require domestic implementation, the provisions of the TSCG requiring a balanced budget are to be implemented in national law ‘through provisions of binding force and permanent character, preferably constitutional’ in nature. What is striking, therefore, is less that the fiscal rules are being tightened and more that they are to be institutionalized and even constitutionalized in domestic law. It is this capacity to effect domestic legal and constitutional change which appears to go beyond what has been possible through the Community method. Of course, the intention is to absorb the TSCG back within the

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framework of EU law (Article 16 TSCG). Insofar as this would be achieved via treaty amendment, this may encounter precisely the same political obstacles which led to the adoption of the international agreement in the first place. If the intention would be to use legislative measures to achieve such a change, there is the potential constitutional objection that by analogy with Opinion 2/94, an EU legislative measure could not be resorted to as a means of seeking change to the national constitutional systems of the Member States.\textsuperscript{11} Already the French Senate has signaled that Article 4 TEU demands respect for national constitutions, to which end, a demand for constitutional change could not arise from EU secondary acts.\textsuperscript{12} In this way, not only has the Community method been avoided through the TSCG, there may indeed be limits to the constitutional capacity of the Community method to bring about certain elements of reforms intended to embed fiscal discipline within national constitutional architectures.

As to the enforcement of the balanced-budget rule, the mechanisms of enforcement also depart from the classic Community method models of centralized enforcement via infringement proceedings and decentralized enforcement through national courts. The TSCG demands the creation of a correction mechanism to be automatically applied in the event of a significantly observed deviation from a contracting state’s MTO or its ‘adjustment path’. The nature of this correction measure was left open with the European Commission tasked to develop common principles for its elaboration.\textsuperscript{13} The principles adopted by the Commission emphasise enforcement by national ‘fiscal authorities’ with support from independent monitoring bodies (a point returned to below). It is not initially obvious that national courts are to be brought into the supervision of fiscal policymaking or the budgetary process. Nonetheless, the demand in the TSCG that its fiscal rules be enshrined in rules of a binding and preferably constitutional nature, does create the potential for supervision by national courts, particularly constitutional courts.\textsuperscript{14} Yet, not only might this draw national courts into a

\textsuperscript{11} Opinion 2/94 on EU accession to the ECHR, [1996] ECR I- 1759.
sensitive area of political discretion, it raises the spectre of constitutional courts seeking to reconcile conflicts between respect for the fiscal discipline of the TSCG and respect for national constitutional guarantees. As amply illustrated by judgments of the Portuguese Constitutional Court, measures taken by national governments to enforce austerity in compliance with fiscal discipline can conflict with substantive constitutional guarantees. Within the framework of EU law, conflicts between EU obligations and domestic law (including constitutional law) are governed by the supremacy principle. With the TSCG operating beyond the Community method and beyond EU law, it will be for national constitutional courts to reconcile any conflicts.

As for the role of EU institutions, the TSCG does harness the European Commission and the Court of Justice of the European Union (CJEU) towards its enforcement.15 However, the European Commission is confined to reporting on whether a contracting state has breached its obligations under Article 3(2) TSCG – i.e. failure to implement the balanced budget rule and/or to adopt a correction mechanism – with no power to refer compliance to the Court of Justice (only a contracting state can bring proceedings before the CJEU). By way of a special agreement under Article 273 TFEU, the CJEU has jurisdiction to hear a case brought by a contracting party alleging breach by another contracting party of Article 3(2) TSCG. The Court is also granted a power analogous to Article 260 TFEU to impose a fine on a Member State. Yet this is hardly the sort of ‘supranational’ enforcement associated with the Community method. Indeed, and as will be illustrated later, substantive compliance with fiscal rules still remains predominantly an exercise in political rather than judicial accountability.

**The ESM Treaty**

The ESM Treaty has a different genesis to that of the TSCG. Its existence owes less to the potential limits of rules-based governance through the Community method and more to the limits and constitutional constraints on the financial capacity of the EU to support Member States in need of financial assistance. It soon became apparent that the

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15 For an extensive discussion of the use of EU institutions outside of the framework of EU law see Steve Peers, ‘Towards a New Form of EU Law?: The Use of EU Institutions outside the EU Legal Framework’ (2013) 9 European Constitutional Law Review 37.
EU instrument of the European Financial Stabilisation Mechanism (EFSM) established by Council Regulation could only operate within narrow legal and financial parameters.\textsuperscript{16} To bolster the financial capacity to support Eurozone state, the European Financial Stability Facility (EFSF) was established as a company under Luxembourg law operating in cooperation with Eurozone states under a framework agreement. However, in an attempt to avoid potential constitutional challenges before the German Constitutional Court, \textsuperscript{17} it was decided that an amendment to the EU treaties was required in order to establish a specific mechanism for financial support for Eurozone states. In the first post-Lisbon use of the simplified revision procedure, European Council Decision 2011/199 was adopted to amend Article 136 TFEU to make provision for a financial stability mechanism.\textsuperscript{18} The ESM itself is, however, a product of an international agreement between the Eurozone states: the ESM Treaty.

The creation of the ESM raises a number of issues concerning \textit{inter alia} the use of, and legal responsibilities of, EU institutions when acting outside of the framework of EU law;\textsuperscript{19} the compatibility of the ESM with Contracting Parties’ duties and obligations under EU law; and the use of the simplified revision procedure to amend the TFEU. These issues were explored by the Court of Justice of the EU in its ruling in the \textit{Pringle} case.\textsuperscript{20} In dismissing the legal challenge to the ESM, the Court has accepted the capacity of Member States to resort to international agreements outside of the EU legal order to the extent that such arrangements are not in conflict with the responsibilities of EU institutions and EU Member States under EU law. Moreover, it has also made clear that the attempted revision to Article 136 TFEU was itself unnecessary given that the ESM is a creature not of EU law but of international law. In this way, the ESM could enter into

\textsuperscript{17} As de Witte and Beukers note, the problem with the EFSM was whether Article 122(2) TFEU constituted an adequate legal basis for its operation, whereas the difficulty with the EFSF was whether it violated Member States’ EU law obligations under Article 125 TFEU (the ‘no bailout’ clause): Bruno de Witte and Thomas Beukers, ‘The Court of Justice approves the creation of the European Stability Mechanism outside the EU legal order: \textit{Pringle}’ (2013) 50 C.M.L.R. 805.
\textsuperscript{18} [2011] OJ L91/1.
\textsuperscript{19} Of particular interest is whether the EU Charter of Fundamental Rights is binding on the EU institutions even when carrying out functions that are not derived directly from the EU treaties.
\textsuperscript{20} Case C-370/12, \textit{Pringle v Government of Ireland, Ireland and the Attorney General} [2012] ECR-000. For a detailed analysis see de Witte and Beukers above n. 17.
operation even without the ratification of European Council Decision 2011/199 being completed.

The implications and ramifications of the Pringle judgment will no doubt continue to be debated and analysed. For present purposes, the point to make is that this response to the economic and sovereign debt crisis illustrates something of a tension. On the one hand, the resort to extra-EU solutions raises concerns about how to ensure that the exercise of executive power is compatible with an expanding repertoire of EU democratic and constitutional norms and values, particularly where that power is harnessed in support of the aims and ambitions of the Union. On the other hand, it may also illustrate the rigidities and inflexibilities of the EU’s constitutional and governance architecture, whether in the form of procedural constraints on treaty revision or more substantive constraints relating to the categorization and exercise of EU competences. In other words, the historic focus on constitutionalising and containing the Community method may well have produced a paradoxical mismatch between limited EU governance capacities and expanding EU normative ambitions.

Memorandums of Understanding and Conditionality
The legal status of measures implementing financial support to EU states and rendering it conditional on a wide range of economic and public administration reforms, also illustrates the limits of the Community method as a legal response to the economic crisis. Indeed, whereas the Community method foregrounds rule by imperium, the instruments adopted to provide financial stabilization highlight rule by dominium\(^{21}\) and governance by conditionality.\(^{22}\) In so doing, the packages of support offered to states typically draw together a range of instruments and mechanisms with their legal bases partly in EU measures and partly outside.

The EFSM was established on the basis of an EU Council regulation.\(^{23}\) Loans and credit lines offered under this regulation are adopted by ‘implementing decisions’ of the

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\(^{22}\) The analogy lies with the EU’s use of conditionality as a means of pushing for reforms in candidate states with membership of the EU as the reward.

\(^{23}\) Council Regulation 407/2010, above n. 16.
Council under conditions to be determined by the Commission and contained in Memorandums of Understanding (MoUs). Given the financial limit on the EFSM of €60bn, this intra-EU support mechanism is relatively limited and is supplemented by more substantial support through the EFSF (€780bn) and ESM (€700bn) as products of international agreements. Thus, the support provided to Ireland, Portugal and Greece is contained in an agreement between those states and the EFSF (as a company under Luxembourg law), with the conditionality set out in MoUs. In this way, the MoU’s float between supporting intra-EU and extra-EU support mechanisms with the European Commission and European Central Bank acting as negotiators and compliance monitors. This is very far from the model of the Community method. Yet, and as will be demonstrated later, it is also a departure from the normative environment of the open method insofar as compliance with obligations under the MoU’s replaces compliance with recommendations which emerge through the economic policy coordination process. All of which serves to illustrate the manner in which normativity emerges in a plurality of locations beyond the EU legislative process and in ways which soften the boundaries between extra- and intra-EU rulemaking.

**Going Inside: The Processes and Products of the Community Method**

The strength of the suggestion of a revival or return of the Community method as a response to the crisis rests upon a particular depiction of rulemaking in the EU. When considering that depiction, Weiler’s distinction between ‘decisional’ and ‘normative’ supranationalism is helpful. The former draws attention to the processes and dynamics of rulemaking and the role assigned to supranational institutions. The latter emphasizes rules and hierarchy as the typical output of rulemaking procedures with enforcement centering around judicial institutions. Both aspects are suggestive of a supranational legal discipline that constrains national political discretion.

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The second claim advanced here is that the processes and outputs of reforms to EU economic governance cannot be equated with a crude supranationalism. The post-Lisbon institutional landscape has to account for the role of the European Council in crisis management and the office of the President of the European Council as a rival to the policy initiating role of the European Commission. Moreover, the task of legislative rule-making is characterized by processes oriented towards seeking consensus in the shadows of the formal procedures and voting rules of the ordinary legislative process. Importantly for the third claim advanced below, the legislative process may be the very means by which techniques of policy coordination may be institutionalized, diffused, and intensified. In particular, the new legislative framework embeds the so-called ‘European semester’ at the heart of the economic governance architecture.

**Decisional Supranationalism – Negotiating the ‘Six Pack’ and ‘Two Pack’**

A notable aspect of the response to the economic crisis has been the adoption of packages of EU legislative measures. First there was the ‘six pack’ of five regulations and one directive. The regulations brought changes to the ‘preventative’ and ‘corrective’ limbs of the Stability and Growth Pact (SGP); created new capacities to sanction and fine Member States for breaches of the SGP fiscal rules; and established a new ‘macroeconomic imbalance procedure’ that would alert Member States to destabilizing elements of their economies. The sole directive establishes a set of minimum requirements for the design and operation of domestic budgetary frameworks. To this initial package of responses applicable to all Member States – subject to their differential obligations depending on their position within the stages of EMU – an additional ‘two pack’ of regulations was added applicable only to Member States whose currency is the Euro. These regulations established new procedures for the reporting

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and monitoring of national budgets,\textsuperscript{29} while creating enhanced surveillance mechanisms for states experiencing financial difficulties.\textsuperscript{30}

The adoption of these measures illustrates the contemporary dynamics of EU rulemaking. On the one hand, all the measures resulted from the European Commission’s monopoly on the right of legislative initiative. On the other hand, the European Commission encountered a certain policy-initiation rivalry from the office of the President of the European Council in that the latter established a Task Force to consider proposals to strengthen EU economic governance. Indeed the management of the economic crisis has been marked as much by regular meetings of the European Council as it has initiatives of the Commission. In this way, Wallace’s characterization of the ‘tandem’ of supranational and intergovernmental institutional decision-making may be a more apt depiction of the interplay of the European Commission and the European Council in shaping the response to the crisis.\textsuperscript{31}

Once initiated, the legislative process exemplified the development of the Community method beyond the Commission-Council tandem, highlighting in particular, the enhanced post-Lisbon Treaty role of the European Parliament as co-legislator with the Council. It also highlighted three contemporary trends in the legislative process: the proposal of legislative ‘packages’; the adoption of measures at first reading following ‘trialogue’ informal discussions between representatives of the European Commission, Council and EP;\textsuperscript{32} and, the avoidance of formal votes in the Council as negotiations seek to build a consensus even where qualified majority voting is permissible.\textsuperscript{33} In the case of the ‘two pack’ a fourth trend is also evident: the adoption of legislative instruments which bind only a group of states, in this case, the Eurozone states. All of which serves to

\textsuperscript{29} Regulation 473/2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring correction of excessive deficits of the Member States in the Euro area: [2013] OJ L140/11.
\textsuperscript{30} Regulation 472/2013 on the strengthening of economic and budgetary surveillance of Member States experiencing or threatened with serious difficulties with respect to their financial stability in the Euro area: [2013] OJ L140/1.
highlight not a simple supranationalism but a continually evolving formal and informal ‘institutional balance’ as the context for decision-making.\textsuperscript{34}

**Normative Supranationalism: Framework Norms and Institutionalising Coordination**

Just as important as changes in the decision-making dynamics of the Community method, what has also changed is what the Community method produces.\textsuperscript{35} The Community method has had strong associations with a model of rules-based governance in which states bind themselves to the discipline of law. Indeed, the Community method has often been treated as a synonym for hierarchy with a consequential depiction of ‘new forms of governance’ as non-hierarchical and beyond law. That opposition between the Community method and new form of governance is misleading.\textsuperscript{36}

Firstly, the nature of rules-based governance in the EU has changed. Thus, scholars of ‘new governance’ in the EU have highlighted trends towards establishing framework norms – typically under conditions of imperfect information and uncertainty – that are elaborated in a post-legislative phase, thereby blurring the boundary between rule-formation and rule-implementation.\textsuperscript{37} As will be discussed more fully in the following section, EU fiscal rules are far from being self-executing norms. Indeed, what has always been important about the legislative framework is that it creates the structures and processes by which such norms are elaborated and compliance evaluated.\textsuperscript{38} In other words, the boundaries between norm production and norm compliance are far from distinct and operate more as a recursive process.

Secondly, what is particularly striking about the legislative packages adopted in response to the crisis is their diffusion of the structures and processes of policy

\textsuperscript{35} Dehousse; Scott and Trubek above n. 3.
\textsuperscript{36} Armstrong, above n. 8.
coordination as a new form of governance. Moreover, different instances of the use of policy coordination are themselves coordinated in what is known as the ‘European semester’. The European semester has its origins in the integration of economic and employment policy coordination processes associated with the Lisbon strategy. 39 During the course of the Lisbon strategy, the formally legally separate economic and employment coordination processes were integrated within a framework of common guidelines and a common reporting structure, with Member States producing National Reform Programmes (‘NRPs’) subject to EU evaluation. This form of ‘multilateral surveillance’ is also applied to fiscal coordination under the SGP with Member States producing ‘stability’ or ‘convergence’ reports that are subject to review by the Commission and the Council. With the adoption of the ‘six pack’ and ‘two pack’, policy coordination is extended first in the development of the macroeconomic imbalance procedure to monitor apparently destabilizing elements of national economies, and secondly in monitoring the budgetary processes of Eurozone states. The function of the European semester is to draw together and synchronise these distinct coordination processes within a single governance framework.

In the first half of the semester, the national reports required under individual coordination processes are developed in light of the Commission’s Annual Growth Survey; the conclusions adopted by the Council of Ministers; and the conclusions adopted by the spring European Council. In the second half of the semester the national reports are discussed with the Commission and ultimately the Council adopts Country-Specific Recommendations (CSRs) for each of the Member States. This, ‘meta-OMC’,40 or the ‘coordination of coordination’,41 was an early response to the economic crisis and,

40 Tholoniat coined the term ‘meta-OMC’ to describe the integrated economic and employment policy coordination process which evolved under the Lisbon strategy. In hindsight that structure looks more like an embryonic version of the more mature meta-OMC of the European semester: Luc Tholoniat, ‘The career of the Open Method of Coordination: Lessons from a ‘soft EU instrument’ (2010) 33 W.E.P. 93.
41 Kenneth A. Armstrong, ‘The Lisbon Agenda and Europe 2020: From the Governance of Coordination to the Coordination of Governance’ in Paul Copeland and Dimitris Papadimitriou (eds), above n. 39.
while initially developed through praxis, is institutionalized in legislation adopted as part of the ‘six pack’ reforms to the SGP.  

That EU legislative action can give rise to policy coordination as an output is not itself novel and was a feature of the SGP prior to the crisis. What is noteworthy is both the intensification of the coordination effort and its relationship to rules-based governance. It is to the interconnection between rules-based and coordination-based forms of governance that attention now turns.

**Hybrid Fiscal Governance**

The third claim that this essay advances is that there are significant interconnections between rules-based and coordination-based forms of governance within the new economic governance architecture. It is important to acknowledge that the claim of a relationship between rules-based and coordination-based fiscal governance is not itself a novel claim. Indeed, in order to understand the new governance of fiscal discipline, it is helpful to briefly reprise the situation prior to the crisis and prior to the reforms of 2010-13.

Since the Maastricht Treaty, Member States have conducted their fiscal policies within the parameters of public deficit and public debt ratios established under European law. To reinforce these numerical fiscal rules and to provide mechanisms for monitoring compliance, the Stability and Growth Pact (SGP) was agreed. The SGP attempted to put in place both a ‘corrective’ framework based on the enforcement mechanisms of the excessive deficit procedure (EDP) and a ‘preventative’ framework based on the multilateral surveillance of Member States’ fiscal positions relative to a MTO. As is well known, the EDP proved hard to operationalize, in part because of the inherent difficulties in measuring deficits and in part because of political reluctance within the Council to take action against Member States alleged to be in breach of the

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43 See in particular, Schelkle above n.4; Hodson and Maher, above n. 38.

44 A maximum deficit of 3% of GDP and a maximum debt of 60% of GDP: Article 1 of Protocol No. 12 on the excessive deficit procedure.
rules. Instead much of the institutional activity focused on the preventative side and the monitoring of fiscal positions within the framework of the EU’s economic policy coordination processes. The SGP was revised in 2005 with a view to addressing apparent weaknesses in EU economic governance. For some observers, these weaknesses were inherent in the deployment of the open method of coordination towards the aims of fiscal policy coordination, with the evaluation of the 2005 reforms tending to critique the continuing role played by the open method. For others, the multilateral surveillance of economic policy coordination and the use of a country-specific cyclically adjusted MTO benchmark offered a more plausible ‘soft’ form of governance than the illusion of ‘hard’ rules and sanctions.

Viewing the more recent round of reforms against this background, we can see how the terms of the debate have often been set in ways which understand the interconnection between rules-based and coordination-based forms of governance as a relationship between ‘hard’ and ‘soft’ law. While this characterization of fiscal governance has certain heuristic capacities, it also has two unfortunate side-effects. The first is the tendency to view ‘soft’ policy coordination as simply substituting for ‘hard’ rules and sanctions. This evaluation was understandable at a time when it was clearly difficult to impose sanctions for breaches of the rules prohibiting excessive deficits under the EDP. However, in the context of the reforms introduced by the ‘six pack’, it is important not to view the relationship between these modes of governance in such zero-sum terms and instead the task is to unpack the complex interconnections and combined effects of rules-based and coordination-based fiscal governance. The second side effect is the rather limited way in which changes in governance are understood as marking a softening or hardening of governance along a continuum. While the literature on ‘legalization’ does attempt to add analytical value by breaking down the apparent

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45 It will be recalled that the reluctance of the Council to take action against France and Germany within the framework of the EDP resulted in legal action being brought by the European Commission against the Council: Case C-27/04 Commission v Council [2004] ECR I-6649. For a more detailed contextualisation of this litigation see Hodson and Maher above n. 38.


47 Schelke above n. 4; Hodson and Maher above n. 38.
features of hard and soft law – obligation, precision and delegation\(^{48}\) – this simply gives us variation within a model of rules-based governance. It is not apt to capture modes of governance with different attributes or characteristics let alone how different modes of governance combine and interact in governance frameworks.

Accordingly, the claim that is made and explored here is that the new governance of fiscal discipline can be characterised as a ‘hybrid’ form of governance. The idea of ‘hybridity’ has been explored in recent literature on ‘new governance’ in the EU.\(^{49}\) Although sometimes depicted as the relationship between ‘law’ and ‘new forms of governance’, it is better thought of as the yoking of different instruments and modes of governance together in order to enhance governance capacity.\(^{50}\) At a minimum it implies the coexistence and complementarity between governance techniques. But it can go further in forms of mutual interaction between apparently distinct modes and instruments.\(^{51}\)

In the analysis which follows it will be suggested that rules-based and coordination-based forms of governance are increasingly combined within the reformed economic governance architecture of the EU. More particularly, hybridity in fiscal governance can be evidenced within and across two analytical dimensions. The first is the manner in which rules-based and coordination-based forms of governance combine to create a normative grid that seeks to exert fiscal discipline on EU states. That is to say that the normative environment for fiscal discipline does not rest solely in legally binding rules but in the signals and steers which emerge out of cyclical processes of policy coordination. The second dimension is the interaction between rules-based and coordination-based governance in rendering Member States accountable for their


\(^{51}\) For further analysis see Trubek and Trubek above n. 49.
implementation of, and compliance with, this normative grid. In this way, the apparent strengthening of sanctions for breaches of fiscal discipline is embedded within the structures and processes of reporting and monitoring that are at the heart of fiscal policy coordination. Indeed, there may be no clear line between the dimension of norm production and the dimension of accountability for non-compliance, but rather repeated cycles of monitoring and surveillance within a more structured accountability framework.

To give specific focus to the discussion and to seek evidence for the claim advanced here, the analysis explores the effects of the ‘six pack’ and ‘two pack’ on ‘fiscal governance’. The term ‘fiscal governance’ is taken to refer to three facets of fiscal and budgetary discipline:

- Numerical fiscal rules
- Independent fiscal institutions
- Budgetary frameworks.52

The analysis begins by evaluating the changes introduced by the ‘six pack’ to EU-level fiscal rules and their enforcement at EU-level through EU institutions. Attention then turns to ‘decentralized’ implementation of fiscal rules in national fiscal frameworks and the role assigned to independent fiscal institutions in monitoring such frameworks. Finally, reforms to the domestic budgetary process will be highlighted with particular attention paid to reforms introduced by the ‘two pack’.

EU Fiscal Rules and “Centralized’ Enforcement

A significant feature of the changes introduced by the ‘six pack’ is the extension of the capacities for sanctioning Member States for breaches of EU fiscal constraints. There are now three key focal points for sanctions: (a) the existence of an excessive deficit in a Member State; (b) significant deviation from a Member State’s MTO; and (c) the existence of an excessive macroeconomic imbalance in a Member State. In general, the

aim of the sanctioning regime is to bring about compliance with an initial Council ‘recommendation’. Failure to comply with the recommendation then leads to the adoption of a Council ‘decision’ which determines non-compliance.

Considering first the excessive deficit procedure, under Article 126(7) TFEU, the Council adopts recommendations with a view to bringing to an end an excessive deficit in a Member State. Subsequent acts are adopted to bring about compliance but with the ultimate power under Article 126 (11) TFEU to adopt a decision imposing sanctions. Regulation 1467/97 now insists on the imposition of a fine as the default sanction for continual non-compliance. Moreover, if the conditions for imposing sanctions are met, then the Council is obliged to impose sanctions. For Eurozone states, Regulation 1173/2011 allows for sanctions to be introduced at earlier stages of the EDP. These sanctions can be in the form of non-interest bearing deposits or, in the case of a Member State that has taken no effective action to correct its excessive deficit, a fine. What is also noteworthy about these sanctions is that they are deemed to be adopted by the Council unless by qualified majority it decides to reject the Commission’s recommendation: the so-called ‘reverse majority’. This seeks to prevent either indecision in the Council or more overt political unwillingness to impose sanctions by influential states. In this way, sanctions are heightened and more automatic once decisions determining non-compliance are made. This attempts to overcome at least the political difficulties associated with securing compliance. Whether this makes the EDP more credible, however, remains to be seen and is, in any event, reliant on the initial determination than an excessive deficit persists.

Under the ‘preventative’ arm of the SGP, recommendations under Article 121(4) TFEU are addressed to Member States based on their national stability or convergence programmes. Article 121(4) TFEU recommendations can also be addressed to Member States with a view to correcting excessive macroeconomic imbalances. The ‘six pack’ also increases the sanctioning capacity of the Commission and Council in respect of non-compliance with these recommendations. Within the preventative arm of the SGP,

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53 Article 11 Regulation 1467/97 as amended. Fines constitute revenue for the EU and are assigned to the ESM.
failure to comply with earlier Commission warnings and Council recommendations concerning significant deviation from the MTO can result in the adoption of a Council decision that no effective action has been taken. That decision is taken by a qualified majority. If the decision is not taken and the issue persists, then the decision is deemed adopted by the Council unless a simple majority votes against. Similarly, under the excessive macroeconomic imbalance procedure, the Council can adopt a recommendation under Article 121(4) TFEU determining the existence of such an imbalance. A decision that a Member State has not taken the necessary corrective action is deemed to be adopted by the Council unless by a qualified majority it votes not to adopt the decision. Non-compliance with these decisions has particular consequences for Eurozone states. Interest-bearing deposits can be demanded when decisions are adopted determining non-compliance with recommendations and, in the event of persistent failure to correct a macroeconomic imbalance, an annual fine can be imposed.

In this way, what emerges is a somewhat different representation of the relationship between rules-based and coordination-based governance than the one in which the latter substituted for the difficulties in enforcing the former. The power to adopt recommendations under Article 121(4) TFEU is both the outcome of a system of economic policy coordination, and the beginning of a process of heightened sanctioning with non-compliance with recommendation resulting in Council decisions. This erodes the dichotomous relationship between the ‘hard’ sanctions of the EDP and the ‘soft’ persuasion of economic policy coordination.

If this depiction of sanctions for breach of fiscal discipline might, nonetheless, imply a decisive shift towards a traditional rules-based model of accountability, such an interpretation is, however, premature for two reasons. Firstly, note that the compliance process is based on Commission initiatives with the Council adopting recommendations/decisions. This is very different from the Community method model of centralized enforcement under the infringement procedure of Article 258 TFEU, in which the structured process of seeking compliance takes place in the shadow of court proceedings. The processes outlined above remain political albeit that discretion has either been confined or eliminated. Secondly, sanctions only follow determinations of breaches of fiscal rules. While such determinations are guided by numerical benchmarks
– the deficit and debt ratios; the MTOs; adjustment paths and correction efforts – decisions of non-compliance remain discretionary and are based on balanced assessments of a range of factors. Building on the earlier reforms to the SGP, an interesting feature of the ‘six pack’ is the elaboration of the range of factors to be taken into account when determining deviations from numerical benchmarks or, in the case of the macroeconomic imbalance procedure, from the indicators contained in a scoreboard. Not only are determinations of non-compliance matters of judgment about which there is room for disagreement – indeed, the process may involve structured disagreement in which the plausibility of economic forecasts produced by Member States may be contested by the European Commission – they rely upon flows of data and information under conditions of uncertainty. To that extent, they rely upon the systematic data collection, reporting and monitoring which are intrinsic to the processes of economic policy coordination. Indeed, the ‘recommendations’ under Article 121(4) TFEU from which sanctioning efforts may follow, form a significant outcome of the European semester as the framework which coordinates coordination. In this way, ‘framework’ rules-based governance is deeply embedded within coordination-based governance in a hybrid structure. It is coordination processes which allow framework numerical ratios, benchmarks and indicators to be put into operation.

Decentralized Implementation: National Fiscal Rules and Independent Monitoring

Despite all the focus on EU-level rules and EU mechanisms for seeking compliance, state-level fiscal rules – balanced-budget, ‘golden’ rules, public debt and deficit rules; rules on revenues and expenditures – have actually been a phenomenon of fiscal governance inside and outside of Europe, for many years. Since the mid-2000s, and based on questionnaires circulated and coordinated by the Economic Policy Committee (EPC) – a committee of senior national officials that assists in the coordination of national economic policies – the European Commission has produced periodic evaluations of national fiscal frameworks. The response to the crisis deepens EU engagement with national fiscal rules in two ways. One prong of the strategy is the adoption of Directive 2011/85/EU as part of the ‘six pack’ with the aim of setting minimum requirements for national fiscal frameworks. The second prong builds upon the pre-crisis coordination through the EPC and uses ‘peer review’, policy advice and
recommendations as mechanisms of persuasion. Not only is the content of the Directive inspired by the pre-crisis experience gained in monitoring national fiscal frameworks, the conduct of peer review during the crisis highlights a continuing interaction between rules-based and coordination-based governance.

The visible manifestation of influence over domestic fiscal frameworks lies in Directive 2011/85/EU: the only directive adopted under the ‘six pack’. In particular, Articles 5-7 require Member States to put in place numerical fiscal rules. Not unsurprisingly, these include incorporation of EU fiscal limits. Moreover, Regulation 1175/2011 adopted under the ‘six pack’ requires that domestic fiscal rules include respect for the MTO target under the preventative arm of the SGP. Otherwise, and consistent with its status as a ‘directive’, the emphasis lies on national implementation of a framework of fiscal rules and procedures.

The less visible part of the governance framework lies in the influence of the mechanism of peer review. As intimated above, the EU had developed an information-gathering and evaluation approach based around the EPC. This intensified when in May 2010, ECOFIN called for a regular assessment and peer review of national fiscal frameworks. Coordinated by the EPC, the peer reviews took place in 2011 and produced country fiches with accompanying ‘policy advice’ for the Member States. This produces interesting interactions between rules-based and coordination-based governance.

Firstly, we can find the use of the peer review process to monitor and drive implementation of the directive during the transposition period. Even in advance of the final adoption of the directive, in a statement by the Heads of State and Government of the Eurozone in July 2011, Member States committed to introduce by the end of 2012 the fiscal frameworks envisaged by the Directive. To this end, Article 15(3) of the Directive obliged the European Commission to produce an interim progress report on

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54 These articles do not apply to the United Kingdom.
the implementation of the main provisions of the directive by 14 December 2012. Production of the report was rendered possible through the institutions and methods of economic policy coordination which had been developed through the EPC. Consistent with its earlier efforts at monitoring domestic fiscal frameworks, the EPC produced a questionnaire to which EU states responded, with the Commission then able to report on the implementation of the Directive even during the transposition period. What this helpfully illustrates is the manner in which effectively and timely transposition of a directive – something which EU lawyers have typically associated with the Community method mechanisms of judicial enforcement – is supported through the institutions and methodologies more closely associated with the technique of policy coordination.

Secondly, for states that already had fiscal frameworks that would formally comply with the requirements of the Directive, the ‘policy advice’ emanating from the peer review process acts as a source of normative elaboration: for example, by requesting that numerical fiscal rules be placed on a statutory legal footing and include expenditure rules. While formally non-binding, there is a sense in which the policy advice normatively piggy-backs on the directive by amplifying and expanding the minimum requirements of the directive. In this way, rules-based governance under the directive and coordination-based governance via peer review are not two ways of doing two things but rather the latter expands and deepens the former in generating a hybrid normative grid. For the UK which is not bound by the Directive in respect of its provisions on numerical fiscal rules, the peer review process acts as a more independent source of normativity, for example, in its exhortation for the UK to adopt an explicit MTO in line with the SGP. All of which highlights the capacity for both rules-based and coordination-based governance to produce normative steers around the same issues.

The ‘policy advice’ which emanates from the peer review process can itself be incorporated in a different and more significant source: the ‘country-specific recommendations’ (CSRs) which form a central output of the European semester ‘meta-

\[59\] Policy advice to Estonia; above n. 57.
\[60\] Policy advice to the United Kingdom: above n. 57.
OMC’. The CSRs are a different sort of ‘recommendation’ from those discussed above which determine non-compliance with fiscal rules. The latter are more executive in nature and have a different legal basis. The CSRs have their legal basis in Articles 121(2) TFEU and 148(4) TFEU: the provisions which refer to the guidelines and recommendations for the conduct of economic and employment policy coordination. The quasi-legislative nature of the CSRs has increased with the formalization of the European semester within Regulation 1175/2011 which makes clear that failures by Member States to act upon the guidance they receive via the CSRs can give rise to escalating sanctions from a further recommendation, to a warning by the Commission or to sanctions under the EDP.61 We can illustrate the interaction between the CSRs as a product of policy coordination through the European semester and Directive 2011/85/EU by considering the role to be played by independent fiscal bodies.

Independent fiscal bodies or ‘councils’ have been a developing feature of domestic fiscal and budgetary policymaking. They can be used to give an objective view of the domestic fiscal position and hence support budgetary policymaking. They can also monitor compliance with numerical fiscal rules. In this way, they support the decentralization of fiscal discipline in the EU and seek to enhance national ownership of, and accountability for, fiscal policy. The role of such bodies formed part of the EPC’s pre-crisis analysis of fiscal governance. They are also considered in Directive 2011/85/EU. The Commission’s original proposal stopped short of mandating the establishment of independent ‘fiscal councils’, with the use of independent bodies treated as one of a range of possible approaches. The peer review process that was initiated while the directive was under negotiation established a much stronger preference for their creation, with ‘policy advice’ to ten Member States addressing the role of national independent fiscal bodies. For Spain and Slovakia that advice was incorporated directly into the CSRs addressed to them which recommended the establishment of independent bodies. The text of the adopted Directive was, therefore, less concerned with mandating the creation of independent fiscal bodies and instead focused on their use to support budgetary forecasting (Article 4) and in monitoring compliance with fiscal rules (Article 6).

61 Article 2a (3) Regulation 1466/97 as amended by Regulation 1175/2011.
However, the influences upon national fiscal frameworks are not merely those that derive from the mutual influence of Directive 2011/85/EU and the outcomes of policy coordination. Indeed, two additional sources of influence have a direct impact on the role to be played by independent fiscal bodies within national fiscal frameworks. The first source takes us back to the Memorandums of Understanding and Council decisions adopted as a condition for financial support to EU states. For those Member States in receipt of such support, the CSRs are replaced by the conditions contained in the MoUs and Council decisions. For example, Council Implementing Decision 2011/344/EU addressed to Portugal required it to establish an ‘independent fiscal council’, 62 whereas for Ireland, the pressure was not only to create an independent fiscal body, 63 but to put it on a statutory footing. Albeit a relatively trivial example compared with the more substantive economic conditionality contained in these documents, it does serve to illustrate not only the diversity in the sources of normative influence on domestic fiscal frameworks it also indicates the pre-emptive qualities of these norms over the CSRs. The second additional source of influence on the status and role of independent fiscal bodies arises from Regulation 473/2013 adopted under the ‘two pack’ and applicable only to Eurozone states. It formally requires Eurozone states to establish ‘independent bodies’ at national level charged with ensuring compliance with both EU and national numeral fiscal rules. Under Article 4 of the Regulation, independent bodies are also charged with the task of making an assessment of the ‘circumstances leading to the activation’ of the correction mechanism to be established under the TSCG. All of which highlights a very strong role for independent bodies in promoting compliance with fiscal rules, 64 as well as a rather interesting interaction between the TSCG and EU regulations.

64 It is worth noting that in a reasoned opinion, the French Senate raised subsidiarity issues in respect of draft Articles 3 and 4 of the Regulation which require ‘independent’ macroeconomic forecasts and ‘independent’ fiscal bodies. The Senate noted that these provisions had to be interpreted as leaving to the Member States a large measure of discretion in the composition and functioning of such bodies; something that was consistent with the original use of a directive in the six pack: Resolution of 24 January 2012 (Session 2011-12): http://www.senat.fr/leg/tas11-053.html.
Budgetary Frameworks

A key requirement of Directive 2011/85/EU is that Member States establish medium-term budgetary frameworks that operate across at least a three year period and are not only consistent with numerical fiscal rules but are also based on realistic macroeconomic and budgetary forecasts. Again, the CSRs repeat and amplify this message by demanding, for example, that such frameworks have a binding and statutory legal basis. The Directive also requires that annual budgets are consistent with the medium-term framework. However for Eurozone states, EU influence over the budgetary process is exerted more directly through the extension of the technique of multilateral surveillance pioneered in the context of economic policy coordination to the budget-setting process itself. This is the effect of Regulation 473/2013 adopted under the ‘two pack’.

Regulation 473/2013 brings the cycle of domestic budgetary policy within the framework of monitoring under the European semester. To this end, Member States publish their medium-term fiscal plans by mid-April, with the aim being to facilitate the inclusion into these plans of policy messages emerging from the annual cycle of surveillance under the European Semester as well as any specific recommendations addressed to that state. Draft national budgets – based on the independent macroeconomic forecasts discussed above – are then to be submitted by mid-October for monitoring by the European Commission which then adopts an opinion which is made public. Where the Commission considers that a draft budget is seriously non-compliant with a state’s budgetary obligations, the Commission can, exceptionally, adopt an opinion requesting that a revised draft budget be submitted. On the basis of the Commission’s opinion, the Eurogroup discusses the opinion and the results made public ‘where appropriate’. It is then for the Member States to adopt national budget laws by the end of the calendar year.

Three effects are generated by the surveillance of the domestic budgetary process. First, the annual surveillance process can be used to monitor the fiscal frameworks which are demanded by Directive 2011/85/EU, and their actual impact on the budgetary process. Secondly, based on the information generated by the reporting obligations, the Commission and Council are in a position to detect deviation from fiscal rules and to
deploy the specific sanctions described earlier. Thirdly, one of the historic weaknesses of EU policy coordination lay with the lack of fit between recommendations for policy reform and the domestic budgetary and planning cycle. Within the framework of the ‘meta-OMC’ of the European semester, the alignment of budgetary surveillance with the wider processes of economic policy coordination opens up the domestic policymaking system to an increasing European influence.

**Conclusions**

While the lexicon of EU law may not have needed the addition of the terms ‘six pack’ and ‘two pack’, the grammar and discourse through which these new terms have been deployed has tended to revert to unhelpful and misleading oppositions between the Community method and the open method. The claims advanced and defended here suggest not only that the response to the economic crisis is not coterminous with the return or revival of the Community method, more importantly, insofar as the Community method is in evidence it is as part of a hybrid governance framework that combines rules-based and coordination-based forms of governance.

Indeed what is striking about the legal response to Europe’s economic crisis is the plurality and diversity of instruments and techniques which are harnessed to strengthen fiscal governance. The normative grid of fiscal discipline is produced out of EU and international treaties; regulations and directives; MoUs and implementing decisions; policy advice and recommendations. These norms create different patterns of obligations for different states. They can amplify and extend, or substitute for, one another. Yet this complex normative grid is not one easily captured by the post-Lisbon Treaty constitutional settlement which focuses on the interior EU world of legislative and executive rulemaking framed by constrained categories of legislative competence. There is much in the new governance of fiscal discipline which is simply not recognized in the post-Lisbon constitutional order.

What is also noteworthy about the new fiscal governance architecture is the manner in which rules-based governance is embedded within the accountability structures of policy coordination. Breaches of EU fiscal discipline are not mechanistically determined but are reliant on the flow of information and data through the reporting and
surveillance mechanisms associated with policy coordination through the ‘meta-OMC’ of the European semester. The exercise of political discretion which may produce formal determinations of non-compliance and which may result in sanctions, is structured through the political accountability mechanisms of policy coordination rather than by ‘traditional’ judicial enforcement. Indeed, insofar as judicial enforcement is envisaged it is outside of the Community method and likely to give rise to tensions.

Finally, with all the attention paid to the EU level – of rule-making and compliance – we risk losing sight of the significant changes taking place at the national level. Some of these changes in fiscal governance were already happening prior to the crisis with reforms accelerated in the context of the crisis, particularly for those states for whom financial stabilization has brought with it governance by conditionality. Notwithstanding that political energy is focused on further changes to bring about a ‘genuine’ EMU, in the absence of a larger EU budget and a transfer of fiscal responsibilities to the EU level, fiscal policymaking will likely remain a core function of Member States albeit subject to greater external discipline. There are, therefore, two challenges for scholarship. The first challenge is to evaluate the modalities and effects of EU discipline on national fiscal and budgetary processes as this new governance architecture is put into practice. The second challenge is to address the constitutional legality and democratic legitimacy of the new governance of fiscal discipline.

65 Above n. 7.