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Learning about and understanding the Budgetary Pact

The Treaty on Stability, Coordination and Governance (TSCG), better known as the European budgetary pact, was signed on 2nd March 2012 in Brussels by the heads of State and government of 25 Member States of the European Union (all except for the UK and Czech Republic). It will enter into force once 12 euro zone Member States have ratified it. It will apply to the States that do not have the euro as their currency once they have ratified the treaty. Its implementation is planned for January 1st 2013. Before the French parliamentary debates that should lead to its ratification the Robert Schuman Foundation is offering its readers a special dossier on this treaty.

The Robert Schuman Foundation offers you a special dossier including:

- A paper by the Chairman of the Robert Schuman Foundation, Jean-Dominique Giuliani entitled "Learning about and understanding the Budgetary Pact" which recalls the context in which the treaty was adopted and defines the main outline of its content.
- Three summary sheets on the rule (definition, goals and impact) written by Sébastien Richard, lecturer in economy and public policy at the University of Paris X Nanterre.
- An explanatory paper on the Budgetary Pact as well as a table of the ratifications of the treaty on Stability, Coordination and Governance per country.

LEARNING ABOUT AND UNDERSTANDING THE BUDGETARY PACT

Jean-Dominique Giuliani, chairman of the Fondation Robert Schuman

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union was signed on 2nd March 2012 by 25 EU Member States (without the UK and the Czech Republic). To date it has been ratified by 14 of them (including 10 in the euro zone). It will enter into force as soon as 12 States which use the euro as their currency (there are 17) have ratified it. The signatories would like it to be implemented as of 1st January 2013.

AN EAGERLY AWAITED TREATY

The Maastricht Treaty, which led to the creation of the Economic and Monetary Union (EMU) did not go as far as introducing common economic and budgetary rules due to reticence on the part of some States. From the very beginning it was criticised because of this and this shortfall has greatly contributed to the public debt crisis which is now affecting the euro zone.

Strengthening governance of the euro

The Budgetary Pact clearly states, both in its preamble as in article 1 [...], that its goal is *"to strengthen the economic pillar of the economic and monetary union by adopting a set of rules intended to foster budgetary discipline through a fiscal compact, to strengthen the coordination of their economic policies and to improve the governance of the euro area ..."*

Growth and Employment

The same article explains that the treaty aims to *"support the achievement of the European Union's objectives for sustainable growth, employment, competitiveness and social cohesion."*

Recovering Confidence

The present world crisis crossed the Atlantic and because some Member States have undertaken very dif-

ferent economic, budgetary or fiscal policies they have fallen into excessive debt and deficit. This is damaging to the entire euro zone and their partners since they have not respected the strict rules set by the Stability and Growth Pact adopted on 17th June 1997 in view of the launch of the euro (January 1st 1999).

Lenders have expressed their mistrust of a badly governed European economy which has led to difficulties in refunding the public debts of some Member States who have had to turn to Europe for help. The aim of the Budgetary Pact is therefore to recover confidence for the stability and coordination of economic and budgetary policy in Europe.

AN ORIGINAL TREATY

A solemn commitment to improve public finance management

This treaty is a solemn commitment on the part of the signatory States to govern the euro zone together, to consult each other on all economic, budgetary and fiscal measures that may affect the other partners and the euro, therefore to bring order to their public finance management and to reduce their debt.

This treaty has been signed between the States outside of the normal EU procedures, whose applicable law it has to integrate within the next five years. But it has "borrowed" its rules, notably taking up five directives and a regulation adopted by the European Parliament (known as the "six-pack" and which have been in force since 13th December 2011) . It also uses its institutions (Commission, Court of Justice).

Originality

The respect of the commitments made in the treaty has been granted to the Council of the European Union (the ministers representing the States), under the authority of the European Council (heads of State

and government who appoint a euro zone President to represent it). The European Commission is not the decision maker in terms of its implementation, but its role as “guardian” of the commitments made is respected. It is an “intergovernmental treaty” ratified by each national Parliament whose competent committees will meet with that of the European Parliament to ensure its implementation.

A PRAGMATIC TREATY

A more intelligent, more flexible Stability Pact

The Stability and Growth Pact, adopted in 1997, which limited budgetary deficit to 3% and public debt to 60% of the GDP has often been criticised because of its harshness and its lack of adaptability. Criticism rose to the extent that under pressure by Germany and France it was not respected and was relaxed (23rd March 2005). In part this modification has been the cause of the euro zone’s present difficulties.

Modified and strengthened by the “Euro Plus” pact in 2011, it has now been modified and adapted by the Budgetary Pact.

The latter, which is better thought out, stipulates that “*the budgetary situation of the public administrations is balanced or in surplus*” (art. 3). This is simply the assertion of the principle whereby a State’s running costs must be financed by its revenues and not by debt. This is what the pact means by “*an annual structural balance of public administrations*” whose deficit will not exceed 0.5% of the GDP.

Furthermore, the Pact includes the respect of this rule in a “mid-term goal” taking on board the fact that the structural balance of many Member States is not balanced. It therefore allows for the return of balance, which has to be planned as part of a “convergence agenda”, drawn up between the Member States and the European Commission.

In addition to this the structural deficit may rise to 1% of the GDP if the Member State’s debt is deemed below 60% of the GDP, i.e. if that deficit does not increase its debt.

Finally it is the Member States which have to implement corrective measures and they have the choice and the responsibility of adapting them to the national context.

This Budgetary Pact therefore seems more intelligent and more adaptable than the previous ones. It is also more flexible.

A MORE FLEXIBLE PACT

In the implementation of the Pact a great amount of flexibility has been planned for.

It is the Council, i.e. the Member States, which according to a Commission report, monitors the respect of the Pact. This measure enables the adjustment of the application of the rules to specific situations, for example to that of a State in major difficulty which needs more time to respect its commitments.

“Cyclical adjustments” and “one-off, temporary measures » (art.3 § 2.a) are not part of the definition of the annual “structural balance” of public administrations. The aim of recovering growth to boost a struggling economy is therefore preferred to that of implementing strict rules.

Moreover article 3 (§1.c.) anticipates the possibility of bypassing the rules in the event of “*exceptional circumstances*” the definition of which includes “*periods of severe economic downturn*” (§2.b.) and mentions “unusual events outside of the control of the States.”

Finally the Pact anticipates (art. 5) that the States in difficulty will implement a “budgetary and economic partnership programme” with their partners and the European Commission to complete reforms that will enable them to respect their commitments. It is the general aim of this treaty which purposely anticipates that aid granted by the States involves the joint search for a solution to the crisis and therefore the signature and the respect of the said Budgetary Pact.

In all it might be said that the Budgetary Pact is much better thought out and really more flexible than any of its predecessors.

Democratic Rules

The Pact respects the governments’ political responsibility towards their citizens and their Parliaments.

Corrective mechanisms concerning discrepancies with the objectives that it sets have to be introduced on

a national level (art.3 §2). One year after the treaty enters into force the Member States have to have integrated into their national law *"provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes and [...]"* that shall fully respect the prerogatives of national Parliaments".

The Pact is a commitment on the part of the Member States that has to be adopted by the national parliaments.

The latter are involved in the implementation of the Pact. Their permanent committees are linked to those at the European Parliament and within a Conference that will *"discuss budgetary policies and other issues covered by this Treaty"* (art. 13). This is an all time first which might set a useful precedent for possible developments towards an association of parliaments in the management of the euro zone.

Stricter Discipline

The signatory States maintain that the principle of running costs funded by normal tax revenues is a necessary, reasonable, normal goal that they want to achieve.

They maintain that the goal to reduce their debt to 60% of the GDP has to be respected. For those who do not respect this threshold it will be achieved by reducing their debt progressively and concertedly at an average rate of one twentieth per year. (art. 4).

The States voluntarily and collectively promise to include stricter discipline rules in their national law, notably almost automatic mechanisms to return to balance (art. 8) and to reduce their public debt. This measure is designed to prevent the so-called "free riding" phenomenon which has led to some States endangering the euro zone because of their lack of seriousness in the management of their public finances.

The European Commission and any other State can refer to the Court of Justice of the European Union if they believe that a State has not integrated these common rules correctly into its national law. If the Court believes that its orders have not been respected, it can then decide on financial sanctions (lump sum or

penalty payment within 0.1% of the GDP) against a defaulting Member State (art. 8 §2.), which is paid to the European Stability Mechanism, as far as the euro zone States are concerned, or to the Union budget for the others.

Bypassing the rules of the Pact will be more difficult since any infringement will only be possible with the support of a "reversed qualified majority" of the Members of the Council (255 votes out of 345 and 14 Member States, then as of 31st March 2014, 55% of the States representing 65% of the population), who want to challenge the Commission's recommendations.

TOWARDS BETTER ECONOMIC GOVERNANCE OF THE EURO

Finally with this Pact the heads of State and government of the euro zone decided (art 12) to meet "at least twice a year" to lead the European economy together. They will elect, by a simple majority "a president of the euro zone summit" at the same time as the President of the Council for the same renewable mandate of two and a half years.

This president will prepare the summits with the Euro-group (meeting of Euro zone Finance Ministers).

The non-Member States of the euro will be convened when the agenda includes modifications that might involve them since they are under the obligation (save for some exceptions) to adopt the common currency.

The Budgetary Pact is a pragmatic, original treaty which strengthens the economic pillar of the Economic and Monetary Union, which has been lacking in the euro zone.

Above all it is a solemn commitment on the part of the signatory States:

- To work systematically together with their partners in view of guaranteeing stability that is necessary for a return of confidence, a vital condition to recover employment creating growth,

- To respect discipline that has been freely consented to as part of their national prerogatives under the supervision of their parliaments,
 - To undertake together the necessary reforms to recover competitiveness which the European economy is capable of, providing they do it together,
 - To give value to the efforts made by the citizens, the European institutions, the Member States' governments and the European Central Bank to solve the present crisis by mutualising their economic policies.
- It should help the European states to complete the national reforms they need to undertake together in order to return to a healthy management of public finance and progressively to reduce their debts so that there is no doubt about the strength of the European economy.

SHEET 1

THE GOLDEN RULE: DEFINITION, GOALS AND IMPLICATIONS

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THE GOLDEN RULE : ATTEMPTED DEFINITION AND GOALS

Definition

A golden budgetary rule refers to a legal constitutional measure or its equivalent that is supposed to lead to the respect of the principle of a balanced budget – and even contributing to the achievement of budgetary surplus [1].

Since a more scientific definition of this concept does not exist, there are several possible options available:

- in theory the golden rule makes a zero public deficit obligatory. However it can make allowances for a deficit in investment spending which is then funded by borrowing,
- the golden rule sets one or several thresholds that should not be transgressed: the public deficit [2] in relation to the Gross Domestic Product (GDP), or the debt expressed as a percentage of the GDP for example,
- the golden rule sets a goal to be reached at a given time and lays out the necessary steps to achieve this.

The Golden Rule and the Euro Zone Crisis

The golden rule, which was implemented by some Member States even before the start of the sovereign debt crisis, has progressively come to the fore in the debate over euro zone governance. Public deficit is deemed, by those who support the rule, to be the reason why the financial markets have been turned to and therefore it is behind the continued rise in public debt. Guaranteeing budgetary balance will therefore limit the States' debts, it will safeguard its sustainability [3] and will help to stabilise the euro zone. We should note in this regard that the Germans do not use the phrase "golden rule" to qualify this measure but rather call it "a debt brake or cap".

- A response to the shortfalls of the Stability and Growth Pact

This logic takes on board the shortfalls of the Stability and Growth Pact (SGP), adopted in 1997, which obliges Member States to respect two main criteria: a public deficit below 3% of the GDP and a public debt under 60% of the GDP. In the event of an excessive deficit an infringement procedure can be launched by the Commission, 23 of the 27 Union's Member States have experienced or are experiencing excessive debt, only Estonia, Finland, Luxembourg and the Netherlands have respected the 3% criteria since the Pact entered into force. Deemed too harsh however by some States, including Germany and France, the measure was reformed in 2005. The Member States could then elude an excessive debt procedure [4] if they found themselves in recession [5] whilst this dispensation had until that date only been granted to States that were suffering a severe growth crisis, ie a loss over or equal to 2 GDP points. Moreover, the decision to launch an excessive debt procedure was only taken after the assessment of a certain number of "pertinent factors" (economic conditions, ongoing reforms). The assessment times were also extended.

The "Governance" Package or the six-pack that was adopted at the end of 2011 enhanced the supervisory procedure and the sanction mechanism. The countries involved will now notably be obliged to reduce the difference between their debt level expressed as a ratio of the GDP and the 60% threshold by 5% on average over three years.

According to the Stability and Growth Pact budgetary policy is still a national competence. The introduction of a golden rule into the Constitutions of the Member States makes it possible to palliate the danger of a State not implementing the Pact by introducing *a priori*

1. A budget is said to be balanced if spending is equal to revenue. A budgetary deficit which occurs when spending is higher than revenue is fund by borrowing and contributes to an increase in the debt. Budgetary surplus, achieved when revenues are higher than spending enables the reimbursement of the debt.

2. The public deficit implies the annual negative balance between State, local authorities and social security organisations' revenue and spending.

3. A State's debt is sustainable if the latter can reimburse mid-term.

4. Anticipated in article 126 of the TFEU the excessive deficit procedure targets States whose public deficit is over 3% of the GDP. The Commission assesses this deficit and the Council decides whether it exists. When the Council decides that there is excessive deficit within a Member State it first addresses recommendations to the State in question. The latter has to settle this situation within a specific time limit. If the State does not abide by these recommendations, the Council can issue a warning about taking the appropriate steps to reduce the deficit. If necessary the Council can also implement sanctions or fines.

5. Recession is a slowing in the economic growth rate. In times of recession a country's growth is below that of its growth potential.

national supervision: since the legislator is obliged to adopt a balanced budget and an independent national body will ensure that it is implemented.

- An effective tool against free-riding

Furthermore the mechanism should lead to the eradication of budgetary free-riding on the part of some Member States. For a long time and before the start of the crisis euro zone membership enabled several countries to adopt lax budgetary policies: this was notably the case with Cyprus, Greece, Malta, Portugal and Slovakia. Nominal convergence [6] allowed them to enjoy low interest rates, which were then below inflation rates. The lack of any problems encountered on the debt market led them to believe that they could access easy money, and reject any

idea of adjusting the policies they were undertaking. Free-riding is all the more inadmissible if the principle of pooling States' debts [7] is to be implemented in the future. The golden rule can therefore be seen as a vital forerunner to the creation of Eurobonds.

The golden rule indeed helps to strengthen euro zone governance which was relative to date, whereas the entire monetary zone requires greater budgetary policy coordination. This rule should succeed in this since it counts on the responsibility of the States themselves, thereby avoiding any federal "leap".

- A message to the financial markets

Finally the golden rule has the virtue of reassuring the financial markets and ratings agencies that are quick to anticipate a downturn in public deficits.

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6. Nominal convergence implies the convergence of the indicators of inflation, interest rates and the fluctuation in exchange rates of the countries that want to join the Economic and Monetary Union and therefore adopt the euro. The indicators comprise the Maastricht criteria.

7. The pooling of the euro zone Member States' debt entails the issue of bonds by these countries that are guaranteed by the entire euro zone. If a country cannot pay back its annual interests or its debt the other States would do so in its place.

SHEET 2

THE GOLDEN RULE INTRODUCED BY THE TREATY ON STABILITY, COORDINATION AND GOVERNANCE (TSCG)

The Treaty on Stability, Coordination and Governance (TSCG) adopted by 25 Member States of the European Union in March 2012 includes to rules in the Budgetary Pact chapter: the first pertain to the structural deficit [8], the second specifically targets euro zone countries whose debt is over 60% of the GDP.

The Golden Budgetary Rule

- Obligatory inclusion in national law

The rule which targets structural deficits can really be qualified as golden since the Treaty demands its inclusion in a truly binding, permanent text, which is preferably part of the constitution, without this being an obligation however. The full respect of this rule must however be guaranteed in the entire national budgetary procedure.

The principle of the golden budgetary rule as part of a constitutional or equivalent text was already part of the draft regulation put forward by the Commission on 23rd November 2011, which refers to the monitoring and assessment of draft budgets and the correction of deficits. This text, which along with another proposal is part of the two-pack regulation, should apply exclusively to euro zone Member States. The care taken in adopting the principle of the golden rule to include it in a Treaty is significant from a legal point of view. Indeed it would have been surprising if the revision of Member States' Constitutions had resulted in the wake of a simple community regulation. Moreover the Treaty has a wider base since, except for the UK and the Czech Republic, it will apply to the entire European Union.

The Budgetary Pact plans for referral to the European Court of Justice if a contracting party does not include the golden rule into its national law. The European Commission is due to be responsible, in this regard, of assessing the measures adopted by the Member States. If after communicating with the country in question it concludes that some parties are not respecting the principle then the European Court of Justice can be referred to by one or several of the Treaty's contrac-

ting parties. The Commission's report is not however a vital prerequisite for this referral since a Member State can refer to a judge if it believes that one of its partners has not implemented the golden rule. In any event the European Court of Justice's decision is binding and it will set a deadline for the implementation of the rule.

If a State participating in the Pact believes, after its own assessment or by using the work undertaken by the Commission, that another State has not taken heed of the Court's decision it can refer to the judge and request the implementation of financial sanctions. The fine, which will not exceed 0.1% of the GDP of the State in question is paid to the European Stability Mechanism, the euro zone's rescue fund, or to the Union's budget if the country's currency is not the euro.

- Implementation

The principle set by the golden rule in the TSCG is the budgetary balance of the public administrations of the signatory States. Whereas the Stability and Growth Pact sets a 3% threshold not to be surpassed in terms of public deficit, the Budgetary Pact targets the structural deficit. The golden rule is indeed deemed to be respected if the structural deficit does not rise beyond 0.5% of the GDP.

The Stability and Growth Pact already set a threshold for the structural deficit: it then lay at 1%. The golden rule, as defined in November 2011 by the two-pack, also set this threshold.

The 0.5% threshold is not immediately applicable The rule is indeed considered to be respected if the annual structural deficit matches the forecasts that the government communicated to the Commission via the four yearly stability programme. This programme sets a mid-term objective (MTO), defined in terms of a structural balance [9]. The TSCG now stipulates that the MTO should come within -0.5 GDP points and a surplus.

The stability programme communicated by France for the period 2012-2016 sets a structural balance at 1.2% of the GDP in 2016. To achieve this, the government anticipates

8. A State's structural deficit matches a public deficit, adjusted to measures linked to the economic situation: increase in unemployment benefits during a time of crisis for example.

9. The structural balance is defined as the annual balance between a State's public administrations' spending and revenues adjusted to economic variations and net of one-off, temporary measures.

that the structural deficit will rise to 2.6% of the GDP in 2012, then to 1.2% in 2013 and -0.4% in 2014. The golden rule will therefore be correctly implemented if this trajectory is respected.

- Dispensations and consideration of the crisis

Noting the difficulties experienced by some euro zone countries, in spite of their work to consolidate their public finances, the treaty allows a State to distance itself temporarily from the MTO and its adjustment trajectory in periods of "severe economic downturn". Exceptional circumstances, beyond the States' control also enable them to dispense with the golden rule.

The most virtuous countries as far as debt is concerned, i.e. those whose debt is below 60% of the GDP have an MTO set at between -1% of the GDP and surplus.

We should note that the golden budgetary rule retains the public administrations' structural balance as its reference. This choice is significant. The structural balance is defined as the annual balance adjusted to economic variations, net of one-off, temporary measures: for example this means that cash payments [10] are not counted as revenues and in periods of crisis automatic stabilisers [11] are not taken into account in public spending, unlike in the calculation of the public deficit. The structural deficit takes better account of the effects of an economic crisis like the one that Europe is going through at present.

- Supervising the implementation of the rule

The rule comes into force in national law in the year following the entry into force of the Treaty.

The Treaty plans that the implementation of budgetary balance rule be guaranteed by an independent national body. The text does not make the creation of an ex nihilo structure obligatory; this independent budgetary council, already part of the two pack must however enjoy functional autonomy as far as the budgetary authorities are concerned.

The Budgetary Pact also makes the introduction of a "corrective mechanism" into national law obligatory, in order to correct any differences seen as far as the adjustment trajectory and the MTO are concerned. The mechanism should include the obligation to implement adapted measures over a given period in view of correcting the difference that has been observed. The European Commission will soon put forward common principles to the States for the definition and introduction of this mechanism.

A specific goal to reduce debt

This second rule comprises the integration of a six-pack measure into the Treaty. It stipulates that the euro zone Member States, whose debt is beyond 60% of the GDP (12 States out of 17 at present) must be reduced by 1/20th per year.

Unlike the budgetary balance rule it does not have to be included in a constitutional or equivalent text by the signatory States.

10. A cash payment may comprise the payment of a sum by a company to the State in compensation for the cost of transferring the retirement pensions of the company over to the State budget.

11. An automatic stabiliser is an economic, regulatory, passive measure that enables the reduction of the effects of an economic shock suffered by a country: recession or overheating. In times of crisis unemployment benefit tempers the effects on consumption of the increase in the number of job seekers.

SHEET 3

THE GOLDEN RULE: EUROPEAN EXPERIENCES

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Several European Union States have already introduced measures into their Constitution designed to cap deficits and impede debt. Some have also opted to create independent agencies that are responsible for monitoring the achievement of the targeted budgetary goals. Germany and Sweden have demonstrated the pertinence of the mechanism by substantially reducing their public deficits over the past few years. Most of the other others countries adopted this measure at the peak of the economic and financial crisis and prudence is called for before we assess its effects on their budgetary policy.

At the end of the 1960's **Germany** adopted a budgetary rule stipulating that the public deficit could not rise over total gross public investment. Included as part of article 115 of the fundamental law, provisions were made for exceptions that have limited the extent to which it is respected: it cannot be implemented if there is a disruption in the macro-economic balance. It does not include any real effort to counter deficit at the peak of the cycle. These limitations explain in part the rise of the Federal State debt from 17.5% of the GDP in 1970 to 67.9% in 2006. Berlin hoped to revise this rule in August 2009 by obliging the Federal State to maintain a structural deficit below or equal to 0.35% The *Länder* have to achieve structural balance by 2020. The application of this new rule can be suspended in the event of exceptional circumstances: natural disasters or emergency situations. The differences observed are now recorded in an ad hoc fund and must then integrate an amortisation table. The introduction of this rule has gone together with the creation of a Stability Council. Comprising federal economy and finance ministers, as well as 22 finance ministers from the *Länder*, it is responsible for monitoring the execution of the federal and regional budgets. It is responsible for taking corrective measures if necessary. Lying at 1.1% in 2011 the German public deficit which also includes local authorities and the social security coffers, as well as the Federal State and the *Länder*, is due to rise to 0.5% at the

end of this year. The public debt is due to rise to 83.5% of the GDP against 81.6% the previous year.

In 2007 **Austria** adopted a multiannual budgetary framework which has effectively been part of its constitution since 2009. This framework caps the Federal State's spending. No political agreement was met however last year concerning a constitutional law on the return of budgetary balance. Finally adopted in the shape of an ordinary law in December 2011, it anticipates that public deficit cannot rise beyond 1.25% of the GDP yearly. The 2012 draft budget forecasts a public deficit of 3.2% of the GDP. The debt is due to rise to 74.6% of the GDP this year.

In September 2011 **Spain** adopted a constitutional measure whereby the State and the autonomous communities cannot run up a structural deficit over the limits set by the European Union. According to an organic law adapted in spring 2012 the State's structural deficit cannot rise above 0.26% by 2020, those of the regions should not be over 0.14% of the GDP at the same date. The European Commission believes that the Spanish public debt will however rise to 6.4% of the GDP at the end of 2012, thereby drawing away from the goal of 5.3% set by the government.

The principle of providing the debt with a constitutional framework was adopted by **Hungary** with its new constitution that entered into force in January 2012. This precaution will not have prevented the debt rising to 76.5% at the end of the present financial year. At present Budapest is negotiating the payment of a precautionary credit line with the International Monetary Fund and the European Union.

Italy introduced a golden rule into its constitution last April. It is guaranteeing a return to balance of public accounts in 2013. In the future it will only be possible to avoid budgetary balance in the event of a serious economic crisis, after the approval of the absolute ma-

majority in Parliament. A detailed timetable for a return to balance should be adopted at the same time. The government has however revised its forecasts for 2012. Whilst it initially believed that the public deficit would rise to 1.3% of the GDP at the end of 2012 it brought this figure up to 2% last July.

Since 1997 the **Polish** Constitution has planned for the debt not to rise over 60% of the GDP. An organic law approved in 2009 set warning levels at 50 and then 55% of the GDP. The warning threshold of 55% might be surpassed during this financial year. A settlement plan is then due to be adopted, whilst the goal of a 2.9% budgetary deficit of the GDP in 2012 might not be achieved according to the European Central Bank.

In 1997 the **UK** adopted a budgetary stability law, based on two rules. A golden rule demands that the government only borrow to invest, since current expenditure is funded by taxes. A sustainable investment rule means that the public debt has to remain at a stable level: the law anticipated a public debt/GDP ratio of 40% over the period 1997-2007. The economic and financial crisis led the UK to suspend this law however. An operational rule has substituted this and is designed to lead back to budgetary balance adjusted according to economic trends, by 2017-2018. The debt is due to decrease by 2015-2016. The budgetary deficit in the financial year 2011-2012 is due to reach 8.3% of the GDP after rising to over 10% 2009-2010 (9.2% in 2010-2011). Debt is not following the same trajectory. The public debt which represented 61.8% of the GDP in the previous financial year, is due to rise to 65.7% of the GDP. In May 2010 the British government decided to set up an independent authority – the Office for Budget Responsibility – which is responsible of assessing during the pre-budget (November) and of the budget (March) appraisals whether draft finance laws have at least a 50% chance of achieving the government's goal. The Office also has to assess the State's balance, by notably integrating costs incurred by the

ageing population. Chaired by a professor of economy, who is assisted by an economic and an executive civil servant, it employs around 10 experts from the Finance Ministry.

In the face of a serious slippage in public accounts at the start of the 1990's – the public deficit totalled 12.3% of the GDP – **Sweden** introduced a "model framework" in 1996 which modified the conditions according to which Parliament adopted the State budget. The government must respect two multi-annual rules: the capping of three yearly spending and the surplus goal over an economic cycle. According to this goal the government must achieve a GDP surplus over the entire cycle. Moreover, the budget was re-organised into 27 "spending sectors". The budgetary procedure means that overall spending limits have to be defined before any loans are distributed. This measure was significant when Sweden suffered the effects of the economic crisis in 2008. The surpluses achieved previously enabled Stockholm to control the excesses of public spending and to undertake an active budgetary policy. In surplus in 2008 (+2.5% of the GDP), the government recorded a public deficit of 2.2% of the GDP the following year. It is due to lie at 1.1% of the GDP this year. The government intends however to go further in view of strengthening the spending caps and to make the budgetary surplus goal sustainable at the same time. The country also set up an independent authority, the Finanspolitiska radet, whose 8 members are appointed by the government for a three year period. Six economists and two politicians are members of it at present. It is responsible for assessing whether the government is achieving its budgetary goals. Several goals are being explored: long term sustainability, the budgetary surplus target; capping State spending and the coherence of the budgetary policy with the country's economic trajectory. It deems whether there is compatibility between the Swedish economic structure and healthy, long term growth principles and high employment levels.

SHEET 4

EXPLANATORY NOTE

ROBERT SCHUMAN FOUNDATION

The Treaty on Stability, Coordination and Governance (TSCG), better known as the European Budgetary Pact was signed on 2nd March 2012 in Brussels by the heads of State and Government of 25 Member States of the European Union (all except for the UK and the Czech Republic). This treaty anticipates the implementation of stricter rules in view of countering deficits and public debt, as well as possible sanctions against the States which are lax in this area.

The treaty will enter into force on January 1st 2013 if 12 Member States of the euro zone have ratified it. The other States can then ratify it and this will launch its implementation there too.

This treaty comprises sixteen articles divided into six titles. It can be summarized as follows:

AIM AND FIELD OF APPLICATION (ARTICLE 1)

After seven pages justifying the importance of budgetary discipline, as well as the decisions taken previously in this area, including the legal bases of enhanced cooperation between euro zone Member States, the first article summarizes the three subjects addressed in the TSCG: budgetary discipline, economic policy coordination and euro zone governance. It is recalled that the TSCG's main aim is to "*strengthen the Economic and Monetary Union's economic pillar.*"

COHERENCE AND LINK WITH EU LAW (ARTICLE 2)

The TSCG has to be interpreted and implemented in line with the existing European treaties. In particular it applies "in that it is compatible with the treaties on which the European Union is based and with the EU's law" and does not change the European Union's competences in the area of Economic Union.

BUDGETARY PACT (ARTICLES 3 TO 8)

This section lists the new rules that apply to the signatory States in the budgetary domain, including the sanctions that apply if the rules are not respected:

- The States' budgets must be in surplus or be balanced. When a country's budget is in deficit the States are given mid-term deficit goals in line with the new rules included in the stability and growth pact. In any event the structural deficit (i.e. "adjusted according to cyclical fluctuation" and "one-off and temporary measures") must not be in excess of 0.5% of the GDP except in the event of "exceptional circumstances" (defined as "unusual events independent of the control" of the State in question, and affecting its public finances or "during periods of serious economic downturn") during which time "a temporary difference" in relation to this limit is allowed.
- A convergence timetable on a mid-term goal set for the States in deficit is established by the European Commission and the respect of this goal is assessed.
- When a State's debt is below 60% of the GDP and that "dangers for the sustainability" of public finances are deemed "low" the maximum limit on structural deficit totals 1% of the GDP.
- If a State strays too far from its mid-term goal or that the development of public accounts diverge too far from the trajectory required to achieve this goal, a correction mechanism is "automatically" triggered.
- The States must introduce "binding and permanent" national rules for balance in their public accounts into their own national legislation according to the rules set out in the TSCG within one year maximum of the entry into force of the TSCG. Preferably these should be constitutional rules or, failing that, rules whose legal value is adequate enough to guarantee that they are respected. The correction mechanism also has to be established on a national level "based on common principles put forward by the European Commission."
- When a State's public debt is higher than 60% of the GDP the State in question must reduce it "at an average rate of" one twentieth per year.

- When a State is the focus of an excessive debt procedure as set out in the European treaties it must establish a “budgetary and economic partnership programme” which lays out the reforms it promises to make. This programme is presented for agreement at the Council of the European Union and to the Commission which supervises its implementation.
- The States also have to communicate “indications” about their plans regarding debt emission to the Council and to the European Commission.
- In the event of an excessive deficit procedure against a euro zone State, a qualified majority of euro zone States (excluding the State that is the focus of the procedure itself) is required to stand against the implementation of the recommendations or proposals made by the Commission. If no qualified majority of States expresses its opposition then the euro zone States commit to “supporting” the Commission’s proposals or recommendations
- The Commission checks that the States introduce the budgetary rules set by the TSCG into their national legislation and write a report on this. If they believe that this rule has not been respected, a case is brought before the Court of Justice of the European Union. A State can also bring a case against another State, independent of the Commission’s report, if it believes that that State in question has not fallen in line with the obligation to adopt national budgetary discipline rules.

COORDINATION OF ECONOMIC AND CONVERGENCE POLICIES (ARTICLES 9 TO 11)

In general terms this section lays the foundation for greater coordination of the economic policies of the euro zone States:

- The general aims of Member States’ economic policy are recalled: “greater competitiveness, the promotion of employment, greater contribution to the sustainability of public finances and greater financial stability.” To do this the States commit to undertake “an economic policy that fosters the good functioning of the Economic and Monetary Union” and which “promotes economic growth thanks to greater convergence and competitiveness,” as well as “undertaking action and the necessary measures for the smooth functioning of the euro zone.”

- The signatory States state that they want to “use actively” the opportunities offered by enhanced cooperation or measures that are specific to the euro zone Member States.
- The States declare that they want to debate economic reforms that they are undertaking at home and even coordinate them at an early stage

EURO ZONE GOVERNANCE (ARTICLES 12 AND 13)

This section establishes the euro zone summits and includes some measures enabling the involvement of the European and national parliaments in the debate over economic issues.

Informal euro zone summits are established. They will bring together the heads of State of the euro zone that have approved the TSCG as well as the President of the European Commission. The ECB President is invited and the President of the Parliament may also be invited to speak. A president of these summits elected by a simple majority by the heads of State and government of the euro zone States that have approved the TSCG, at the same time and for a term in office lasting the same amount of time as that of the President of the European Council. He is responsible for ensuring the “preparation and continuity” of the summits together with the President of the Commission.

The euro zone summits whose “preparations and follow up are handed over to the Eurogroup” will take place “when necessary” but at least twice yearly. They will focus on subjects relative to the “specific responsibilities” shared by the euro zone States, to the governance of the euro zone as well as economic convergence within the monetary zone and to economic policies that enable its achievement. After each of these summits a report will be submitted to the European Parliament.

The heads of State and government of countries which have ratified the TSCG but which do not belong to the euro zone can take part in some euro zone summit discussions regarding competitiveness, the overall “structure” of the euro zone, rules governing the euro zone and the implementation of the TSCG.

Finally non-members of the euro zone and/or non TSCG members are kept informed of the “preparation

and the results" of the euro zone summits.

The European Parliament and the national parliaments of States that have approved the TSCG "organise" and "promote" a conference that aims to debate "issues governed by the TSCG". It comprises the representatives of the "committees involved" in each of these institutions.

GENERAL FINAL MEASURES (ARTICLES 14 TO 16)

- The ratification procedure follows the constitutional rules in application in each Member State.
- The treaty enters into force on January 1st 2013, if 12 euro area Member States have ratified it. If the number of necessary ratifications has not been rea-

ched on 1st January 2013 the treaty will enter into force on the first day of the month that follows the 12th ratification by a euro zone Member State.

- When the treaty enters into force it will apply to the euro zone States which have ratified it.
- For the euro zone States which ratify the treaty after its entry into force, the treaty will apply as of the first day of the month following its ratification.
- States outside of the euro zone can also ratify the treaty and decide to be associated to "all or part" of the budgetary rules that are included in it.
- Non-signatory States may also join the treaty.
- Within a five year time limit after the entry into force of the TSCG the "necessary measures" must have been taken to integrate its content into the Union's legal framework

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APPENDIX :

RATIFICATION TABLE

At October 11th, 2012, 14 Member States [12] of the 25 signatories including 10 Eurozone States [13] have already ratified the Budgetary Pact.

The Foundation has updated this table which provides an overview of the ratifications in the various Union countries.

Countries	Ratification Method	Date	Résultats
Germany €	by parliament	29/06/2012 30/06/2012	Yes (Bundestag: 491 votes for, 111 against, 6 abstentions; Bundesrat: 65 voix for, 4 against)
Austria €	by parliament	4/07/2012 6/07/2012	Yes (Nationalrat: 103 votes for, 60 against; Bundesrat : 42 votes for, 13 against)
Belgium €	by parliament		
Bulgaria	by parliament		
Cyprus €	<i>Council of Ministers Act</i>	20/04/2012	Council of Ministers' ruling
Denmark	by parliament	31/05/2012	Yes (80 votes for, 27 against)
Spain €	by parliament	21/06/2012 18/07/2012	Yes (Congreso de los Diputados : 311 votes for, 19 against ; Senado : 240 votes for, 4 against, 1 abstention)
Estonia €	by parliament		
Finland €	by parliament		
France €	by parliament	9/10/2012 11/10/2012	Yes (National Assembly: 477 votes for, 70 against and 21 abstentions ; Senate: 306 votes for, 32 against)
Greece €	by parliament	28/03/2012	Yes (194 votes for, 59 against and 47 abstentions)
Hungary	by parliament		
Ireland €	<i>referendum</i>	31/05/2012	Yes (60.29% of the votes cast)
Italy €	by parliament	12/07/2012 19/07/2012	Yes (Senate: 216 for, 24 against and 21 abstentions; Cham- ber of Deputies: 368 for, 65 against and 65 abstentions)
Latvia	by parliament	31/05/2012	Yes (67 for, 29 against, 1 abstention, 3 absent).
Lithuania	by parliament	28/06/2012	Yes (80 for, 11 against and 21 abstentions)
Luxembourg €	by parliament		
Malta €			
Netherlands €	by parliament		
Poland			
Portugal €	by parliament	13/04/2012	Yes (Parliament: 204 votes for, 24 againsts and 2 abstentions)
Czech Republic			Non signatory of theTSCG
Romania	by parliament	08/05/2012 21/05/2012	Yes (Chamber of Deputies: 237 votes for, 2 abstentions; Senate: 89 for, 1 against, 0 abstentions)
UK			Non signatory of theTSCG
Slovakia €	by parliament		
Slovenia €	by parliament	19/04/2012	Yes (74 votes for and 2 abstentions out of 76 by MPs in attendance)
Sweden	by parliament		

Comments :

The ratifications in this table are deemed complete when they are approved by Parliament [14].

Key :

€ Euro zone country which has ratified the Budgetary Pact

EU country which does not belong to the euro zone but which has ratified the Budgetary Pact.

12. Germany, Austria, Cyprus, Denmark, Spain, France, Greece, Ireland, Italy, Latvia, Lithuania, Portugal, Romania, Slovenia.

13. Germany, Austria, Cyprus, Spain, France, Greece, Ireland, Italy, Portugal, Slovenia.

14. Except for Ireland which used the referendum