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How can a reform of the Stability and Growth Pact foster sound fiscal policies?

Reaction to the Communication COM(2020) 55 on economic governance review

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On 5 February 2020, the EU Commission released a Communication on the review of the economic governance framework and, most importantly, of the Stability and Growth Pact (SGP). Criticism of the current SGP has been voiced by various institutions owed to a lack of compliance with its rules. cep gives the following assessment:

- In order to account for a range of changing circumstances, the rules of the SGP have become overly complex. There are too many objectives, a wide array of unobservable variables whose estimates are subject to error and revision, and too many escape clauses allowing deviations from the rules.
- As a consequence, the assessment of compliance with the SGP is sometimes unpredictable and open to discretion. Member States exploit such complexity to contest adjustments required by the rules. The Commission makes use of its scope for discretion to avoid political backlashes.
- A single expenditure rule could replace the many objectives of the SGP. It would be easier to assess compliance with the rule and to inform the public.
- The number of escape clauses should be reduced to one. An independent body could assess compliance and the existence of circumstances justifying a deviation without being subject to political pressure.

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1 Introduction

In the eurozone, a single monetary policy that pursues price stability is combined with decentralised fiscal and economic policies under the responsibility of Member States. Sound fiscal policies are key to the stability of the eurozone. They ensure that eurozone Member States can take policy action when needed, e.g. during an economic crisis. Unsound fiscal policies in one or more eurozone Member States, however, can threaten price stability, if the European Central Bank is forced to finance such budget deficits.[1] In order to ensure sound fiscal policies in the eurozone, its Member States have agreed on common rules that define ceilings on public spending and public debt. As all EU Member States – except Denmark – are required to join the eurozone,[2] such common rules apply to all Member States. These rules are inscribed in the Stability and Growth Pact (SGP). In addition to the SGP, EU Member States have introduced at the EU level a mechanism for the surveillance of macroeconomic imbalances,[3] as well as an instrument for the coordination of national economic policies and reform efforts.[4] Furthermore, EU Member States have introduced at the national level, outside the framework of EU law, common fiscal rules.[5] These instruments, collectively known as the EU economic governance framework,[6] foster the pursuit of sound fiscal policies. They do it either directly through numerical fiscal targets or indirectly by recommending growth enhancing reforms to increase tax revenues.

As a consequence of the COVID-19 pandemic, public debt in most Member States is expected to increase sharply.[7] Therefore, it is even more important that the SGP – which was put on hold on 23 March 2020[8] in order to give Member States the fiscal space to counteract the effect of the crisis – is effectively able to foster sound fiscal policies when it comes back into force. This is all the more important as some Member States were already experiencing high levels of public debt before the start of the COVID-19 crisis.[9]

On 5 February 2020, the Commission released a communication initiating a debate on the review of the EU economic governance framework and, most importantly, the SGP. Secondary legislation requires such a review every five years.[10] In addition, various institutions and academics have in recent

1 COM(2020) 55 on economic governance review, P. 2.

2 Art. 140 TFEU. Demark is the only Member State which is not required to join the eurozone: see TFEU, Protocol No 16 on certain provisions relating to Denmark.

3 The Macroeconomic Imbalance Procedure; see for an overview: European Commission (2016), "The Macroeconomic Imbalance Procedure. Rationale, process, application: a compendium", Institutional Paper 39.

4 The European Semester; see for an overview: https://www.consilium.europa.eu/en/policies/european-semester/.

5 The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, commonly known as fiscal Compact; see https://ec.europa.eu/commission/presscorner/detail/en/DOC_12_2.

6 See for an overview: https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester/framework/eus-economic-governance-explained_en.

7 European Commission (2020), "European Economic Forecast – Spring 2020".

8 Council of the EU (2020), "Statement of EU ministers of finance on the Stability and Growth Pact in light of the COVID-19 crisis", press release 173/20.

9 See Gasparotti A. (2019), "Addressing the Italian malaise – ways to revive economic growth and reduce public debt", cepInput 9 (2019).

10 Art. 13 Regulation 1173/2011 on the effective enforcement of budgetary surveillance in the euro area; Art. 7 Regulation 1174/2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area; Art. 16 Regulation 1175/amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies; Art. 16 Regulation No 1176/2011 on the prevention and correction of macroeconomic imbalances; Art. 14 Regulation No 1177/2011 of 8 November 2011amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure; Art. 16 Regulation 473/2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the member states of the euro area.

years voiced their criticism of the functioning of the SGP, stressing the importance of reform.[11] This cep**Input** will therefore consider how the SGP should be reformed. Section 2 describes the functioning of the SGP, indicates the lack of compliance with its rules and explains why it is not working properly. Section 3 will then introduce the Communication on the EU economic governance framework review and what the Commission considers to be the shortcomings of the SGP. Section 4 discusses which measures could be introduced to address the shortcomings of the SGP and Section 5 provides a conclusion.

2 The rules of the Stability and Growth Pact and its shortcomings

For a better understanding of the SGP, its current rules are first summarised (Section 2.1). Then compliance with these rules is assessed (Section 2.2.). Eventually, the main shortcomings of the SGP and their consequences are presented (Section 2.3).

2.1 Current rules of the Stability and Growth Pact

The SGP[12] was established in 1997 to ensure the smooth functioning of the Economic and Monetary Union. It was built upon the Protocol on the Excessive Deficit Procedure (EDP) established in the Maastricht Treaty.[13] The SGP has been amended throughout the years – to adapt to new crises and challenges – in order to strengthen both EU surveillance of national fiscal policies and the enforcement of the rules for eurozone Member States. The current fiscal rules of the SGP include a "preventive arm" (Section 2.1.1) und a "corrective arm" (section 2.1.2).[14]

2.1.1 The preventive arm of the Stability and Growth Pact

The preventive arm of the SGP includes the following rules:

1. **Each Member State must have a public deficit under 3% of GDP**.
2. **Each Member State must be in line with its medium-term objective (MTO)** for its budgetary position. This MTO is a budget balance in structural terms – i.e. a nominal budget balance adjusted by the cyclical component, and excluding one-off and temporary policy measures[15] – and must fulfil the following criteria:
   - It should be close to balance or in surplus;
   - It must provide a safety margin to prevent public deficit from exceeding 3% of GDP;
   - It must ensure the sustainability of public finances or rapid progress towards it while allowing room for budgetary manoeuvre, in particular for public investment;

11 For an overview: Deutsche Bundesbank (2019), "European Stability and Growth Pact: individual reform options", monthly report April 2019, P.77-90; European Central Bank (2019), "Fiscal rule in the euro area and lessons from other monetary unions", ECB economic bulletin, issue 3/2019, P. 63-84; International Monetary Fund (2018), "Second-generation fiscal rules: balancing simplicity, flexibility, and enforceability", Staff Discussion Notes No. 18/04.

12 Section 2.1 is based upon: European Parliament – EGOV (2019), "An overview of the Stability and Growth Pact – September 2019". For further details: European Commission (2019), "Vade Mecum on the Stability & Growth Pact – 2019 Edition".

13 TFEU, Protocol No 12 on the excessive deficit procedure.

14 The main legal sources used in Section 2.1. are: Art. 121,126, and Protocol 12 TFEU; Regulation 1175/2011 amending Regulation 1466/97: On the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, so-called "preventive arm"; Regulation 1177/2011 amending Regulation 1467/97: On speeding up and clarifying the implementation of the excessive deficit procedure, so-called "corrective arm"; Regulation 1173/2011: On the effective enforcement of budgetary surveillance in the euro area, which strengthen the use of sanctions for eurozone Member States; Communication COM(2015): On making the best use of the flexibility within the existing rules of the Stability and Growth Pact, which clarifies how temporary deviations from the rules are interpreted .

15 For more details see: European Commission (2019), "Vade Mecum on the Stability & Growth Pact – 2019 Edition", P. 8-9.

- It must be revised every 3 years, other than in the event of a structural reform with a major impact on the sustainability of public finances.

Member States that have not achieved their MTO, should improve their structural balance by 0.5% of GDP per year as a benchmark. If the Commission establishes a significant deviation from their MTO or from the adjustment path towards it, it can trigger a corrective procedure, a so-called Significant Deviation Procedure (SDP). In the case of eurozone Member States an SDP can lead to a sanction consisting of an interest-bearing deposit of – by default – 0.2% of GDP.[16]

3. **Each Member State must have a public debt not exceeding 60% of GDP.** For Member States whose public debt exceeds 60% of GDP, the preventive arm includes a debt reduction benchmark, according to which **the distance to the 60% threshold should be reduced by an average of 5% yearly**.
4. Member States must respect an expenditure benchmark, according to which **the growth of public expenditure must not exceed the medium-term potential GDP growth.** For Member States that have not reached their MTO, net expenditure must grow at a rate which is below the medium-term rate of potential GDP growth.

Several clauses allow for a temporary deviation from these rules. It is for example possible to deviate from the MTO to implement structural reforms with a positive impact on potential GDP growth (so-called "structural reform clause"),[17] or to accommodate public investment, provided the GDP remains well below its potential (so-called "public investment clause").[18]

2.1.2 The corrective arm of the Stability and Growth Pact

A Member State

- whose public deficit exceeds the 3% of GDP threshold or
- whose public debt exceeds 60% of GDP and not diminishes according to the debt reduction benchmark

falls under the corrective arm of the SGP, if an EDP is triggered. Once a Member State is subject to the EDP, it is required to achieve annual budgetary targets in order to correct the excessive deficit within a set timeframe.[19] In case of non-compliance the EDP can result in financial sanctions. For eurozone Member States, sanctions take the form of annual fines of up to 0.5% of GDP until the EDP is placed in abeyance[20] or abrogated.[21] The fines are assigned to the European Stability Mechanism.[22]

2.2 Compliance with the rules of the Stability and Growth Pact

Compliance with the rules of the SGP has been low since it was established in 1997.[23] Low compliance levels are often caused by a lack of commitment from Member States to the SGP rules. For example,

16 Ibid. P. 38.
17 Ibid. P. 18-23.
18 Ibid. P. 24.
19 Ibid. P. 39-45.
20 Ibid. P. 66-67.
21 Ibid. P. 71-73.
22 Ibid. P. 70-73.
23 See for an overview: Ioannou D. and Stracca L. (2014), "Have the euro area and EU governance worked? Just the facts", European Journal of Political Economcy, Volume 24, page 1-17; Schuknecht L., Moutot P., Rother P., Stark J. (2011), "The Stability and Growth Pact: crisis and reform", ECB Occasional Paper No. 129; Baerg N., Hallerberg M. (2016), "Explaining

during the last cycle of surveillance – in November 2019 – as many as 10 of the 19 draft budgets of the eurozone Member States were assessed as being at risk of non-compliance with the rules of the SGP.[24] The European Fiscal Board (EFB) – an independent advisory board set up by the Commission whose role is to evaluate the implementation of EU fiscal rules[25] – produced an empirical investigation into compliance with the four numerical fiscal rules employed in the current version of the SGP (Table 1).[26] The results show that compliance with the SGP rules is low both for eurozone and non-eurozone Member States. This means that the SGP is not working properly.

Tab. 1: Compliance with EU fiscal rules: 1998–2018 (in % of Member States)

	Deficit rule	Structural balance rule	Debt rule	Expenditure benchmark rule	Overall compliance
EU-28	64%	49%	72%	42%	**57%**
EA-19	64%	46%	64%	40%	**54%**

Source: European Fiscal Board (2019a) P. 31. Note: (1) Compliance with a rule is the frequency of compliant cases across all Member States and years. (2) Overall compliance is the frequency of compliant cases across all rules, years, and Member States.

2.3 Shortcomings of the Stability and Growth Pact

The main shortcoming of the current SGP is the fact that its rules are overly complex. In its most comprehensive presentation, the document detailing the rules of the SGP is made up of over 200 pages.[27] This complexity results from the following issues:

- **Too many objectives**. The compliance assessment focuses on compliance with the four main rules. The fiscal adjustment required in order to comply with each rule varies between the member states because the necessary adjustment is based on the specific economic conditions of each Member State. Furthermore, explaining the need for fiscal adjustments to the public is difficult, as many rules and their underlying indicators are not easy to understand. It is also unclear whether partial compliance – e.g. with all rules but not the debt reduction – will be seen by the Commission as a breach of the SGP rules or not. For example, during the 2018 SGP surveillance cycle, the Commission's decision not to proceed with an EDP against Italy for breaching the debt rule was based entirely on projections provided by the Italian government.[28]
- **Unobservable variables**. The indicators used to calculate structural balance, the expenditure benchmark and the adjustments required to meet debt and deficit ceilings rely on forecasts and many unobservable variables.[29] The estimation of these variables is often "subject to massive errors

instability in the Stability and Growth Pact: the contribution of Member State power and euroskepticism to the euro crisis", Comparative Political Studies, Volume: 49 issue: 7, page(s): 968-1009.

24 European Parliament – EGOV (2020), "Implementation of the Stability and Growth Pact – March 2020".
25 See: https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/european-fiscal-board-efb.
26 European Fiscal Board (2019a), "Assessment of EU fiscal rules with a focus on the six and two-pack legislation".
27 European Commission (2018), "Vade Mecum on the Stability & Growth Pact – 2018 Edition".
28 European Fiscal Board (2019b), "Annual report 2019", P. 35-37.
29 See for a discussion and literature review on the subject: European Parliament – EGOV (2020), "Potential output estimates and their role in the EU fiscal policy surveillance – February 2020".

and revision".[30] Moreover, if the estimates made by the Commission are contested, Member States can try to justify non-compliance by claiming that it was based on more realistic estimates.

- **Too many escape clauses**. Assessing whether a special circumstance can be invoked for a temporary deviation from the rules and quantifying the permitted deviation is performed on a case by case basis. Consequently, some Member States are able to extensively (mis)use e.g. the structural reform clause in order to negotiate the right to deviate from their MTO.[31] This is possible because the Commission relies – at least partially – on information provided by the Member States. The more escape clauses that are available, the more likely it is that a Member State will (at least potentially) fulfil the conditions of one of these clauses.

Too many objectives, unobservable variables, and too many escape clauses give rise to the following issues:

- **The assessment of compliance with the rules is unpredictable.** Particularly, the Commission's and the Member States' assessments of compliance with fiscal rules may diverge.[32] Such divergence can be exploited by national governments or populist parties as an excuse not to commit to the rules of the SGP. The unpredictability of the assessment paves the way for it to be contested. National governments could exploit the complexity of the rules to contest the adjustment that is required to comply with them.
- **The assessment of compliance with the rules is open to discretion.** The Commission has institutional goals and long-term objectives – for example the 2030 climate and energy objectives[33] – that could be jeopardised if a Member State reduces green investments to comply with the SGP. When assessing compliance with the SGP rules, therefore, the Commission will exercise its scope for discretion to make political decisions instead of simply relying on an economic assessment. One way of doing this is the structural reform clause, as ii it does not specify a numerical target defining the major effect of a reform: Thus, the Commission can interpret it according to its discretion.[34] Ahead of elections, the Commission could grant a Member State a higher deficit than a strict interpretation of the rules would allow for, to prevent the rise of a populist party. For example, in the 2018 SGP surveillance cycle, the Commission used this scope for discretion granting Belgium, Italy, Latvia, Portugal, Slovenia, and Slovakia, a more lenient assessment.[35] Some Member States might decide not to commit to the SGP in the expectation that the Commission will offer them a more lenient assessment of compliance. The Commission, in turn, might feel compelled to grant leniency to avert a political backlash.

The SGP's main shortcomings thus erode the credibility of the SGP.

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30 Darvas Z., Martin P., Ragot X. (2018), "European fiscal rules require a major overhaul", Bruegel Policy Contribution Issue 18, P. 4.

31 Schout A., and Padberg C. (2019), "Monitoring and enforcement in the European Union: towards a multilevel subsidiarity-based independent governance model – the case of the Stability and Growth Pact", Clingendael Policy Brief, P.11.

32 European Court of Auditors (2019), "EU requirements for national budgetary frameworks: need to further strengthen them and to better monitor their application", Special Report No 22/2019.

33 See for an overview: https://ec.europa.eu/clima/policies/strategies/2030_en.

34 Schout A., and Padberg C. (2019), "Monitoring and enforcement in the European Union: towards a multilevel subsidiarity-based independent governance model – the case of the Stability and Growth Pact", Clingendael Policy Brief, P.11.

35 European Fiscal Board (2019), "Annual report 2019", P. 9.

3 Communication COM(2020) 55 on economic governance review

On 5 February 2020, the Commission released its review on economic governance [COM(2020) 55]. In parallel, the Commission launched a public debate on the effectiveness of the SGP and the broader economic governance framework. The Commission will consider all views and, on that basis, form an opinion by the end of 2020.[36] The Communication discusses the SGP's "strengths as well as possible areas for improvement".[37] As further elaborated in the Staff Working Document[38] accompanying the Communication, the Commission's main findings in the review are:

- The SGP has contributed to the strengthening of EU economies and the reduction of debt levels, which has helped to create the conditions for sustainable growth and reduced vulnerabilities and harmful spillovers related to economic shocks. However, public debt levels remain high in some Member States, which are also far from their fiscal objectives, while reform efforts are waning.
- The SGP has fostered convergence in the economic performance of Member States, with all Member States having exited the EDP. However, the fiscal stance at Member State level has often been pro-cyclical. Moreover, the composition of public finances has not become more growth-friendly, with Member States often increasing expenditure on consumption rather than on investment.
- The SGP has grown excessively complex. The complexity results from the SGP pursuing multiple objectives and the need to consider a wide variety of evolving circumstances. Such complexity is reflected in the use of several indicators, of which a number are non-observable. As a result, the SGP has become less transparent, which hampers predictability, communication, and political ownership.

The Communication finally presents a list of issues for public debate on how the current framework can be improved. These main issues are summarised in Figure 2.

Fig. 1: Non-exhaustive issues open for public debate on the economic governance review

1. How can the SGP ensure fiscal policies that safeguard long-term sustainability, while allowing for short-term stabilisation?
2. How can the SGP incentivise Member States to undertake key reforms and investments needed to help tackle economic, social, and environmental challenges while preserving debt sustainability?
3. How can one simplify the SGP and improve the transparency of its implementation?
4. How can the SGP ensure effective enforcement? What should be the role of pecuniary sanctions, reputational costs and positive incentives?

The Commission acknowledges that the complexity of the SGP has negative consequences. In the Communication, it specifically mentions that the complexity of its rules has made the SGP less transparent and predictable.[39] To a certain extent, therefore, the Commission's assessment recognises

[36] COM(2020) 55, P. 20.
[37] Ibid. P. 16.
[38] Commission Staff Working Document "Report on the application of Regulations (EU) No 1173/2011, 1174/2011, 1175/2011, 1176/2011, 1177/2011, 472/2013 and 473/2013 and Council Directive 2011/85/EU", SWD(2020) 210 final, accompanying COM(2020) 55 final.
[39] COM(2020) 55, P. 16.

the shortcomings elaborated in Section 2.3. The main point, however, is overlooked by the Commission: It is the ample use of the existing scope for discretion.

4 Better enforcement of the SGP

As highlighted in the previous sections, the SGP has not been able to fulfil its task. The complexity of the rules leads to unpredictability and creates scope for discretion in the assessment of compliance. Both aspects contribute to a lack of compliance with the rules. There is therefore a convergence of views on the need to simplify the SGP rules.

While the rules can be simplified, there are trade-offs in this process. First, the number of objectives could be reduced. With fewer objectives, the assessment of the development of public finances will be less overarching. Second, the number of unobservable variables could be reduced but, as the SGP is based on forward-looking elements, a certain degree of unobservability should be permitted. Third, the number of escape clauses could be reduced. But for economic reasons there should at least be a general escape clause that allows a Member State to deviate from the SGP rules in case of circumstances outside of the Member State's control, e.g. a natural disaster. Whether a circumstance justifies the activation of such escape clause remains a discretionary decision.

To enable the SGP to foster sound fiscal policies in the Member States, a viable reform of its functioning is introduced.[40] The proposed improvements address the root causes of complexity in the SGP, curbing – to a high degree – its negative consequences. The legislator should:

Remedy for shortcoming 1 (too many objectives): **Focus on one objective**. The rule of choice should ensure debt sustainability – which is currently the most important aim of the SGP. Such a rule should be an expenditure rule with a debt correction.

- It could entail a ceiling on the growth rate of nominal expenditure based on potential GDP growth, minus a coefficient for the correction of high public debt.
- Such debt coefficient could either be applied uniformly to all Member States every year or be set individually and attained over a period of e.g. 3 years.
- The former allows for greater correction the higher the public debt, e.g. a reduction of 5% in the distance to the 60% threshold per year.
- The latter gives each Member State more flexibility to define its debt reduction goals – possibly paving the way for adjustments of smaller magnitude – but it may also increase national ownership with regard to reaching this target.
- Once the debt correction is factored into the maximum growth of expenditure, Member States only have one objective to pursue, through compliance with an indicator that is under their control.
- Therefore, a decision over compliance with this rule is easier to scrutinise, making the government more accountable.

Remedy for shortcoming 2 (unobservable variables): **Reduce the number of unobservable variables.** Unobservable variables cannot be completely discarded, due to the forward-looking nature of the SGP.

- Nevertheless, moving to a single objective will reduce their number.

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[40] The Table builds upon – and develops – a growing body of reform proposals: European Fiscal Board (2017), "Annual report 2017", P.52-64; International Monetary Fund (2015), "Reforming fiscal governance in the European Union", Staff Discussion Note/15/09; Clayes G., Darvas Z., Leandro A. (2016), "A proposal to revive the European Fiscal Framework", Bruegel Policy Contribution Issue 07; Kopits G. (2018), "How could the Stability and Growth Pact be simplified?", European Parliament - EGOV PE 614.509; Cottarelli C. (2018), "How could the Stability and Growth Pact be simplified?", European Parliament - EGOV PE 614.503; Heinemann F. (2018), "How could the Stability and Growth Pact be simplified?", European Parliament - EGOV PE 614.501.

- Moreover, as expenditure rules rely on multi-year averages of potential GDP growth, the margin for error or revision is limited. This is especially true when compared with the magnitude of errors that occur under the current rules.

Remedy for shortcoming 3 (too many escape clauses): **Shift to one general escape clause and install an independent assessment body.** Exceptional circumstances may still require intervention by the Member State outside the boundaries of the expenditure rule.
- Such measures should be assessed on a case by case basis. This avoids the need to codify detailed rules whose reference values still cannot cover all possible events.
- Assessing the existence of special circumstances that justify a deviation from the rule – and consequently overall compliance with the SGP – should be handed over to an independent body. This ensures that the assessment of compliance is insulated from political considerations.
- The European Fiscal Board[41] could be given this task, provided it is granted full independence from the European Commission and national governments.
- When the independent body certifies non-compliance, it would prompt the Council to issue a recommendation to the concerned Member State to take corrective action.
- The recommendation from the EFB will be deemed to be adopted unless the Council decides by qualified majority to reject it.[42] That way, the Council will be held accountable for inaction against a non-complying Member State.

5 Conclusion

The review of the SGP should be regarded as key by EU institutions and Member States. As a consequence of the COVID-19 crisis, public debt will increase sharply in most Member States, leaving some of them with virtually no fiscal leeway in the event of a new crisis. It is therefore fundamental that the SGP fosters sound fiscal policies in Member States. This is especially important in the eurozone, where unsound fiscal policies in a Member State can threaten price stability if the ECB is forced to indirectly finance budget deficits, e.g. via programs like the Public Sector Purchase Programme (PSPP) or the Pandemic Emergency Purchase Programme (PEPP).

Since its entry into force in 1997, the SGP has not worked properly. There has been a lack of compliance with its rules, as some Member States are not committed to them. The main shortcoming of the current SGP is that its rules have become overly complex. This is because the rules account for a growing number of evolving circumstances. Currently the SGP has four different objectives, the fulfilment of which is analysed by monitoring different variables, several of them unobservable, meaning that their estimate is subject to revision and error. Additionally, the SGP includes a set of escape clauses that allow for a deviation from the rules in specific circumstances. The complexity of the rules has two main consequences: the assessment of compliance with the SGP is unpredictable and open to discretion. First, it is unpredictable because the rules can be interpreted differently by different actors, leading Member States and the Commission to produce diverging assessments of compliance with the rules. This undermines the credibility of the whole SGP and gives national governments grounds to contest the assessment performed by the Commission. Second, it is open to discretion because some of the existing rules have only loosely defined targets. As the Commission has various interests to protect and goals to pursue, it may use its discretion for political reasons, e.g. to ensure that environmental targets are met. The ample use of discretion by the Commission

[41] See Section 2.2.

[42] So-called Reversed Qualified Majority Voting (RQMV). Such voting system is already in place for decisions on most sanctions under the SGP. See: European Commission (2019), “Vade Mecum on the Stability & Growth Pact – 2019 Edition”, P. 94.

undermines the functioning of the SGP: Member States may decide not to comply with the rules – expecting the Commission to give them leeway – while the Commission may be compelled to grant such leeway to avoid political backlashes.

This cepInput, therefore, proposes a reform of the SGP that would limit these problems whilst fostering sound fiscal policies in Member States. First, the rules of the SGP should be simplified. This can be done by moving from four objectives to a single objective, fulfilment of which would be assessed by way of an expenditure rule. A single objective is easier to understand and communicate to the public. Moreover, a single objective would reduce the use of unobservable variables. The presence of many escape clauses should be reduced to a general escape clause for exceptional circumstances, to be assessed on a case by case basis. Second, to avoid political exploitation of the discretion incorporated into the escape clause, an independent body should be tasked with assessing compliance with the rules of the SGP. Being insulated from both Member States and the Commission, such a body would resist political pressure and commit to its single task, i.e. the assessment of national budgets.

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