THE EUROPEAN UNION'S FISCAL GOVERNANCE ARCHITECTURE AND IMPLICATIONS FOR THE NEW MEMBER STATES

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Abstract: *The purpose of this paper is to briefly present the architecture of the tax governance of the European Union and the instruments through which it acts. The numerous crises and the great difficulties or pressures faced by the European Union's economies have made it possible to create a solid framework for the coordination and surveillance of fiscal policies, thereby striking the right balance between the objectives of sustainability and flexibility. In addition, this study emphasizes the implications for countries that joined the European Union after 2004. Although the regulatory framework has undergone many changes over time, we observed that, in addition to bringing benefits, it has significantly reduced the credibility that the Member States of the Union had concerning the three pillars of fiscal governance.*
Keywords: *fiscal governance, credibility, reforms, fiscal prudence*

Introduction

In 2004, the European Union experienced one of the most difficult challenges in the integration process with the accession of the 10 Central and Eastern European countries: Estonia, Latvia, Lithuania, Cyprus, Malta, Poland, Slovakia, Slovenia, Hungary and the Czech Republic. Three years later, in 2007, Romania and Bulgaria joined the European Union, and on July 1, 2013, Croatia also joined the block, bringing the total number of members to 28. In December 2020, the UK left the European Union, following a referendum on May 24, 2016, in which 51.9% of Britons voted to leave the EU. To join the EU, the 13 countries had to fulfil the provisions of Articles 2 and 49 of the Treaty on European Union, as well as the criteria and conditions for membership. In the case of Romania and Bulgaria, the accession treaty provided for additional safeguard clauses to address possible economic, internal market and justice difficulties. The entry of the 10 former communist countries in 2004 has raised some mistrust in European integration, leading sceptics to say that another accession will not be possible very soon (Emerson, et. al, 2006). However, two more countries joined in 2007. The gaps between the "Europe of 15" and the "Europe of 12" were very large, which led to their organization in the two categories (Onofrei, 2013). The fact that the countries that joined after 2004 did not have the same level of development as those already existing in the European construction meant that their accession process generated high costs for the already existing members (Lammers, 2004).

Improving economic policies at EU level became a necessity following the outbreak of the great economic crisis in 2008, when the US investment bank Lehman Brothers went bankrupt. The effects of the crisis included: spending restraint among both consumers and business, thus highlighting weaknesses in economies; the negative impact

on public finances, the banking sector, economic growth, competitiveness and jobs. The economy began to stagnate and went into recession, businesses closed their doors, people lost their jobs and funding for unemployment benefits increased as tax revenues fell and states had to borrow money, raising public debt and interest rates to intolerable levels, bringing some states close to bankruptcy (The General Secretariat of the Council, 2017).

The fiscal behavior of a government, according to the study of Mihaela Onofrei et. al (2020), is to ensure cash flows to support the long-term needs of future generations, which leads to the need for a sound fiscal policy. Furthermore, the authors argued that after the crisis that broke out in 2008, attempts were made through the fiscal governance framework to improve the quality of public finances by striking a balance between the needs of political stakes and sustainable objectives.

In order to address its credibility shortcomings following the crises it has experienced, the EU's fiscal governance has been reformed in three waves, according to Alexandre de Steel (2014). The first wave consisted of the adoption in November 2011 of the "six-pack", a set of five regulations and one directive; the second wave was the adoption in March 2012 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union – signed by 25 EU member states – that is outside the Union's legal framework but based on its institutions; the third wave was the adoption in May 2013 of the "two-pack", which applied only to euro area countries and introduced new monitoring tools. Overall, the author concluded that these instruments improved the institutional framework and strengthened Commission and Council surveillance of national fiscal policies.

Briefly, in what follows, we provide an x-ray of the main instruments that are the subject of our study.

The Stability and Growth Pact (SGP) is one of the pillars of fiscal governance of the European Union. Its legal basis can be found, in primary EU law, in Articles 121 and 126 of the Treaty on the Functioning of the European Union and in Protocol No 12 on the excessive deficit procedure; in the Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure, as amended by Council Regulation (EC) No 1056/2005 of 27 June 2005 and by Council Regulation (EU) No 1177/2011 of 8 November 2011 as the corrective arm of the Pact, and last but not least, in the Council Regulation (EU) No 1173/2011 of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area (Angerer, 2021).

The "watchdog that doesn't bite", as the Stability and Growth Pact is metaphorically considered, has as its main purpose the defense of EMU. Studies show that while it has been instrumental in getting Member States to comply with the two macroeconomic indicators of not exceeding the 60% of GDP public debt threshold and limiting the budget deficit to 3% of GDP, it has not given firm sanctions to countries that have broken these rules (Angerer, 2021). Relevant examples in this respect are considered to be France and Germany, which, although they have repeatedly violated the 3% deficit rule, have not been subject to sanctions (Turșie, 2012).

The first credibility crisis faced by the Stability and Growth Pact was in 2003, when the Member States meeting within the Council decided to suspend the recommended excessive deficit procedure against France and Germany, even though, as mentioned above, they had repeatedly breached this threshold. This lack of credibility was caused by the very inconsistency of the pact, as Corina Turșie (2012) points out, which has so far

suffered from several reforms caused by crisis situations. Moreover, regarding the failure of the SGP, the author questions the functional inconsistency of the Pact that is due to the existence of an asymmetry between the centralized monetary regime at EU level and the highly decentralized fiscal regimes at Member State level, the single market and the single currency not being coupled with a single fiscal policy, causing the failure to manage the resulting conflicts. Montesserat Ferré (2012) also admits that the credibility of the Pact has been undermined both by the reluctance to apply sanctions when France and Germany ran excessive deficits and by the reforms introduced in 2005 and 2011, which showed that countries were unwilling to comply with the fiscal discipline imposed by the original SGP.

Institutional inconsistency, a second explanation for the failure of the SGP according to the study of Turșie (2012), refers to the political rather than economic nature of the SGP. Specifically, it refers to those monetary sanctions against states that violate the rules that must be voted by a qualified majority of the Council, fact that implies the reluctance of states to impose sanctions on each other for fear that at some point they could end up being judged by their peers for the same reasons (see also Begg & Schelkle, 2004). Another weakness of the SGP is the asymmetric, undemocratic application of the Pact according to the size and influence of the states (Buti & Martinot, 2000; Eriksen, 2018). Thus, large states such as France and Germany have been in breach of these provisions far more often than small states such as Greece or Portugal. The counterintuitive explanation for this is that, from an economic point of view, large states made greater sacrifices when they gave up their own monetary policy, thus having greater freedom to mitigate economic shocks. A second consideration of asymmetric application is the weight of the large states' membership in the Council, which gives them more voting power (Turșie, 2012).

The SGP contains three components whose aim is to establish the necessary instruments for surveillance of fiscal policies and correction of excessive deficits. More precisely, the SGP components are:

1. The preventive component – that aims to ensure sound public finances through multilateral surveillance in accordance with Article 121 TFEU, Regulation (EC) No 1466/97 as amended and the new Regulation (EU) No 1173/2011. The main instruments of the preventive arm of the SGP are the stability and convergence programmes.
2. The corrective arm: Excessive Deficit Procedure (EDP) – that aims to prevent the occurrence of excessive deficits and to correct them promptly. The EDP is governed by Article 126 TFEU, Protocol 12 to the Treaty, Regulation (EC) No 1467/97 as amended and the new Regulation (EU) No 1173/2011. According to the amended SGP, the EDP can be triggered if the deficit criterion (a general government deficit is considered excessive when it exceeds the 3% of GDP reference value at market prices) and the debt criterion (debt exceeds 60% of GDP) are breached (European Commission, 2020).
3. The general derogation clause in the SGP – first activated in March 2020 to give Member States room to maneuver to adopt emergency measures with major budgetary consequences (Angerer, 2021). Once activated, the clause allows a Member State in the precautionary phase to temporarily deviate from the adjustment path towards the medium-term budgetary objective, provided it does not jeopardise the sustainability of public finances in the medium term. In short, the general escape clause does not suspend the SGP procedures but allows the Commission and the Council to deviate from the budgetary requirements that would normally apply.

In March 2012, at the European Council meeting, all Member States except the UK and the Czech Republic signed the Treaty on Stability, Coordination and Governance (TSCG) in the Economic and Monetary Union, the budgetary component of which is the Fiscal Compact. The aim of the TSCG is, as stated in article. 1, para. (1) "[...] 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, thereby supporting the achievement of the European Union's objectives for sustainable growth, employment, competitiveness and social cohesion" (TSCG, 2012:9).

The Treaty shall apply to the Member States whose currency is the euro and to the other States to the extent and under the conditions laid down in Article 14, namely the Contracting Parties which have ratified this Treaty. According to Article 12(3), the Heads of State or Government whose currency is not the euro and who have ratified the Treaty must participate in the discussions at the euro area summits on the competitiveness of the Contracting Parties, on the changes to the overall architecture of the euro area and on the basic rules which will apply to it in the future and, where appropriate and at least once a year, in the discussions on specific issues related to the implementation of the Treaty.

The Fiscal Compact is based on the 1997 Stability and Growth Pact and its 2005 revised version. The measures taken in the "Six Pack" and later in the "Two Pack" are intended to increase fiscal prudence and overlap with the Fiscal Compact. The main innovations of the Fiscal Compact are the introduction of the structural budget balance as an operational objective in fiscal policy and the aim to strengthen the accountability of countries for their fiscal performance. The use of the structural balance is intended to reduce the risk of pro-cyclical fiscal policies, while ensuring a smooth evolution of the debt stock as a percentage of GDP (Schimmelfennig, 2014). However, turning the structural balance into an operational target has also disadvantages. These arise from the uncertainties of the calculation and of the forecasting of the cyclically adjusted balance, as well as from the possibilities of discretionary adjustment of the structural balance. Uncertainties complicate the implementation and enforcement of the structural deficit target and may also provide opportunities for distortion and concealment of information. For these reasons, national ownership of the structural balance target is of fundamental importance for the effectiveness of the Fiscal Compact (Kukk & Staehr, 2015). Some authors consider that the Fiscal Compact can be seen as a simple instrument for forcing through fiscal austerity, and, in addition, that its general fiscal objectives do not consider country-specific characteristics. At the other end of the spectrum are those who argue that it could be effective as it forces countries to take more responsibility for their fiscal management. (Kukk & Staehr, 2015)

According to Article 3 of the TSCG, Member States' budgetary positions must be in balance or in surplus. This rule is respected when the annual structural balance corresponds to the country-specific medium-term objective, with a lower limit on the structural deficit of 0.5% of GDP at market prices, and if the general government deficit is below 60%, the limit is 1% of GDP, cf. para. (d) of the same article. Paragraph (e) states that if significant deviations from the medium-term objective are observed, a correction mechanism is automatically triggered, whereby the contracting parties concerned are obliged to implement measures to correct the deviations within a set timeframe.

The European Semester is a new governance architecture aimed at coordinating socio-economic policies in the EU and was created in 2010 in the wake of the sovereign debt crisis. The Semester's procedures build on the EU's existing processes for coordinating fiscal, economic, employment and social policies. It was introduced as part of a comprehensive set of measures to strengthen economic governance (the so-called "SixPack", "Two-Pack" and "Fiscal Compact"). The Semester was designed to serve as the governance architecture for the "thematic coordination" of Member States' policies to achieve the Europe 2020 strategy's objectives of "smart, sustainable and inclusive growth", which was explicitly designed to have a stronger social dimension than the Lisbon Strategy, including specific guidelines and targets on poverty and social inclusion (Verdun & Zeitlin, 2018).

Literature review

Literature defines fiscal responsibility as "the sum of institutional arrangements in support of government actions to achieve responsible, sustainable and transparent fiscal policy" (Onofrei et. al., 2020). According to the authors there are a number of dysfunctions within the European Union, both at the level of institutional architecture and the underpinning of the fiscal governance framework. These dysfunctions reveal the lack of mechanisms to coordinate and establish a common framework for action. Fiscal councils play a significant role in strengthening the sustainability of public finances; and strengthening their role and independence, together with addressing numerical fiscal rules, will strengthen the fiscal-budgetary framework. However, in the absence of European unity, the role of fiscal councils in stabilizing fiscal policy depends on the specificities of individual countries and the climate of fiscal conservatism.

On the EU governance architecture, Jonathan Zeitlin (2016), in his paper 'EU experimentalist governance in times of crisis', characterizes it as 'a new experimentalist architecture'. In this type of iterative, multi-level architecture, open framework objectives and indicators for assessing their achievement are jointly set by the EU institutions and Member States, usually in consultation with civil society stakeholders. Lower-level units (such as national ministries and regulators) are then given discretion to take these targets forward in the most appropriate ways, tailored to their local contexts. But in return for this autonomy, such units must report regularly on their performance and participate in a peer review in which their results are compared with those of other units following different means to the same ends. If lower-level units do not make considerable progress, they are expected to take corrective action, based on an improvement plan that draws on the experience of their peers. Objectives, measurements and decision-making procedures are then periodically reviewed in response to problems and opportunities revealed by the review process and the cycle is repeated.

The advantages of such governance architectures are, according to Zeitlin (2016), the following: adapting common objectives to local contexts that are varied, rather than imposing one-size-fits-all solutions; providing a mechanism for coordinated learning from experimentation by other participants by comparing different approaches; problems identified in one implementation phase can be corrected in the next iteration, since the objectives and means of achieving them are provisional and subject to revision. (Zeitlin, 2016)

The long-term objectives of balanced and sustained economic growth are closely followed by both cohesion policy and economic governance. The new Member States have made noteworthy progress in the area of cohesion following their accession to the EU. Countries such as the Czech Republic and Slovenia have reached a similar level to that achieved by the older cohesion countries (Greece, Ireland, Portugal and Spain). For some new Member States, namely Bulgaria and Romania, rapid real GDP growth before the crisis was not necessarily accompanied by commensurate improvements in SEDI.

The dynamics of public debt ratios started to differ significantly after the onset of the economic crisis in 2007-2010. After the onset of the economic recession in 2007, public debt to potential GDP ratios started to deteriorate in all Member States. Mehrota and Peltonen (2005) analyzed the links between socio-economic development and fiscal policy, using socio-economic development as a dependent variable. For the sample of four countries (Portugal, Greece, Ireland and Spain) with a long history of cohesion, they find that a decrease in public debt is beneficial for socio-economic development in the medium term and that fiscal consolidation is important when it comes to promoting socio-economic development in countries that have benefited from cohesion funds, relative to other Member States.

The increase in the share of public debt in potential GDP after 2007 was almost as large as its reduction in the period 1998-2007, leading to almost unchanged average ratios for the whole period 1998-2010 (increases of 1.25 points of potential GDP). In contrast, in addition to the four oldest cohesion countries, the new Member States that joined in 2004 were left at the end of the 1998-2010 period with a higher share of gross public debt in potential GDP (an increase of 28 points of potential GDP for the former and 14 points of potential GDP for the latter). The public debt-to-potential GDP ratios of the newly acceded Member States are on average relatively low, apart from Hungary, which is the only country in this group with a public debt-to-potential GDP ratio above the 60% reference value in the period 1998-2010. In contrast, in 2010, the old non-cohesion Member States had on average public debt-to-potential GDP ratios of 66%, which is relatively close to the reference value. SEDI showed an upward trend, although some countries progressed faster than others. Prior to 2007, SEDI experienced declines only in rare cases, i.e., Latvia and Estonia in the mid-1990s due to the disruptive transformation of the transition to market economies, but also in Sweden in the early 1990s due to the economic and banking crisis (Tomova et. al., 2013).

From an economic point of view, enlargement to central and eastern Europe has benefited all Member States. The GDP of the 12 countries that joined the EU in 2004 and 2007 increased from €577 billion in 2004 to €1026 billion in 2013, an increase of 77%. The GDP of the 15 countries that were already members of the EU before 2004 was €10 047 billion, rising to €11 999 billion in 2013, an increase of 19%. As for trade between countries already members before 2004 and those that joined after 2004, it has increased significantly, from €162 million in 2004 to €300 million in 2013, an increase of 185%.

In a Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, the former outlines the need to use the surveillance instruments available under the Treaty on the Functioning of the European Union, to amend and complement them if the situation so requires, to establish a European Semester to help coordinate economic policies so that Member States benefit from early

coordination in drawing up their national stability or convergence programmes, national budgets and national reform programmes. As regards strengthening economic policy coordination, the Commission has proposed to ensure the strictest compliance with the Stability and Growth Pact and the closest possible coordination of budgetary policies. This could be achieved through measures such as strengthening the preventive dimension of budgetary surveillance, respecting the rules on the sustainability of public finances, the design and assessment of stability programmes through the introduction of the European Semester and the imposition of mandatory interest rate deposits in case of inappropriate budgetary policies, greater accuracy in reflecting EU budgetary surveillance priorities in national budgetary frameworks by integrating the objective of sound public finances into national legislation, giving high priority to public debt and sustainability of public finances, effective implementation of the public debt criterion in the excessive deficit procedure. Thus, Member States with a public debt exceeding 60% of GDP must be subject to an EDP if the debt level does not fall below the reference value (European Commission, 2010).

As far as the euro area is concerned, a macroeconomic surveillance framework is to be developed on the basis of the Europe 2020 strategy, in the form of a regulation based on Article 136 TFEU, the creation of a scoreboard reflecting internal and external developments, country-specific recommendations, etc.

Conclusions

The present study aims to present the regulatory framework and the main instruments of fiscal governance of the European Union. To carry out this work, we used the documentary research method, analysing documents relevant to the topic (specialised articles, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, communications, official websites of the European Union). The present analysis is descriptive, comparing (using deductive and inductive methods) the rules applicable in the European Union, and the expectations created by them, with the way in which it actually works, in order to highlight the architecture of EU fiscal governance and the implications it has had on the countries that joined the EU after 2004.

We have been able to observe during the course of the work that the fiscal governance of the European Union has undergone a series of changes and improvements over time, with the main aim of creating a framework that is as solid as possible for coordinating and supervising the fiscal policies of the Member States, a framework that prevents the emergence of situations in which public finances become unsustainable. It is of an experimental nature due to the numerous changes made, changes which have only cast doubt on its credibility. The very large discrepancies between the Member States of the Union show that this governance model needs further revision in order to meet all the needs of the Member States, to be carried out once the problems linked to the COVID-19 pandemic have been overcome.

The accession to the European Union of the Central and Eastern European countries has brought many economic as well as political benefits to both existing and newly acceded countries. The price paid by the existing countries was quite high, as the new countries were not at the same level of development as the old ones, which made future enlargement viewed with scepticism by EU citizens. Most of the countries that joined in 2004 have had quite brisk growth rates, relative to GDP per capita, which shows that the EU's fiscal policy

architecture has had positive implications for them. In agreement with Mihaela Onofrei et al. (2020), I believe that the period after the COVID-19 pandemic is over will bring changes to the European governance framework, both in terms of fiscal-budgetary rules and the mechanisms underlying their implementation.

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