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OPINION OF THE LEGAL SERVICE¹

From: Legal Service

Subject: Proposed incorporation into Union law of the substance of Title III 'Fiscal Compact' of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) by Commission proposals for a Regulation of the European Parliament and the Council on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97, for a Council Regulation amending Regulation No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure and for a Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States

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I. INTRODUCTION

1. On 26 April 2023, the European Commission presented proposals for a Regulation of the European Parliament and the Council on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97², for a Council Regulation amending Regulation No 1467/97³ on speeding up and clarifying the implementation of the excessive deficit procedure and for a Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States⁴ (referred together herewith as the ‘Economic Governance Review (EGR) package’).
2. The proposals aim *‘at making the EU governance framework simpler (by using a single operational indicator in the form of a net expenditure path and by simplifying reporting requirements in particular through the introduction of a holistic, single, integrated medium-term fiscal-structural plan), more transparent and effective, with greater national ownership and better enforcement, allowing for reform and investment while reducing high public debt ratios in a realistic, gradual and sustained manner’*⁵. Moreover, *‘by aiming at sound and sustainable public finances as well as growth promotion, the reformed framework also meets the main objectives of the Fiscal Compact which forms Title III of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG). In addition, other elements of the proposed legislation retain the substance of the Fiscal Compact’*⁶.

² COM(2023) 240 final.

³ COM(2023) 241 final.

⁴ COM(2023) 242 final

⁵ Explanatory Memorandum to the proposal for a Regulation on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97, p. 2.

⁶ Ibid., p. 3.

3. Accordingly, all the three proposals from the EGR package contain an identically worded recital, which specifies that *‘they establish a reformed Union economic governance framework that incorporates into Union law the substance of Title III ‘Fiscal Compact’ of the [TSCG] in the Economic and Monetary Union, in accordance with Article 16 thereof*⁷.
4. In this connection, during the ongoing preparatory work in the Council on the proposals, the following questions have been raised in the Financial Counsellors’ working party:
- i) does the EGR package incorporate the ‘substance’ of the Fiscal Compact within the meaning of Article 16 TSCG;
 - ii) what would be the consequences on the legal regime of the TSCG of the adoption of the EGR package; and
 - iii) would Article 7 TSCG remain applicable where the EGR package supersedes the TSCG.
5. The Council Legal Service (CLS) recalls that identical issues have already been analysed in its opinion of 25 April 2018⁸ on the proposal for a Council Directive laying down provisions for strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States.

⁷ Respectively recital (32) of the proposal for a Regulation on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97, recital (23) of the proposal for a Council Regulation amending Regulation No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure and recital (8) of the proposal for a Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States.

⁸ Document 8336/18 (‘the 2018 CLS opinion’).

6. Thus, issues related to the effects on the legal status of the TSGC provisions if they were incorporated into Union law in a manner which corresponds to its ‘substance’ have already been discussed and answered in points 30 to 39 and 41 of the 2018 CLS opinion. Given that the current questions (2) and (3) are premised on the same assumption, there are no new elements in the EGR package that alter the conclusions of the 2018 opinion in this regard. Accordingly, the present opinion will focus on question (1), to the extent that the EGR package is materially different from the proposal which was subject to the analysis in the 2018 CLS opinion. However, where relevant, this opinion still relies on the 2018 opinion in support of this analysis.

II. LEGAL AND FACTUAL BACKGROUND

7. The TSCG entered into force on 1 January 2013 and brought in the obligation for Contracting Parties to enshrine in binding and permanent national provisions, preferably constitutional, a balanced-budget rule in cyclically adjusted terms, with a lower limit of a structural deficit of 0.5% of their gross domestic product (GDP), which can become 1% of GDP for Member States with a debt level significantly below 60% of GDP and with low risks for the long-term sustainability of public finances (‘balanced budget rule’, Article 3(1) TSCG). The TSCG further requires that the balanced budget rule takes effect in the national law of the Contracting Parties *‘through provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes’* (Article 3(2) TSCG). This is complemented by the requirement to ensure that significant deviations automatically trigger a correction mechanism (Article 3(2) TSCG). The Commission has further proposed some common principles on the national fiscal correction mechanisms, including the role and independence of monitoring institutions⁹.

⁹ Communication from the Commission on common principles on national fiscal correction mechanisms (COM(2012) 312 final).

8. The TSCG equally contains specific enforcement mechanisms, whereby the failure to duly incorporate into national law the balanced budget rule may lead to an action before the Court of Justice of the EU for breaching the obligations under the Treaty (Article 8 TSCG), as well as more general governance commitments, such as those relating to the voting in the framework of the Excessive Deficit Procedure (EDP) (Article 7 TSCG), the ex-ante coordination of economic policy reforms (article 11) and the possibility to hold Euro Summits (Article 12 TSCG).¹⁰
9. The TSCG also mandates that *‘within five years, at most, of the date of entry into force of this Treaty, on the basis of an assessment of the experience with its implementation, the necessary steps shall be taken, in accordance with the [TEU] and the [TFEU] with the aim of incorporating the substance of this Treaty into the legal framework of the European Union’* (Article 16 TSCG).

¹⁰ This corresponds to paragraph 6 of the 2018 CLS opinion.

10. The Commission considers that:

‘by building on the experience with the implementation of the TSCG by the Member States, the proposed legislative package retains the Fiscal Compact’s medium-term orientation as a tool to achieve budgetary discipline and growth promotion. The package includes a strengthened country-specific dimension aimed at enhancing national ownership, including by means of a stronger role for Independent Fiscal Institutions, which draws essentially on the Fiscal Compact’s common principles proposed by the Commission in accordance with Article 3(2) of the TSCG. The analysis of expenditure net of discretionary revenue measures for the overall assessment of compliance required by the Fiscal Compact is set out in this Regulation. As in the Fiscal Compact, temporary deviations from the medium-term plan are allowed only in exceptional circumstances in this Regulation. In a similar vein to the Fiscal Compact, in case of significant deviations from the medium-term plan, measures should be implemented to correct the deviations over a defined period of time. The package strengthens fiscal surveillance and enforcement procedures to deliver on the commitment of promoting sound and sustainable public finances and sustainable and inclusive growth. The economic governance framework reform, thus, retains the fundamental objectives of budgetary discipline and debt sustainability set out in the TSCG’¹¹.

¹¹ Respectively recital (32) of the proposal for a Regulation on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97, recital (23) of the proposal for a Council Regulation amending Regulation No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure and recital (8) of the proposal for a Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States.

III. LEGAL ANALYSIS

11. Two preliminary remarks must be made: first, the TSCG obligation to take the necessary steps with the aim of incorporating the ‘*substance*’ of that Treaty into the EU legal framework, cannot have the effect of restricting the level of discretion of the EU legislator to adopt the framework of economic governance that it sees fit. International agreements concluded among Member States cannot jeopardise the autonomy of the EU legal order.
12. Second, as explained in paragraph 9 of the 2018 CLS opinion, ‘*it is up to the Contracting Parties to the TSCG to assess the meaning and effects of the provisions they themselves have negotiated and ratified.*’ As in that opinion, the present opinion is thus limited to a number of criteria for interpretation to allow the Contracting Parties to assess whether the proposed EGR package would incorporate into the law of the Union the ‘*substance*’ of the TSCG, in the sense referred to by Article 16 TSCG.
13. First and foremost, Article 2(1) TSCG lays down that it is to be applied and interpreted in conformity with the EU Treaties, in particular the principle of sincere cooperation enshrined in Article 4(3) TEU, and with secondary EU law. Second, in accordance with Article 31(1) of the Vienna Convention on the law of Treaties (VCLT), Treaties, such as the TSCG, are to be interpreted on the basis of their text, context, object and purpose: ‘*a treaty shall be interpreted [...] in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.*’
14. Moreover, Article 32 VCLT refers to means of interpretation supplementary to the ones referred to in the previous paragraph, including the preparatory work of the Treaty and the circumstances of its conclusion.

15. The term ‘*substance*’ has thus to be interpreted in accordance with the above criteria.
16. Article 1 TSCG lays down the Treaty’s objectives: i) 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; ii) to strengthen the coordination of their economic policies and iii) to improve the governance of the euro area. All of these three objectives may be considered as essential elements of the TSCG and, accordingly, part of its substance.¹² However, as per its recitals, the EGR package aims at the incorporation only of Title III of the TSCG (‘Fiscal Compact’), which corresponds to the first of the TSCG’s objectives mentioned above. Accordingly, the following analysis will focus on this first objective of fostering budgetary discipline through a fiscal compact.
17. This objective is, in essence, reflected in Article 3 TSCG, which introduces: i) a balanced budget rule, expressed in actual numerical terms (lower limit of structural deficit of 0,5% of the gross domestic product at market prices); ii) an obligation to transpose that rule one year after the entry into force of that Treaty ‘*through 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 iii) an automatic correction mechanism.
18. The purpose and content referred to in the previous paragraphs have to be interpreted in the context in which the TSCG was negotiated. The Intergovernmental Conference in charge of its negotiation was set up pursuant to a Statement by the Euro Area Heads of State or Government of 9 December 2011. In that Statement, the Heads referred to their intention to introduce a reinforced architecture for the EMU, in particular through the commitment to establish a new fiscal rule, based on the principle that general government budgets shall be balanced or in surplus. The Statement specified that ‘*this principle shall be deemed respected if, as a rule, the annual structural deficit does not exceed 0.5% of nominal GDP*’¹³

¹² This corresponds to paragraphs 10 to 14 of the 2018 CLS opinion.

¹³ This corresponds to paragraph 16 of the 2018 CLS opinion.

19. In consequence, Article 3 TSCG can be regarded as the ‘*substance*’ to which Article 16 TSCG refers¹⁴.
20. In turn, the proposed EGR package reprises several elements that are part of Article 3 TSCG. As noted by the Commission: ‘*the reformed framework also meets the main objectives of the Fiscal Compact which forms Title III of the [TSCG] ... With a medium-term orientation anchored on country-specific debt challenges, the [proposed Regulation replacing Regulation 1466/97] reflects in part the Fiscal Compact’s requirement of convergence to medium-term positions to be proposed taking into account country-specific public debt challenges (Article 3(1) point b of the TSCG). While emphasising the structural balance, the Fiscal Compact also requires an analysis of expenditure net of discretionary revenue measures for the overall assessment of compliance (Article 3(1) point b, of the TSCG), and this analysis is upheld in [the proposal]. The Fiscal Compact allows for temporary deviations from the medium-term objective or adjustment path towards it only in exceptional circumstances (Article 3(1), point c of the TSCG), as envisaged in [the proposed Regulation]. The Fiscal Compact stipulates that in case of significant observed deviations from the medium-term objective or the adjustment path towards it, measures have to be implemented to correct the deviations over a defined period of time (Article 3(1) point e of the TSCG). In the same vein, the reformed framework requires corrections of deviations from the net expenditure path set by the Council. Moreover, when deviations result in a deficit in excess of 3% of GDP, the Member State could be placed under the excessive deficit procedure. [...] The Fiscal Compact provides that the Commission and the Council play a role in the enforcement process (Article 5 of the TSCG), as stated in the proposal for a Council Regulation amending Council Regulation (EC) No 1467/97*’¹⁵.

¹⁴ This corresponds to paragraph 17 of the 2018 CLS opinion.

¹⁵ Explanatory Memorandum to the proposal for a Regulation on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97, pp. 3-4.

21. In view of this, the Commission concludes that *‘the proposed reformed economic governance framework can be considered as incorporating the substance of the fiscal provisions of the TSCG into the legal framework of the EU, as per Article 16 of the TSCG’*¹⁶.
22. It is also notable that, unlike the 2017 proposal for a Council Directive laying down provisions for strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States, the EGR package proposes only to use EU Regulations as a means of incorporating the *‘substance’* of the Fiscal Compact in Union. In paragraph 18 of the 2018 opinion the CLS noted, in respect of the obligation by the TSCG to incorporate the balanced budget rule *‘through provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes’*, that by acting through a Directive the EU legislator *‘leaves Member States the choice and the methods for transposition [thus allowing them to] enjoy under the proposal a margin of discretion they do not enjoy under the TSCG’*. Conversely, in the present proposals, such discretion would not be available, since EU Regulations are binding in their entirety and directly applicable in accordance with Article 288 TFEU.
23. However, there are two elements on which the *‘substance’* of the Fiscal Compact and the proposed EGR package differ:
- first, the proposals do not impose a specific and mandatory numerical fiscal rule; and
 - second, the proposals replace the *‘1/20th rule’* as a metric for the debt-based EDPs by a reference to the departure from the net expenditure path, since the former rule is considered by the Commission as imposing *‘a too demanding fiscal effort for some Member States’*¹⁷.

¹⁶ Ibid.

¹⁷ Explanatory Memorandum to the proposal for a Regulation on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97, p. 4.

24. The fundamental question is whether, notwithstanding the above two differences, the EGR corresponds to the '*substance*' of the fiscal provisions of the TSCG. In examining this question, several criteria are to be taken into account.
25. The equivalence of aims between the two regimes (the so-called 'teleological approach') is an important criterion to assess the question whether the EGR package corresponds to the '*substance*' of the relevant provisions of the TSCG and, accordingly, it has been relied upon by the Commission for this purpose. It is incontestable that both the TSCG and the proposed EGR package share as their aim the reduction of government debt and the compliance with the obligation to avoid excessive government deficits.
26. However, as noted in paragraph 21 of the 2018 CLS opinion, the fact that the two mechanisms share the same purpose does not necessarily require that the means used to this end are the same. Therefore, it is possible to conclude that the proposed EGR package contains the '*substance*' of the Title III of the TSCG provided that the approaches of the two instruments in reaching this shared goal allow the achievement of equivalent results in economic terms.
27. In essence, as noted in paragraph 22 of the 2018 CLS opinion, the Contracting Parties need to be satisfied that, if there were no longer in force an international treaty obligation as currently contained in Article 3 TSCG, the commitments made by virtue of the proposed EGR package would achieve an outcome equivalent to the one resulting from the Fiscal Compact.
28. But such assessment cannot be based on an examination of economic equivalence alone. As set out in paragraphs 23-29 of the 2018 opinion, this calls for two qualifications.

29. First, the Contracting Parties should also take into account the governance and implementation approaches on which the two instruments, the TSCG and the proposed EGR package, are founded. Both instruments respond to very different models of governance and implementation. The TSCG is based on a common numerical parameter known as ‘ex ante’ and is applied equally to Contracting Parties. It is a centralised, rules-based model, and this was a fundamental element of its negotiations (see the Statement of the Euro Area Heads of State or Government, referred to in paragraph 18). The proposed EGR package relies on a decentralised approach where obligations are determined individually for each Member State in partnership with the competent EU institutions (primarily the Commission).
30. Second, as discussed at length in the 2018 CLS opinion with respect to the meaning of the term ‘*substance*’ in this context, ‘*the incorporation of the ‘substance’ of the TSCG in the law of the Union cannot be understood as fulfilled only when an equivalence of results of the two legal instruments is guaranteed, whichever the means to achieve it are, but also when a high level of homogeneity and identity between the material elements of both instruments is ensured.*’¹⁸
31. Moreover, the CLS would add that the obligation relating to the incorporation of the substance contained in Article 16 TSCG cannot be read independently of the context in which it is set out. Thus, it is to be noted that the text of that provision contains several important qualifiers: first, the process of incorporation must be based on ‘*an assessment of the experience with [the TSCG’s] implementation*’ and, second, that process consists in taking the *necessary steps... with the aim of incorporating the substance of [the TSCG] into the legal framework of the European Union*’.

¹⁸ Para 29 of the 2018 CLS opinion. See also paras 25-28 thereof.

32. Thus, the wording of this provision clearly requires that experience gained in the application of the Fiscal Compact is taken into account for the purposes of its incorporation into Union law. In turn, complying with this requirement presupposes that the incorporation process cannot be conceived as a mechanical transcription of the text of the TSCG into EU legislative instruments. The text also sets out an obligation of means (*'steps with the aim to'*) rather than mandates a specific end result. Both of these elements clearly point to the necessity of assessing the equivalence of the measures in a comprehensive manner, taking into account the context in which the new EGR provisions are to be applied and changes in that context, including the experience gained since the TSCG's signature.

33. The current package explicitly refers in the preamble to a number of elements that are relevant to the application of the economic governance framework of the Union¹⁹. The need to take into account this recent experience in the current reform has been explicitly recognised by the Council²⁰. Therefore, these contextual elements are also relevant when assessing whether the proposals duly incorporate the ‘*substance*’ of the TSCG, in line with the wording of Article 16 TSCG.

¹⁹ Recital (5) of the proposal for a Regulation on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97 and of the proposal for a Council Regulation amending Regulation No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure: *‘The economic governance framework of the Union should be adapted to better take into account the growing heterogeneity of fiscal positions, sustainability risks and other vulnerabilities across Member States. The strong policy response to the COVID-19 pandemic proved effective in mitigating the economic and social damage of the crisis, but the crisis resulted in a significant increase in public- and private-sector debt ratios, underscoring the importance of reducing debt ratios to prudent levels in a gradual, sustained and growth-friendly manner and addressing macroeconomic imbalances, while paying due attention to employment and social objectives. At the same time, the economic governance framework of the Union should be adapted to help address the medium- and long-term challenges facing the Union, including achieving a fair digital and green transition, including the Climate Law, ensuring energy security, open strategic autonomy, addressing demographic change, strengthening social and economic resilience, and implementing the strategic compass for security and defence, all of which requires reforms and sustained high levels of investment in the years to come.’*

²⁰ Council Conclusions on Orientations for a reform of the EU economic governance framework of 14 March 2023, point 6: *‘CONSIDERS that the economic governance framework and further steps in deepening the Economic and Monetary Union (EMU) should take into account the lessons learnt from the Union's economic policy responses to previous crises.’*

IV. CONCLUSION

34. It is up to the Contracting Parties to the TSCG to assess the meaning and effects of the provisions they themselves have negotiated and ratified, including the obligation to take the necessary steps with the aim of incorporating the '*substance*' of Title III of that Treaty into the legal framework of the European Union, as laid down in Article 16 thereof.
35. The incorporation of the '*substance*' of the TSCG into the law of the Union depends on the assessment of the equivalence between Article 3 TSCG and the fiscal provisions of the EGR package. When carrying out this assessment the Contracting Parties should take into account the following: the degree of economic equivalence between the two mechanisms; the comparison between the different models of governance and implementation laid down in the TSCG and proposed in the EGR; the interpretation of the term '*substance*' (translated in certain language versions of the TSCG as 'content'), and the overall context on which Article 16 TSCG premises this incorporation, including an assessment of the experience with the implementation of that Treaty.
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