Chapter 1

EU Law on Public Finance Rules

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Abstract

This chapter discusses the public finances of the European Union (EU). The first subchapter covers the history of the EU public finances, examining the basic regulatory framework pursuant to the Maastricht Treaty and the Stability and Growth Pact and analysing in detail the connection with the 2008 crisis and its aftermath. The most important developments in the control over EU public finances are also discussed in this subchapter. The second subchapter introduces a critical approach to the current framework of the EU public finances, exploring the impact of the Stability and Growth Pact and its reforms, and discussing the possibility of the establishment of an Economic and Monetary Union 2.0 from multiple perspectives. The third subchapter focuses on contemporary challenges, in particular the COVID-19 pandemic and its impacts, as well as the effects of climate change and digitalisation on EU public finances.

Keywords: *2008 financial-economic crisis, 2021-2027 Multiannual Financial Framework, climate finance, digital finance, Economic and Monetary Union 2.0, European Central Bank, European Commission, NextGenerationEU, Recovery and Resilience Facility, Stability and Growth Pact*

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1. History of the EU public finances

1.1. Public finances pursuant to the Maastricht Treaty

It is undebatable that the Maastricht Treaty (1993) was a crucial milestone that provided the agenda and tools that made it possible for the Economic and Monetary Union (EMU) to set off with its full potential. The previous amending Treaty, the Single European Act (1987), completely ignored the whole issue, and there was no consensus on what a few years later became dogma, that the EMU is a prerequisite of a united Europe.[1] The Delors III package, which a short time afterwards tried to compensate for this deficiency and brought about relevant innovations, did not have the necessary legal status and, therefore, the legal effects of an amending Treaty. As such, its innovations did not become part of the primary law of the then-so-called European Communities (known as the European Union (EU) since the Maastricht Treaty).[2]

The Maastricht Treaty established a three-stage agenda for introducing the euro and realising the related financial institutions, such as the European Central Bank (ECB), the European System of Central Banks, and the Eurozone. The EU still adheres to these criteria today, although this issue is not discussed in detail in this chapter.[3]

The Maastricht Treaty also introduced the *convergence criteria* for joining the Eurozone, which are still in effect today. The official website of the European Union[4] summarises these criteria as follows (although, of course, in reality, the criteria comprise a detailed and complicated set of rules): price stability, sound and sustainable public finances, exchange rate stability, and rules related to long-term interest rates. This chapter discusses the second of the criteria listed above, public finances.

1.2. The Stability and Growth Pact

As Warin mentions, the Maastricht Treaty introduced the concept of 'excessive deficits'. While the three monetary entry criteria – low inflation, low interest rates, and exchange rate stability – become moot once a country has joined the monetary union, the two budget entry criteria – public deficit and debt – remain a live issue. To that effect, the Treaty calls for the adoption of an excessive deficit procedure (EDP) that makes fiscal discipline a permanent requirement. The Stability and Growth Pact (SGP) defines and implements this procedure.[5]

1 Arató and Koller, 2015, pp. 197–198.
2 Chang, 2016, pp. 9–34; Horváth and Szalai, 2004, pp. 15–27.
3 Chang, 2016, pp. 9–34; Horváth and Szalai, 2004, pp. 15–27.
4 See: *Conditions for joining the euro area: Convergence criteria* [Online]. Available at: https://www.consilium.europa.eu/en/policies/joining-the-euro-area/convergence-criteria/ (Accessed: 30 August 2023).
5 Warin, 2008, p. 4050.

The SGP, adopted in Amsterdam on 16-17 June 1997,[6] involves three main elements.[7] The first is a *political commitment* to a budget surveillance process, with the desired effect being that 'effective peer pressure is exerted on a Member State failing to live up to its commitments'. The second comprises *preventive elements* to stop countries from exceeding the 3% reference value, with Member States submitting stability and convergence programmes to the Council of the European Union. On the recommendation of the European Commission, the Council (acting by a qualified majority) can issue an early warning to Member States before an excessive deficit occurs, with the expectation being that the transgressing state will take steps to rectify its budgetary situation. The third are *dissuasive elements* in the form of the EDP, which demands immediate action on the part of the Member State and can entail the imposition of monetary fines. Such sanctions begin as a non-interest bearing deposit with the Commission that is equal to 0.2% of the Member State's gross domestic product (GDP) plus a figure linked to the size of the deficit. The Council may intensify these sanctions each subsequent year with the imposition of additional fines that may not exceed 0.5% of the Member State's GDP on an annual basis. The deposit becomes a fine if the excessive deficit remains after two years. Exceptions can be made if an unusual event beyond the Member State's control impacts its financial situation or if the country experiences a severe economic downturn that causes its real GDP to drop by at least 2%.

The *Lisbon Treaty* regulates this point as follows. The general legal basis of the convergence criteria is Art. 140 of the Treaty on the Functioning of the EU (TFEU). In accordance with Art. 1 of Protocol (No 12) on the EDP (attached to the Treaties), the reference values referred to in Art. 126 para. (2) of the TFEU are (i) 3% for the ratio of the planned or actual government deficit to the GDP at market prices; and (ii) 60% for the ratio of government debt to the GDP at market prices.

Protocol (No 13) on the convergence criteria also refers to this issue. Art. 2 states:

> The criterion on the government budgetary position referred to in the second indent of Article 140(1) of the said Treaty shall mean that at the time of the examination, the Member State is not the subject of a Council decision under Article 126(6) of the said Treaty that an excessive deficit exists.

The SGP is based on a two-pillar system, including a so-called 'preventive arm' and a 'corrective arm'.[8] The SGP's preventive arm aims to prevent excessive deficits from occurring in the first place. Member States are required to maintain their budget deficits within the 3% limit. If a Member State's deficit is approaching the limit, the European Commission monitors the situation and may issue warnings

6 Mongay, 2022, p. 4.
7 Coricelli, 2005, pp. 6–7.
8 Ferrán, 2012; Coricelli, 2005.

or recommendations to take corrective measures. The SGP's corrective arm comes into play when a Member State exceeds the 3% deficit or breaches the 60% debt threshold. The EDP is activated, which involves the following series of steps:[9] (i) the European Commission assesses the situation and presents recommendations to the Council of the EU; (ii) based on the Commission's assessment, the Council can issue recommendations for the Member State to take corrective actions; and (iii) the Member State is then required to submit a plan outlining how it intends to correct the excessive deficit or reduce debt.

The SGP has faced criticism for its perceived lack of enforcement mechanisms. While theoretically, Member States that repeatedly fail to comply with the rules could face financial penalties, in practice, such penalties have rarely been imposed. The SGP also allows for some flexibility during economic downturns or exceptional circumstances, and Member States facing severe financial challenges can be granted leeway in meeting the deficit and debt targets.[10]

1.3. The consequences of the 2008 global financial crisis and the subsequent Euro crisis

What do market failures mean? Economics points out that the market can only work efficiently under certain conditions, however, there are some conditions under which such efficiency will not occur. An excellent example of this is the 2008 economic crisis.[11] This crisis began with the busting of the United States housing bubble in 2007, which led to a collapse in the subprime mortgage market. As financial institutions faced massive losses, a chain reaction was triggered, causing a severe liquidity crisis and loss of confidence in the global financial system.[12] The financial crises (2008-2012) significantly affected the EU owing to its strong financial ties with the United States. European banks had invested heavily in US mortgage-backed securities and complex financial products, resulting in significant losses when those investments plummeted in value. Consequently, European banks faced a liquidity crunch and a loss of trust among lenders, resulting in a freeze in interbank lending. This made it difficult for banks to access funds and led to a credit squeeze, impacting businesses and consumers.

In terms of European fiscal/budgetary issues, the sovereign debt crisis is perhaps the most relevant impact of the financial crises. Some EU countries, particularly the so-called 'GIIPS' countries (i.e. Greece, Italy, Ireland, Portugal, and Spain), and others such as Cyprus and Hungary, faced escalating levels of public debt and deteriorating

9 Ferrán, 2012; Coricelli, 2005.

10 Ferrán, 2012; Boonstra, 2005; Chang, 2006; Ferrán, 2012; Halmai, 2021a; Halmai, 2021b; Mérand, 2022; Sigl-Glöckner et al., 2022; Mongay, 2023.

11 Ferrán, 2012; Nagy, 2019, p. 291.

12 Ferrán, 2012; Lentner, 2015, pp. 24–35; Urbanovics and Teleki, 2021.

economic conditions.[13] The 2008 financial crisis had long-lasting effects on the EU. It revealed the vulnerabilities in the Eurozone's structure and highlighted the need for deeper economic and fiscal integration.[14] Unfortunately, the crisis also contributed to the rise of anti-EU sentiments and populist movements in some Member States.[15] Some EU countries implemented austerity measures involving spending cuts and tax hikes to address the sovereign debt crisis. However, these measures faced backlash due to their impact on social welfare and public services as the crisis exposed the need for stronger financial regulations and supervision. The EU responded by implementing reforms such as creating the European Supervisory Authorities and, later, the European Banking Union.[16]

Regarding the responses in the field of fiscal policy, many new measures were introduced. The European Semester promotes economic stability, structural reforms, and fiscal responsibility across the EU. It fosters coordination and ensures that Member States align their policies with EU priorities to enhance the overall economic performance and resilience of the EU. This process is critical to the EU's efforts to prevent economic imbalances like those experienced during the Eurozone crisis.[17]

The EU Fiscal Pact, also known as the 'Fiscal Compact' or the 'Treaty on Stability, Coordination, and Governance in the Economic and Monetary Union', is an intergovernmental Treaty adopted in response to the Eurozone crisis. It was signed by 25 EU Member States in March 2012, aiming to strengthen fiscal discipline and coordination within the Eurozone and ensure the stability of the euro currency.[18] It is important to note that the EU Fiscal Pact operates in parallel with the existing EU framework for economic governance, which includes the SGP and the European Semester process. While the Fiscal Pact is intergovernmental and applies to a subset of EU Member States (those in the Eurozone that have adopted the euro as their currency), the SGP and the European Semester involve all EU Member States.[19]

13 This exposed weaknesses in the Eurozone's design as it rendered its three inherent denials questionable. These denials are: (i) No state bankruptcy can occur within the Eurozone; (ii) No bail out is allowed for Member States within the Eurozone; and (iii) No Member State can leave the Eurozone. Moreover, the crisis resulted in an economic recession, with the EU experiencing a severe economic downturn, GDP contracting, and unemployment rising. Export-oriented economies suffered due to decreased global demand, and consumer spending and business investment declined. See: Arató and Koller, 2015.

14 Halmai, 2020.

15 Ágh, 2020, pp. 30–32.

16 Moloney, 2012; Imre, 2013; Imre, 2019; Lastra, 2019; Van Cleynenbreugel, 2019; Szegedi, 2020; Szegedi, 2022; Vértesy, 2022.

17 See: *The European semester* [Online]. Available at: https://commission.europa.eu/business-economy-euro/economic-and-fiscal-policy-coordination/european-semester_en (Accessed: 30 September 2023); Arató and Koller, 2015, pp. 269–280.

18 See: European Central Bank, 2012, pp. 101–102; Arató and Koller, 2015, pp. 269–280.

19 Arató and Koller, 2015, pp. 269–280.

Since the crisis, the EU's economic governance rules have been strengthened through eight EU regulations and one international Treaty: the Six Pack,[20] which introduced a system to monitor broader economic policies for the early detection of problems like real estate bubbles or falling competitiveness; the Two Pack,[21] a new cycle of monitoring for the euro area, with countries – except those with macroeconomic adjustment programmes – submitting their draft budgetary plans to the European Commission every autumn; and the 2012 Fiscal Pact, which introduced stricter fiscal provisions than the SGP.[22]

It should be briefly mentioned that after the initial years of the 2007-2008 crisis, monetary policy institutions, national banks, and the ECB played a decisive role in meeting public finance targets. Some of the literature, though, suggests that there should not be too close a connection between fiscal and monetary areas. According to Canzoneri et al., legislative processes are too slow for the discretionary component of fiscal policy to interact strategically with monetary policy at business cycle frequencies.[23] Meanwhile, Darvas and Merler argue that there are three main constraints on monetary policy: fiscal dominance, financial repercussions, and regional divergences.[24] In accordance with its secondary mandate set out in Art. 127 para. (1) of the TFEU,[25] the ECB supports EU economic policies: along with the Commission, the ECB participates in the monitoring of financial assistance programmes and in macroeconomic surveillance missions.[26]

It is worth summarising the situation in certain GIIPS countries pursuant to the 2008 crisis and the Eurocrisis. As Pagoulatos and Triantopoulos mention, Greece's performance was found lacking when compared with other EU Member States, exhibiting relatively conservative credit policy stances and a limited integration of

20 The 'Six Pack' is a package of five regulations and one directive adopted in December 2011. The regulations are designed to strengthen the EU's economic governance framework, particularly for Eurozone countries. Key components of the Six Pack include rules on fiscal discipline, public expenditure, and economic policy coordination. It introduces the EDP, which establishes a framework to address Member States with excessive deficits and imbalances. The Six Pack aims to enhance fiscal surveillance and enforcement mechanisms, ensuring that Member States maintain sound fiscal policies and avoid excessive debt.

21 The 'Two Pack' consists of two regulations adopted in 2013, which are designed to complement the Six Pack and further strengthen economic governance within the Eurozone. The Two Pack focuses on the surveillance and coordination of economic policies in Eurozone Member States. It establishes the European Semester, a process that allows for closer scrutiny of national budgets, economic policies, and structural reforms. The Two Pack aims to enhance the coordination of economic and fiscal policies among Eurozone members to promote greater convergence and stability within the currency union.

22 See: *Stability and Growth Pact* [Online]. Available at: https://eur-lex.europa.eu/EN/legal-content/glossary/stability-and-growth-pact.html (Accessed: 19 September 2023).

23 Canzoneri et al., 2002, p. 334.

24 Darvas and Merler, 2013, p. 1.

25 'Without prejudice to the objective of price stability, the ESCB [European System of Central Banks] shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union'.

26 Darvas and Merler, 2013, pp. 3–5.

the Greek banking system with international financial markets.[27] Greece had been running large budget deficits for years, accumulating significant levels of public debt.[28] The true extent of these deficits was often hidden or understated, leading to a loss of investor confidence. In October 2009, Greece's public debt reached unsustainable levels, exceeding the country's GDP. This high debt burden made it difficult to attract investors and maintain financial stability.[29] Greece's membership in the Eurozone limited its ability to devalue its currency to boost exports and stimulate economic growth. It also complicated negotiations with international creditors. Greece implemented harsh austerity measures in exchange for financial assistance from international institutions like the International Monetary Fund and the ECB. These measures included tax increases, public spending cuts, and structural reforms, which had significant social and economic impacts.[30] When considering Greece, perhaps the largest problem with the Maastricht Treaty system was the *de facto* prohibition of bail-outs.[31] Another problem was that in the early phase of the crisis, Greece did not ask for help and later falsified data regarding its economy.[32]

In addition, the economic crisis led to political instability in Italy, with frequent changes in government leadership and a lack of consensus on addressing economic challenges. However, according to Di Quirico, political turmoil was also a problem before the crisis.[33] This made it difficult to enact and sustain economic reforms. Italy's fiscal situation raised concerns among EU authorities and the ECB. As Quaglia puts it, Italy suffers from 'a financial system that does not speak English'.[34] Italy faced pressure to adhere to the EU fiscal rules and reduce its budget deficit, further complicating the country's ability to stimulate economic growth. Italy's high public debt levels led to concerns about a potential sovereign debt crisis as rising yields on Italian government bonds made borrowing more expensive and raised doubts about the country's ability to meet its debt obligations.[35] In response to the economic challenges, the Italian government implemented austerity measures to control public spending, reduce the budget deficit, and stabilise public finances. These measures included tax increases and public expenditure cuts.[36] In reality, Italy has always been unfit for the conditions of the Maastricht convergence criteria: even at the time of the Maastricht Treaty in 1993, when the criteria for entry into the Eurozone was set, the Italian government's debt hovered at around 108% to 120% of GDP.[37]

27 Pagoulatos and Triantopoulos, 2009, p. 39.
28 Hausken and Welburn, 2020, pp. 26–27.
29 Pagoulatos and Triantopoulos, 2009, pp. 35–36.
30 Pagoulatos and Triantopoulos, 2009, pp. 35–36; Hausken and Welburn, 2020.
31 Nelson et al., 2010, p. 10.
32 Arató and Koller, 2015, pp. 270–272.
33 Di Quirico, 2010, pp. 3–4.
34 Quaglia, 2009.
35 Quaglia, 2009.
36 Di Quirico, 2010, pp. 4–6.
37 Mascitelli, 2011.

Murphy and O'Brennan argue that Ireland should be considered one of the more compelling case studies during this period of protracted EU crises. They compare the 2008 financial crisis to the Brexit crisis in terms of crisis management.[38] 2008, Irish banks had overextended themselves in the property market, and their balance sheets were severely affected when property prices plummeted. The government had to intervene with significant financial support to prevent a complete collapse of the banking system.[39] The banking crisis put immense pressure on Ireland's public finances, leading to a severe sovereign debt crisis. The government's deficit soared, and the country faced increasing borrowing costs in the international bond markets. The Irish government implemented austerity measures to address the fiscal challenges, including tax hikes and spending cuts. These measures aimed to control the budget deficit and stabilize the country's finances but had significant social and economic consequences. Ireland ultimately sought a bailout from the International Monetary Fund, the European Union, and the European Central Bank to stabilize its economy and banking sector. This bailout came with conditions, including implementing further austerity measures and financial sector reforms.[40] As Ireland emerged from the worst effects of the financial crisis, the UK's decision to leave the EU in June 2016 precipitated a political, economic, and constitutional crisis for the Irish state. However, the EU's solidarity with Ireland throughout the Brexit[41] negotiations resulted in an entirely different political dynamic than that which prevailed during the financial crisis.[42] Similarly to Italy, Ireland was also a victim of private sector indebtedness, mainly due to the financial sector. According to Karsai, the lesson here is that the significance of the current account balance and the outstanding private loans indicate that macroeconomic variables regarding the private sector should also be included in the Maastricht convergence criteria and the Stability and Growth Pact.[43]

As the examples of Greece, Italy, and Ireland demonstrate, the peripheral Member States, especially those in the Mediterranean, suffered huge losses as a combined consequence of the financial crisis and the vulnerability of their own economic and financial systems. This underlines the need for a more flexible approach toward the Member States when it comes to expectations around public finances. The idea of the EMU 2.0 (see below) intends to move in this direction.

1.4. Control over EU public finances

This subchapter briefly discusses European control over public finances. Although the Cohesion Policy funds are part of the Union budget, the way they are spent is based on a system of shared responsibility between the *European Commission*

38 Murphy and O'Brennan, 2019, p. 472.

39 Honohan, 2009, pp. 2–3.

40 Murphy and O'Brennan, 2019, pp. 473–478.

41 Halmai, 2020.

42 Murphy and O'Brennan, 2019, p. 484; Honohan, 2009; Halmai, 2020.

43 Karsai, 2012, pp. 111–112.

and *national authorities*.[44] In general, the European Commission shall implement the budget in cooperation with the Member States.[45]

The *European Court of Auditors* helps the other EU institutions and the Member States to better manage and supervise the use of the EU funds, which is particularly important to the European Parliament when deciding whether the EU's accounts for the previous year are accurate and the funds are properly spent, a process known as 'granting discharge'.[46]

In post-2008 European practice, the role of *fiscal councils* as a means of control has become increasingly important. As the ECB puts it, fiscal councils are generally defined as independent public institutions that are aimed at strengthening commitments to sustainable public finances. According to the Two Pack, Eurozone countries should have in place an independent body, such as a fiscal council, that is in charge of monitoring compliance with numerical fiscal rules and, where appropriate, assessing the need to activate the correction mechanism foreseen under the Fiscal Compact.[47] According to Wildowicz-Giegiel – to use the OECD terminology – fiscal councils can be defined as independent institutions financed by public funds that have a mandate (established mainly by constitutional or organic laws) to produce independent analyses, forecasts, and advice on fiscal policy.[48] Georgescu and Căpraru point out that though the mandates with which fiscal councils are invested at the EU level differ from country to country, common responsibilities can be identified for making, approving, and analysing macroeconomic and budgetary forecasts, as well as monitoring compliance with established fiscal rules.[49] Their main advantage is that the continuous monitoring by these independent institutions raises the level of transparency and accountability in the budgetary process. At the same time, information asymmetry diminishes, and the quality of the debates on fiscal policy increases.[50] Debrun et al. argue that, where they exist, the influence of independent fiscal institutions playing a role in fiscal policy (e.g. fiscal councils) is more ambiguous: they might or might not favour the presence of rules, depending on whether numerical rules and the institutions themselves complement or substitute each other.[51]

Although it is not the topic of this particular chapter, it should be briefly mentioned that there are three levels of public financial control at the level of the Member States, which are also involved in the control over EU funds: (i) the audit

44 See: *European Commission: Financial management* [Online]. Available at: https://ec.europa.eu/regional_policy/funding/financial-management_en (Accessed: 26 January 2024).

45 Nyikos, 2021, p. 211; Art. 317 of the TFEU.

46 See: *European Court of Auditors: What we do* [Online]. Available at: https://www.eca.europa.eu/en/what-we-do (Accessed: 26 January 2024); Nyikos, 2021, p. 214.

47 European Central Bank, 2014, p. 96.

48 Wildowicz-Giegiel, 2019, p. 615.

49 Georgescu and Căpraru, 2020, p. 7.

50 Ibid.

51 Debrun et al., 2008, p. 325.

bodies under parliamentary authority; (ii) the government; and (iii) the internal audit control in the budget holders.[52]

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2. A critical approach

2.1. Impact of the Stability and Growth Pact – partial success

As mentioned above, the SGP is a set of rules designed to ensure fiscal discipline among EU Member States and maintain stability in the Eurozone. However, a considerable portion of the literature suggests that the SGP has only partially achieved its goals, highlighting some key points and relationships related to fiscal policy and economic growth. Consequently, there have been questions about the SGP's effectiveness since its inception. This discussion intensified during the post-2008 European financial crises. There were several waves of criticism, among which that after 2008 was perhaps the most vivid; however, there were also serious concerns before the crisis. These concerns resulted in the reform of the SGP – the 'new' SGP – which was accepted in March 2005.[53]

Shortly before the aforementioned reform, some voices suggested that the SGP should be abolished, as Boonstra submitted in his article, 'Should we just forget the Pact?' in early 2005. Boonstra questioned whether it would be impossible to imagine what we consider doing without budgetary standards. He argued that by improving the transparency of national budgets and regular monitoring by the European Commission, the market can be supplied with even better information. Rating agencies could also play a part in this. With the 'no bail out' clause of the Maastricht Treaty, the financial markets would put pressure on the countries with poor budgetary policy.[54] Nevertheless, the SGP was, of course, not abolished. The 2008 crisis and its consequences strongly disproved this way of thinking, that is, the neoliberal dogma of the sufficiency of the self-regulatory market. It has quickly become clear that strong regulatory institutions must be established in order to make financial markets safe.[55]

52 Lentner, 2013, pp. 255–258.

53 See: Boonstra, 2005; Chang, 2006; Ferrán, 2012; Mérand, 2022; Sigl-Glöckner et al., 2022; Mongay, 2023.

54 Boonstra, 2005.

55 'Neoliberalism is the concept according to [which] problems and developments of human nature are bound to be solved through market competition. In other words, all problems can only be interpreted in a market context, and the belief in the self-regulating capacity of markets and their nature of fulfilling the possibility of free choice is unquestionable, and therefore basically, from any point of view, the market is a higher-order distribution mechanism than any of its alternatives'. See: Patomäki, 2009; Lentner, 2013, pp. 48–50.

In addition, as a pre-2008 critic of the SGP, Chang raised concerns about the differences of interest between the larger and smaller Member States. Interestingly, the reason behind these concerns is that the smaller Member States (such as Austria, the Netherlands, Greece, and Portugal) were those that insisted on maintaining the SGP in its original form. The larger Member States, including Germany and France, pushed toward a reform driven by the will to make the SGP more flexible. In line with this, before the reform of March 2005, it was the smaller states that were more rigorous about adhering to the SGP, while Germany and France occasionally ignored the rules that were disadvantageous to them.[56]

As for post-2008 criticism of the SGP, Mérand examines three Member States with budgetary issues (Italy, Spain, and Portugal) and concludes that although these countries were subject to the EDP in 2014, they were out of trouble by 2019. Moreover, the Commission did not have to impose any sanctions on these governments.[57] Unfortunately, these accommodative strategies led to the politicisation of the SGP. According to Mérand, this was a direct, unintended consequence of strengthening the SGP after the Eurozone crisis.[58]

Mongay draws attention to the fact that a central issue regarding the reform of the corrective arm is the extent to which the thresholds established in the abovementioned Protocol 12 of the TEU-TFEU should have been changed to introduce higher thresholds. However, although such higher thresholds could give some temporary leeway to high-debt countries, the need to establish deficit and debt caps and the constraints they impose on fiscal policy would not be fundamentally affected. The Commission's orientations (see below) do not veer toward amending Protocol 12.[59]

Sigl-Glöckner et al. propose a reform that – according to them – should lead to a more effective reduction in debt ratios and a clearer division of tasks between fiscal and monetary policy.[60] They posit that if the Member States' majority cannot comply with the 3% deficit limit, a higher deficit limit could be acceptable, with the restriction that it must be a previously communicated and, therefore, publicly known primary deficit threshold. In Sigl-Glöckner et al.'s proposed reform, only if Member States cannot comply with the latter should the European Union deem their deficit 'excessive'.[61]

2.2. The idea of an Economic and Monetary Union 2.0

In addition to the rules of the SGP being highly debated, another deficiency is that, owing to certain political realities, the fiscal pillar of the EMU is way behind the monetary pillar in terms of development. These issues have already inspired the idea of the so-called EMU 2.0, which would be a different approach with a partially

56 Chang, 2006.
57 See: European Commission, 2014.
58 Mérand, 2022.
59 Mongay, 2023, p. 5.
60 Sigl-Glöckner et al., 2023, p. 2.
61 Sigl-Glöckner et al., 2023, p. 2.

different toolset to help further integration within the fiscal pillar. Regarding the incomplete parts of the EMU, there may be a chance to create a Fiscal Union, but it is quite uncertain that it could really happen within a reasonable time (Moreover, the Banking Union exists but remains incomplete, and currently there is no significant discussion of the Capital Markets Union or the deeper Political Union).[62]

The EMU 2.0 would have to include the aforementioned. The Fiscal Union should consist of, among other things, a stricter Macroeconomic Imbalance Procedure; more integrated, or at least coordinated, national budgets among Member States; and more integrated policies for competitiveness. There is a good chance that many Member States will not be willing to relinquish their budgetary autonomy to this extent.

2.2.1. The Five Presidents' Report (2015)

The introduction of the Five Presidents' Report (hereinafter: the 'Report')[63] is considered the beginning of the second wave of the EMU reforms pursuant to the 2008 crisis and the Eurocrisis (the former was discussed above as the direct consequence and crisis management of the crises).

The Report begins with the following declaration:

> The Euro Summit of October 2014 underlined that "closer coordination of economic policies is essential to ensure the smooth functioning of the Economic and Monetary Union" (EMU). It called for work to continue to "develop concrete mechanisms for stronger economic policy coordination, convergence and solidarity" and "to prepare next steps on better economic governance in the euro area".[64]

In the context of the Report, Begg et al. note that to make the EMU economically sustainable, the first imperative is to acknowledge that it had been left incomplete at Maastricht due to *divergent Member State preferences*.[65] The main consequence is the need for the development of a certain *'resilience'* in the EMU in the context of the economic and social structures in Member States. This is an absolute prerequisite to the long-term success of the *coordination of national economic policies* and the coordination of national development procedures with EU funds.[66]

Perhaps the most crucial point recommended by the Report is a stronger Macroeconomic Imbalance Procedure: 'It should be used not just to detect imbalances but also to encourage structural reforms through the European Semester. Its corrective arm should be used forcefully. It should be triggered as soon as excessive imbalances

62 Langenbucher, 2020; Halmai, 2021a; Halmai, 2021b.

63 The five presidents concerned, who were in office at the time, were Jean-Claude Juncker (European Commission), Donald Tusk (European Council), Mario Draghi (European Central Bank), Martin Schulz (European Parliament) and Jeroen Dijsselbloem (Eurogroup).

64 European Commission, 2015.

65 Begg et al., 2015, p. 804.

66 Halmai, 2021a, p. 43.

are identified and be used to monitor reform implementation'.[67] Beyond that, this strengthened procedure should bring adequate reforms for re-balancing the whole euro area and the EMU.[68]

Under the Report, several key features must be implemented to create the EMU 2.0. Established in the 2017 roadmap of the European Commission[69] and summarised by Halmai,[70] these features include: (i) the development of the *European Monetary Fund* (EMF); (ii) the integration of the Fiscal Pact into the framework of EU law; (iii) new budgetary instruments for a stable euro area within the Union framework; (iv) for the 2018-2020 period: (iva) targeted changes in the Common Provisions Regulation to mobilise funds to support national reforms, and (ivb) strengthening the Structural Reform Support Programme; and (v) communication regarding a *European Minister of Economy and Finance*.

Schweigl notes that the EMF is a step toward further integrating the EMU as a financial assistance fund that existed out of the EU legal framework and is being brought within the realm of EU law. The main advantage this tool brings is realised within the Banking Union through providing financial assistance/loans to EMF member countries in need and securing the functioning of the Single Resolution Fund by operating as a common backstop.[71]

The creation of the *European Fiscal Board* is also a consequence of this package. The European Fiscal Board was realised in 2017 as an independent advisory body of the European Commission. Its main responsibilities are: (i) to evaluate the *implementation of the Union's fiscal framework* and the appropriateness of the actual fiscal stance in the euro area and at the national level; (ii) to make *suggestions for the future evolution* of the Union's fiscal framework; (iii) to *assess the prospective fiscal stance appropriate for the euro area* as a whole based on an economic judgement, as well as the appropriate national fiscal stances, within the rules of the SGP; (iv) to cooperate with the *National Independent Fiscal Councils*; and (v) to *provide ad-hoc advice* to the President of the Commission.[72]

2.2.2. The 10 points of the Commission (2022)

The 10 points of the *Commission's Orientations for Reforming the EU Economic Governance Framework* determine the main features of the new wave of the reform of the EMU. The proposed orientations[73] aim to strengthen debt sustainability, promote sustainable and inclusive growth through investments and reforms, and improve national ownership and the simplification of the framework.

67 Ibid.
68 European Commission, 2015, p. 8.
69 European Commission, 2017.
70 Halmai, 2021a, pp. 51–54; Halmai, 2021b, pp. 253–260; Teleki and Szegedi, 2023.
71 Schweigl, 2019, pp. 522–523.
72 Schweigl, 2019, pp. 522–523; Halmai, 2021a.
73 Markakis, 2023; Sigl-Glöckner et al., 2022; Halmai 2022.

The main features of these proposed orientations include: (i) moving toward a *more risk-based surveillance framework* focusing on debt sustainability and differentiating between countries based on their public debt challenges; (ii) *retaining the current reference values* for deficit and debt criteria (3% and 60% rules) but adapting the 'debt reduction benchmark' to country-specific debt ratios; (iii) introducing *national medium-term fiscal-structural plans* that integrate fiscal, reform, and investment objectives, merging stability and convergence programmes; (iv) allowing Member States *greater flexibility* in setting their fiscal adjustment paths based on the Commission's reference budgetary adjustment path; (v) establishing a *common EU framework for assessing Member States' medium-term fiscal-structural plans*, with the Council adopting the plans based on Commission assessments; (vi) monitoring the implementation of the plans through *annual progress reports* and allowing for plan revisions under certain circumstances; (vii) maintaining *escape clauses* for severe economic downturns and exceptional circumstances; (viii) *strengthening EU enforcement* through various available sanctions, including financial, reputational, and macroeconomic conditionality measures; (ix) increasing the *role of independent fiscal institutions* in monitoring and implementing fiscal rules and improving the setup and performance of these institutions; and (x) addressing the *relationship between fiscal rules and the Macroeconomic Imbalances Procedure*.

Perhaps the most essential reform plan is to give Member States greater flexibility in determining their budgetary correction path. The revised EU budgetary framework would define the requirements to ensure a reduction in debt ratio or its sustainability and keep the budget deficit below 3% of GDP in the medium term. Meanwhile, Member States would develop country-specific budgetary paths and priority public finance and reform commitments.[74]

The Commission, therefore, stands ready to propose country-specific recommendations on fiscal policy for 2024 that are:[75] (1) in line with the fiscal targets Member States set out in their stability and convergence programmes, so long as those targets are consistent with ensuring that the public debt ratio is set on a downward path or stays at a prudent level and that the budget deficit is below the 3% of GDP reference value over the medium term; (2) quantified and differentiated based on Member States' public debt challenges; and (3) formulated based on net primary expenditure, as proposed in the Commission's reform orientations.

As Pench notes regarding this latest reform:[76]

> The Commission's EU fiscal governance reform proposals revolve around the principles of fiscal sustainability and national ownership. […] Political concerns lay behind the demand for additional safeguards, but these should be addressed through institutional rather than rule-based solutions. Implementation and enforcement will be critical.

74 Markakis, 2023; Sigl-Glöckner et al., 2022.
75 See: European Commission, 2023b.
76 Pench, 2023.

3. Challenges of today and outlook for the future

3.1. The COVID-19 pandemic and its effects

The COVID-19 pandemic presented a formidable challenge for the EU; however, it also proved to be an opportunity. The EU's crisis management included a massive injection of extra resources under the umbrella of *NextGenerationEU,* almost doubling the original budget of the 2021-2027 Multiannual Financial Framework (MFF)[77] and adding some additional resources for 'National Resources and Environment'– although this particular field received only around 5% extra compared to the original budget. The total value of the *NextGenerationEU* is EUR 806.9 billion, of which EUR 723.8 billion is designated to the *Recovery and Resilience Facility* – EUR 338.0 billion is provided as grants, and another EUR 358.8 billion is provided in the form of loans.[78]

The priorities of the 2021-2027 MFF and the NextGenerationEU emphasise environmental and climate issues, along with digitalisation. In total, 50 % of the resources are allocated to (i) research and innovation, (ii) climate and digital transition via the Just Transition Mechanism, and (iii) recovery, preparedness, and health issues – another type of resilience of which the EU is in desperate need. Another 30% will entirely be spent on fighting climate change – the highest share this field has ever received in any EU budget. The remaining 20% is allocated for digital transformation. Additionally, in 2026 and 2027, 10% of the annual budgets will be spent on preserving biodiversity.[79]

In 2021, Darvas et al. wrote that in the framework of recovery from COVID-19, 'a review of the European fiscal framework is needed to achieve the EU's green goals more rapidly'. The quality of public finances, how policy-makers spend resources, and the associated reforms are of central importance. Improving the efficiency of insolvency procedures will be crucial for speedy and effective recovery, and it will be essential to adapt social security and taxation systems in the context of the single market for labour, and especially to tailor them to teleworking.[80] Research undertaken in 2020 by McKinsey & Co. emphasises that the recovery from the economic crisis associated with the COVID-19 pandemic coincides with a pivotal time in the fight against climate change; in other words, the post-pandemic recovery will be a decisive period for fending off climate change.[81]

77 European Commission, 2020a; European Commission, 2021; *About Climate-ADAPT* [Online]. Available at: https://climate-adapt.eea.europa.eu/about (Accessed: 23 August 2023).

78 European Commission, 2021b.

79 European Commission, 2021b.

80 Darvas et al., 2021.

81 McKinsey & Co., 2020.

3.2. Challenges related to climate resilience and digitalisation

This subchapter deals with the budget-related challenges related to the ever-more horizontal[82] expectations of transforming the EU into a green/sustainable (and digital) economy and society. Building a sufficiently climate-resilient EU requires serious resources to be allocated to this purpose. This goal is reflected in the 2021-27 MFF, especially with the added extra resources of the Recovery and Resilience Facility; in the reform of the Common Agricultural Policy up to the 2023-27 period; and – indirectly – in almost every policy-making effort today, from the reform of the Erasmus+ programme to the new Industrial Strategy.[83] Furthermore, a risk-oriented approach should be adopted to handle the physical and transitional climate risks.

It is praiseworthy that in 2022, all the relevant budgetary documents of the EU include some kind of response to the issue of climate change. These responses are elaborated programmes, for example, the LIFE programme and the Just Transition Mechanism. Such programmes are explicitly aimed at combating climate risks, including transition risks, which are the most prevalent and perhaps the most hidden in the portfolios of the banks and companies. It is noteworthy, however, that the NextGenerationEU, which added enormous additional resources for environment and climate action, does not include the LIFE programme but doubles the budget of the Just Transition Mechanism. It also cannot be overlooked how the 'green and digital transition' is almost horizontal in the whole spectrum of the sectoral policies of the EU.

It should be noted that in today's EU policy-making, two tendencies are always taken into consideration. The selected policy solutions always aim to enhance these two tendencies in order to make everything as 'green' and 'digital' as possible. Examining policy-shaping in three very different fields in the last few years provides support for this claim – and considering these fields, there are likely also other examples.

The new Industrial Strategy introduced in 2020 has three key priorities. Two of these priorities are 'making Europe climate-neutral by 2050 and shaping Europe's digital future'.[84] Meanwhile, among the five key priorities of the Erasmus+ Implementation Programme, the first and third are 'making Erasmus+ a more environmentally sustainable program and fostering sustainable behaviors' and 'promoting the use of digital tools and the development of digital skills', respectively.[85] Even the Data Act, which is *per definitionem* a digital development, states that '[b]y having more information, consumers and users such as farmers, airlines or construction companies will be in a position to take better decisions such as buying higher quality or more sustainable products and services, contributing to the Green Deal

82 Szegedi and Szirbik, 2023; Szegedi, 2023.
83 Tagliapetra and Veugelers, 2020; Teleki, 2023.
84 European Commission, 2020c.
85 Arroyo, 2020; Nogueiro et al., 2022.

objectives'.[86] Further, the new MiCA regulation, which regulates cryptocurrencies and crypto-asset service providers in the EU, was designed in such a way that the ecological footprint of crypto-related transactions is placed among the top three priorities, in addition to consumer protection and anti-money laundering rules.[87]

The first conclusion that should be drawn here is that with the current post-European attitude to Green Deal policy-making, virtually any policies made and funded by the EU contribute to the green and sustainable (and digital) development of Europe. Consequently, from a financial perspective, the funding of almost all policies should be considered as indirect funding for a greener and more sustainable (and more digital) Europe.

In the European Commission's view, digitalisation is one of the main tools for *'transforming the resilience of Europe'*.[88] Since 2014, the Commission annually issues the Digital Economy and Society Index (DESI) reports, which contain a general analysis of the EU and country profiles of each Member State. As per the last DESI report,[89] measures aimed at digitalising public services and introducing or improving e-government solutions figure prominently across the Recovery and Resilience Plans. The estimated cost of planned investments and reforms under the Recovery and Resilience Facility amounts to EUR 46 billion in the field of digitalising public services and government processes, including e-health, e-justice, and the digitalisation of transport and energy systems. The most significant expenditure will benefit e-government, eID, e-justice (EUR 24 billion), and e-health (EUR 13 billion).[90]

From the perspective of hardcore fiscal policy, ensuring an appropriate way to establish the opportunity for digital taxation is among the EU's priorities. As the Council puts it in its proposal, the current rules governing international taxation were designed to apply to businesses with a physical presence in a country. The increasing digitalisation of economies presents tax challenges, such as the reduction of tax revenues due to tax avoidance and tax evasion. Tax rules, therefore, need to be adequately updated.[91]

Another issue that cannot be overlooked in the context of the EU's digital finances is the *possibility of the digital euro*. Annunziata identifies five types of tensions linked to digital currencies, among which the connection of the potential digital euro to the general body of public law and the whole economic ecosystem (public and private sector), as well as the questions of centralisation and decentralisation,

86 European Commission, 2020d.
87 See: Council of Europe, 2022.
88 See: *2030 Digital Compass: Your digital decade* [Online]. Available at: https://futurium.ec.europa.eu/en/digital-compass (Accessed: 30 September 2023).
89 European Commission, 2023a.
90 European Commission, 2023a.
91 See: *Digital taxation – Tax rules for the digital economy which are based on the principles of tax good governance can help promote growth and, among other benefits, deliver on the green and digital transitions* [Online]. Available at: https://www.consilium.europa.eu/en/policies/digital-taxation/ (Accessed: 30 September 2023).

can be found. These problems are not solely of a monetary nature but also have an intense connection to the fiscal and regulatory fields.[92] Omig adds that introducing a digital euro would mean a 'procedural efficiency' as a bonus, which represents, in economic terms, a positive externality for the EU.[93]

4. Conclusion

Up to the 2008 financial crisis and the Eurocrisis, the two main cornerstones of the EMU were the Maastricht Treaty and the SGP. Pursuant to the subsequent crisis management, many addenda have complemented this regulatory framework with relation to EU public finances, including the European Semester, the Fiscal Pact, the Two Pack, and the Six Pack. Nevertheless, the most pressing question of the current decade is whether the convergence criteria of the Maastricht Treaty and the whole EMU could be reformed to provide a more flexible and viable path for the Member States. These intentions are summarised as the EMU 2.0, and many directions have been considered by policy-makers and the existing literature. The European Commission is devoted to the idea of some kind of reform, as is indicated by the Five Presidents' Report in 2015, the Commission's 10 Points in 2022, and the latest press releases. However, the most neuralgic part of the criteria, the thresholds, seem to remain the same.

There are also some inherently contemporary challenges, such as the green and digital transition, especially since the Recovery and Resilience Fund added considerable extra resources to the central budget of the EU. Notably, this requirement in the last few years has gradually become such a general expectation of all sectoral policies that these two fields are now to be considered relatively horizontal rather than sectoral.

To sum up, the coming years will be crucial for the reform of the EMU. Some sort of realisation of the EMU 2.0 seems inevitable, and the most recent tendencies pose challenges for policy-makers. What exact regulatory answers will be given to all these questions will be intriguing to observe.

92 Annunziata, 2023.

93 Omig, 2023; For a deeper understanding of the issues related to digital taxation, see the 'EU law chapter on EU state aid rules' of this book, written by Szegedi and Teleki.

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