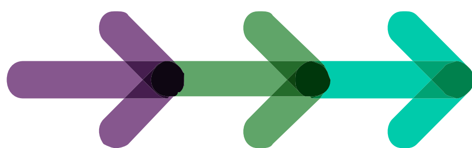

Fickle Formulas

Keep it complex! Prodi's curse and the EU fiscal governance regime complex

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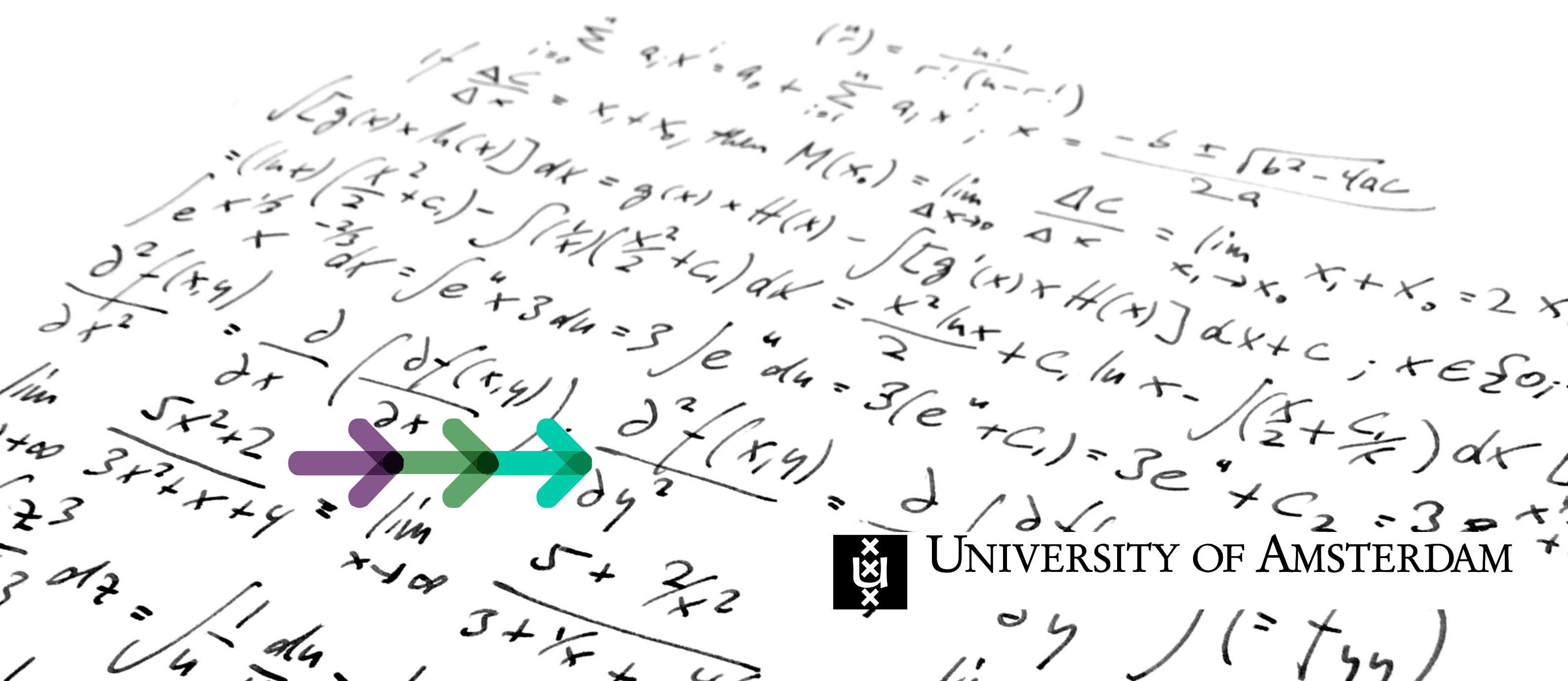
July 2021



Keep it complex!

Prodi's curse and the EU fiscal governance regime complex

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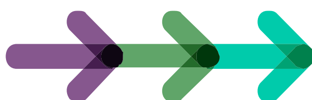
ABSTRACT. The EU fiscal framework has gradually morphed into a regional regime complex through various reforms of the preventive and corrective arms of the Stability and Growth Pact. A regime complex encourages actors to arbitrage between partially overlapping, parallel and nested rules. By drawing on this central insight, this article demonstrates that regime complexity enables member states to respect the letter but not the spirit of the fiscal rules to lower the cost of compliance. It further shows empirically how regime complexity weakens technocratic enforcement capacity when authority is dispersed across multiple levels of governance by focusing on the example of the general escape clauses during the coronavirus pandemic.

KEYWORDS. EU fiscal governance, Stability and Growth Pact, fiscal rules, euro area, regime complexity, European Commission

Word count: 8.028



Introduction

The Stability and Growth Pact (SGP) has been a longstanding point of contention within the European Union (EU) (Heipertz and Verdun, 2010). When in 2002 then President of the European Commission, Romano Prodi, complained about the SGP being 'stupid' and 'rigid', little could he know that the fiscal rules would eventually become so 'intelligent' and 'flexible' that their sheer complexity would render them unenforceable. During the peak of the crisis a landmark reform package consisting of the six and two-pack reforms and the intergovernmental Fiscal Compact ('Treaty on Stability, Coordination and Governance') was hastily agreed upon (Verdun, 2015). These repeated reforms and reinterpretations layered on top of each other have made the EU fiscal governance framework excessively complex and unpredictable. The goal of this article is to gain a better scholarly understanding of how these multiple overlapping, parallel and nested fiscal governance rules affected the enforcement failures in the SGP. In particular, the article seeks to explain member states' SGP compliance rates and EU institutions' failure to enforce the fiscal rules. Tackling these questions will shed light on the conflicts over public finances that have come to dominate European politics and will continue to do so in the aftermath of the corona pandemic.

From the outset, the European Commission emerged as one of the main beneficiaries of the increased complexity of the EU fiscal governance framework (Bauer and Becker, 2014; Savage and Verdun, 2016). The Commission's Directorate-General for Economic and Financial Affairs had authored large parts of the six-pack legislation and stood to gain additional powers from it (Schön-Quinlivan and Scipioni, 2017). The prevailing view among member states was 'that the complexity of the rules make it impossible for anyone bar the Commission to know exactly what is expected in terms of compliance' (Schön-Quinlivan and Scipioni, 2017, p. 1186). This complexity granted the Commission extensive discretion in the interpretation of the fiscal rules and thus fostered its monopoly as the 'fiscal rule interpreter of last resort' (Tesche, 2019, p. 1213). Schmidt (2016, p. 1046) pointed out that 'the increasingly precise definition of rules and numerical targets, although limiting the Commission's room for maneuver actually gave the Commission greater margin for flexibility'. This made it harder for the member states to understand ex ante whether their proposed budgetary plans were compliant with the fiscal rule framework and to challenge the Commission's assessment of them if they were not.

However, our understanding of the consequences of the complexity in EU fiscal governance for member states and EU institutions remains limited at best. In 2020, the Commission has launched a consultation process aimed at a fundamental overhaul of the fiscal governance framework. In an accompanying Communication it lamented the excessive complexity of the fiscal framework and openly admitted that 'the fiscal rules have become less transparent, hampering predictability, communication and political buy-in' (European Commission, 2020, p. 17). This surprisingly frank assessment is puzzling given that the Commission is allegedly the main beneficiary of the six and two-pack reforms. While the Commission calls for a simplification of the fiscal framework, the member states do not seem willing to open the pandora's box of SGP reform even though they are deeply dissatisfied with the way in which the rules are applied (Fleming and Khan, 2019). The activation of the EU general escape clause and soaring debt levels have given fresh impetus to the SGP reform debate. Why does the Commission want to simplify the SGP when it is one of the main beneficiaries of the fiscal regime complex? The Commission's fiscal experts' long-standing preference for incorporating the Fiscal Compact into the EU treaty framework is a testimony of their desire to foreclose avenues for overlapping and inconsistent rules that have 'encouraged some Member States to arbitrage between national and EU rules' (European Commission, 2020, p. 11). It gives rise to a 'complexity puzzle': how did member states navigate the ever more complex fiscal rules without completely disrespecting them?

This article asks the research question how regime complexity in the EU fiscal governance framework affected compliance failures in the SGP. It follows a two-step approach. First, it shows how the EU fiscal governance regime complex affects the enforcement capacity of the European Commission and the compliance capacity of the member states. Second, it demonstrates empirically that the shadow of complexity enables member states to respect the letter but not the spirit of the SGP. Following Raustiala and Victor (2004, p. 279) and Alter and Meunier (2009, p. 13), a regime complex is defined as nested, parallel, 'partially overlapping and nonhierarchical institutions governing a particular issue area'. The constitutive unit of a regime complex, the regime, is broadly defined as 'recognized patterns of practice around which expectations converge' (Young, 1980, p. 332) to account for the multi-level dimension of EU fiscal governance. [1]

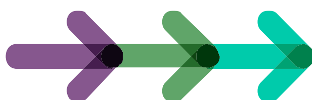
[1] This definition of a regime incorporates national and European fiscal rules and the interpretative communications of these rules as units of the regime complexes departing from Krasner's standard definition of a regime.

This article responds to Henning's call to gain a better understanding of the strategic behavior of actors within a given regime complex (Henning, 2017, p. 258). It also makes a distinct contribution to the literature on regime complexity by showing that regime complexity does not necessarily decrease compliance levels but can deteriorate the quality of compliance. In doing so, this article offers a more granular assessment of rule compliance. Shirking can remain undetected in the SGP regime complex because overlapping, nested and parallel fiscal rules put member states in a position to choose the less stringent fiscal target. This is not just the consequence of the flexibility inherent in any fiscal rule but the result of the negotiated flexibility that was agreed among the member states and the Commission.

The article will proceed as follows. First, it highlights some of the main fiscal governance reforms introduced as a response to the euro area crisis. The following section generates novel theoretical expectations about SGP compliance rates under the shadow of complexity. The subsequent section describes the main features of the EU fiscal governance regime complex. It process-traces key episodes of SGP compliance failure. The empirical application shows how regime complexity has affected the activation and implementation of the general escape clauses during the COVID-19 pandemic. The conclusion proposes potential avenues for SGP reform.

A Brief Overview of the EU Fiscal Governance Reforms

The landmark reforms have led to a panoply of innovations that amended both, the functioning of the SGP and its governance framework (Buti and Carnot, 2012; Mabbett and Schelkle, 2016; Schön-Quinlivan and Scipioni, 2017; Verdun, 2015). First, the SGP's preventive arm was amended by introducing an expenditure benchmark in addition to the structural balance to monitor compliance with the medium-term objective (MTO). The MTO is a country-specific fiscal adjustment target accounting for business cycle fluctuations. The expenditure benchmark was supposed to ensure that public expenditure growth would not permanently exceed potential growth. This two-pillar approach would put the Commission in the position to detect early on whether underlying fiscal trends were driven by discretionary revenue measures (Buti and Carnot, 2012, p. 907). Second, the six-pack reforms operationalized the debt reduction rule (European Fiscal Board, 2019, p. 16). This entailed that high-debt countries would have to make sufficient progress towards achieving a debt-to-GDP ratio in line with the 60% of GDP reference value. In case of non-compliance the Commission could decide to open an excessive deficit procedure (EDP) purely based on the

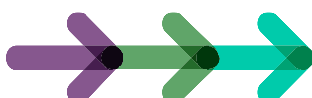


violation of the debt criterion. In essence, this put the deficit and debt criterion on an equal footing. Last but not least, the six-pack introduced the 'reversed qualified majority voting' (RQMV) rule in the Council which was supposed to make the adoption of sanctions semi-automatic (Chang, 2013; Seikel, 2016; Verdun, 2015). This in turn put the burden of proof on the Commission. Paradoxically, it increased the politicization of the Commission, made it more reluctant to propose sanctions and bilateralised fiscal surveillance (European Fiscal Board, 2019, p. 7). Finally, the Fiscal Compact decentralized fiscal discipline by requiring member states to introduce balanced budget rules at the national level so that the cyclically adjusted budget deficit would not exceed 0.5% of GDP (Chang, 2013).

The evolution of the SGP shows that member states have not only grown distrustful of the Commission's role as assessor and judge of the fiscal rules but also that the distrust among member states has increased. Northern member states would complain about the Commission's lenient application of the rules (Schmidt, 2016), which would in turn trigger a process to refine the underlying methodology to strictly separate fiscal actions under the control of a governments from revenue windfalls or shortfalls related to business cycle fluctuations. Non-compliance with EU rules would only add more rules (Savage and Verdun, 2016, p. 103). The result was 'an elusive quest for a "complete contract"', i.e. the tendency to cater for all possible future economic contingencies and to calibrate the SGP accordingly (Deroose, Carnot, Pench, & Mourre, 2018). A byproduct of this climate of distrust was the creation of independent fiscal watchdogs whose task is to make impartial assessments of whether the fiscal rules are respected. At the European level it led to the creation of the Commission's advisory European Fiscal Board and at the national level it spurred the rise of fiscal councils. However, the increasing number of actors in the fiscal domain only fueled politicization rather than bolstering the local ownership of the fiscal rules.

Theory: Regime Complexity in the European Union

Complex sets of institutions that are parallel, (partially) overlapping or nested have been subsumed under the heading of regime complexity (Alter and Meunier, 2009; Drezner, 2009; Keohane and Victor, 2011; Raustiala and Victor, 2004). Regime complexes are pervasive in international politics in such diverse issue areas as climate change (Abbott, 2014; Keohane and Victor, 2011) and international intellectual property (Helfer, 2009). More recently, Henning (2017) demonstrated that Germany among other creditor countries created a financial assistance regime complex during the eurozone crisis to control agency drift of the

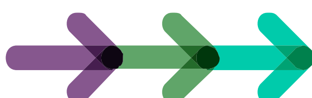


European Commission and the ECB by involving the IMF. Breen, Hodson & Moschella (2019) have shown how the EDP has been one of the drivers of incoherence within the regime complex on economic surveillance by the Commission and the IMF. Under certain conditions, however, a stable division of labor can evolve within a regime complex fostering policy coherence rather than constant turf battles (Gehring and Faude, 2014). This section draws on insights from regime complexity to generate a set of hypotheses about how the EU fiscal governance regime complex shapes the rule compliance capacity of member states and the enforcement capacity of technocrats.

The pioneering work of Alter and Meunier (2009) has mapped different causal pathways in which regime complexity can influence the functioning of politics. First, they highlight the importance of implementation politics for political outcomes. They find that regime complexes bolster rule ambiguity. Heterogenous preferences among member states will propel rule ambiguity and enable member states to cherry-pick their preferred interpretation. When member states' preferences diverge in an EU negotiation setting, the minimum common denominator might give rise to a 'failing forward' dynamic in which new agreements result in new policy failure (Jones, Kelemen, & Meunier, 2016). Given that member states' fiscal preferences widely diverge, coordination among them has been difficult and the emerging set of fiscal rules have become less predictable and enforceable over time. Furthermore, frequent SGP reforms have introduced new fiscal targets at EU and national level alongside the already existing rules rather than replacing them. This has widened the scope for arbitraging opportunities between different national and EU fiscal rules.

> H1: Overlapping, nested and parallel fiscal rules will incentivize member states to pick the fiscal target that is most in line with their respective preferences.

Second, the presence of a regime complex will increase the use of forum-shopping, strategic inconsistency and regime-shifting (Alter and Meunier, 2009; Raustiala and Victor, 2004). 'In forum-shopping, the shopper strategically selects the venue to gain a favorable interim decision for a specific problem. In creating strategic inconsistency, the actors intentionally create a contradictory rule in a parallel venue so as to widen their latitude in choosing which rule or interpretation to follow. In regime-shifting, actors may use forum-shopping, strategic inconsistency, or other strategies with the ultimate goal of redefining the larger political context so as to ultimately reshape the system of rules itself' (Alter and Meunier, 2009, p. 17). Deploying these strategies will enable member states to lower the costs of compliance with the fiscal framework. Formal rule compliance will minimize conflict with the EU institutions,



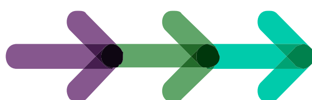
while at the same time it enables member states to pursue a fiscal policy stance geared towards short-term political objectives rather than long-term fiscal sustainability.

> H2: Member states will use forum-shopping, strategic inconsistency and/or regime-shifting to formally comply with the letter but not the spirit of the SGP.

Third, a regime complex can empower actors with superior expertise (Alter and Meunier, 2009). Technocrats and expert fiscal councils with specialized knowledge have the capacity to navigate the EU fiscal regime complex (Heipertz and Verdun, 2010, pp. 89-91). These expert circles often form networks to 'coordinate transnationally to define the "problem" and the needed solution' (Alter and Meunier, 2009, p. 17). However, when the fiscal rules are implemented at various national and supranational levels technocrats may lose their capacity to enforce the rules. Moreover, regime complexity can have various feedback effects and unintended consequences. For instance, it can foster competition between actors that might lead to turf battles and coordination failure but might also facilitate experimentation (Alter and Meunier, 2009, p. 20). It can make it harder for stakeholders to clearly assign responsibility especially when the regime complex is populated by an increasing number of independent actors with dispersed authority.

> H3: Technocratic actors will lose their rule enforcement capacity if their authority is rivalled by an increasing number of independent actors at national and supranational level.

The regime complex for EU fiscal governance provides an ideal case to conduct a plausibility probe into whether these hypotheses can be observed empirically. In comparison to alternative explanations, the conceptualization of the EU fiscal framework as a regime complex has the analytical advantage that it can incorporate complex actor constellations across multiple levels of governance. An explanation based on a P-A framework would direct our attention towards the SGP as an incomplete contract that cannot anticipate all future contingencies and thus creates room for the agent to reinterpret its contractual obligations to avoid sanctions by the principal. However, a P-A explanation does not foresee that the agent can choose between different contracts (i.e. national or supranational fiscal rules) with sometimes alternating principals. In addition, a P-A framework is based on the premise that the principal can credibly threaten to sanction the agent to ensure compliance. Yet, the history of the SGP shows that sanctions have never been imposed despite frequent non-compliance. Nevertheless, a P-A explanation should not be dismissed lightheartedly



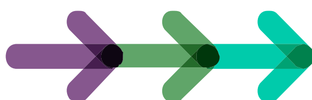
because it can potentially shed light on the question why the Commission's enforcement capacity has weakened.

The EU Fiscal Governance Regime Complex

The EU fiscal governance framework is plagued by excessive complexity (European Commission, 2020). There are various areas that have resulted in parallel, overlapping or nested rules which together constitute the regime complex. First, the SGP in its current form contains 'multiple substantive rules (headline balance, structural balance, public expenditure, debt), mirrored by different indicators for measuring compliance with them and including several clauses allowing for derogations' (Deroose, et al., 2018). These are accompanied by enforcement procedures that are similarly complex like the preventive and corrective arm of the SGP. Member states under an EDP have often relied on a so-called 'nominal strategy', i.e. to observe the 3% of GDP reference value they have relied on temporary revenue windfalls rather than undertaking effective consolidation efforts (European Fiscal Board, 2019, p. 32). This loophole weakened the corrective arm because the fiscal targets could be less demanding than under the preventive arm. Such inconsistencies provided incentives for member states to 'cherry-pick' the less demanding fiscal target.

The intergovernmental Fiscal Compact has deepened the regime complex because national fiscal rules substantially overlapped with the EU fiscal rules (Andrle et al., 2015, p. 10). This opened the door for forum-shopping and rule ambiguity because compliance with EU requirements offered a welcome pretext to ignore the possibly more stringent national fiscal rules (Deroose, et al., 2018). Thus, the Fiscal Compact introduced an element of competition and opened the door for turf battles. The Commission opposed its intergovernmental nature and henceforth tried to integrate it into the treaty framework also to lower the cost of monitoring compliance. Overall, the EU fiscal governance regime complex offers forum-shopping opportunities and fuels rule ambiguity especially because member states hold heterogeneous preferences regarding fiscal discipline. Strategic inconsistency is a widely used tool to escape any fiscal constraints.

The SGP in its multiple iterations has changed incrementally. But rather than replacing old with new rules, they have often come to exist in parallel. The expenditure benchmark co-exists with the structural balance. While the objective of both indicators is to capture the government's fiscal effort, in practice they can contradict each other because they rely on different aggregates and data input (European Fiscal Board, 2019, pp. 47-48). The ensuing



complexity widened the discretion in the interpretation of numerical indicators of fiscal adjustment (European Fiscal Board, 2019, p. 48). As a result, member states tend to comply only with the less demanding fiscal requirement. Furthermore, member states with a disdain for fiscal rules and a preference for fiscal profligacy (i.e. 'regime-shifters') can try to reshape the system of rules itself by continuously testing its boundaries. A common strategy of regime-shifting member states has been to ask for a more flexible application of the rules within the EU fiscal governance regime complex. Temporary flexibility due to 'unusual events' or other circumstances enables the regime-shifters to exclude certain expenditures from the calculation and appear rule-compliant. These multiple escape clauses have undermined the credibility of the rules by overburdening them with always new demands for more flexibility.

The creation of national fiscal councils in the EU is itself a consequence of regime complexity but at the same time also adds another layer of complexity. This is because the need for an independent expert body to monitor a fiscal rule increases with the complexity of the rule (Calmfors, 2015). Simple fiscal rules such as the original Maastricht criteria did not require interpretation from an independent fiscal council. The general public was able to monitor the rule without any expert advice. However, as fiscal rule complexity increased, national ownership declined. The Commission diagnosed the latter as one of the root causes of the chronically low compliance rates. To address this problem a national expert body should disseminate impartial information about the fiscal competence of the government by monitoring the national and/or European fiscal rules and by assessing whether the government's macroeconomic projections were realistic. This would enhance fiscal transparency and better inform voters about fiscal policy. Multiplying expert audiences across the EU would make non-compliance politically costly for governments. National fiscal councils also formed a transnational expert network to exchange best practice and pool their resources. Occasionally, they even challenged the Commission's interpretation of the fiscal rules. In sum, national fiscal councils fostered competitive pressures and facilitated institutional experimentation (Tesche, 2019). The ever-growing complexity of the EU fiscal framework was a driving force behind the empowerment of these expert bodies.

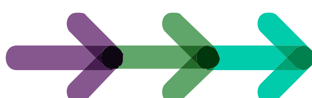
The EU fiscal governance framework has also made accountability relationships more complex. For European mass publics it has become increasingly difficult to identify who is responsible for the enforcement of the SGP and for sanctioning member states in case of SGP violations. The signatories of the fiscal compact could in theory call on the Court of Justice of the EU (CJEU) to adjudicate if they feel that another contracting member state has violated the provisions of the intergovernmental treaty (Fabbrini, 2013, p. 1020). In case of

sanctions related to an EDP, the opaqueness of the European Council shelters member states from having to reveal their true preferences for fiscal discipline. In contrast, when the Commission negotiates on a bi-lateral basis with a member state and then interprets the fiscal rules leniently, it is not clear whether this happened due to the anticipated preference constellation in the Council or due to the Commission's own preference. If national audiences cannot assign responsibility for outcomes produced by the EU fiscal framework, it is not surprising that the rules lack local ownership.

The Second Death of the SGP

The SGP has undergone multiple iterations since its introduction in 1997. In 2003, Germany and France were among the first countries to break the SGP after they breached the 3% deficit rule (Heipertz and Verdun, 2010, pp. 142-153). However, the Council abrogated the EDP for both countries. The Commission sued the Council in front of the CJEU for adopting conclusions in violation of the substantive and procedural requirements of the SGP. The CJEU later confirmed the Council's right to hold an EDP 'in abeyance' via non-adoption of the Commission's recommendation (Heipertz and Verdun, 2010, pp. 160-162). On procedural grounds it reaffirmed the Commission's right of initiative whose recommendations need to form the basis for any action by the Council. This episode revealed early on that the threat of hard sanctions was never credible and that they would likely remain purely symbolic even in case of non-compliance (Hodson and Maher, 2004).

The dilution of the SGP created the political momentum that resulted in the first major overhaul of the fiscal framework in 2005 (Heipertz and Verdun, 2010, pp. 167-169). The 2005 reforms distanced the SGP to some extent from the 'disciplinarian view', i.e. the idea that governments only comply out of fear of being sanctioned (Schelkle, 2007), only to double down on this view in its successive iterations. While the 2005 reform increased the precision of fiscal obligations, it also opened the door towards 'cherry-picking' by combining a more flexible interpretation with the dual goals of fiscal consolidation and structural reforms. In particular, the definition of what constituted a 'severe economic downturn' was relaxed (Matthijs, 2016, p. 381), while the notion of 'other relevant factors' was filled with a Franco-German 'wish list' (Heipertz and Verdun, 2010, p. 168). Interestingly, the design of the escape clause had already been a 'focal point of dissent' during the negotiations of the SGP because therein lied the ultimate lever to exert 'political discretion' (Heipertz and Verdun, 2010, p. 31).



Some of the 2005 SGP modifications like a stronger focus on country-specific structural budget balances seemed sensible at the time. Their introduction was generally regarded as an improvement by most economists because they foreclosed blame-shifting strategies directed at one-size-fits-all fiscal targets (see Buiter, 2006, p. 690; Schelkle, 2007, p. 713). Yet, experience with the latter revealed the problems of relying on unobservable indicators (Heimberger, Huber, & Kapeller, 2019). Output gap estimations are chronically unreliable in real-time and subject to large revisions ex post (Schelkle, 2007, pp. 722-724). Thomas Wieser (2018), former chair of the Economic and Financial Committee and the Eurogroup Working Group, pointed out that

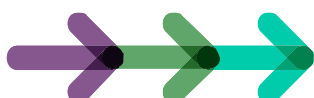
> 'the choice is thus of proposing sanctions on the basis of shaky forecasts, or of not proposing sanctions despite the rules requiring them. If the Commission does not wish to sanction such deviations, it again and again has to devise a new rule that explains why fiscal reality is in conformity with rules. Whatever the Commission ends up doing is seen as contravening its role and duties under the Treaty by some member states'.

Accordingly, the Commission is not only an 'engine of complexity' but also frequently finds itself between a rock and hard place with regard to exercising its sanctioning powers.

Shortly after Jean-Claude Juncker assumed the office of Commission President in November 2014, France, Belgium and Italy were at risk of non-compliance with the SGP provisions. However, the Commission decided to postpone its recommendations on their 2015 draft budgetary plans until March 2015. The postponement undermined the effectiveness of the Commission's opinions as an early intervention tool to steer member states towards the prescribed fiscal adjustment path. Juncker explained that

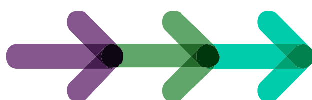
> 'this time I didn't dictate to France, Belgium and [Italy] what they have to do. They were taking the initiative to tell us what they intend to do, and this has to be understood because countries don't like this lecturing coming from Brussels. [...] So now they are proposing themselves what they intend to do, and that's, I do think, a more respectful way to deal with countries and to deal with national parliaments' (Spiegel, 2014).

Juncker's statement was a testimony to what a 'political' Commission meant for its role as assessor and judge of fiscal performance. However, it has been misconstrued as a purely political move when in fact the shadow of complexity laid the groundwork for this decision. France, for instance, had been subject to the corrective arm of the SGP since 2009 when the



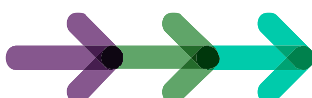
Commission opened an EDP. In its draft budget opinion, the Commission argued that France had made progress on some objectives but only limited progress on the structural part of the recommendations. It was this uneven progress and the inconsistent rules pointing towards different enforcement actions that underpinned Juncker's statement. Nevertheless, the Commission sent letters to France, Belgium and Italy demanding structural reforms and spending cuts to avoid non-compliance. Ultimately, France was able to broadly meet its headline targets in 2015 with significantly less fiscal effort than originally prescribed due to revenue surprises. This so-called 'nominal strategy' is particularly suitable for member states in the corrective arm of the SGP in which the macroeconomic adjustment period is long. This flexibility is not the result of the flexibility inherent in every fiscal rule by default but is rather due to the negotiated and commonly agreed flexibility that has been built up incrementally over decades.

Strengthening the SGP framework during a time when most governments were still in fiscal dire straits casted doubts on the new fiscal framework from the beginning. On the one hand, the Commission didn't want to undermine the credibility of the new rules but, on the other hand, it understood that it was an inconvenient time to enforce them. An interpretative 2015 Communication on 'making the best use of the flexibility within the existing rules of the SGP' offered an escape from this Catch-22 (European Commission, 2015). It identified public investments, structural reforms and cyclical conditions as areas that could create fiscal breathing space for member states. The reinterpretation was supposed to nudge member states into adopting structural reforms and boosting public investment. In February 2016, the ECOFIN Council endorsed a commonly agreed position on flexibility adding an additional layer of complexity. Due to the restrictive eligibility criteria of the flexibility clauses only some countries could benefit from them (European Fiscal Board, 2018, pp. 64-69). The European fiscal watchdog concluded that 'although the flexibility provisions, including the unusual events clauses, reduced the fiscal adjustment by sizable amounts, some Member States nevertheless failed to observe the more comfortable adjustment path' (European Fiscal Board, 2019, pp. 48-49). Moreover, it found that the long-term fiscal sustainability of member states using the flexibility provisions had worsened. Member states needed to merely commit to structural reforms and public investments to respect the letter but not the spirit of the SGP. The Commission used the negotiated provisions in the Communication on flexibility to promote its pet projects. For example, only expenditures co-funded by specific EU programmes like Juncker's fund for strategic investment were eligible under the investment clause. In this way, the Commission can indirectly steer the composition of public spending into a direction in line with its preferences, whereas member states can

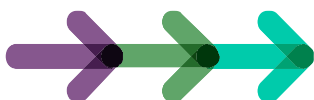


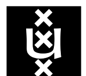
boost investment expenditure in an SGP-compliant manner. It runs the risk of overburdening the fiscal rules and generating formal rule compliance, whereas the prospects for long-term fiscal sustainability are in effect worsened. This debate is likely to continue in the context of the European Green Deal and the proposed 'greening' of fiscal rules.

On 12 July 2016, the Council established that Spain and Portugal had not taken effective action following the EDP recommendations to correct their excessive deficits. In line with the SGP requirements, this obliged the Commission to table a proposal for a fine with a default amount of 0.2% of GDP. The amount could be lowered if it was found that 'exceptional economic circumstances' prevailed or based on a 'reasoned request' submitted by the member state concerned explaining why it could not reduce its budget deficit. Following the submission of a reasoned request by Spain and Portugal, the Commission on 27 July 2016 recommended to the Council to cancel the fines for Spain and Portugal (European Commission, 2016). On August 8, the Council decided not to reject the Commission's recommendation and cancelled the fine for both countries. Pierre Moscovici, then Commissioner for Economic and Financial Affairs, Taxation and Customs, said that the 'decisions reflect an intelligent application of the Stability and Growth Pact. By giving more time to Spain and Portugal to bring their public deficits below 3%, the Council sets new credible fiscal trajectories, which will contribute to strengthening both their economies and the euro area' (European Commission, 2016). The decision of the College of Commissioners to propose no sanctions for Spain and Portugal after repeatedly violating the SGP requirements severely damaged the credibility of the reformed EU fiscal framework. Moscovici later justified the decision arguing that it 'would have been incomprehensible to their crisis-hit populations' (Moscovici, 2019). Leino and Saarenheimo (2017) point to a strong societal consensus in Portugal against any further austerity measures as decisive. Anecdotal evidence suggests that political considerations carried the day. In an unprecedented move former German Finance Minister Schäuble had lobbied several Commissioners to impose zero fines on Spain and Portugal to bolster his conservative political ally Mariano Rajoy, whose political survival was at stake after his attempts to form a new Spanish government had failed (Eder, 2016). The reformed RQMV decision-making rule seemed to matter little in the wake of a powerful member state's intervention to loosen previous commitments. Paradoxically, the Commission's superior sanctioning powers have torn it deeper into the political maelstrom undermining its enforcement capacity. This case shows how powerful member states can act as regime-shifters by choosing the most convenient political forum that enables them to get their way even if it undermines the credibility of the fiscal



framework. Nested decision-making rules rather than overlapping fiscal rules have shaped political considerations on the enforcement of the EU fiscal framework.

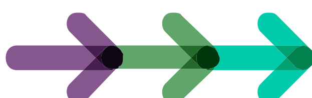




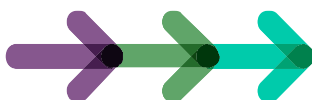
Regime Complexity and the General Escape Clauses During the Coronavirus Pandemic

The 2020 coronavirus pandemic led to a global breakdown of economic activity. On 20 March 2020, for the first time the Commission proposed to activate the EU general escape clause introduced by the six-pack reform for the case that a severe economic downturn was to hit the euro area or the EU as a whole. The rationale for its activation was that the pandemic constituted an 'unusual event outside the control of government'. This decision was rubber-stamped by the ECOFIN Council in a teleconference on 23 March. It enabled member states to temporarily deviate from their MTO by using discretionary fiscal stimulus. However, the activation of the EU general escape clause did not completely suspend the entire fiscal framework. Only budgetary measures related to addressing the economic fallout of the pandemic were excluded from the fiscal compliance assessment with EU fiscal rules, targets and requirements for an undefined period.

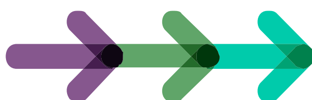
A major challenge was to decide when to reinstate the fiscal rules by deactivating the general escape clause at the national and EU level. Given that the EU general escape clause does not contain a sunset clause, it was crucial to get the timing right when to revert to the fiscal rules in order to avoid engaging in fiscal tightening prematurely (Jones, 2020). However, not reinstating the rules for an indefinite period would have casted doubts on the medium-term sustainability of member states' public finances. The debt to GDP ratios of many EU member states have risen to a level above 100 percent during the corona pandemic threatening long-term debt sustainability. Thus, defining a set of criteria that needed to be satisfied before the rules could be reinstated would have provided the necessary fiscal forward guidance that could reduce uncertainty. If member states were to anticipate that the EU general escape clause would be deactivated prematurely, they might not use sufficient fiscal stimulus out of fear of being subjected to an EDP after the pandemic. This explains why the Commission has communicated that the fiscal rules would not be reapplied before 2023. But even this announcement might not offer a sufficiently long time horizon for member states to return to their pre-pandemic fiscal state.



A potential exit from the general escape clause would be to differentiate the debt reduction benchmark on a country-by-country basis or to trigger the unusual events clause for certain member states that were particularly hard hit by the pandemic (Jones, 2020). The latter would create a transition period allowing these member states to temporarily deviate from their MTO or the adjustment towards it. However, this might only postpone the problem when to reinstate the rules for all member states. The IMF suggests that 'a well-defined escape clause should specify (i) a limited and clearly defined set of events triggering the operation of the clause, (ii) the authority to activate it, (iii) the timeline and procedures to revert to the rule, (iv) an effective control mechanism, and (v) a good communication strategy' (IMF, 2020, p. 2). While currently only some of these criteria are broadly met by the EU fiscal framework, the presence of regime complexity makes it challenging to fulfil these criteria due to the partially overlapping, nested and parallel fiscal rules.



As a result of the EU-level decision to trigger the general escape clause, member states subsequently also triggered the escape clauses in their national fiscal frameworks (where they existed). In some member states (France, Italy and Portugal) the activation of the national escape clause is automatically linked to the triggering of the general escape clause at the European level, thus requiring no action on the part of the national legislature (Eisl, 2020, p. 3; IMF, 2020, p. 3). It shows that some national fiscal rules are nested within the European rules. In contrast, other countries like Germany require the parliament to suspend the constitutionally enshrined debt brake and approve a supplementary budget with a supermajority (IMF, 2020, p. 3). In addition, a strict reimbursement plan needs to set out how to finance the extra borrowing 'within a reasonable period of time' (Eisl, 2020, p. 4). In countries in which the general escape clause exists in parallel to the European level, national parliaments possess the discretion to either emphasize fiscal consolidation going beyond what is required by the EU (i.e. Germany) or to delay fiscal consolidation for longer. Other countries like Slovakia have no escape clause enshrined in their national fiscal framework but their existing national fiscal rules linked to the Maastricht debt criterion might trigger quasi-automatic sanctions due to the sudden increase in the debt level (Eisl, 2020, p. 4). But not in all member states the parliament is the sole arbiter on the activation of/exit from the national escape clause. In most member states independent national fiscal councils are tasked with monitoring whether the activation of the national general escape clause is warranted given the macroeconomic environment (OECD, 2020, p. 12). Afterall, national fiscal councils are supposed to create national ownership of the fiscal rules, improve the accuracy of the macroeconomic and budgetary forecasts and make non-compliance more costly for fiscally profligate governments. They essentially import European SGP constraints into national politics. In doing so, they have further dispersed the authority regarding the general escape clause.



These empirical examples indicate that the Commission faces formidable challenges in ensuring that the general escape clauses are applied in a coherent manner under the shadow of complexity. Even if an agreement would be found to define a set of criteria when to revert to the EU fiscal framework, member states with parallel or partially overlapping national escape clauses could deliberately delay their escape from the national escape clause. Germany as the key architect of the intergovernmental fiscal compact wanted to institutionalize a German-style 'debt brake' in the national legislation/constitution of all signatory states (Dawson, 2015, p. 981). Yet, when the first signs appeared that the stringent debt brake would become binding, the German government signaled its willingness to weaken it already before the corona pandemic triggered the EU general escape clause (Chazan, 2020). Regime-shifting member states could use the aftermath of the coronavirus pandemic to rid themselves of overly constraining fiscal rules by using strategic inconsistency and forum-shopping opportunities provided by the fiscal regime complex. Since the Fiscal Compact instigated the partial repatriation of fiscal competences to the national level, the Commission has cautioned against the possibility that member states might be incentivized to arbitrage between national and EU fiscal rules. In this regard, the pandemic might vindicate the Commission's worst fears because of the extraordinary challenge the pandemic poses for public finances and the fiscal surveillance methodology (including the calculation of output gaps and other crucial indicators).

Conclusion

Prodi's curse has unleashed an open-ended process of institutional experimentation with the goal to make the fiscal framework 'smarter'. It led to the introduction of innovations that were supposed to remedy previous design flaws only to subsequently become subject to heavy criticism. Over time, the incremental changes have created an array of partially overlapping, nested and parallel nonhierarchical institutions. Even the Commission itself frankly admits that the framework has become 'excessively complex' incentivizing member states 'to arbitrage between national and EU rules' (European Commission, 2020, p. 11). A view shared by other 'connoisseurs of the Pact' at the IMF and the ECB (Andrle, et al., 2015; Kamps and Leiner-Killinger, 2019). In 2020, the Commission launched a public consultation on how to reform EU fiscal governance. The emerging consensus entails a stronger focus on debt developments, limiting expenditure growth to potential growth and introducing financial rewards for rule-compliance rather than punitive sanctions (Kamps and Leiner-Killinger, 2019). One could also envision a return towards 'identifying gross errors' as defined

in the treaty, i.e. going back to the debt to GDP ratio of 60% and the 3% deficit. While the 60% reflected the average gross debt of EU governments at the time the Maastricht treaty was negotiated, the 3% deficit criteria was supposed to be compatible with this debt ratio assuming a long-term nominal growth rate of 5% (Savage, 2005, pp. 32-33).

The irony of the original Maastricht criteria is that while the 3% seem to work politically, economically it does not necessarily foster fiscal sustainability (European Fiscal Board, 2019, pp. 81-93). Vice versa, while the 60% are comparatively more sensible from an economic perspective, compliance is much harder from a political perspective especially in high-debt, low-growth countries. This suggests that the fiscal pendulum might swing from continuous 'police patrol' fiscal surveillance back towards a 'fire alarm' approach. But whether these should be carried out at the national or supranational level remains a moot point. With the creation of fiscal councils some of the responsibility for fiscal surveillance has been partially repatriated to the national level. Eichengreen and Wyplosz (2016), for example, favor a complete renationalization of fiscal policy by building effective domestic budgetary institutions. On the one hand, a complete renationalization of fiscal policy would enable the Commission to return to its core mandate but on the other hand financial markets would likely become the sole enforcer of fiscal discipline which has not worked well in the past. However, the biggest obstacle to a fundamental overhaul of the EU fiscal governance framework seems to be the reluctance of member states afraid of 'losing' if the rules change (Fleming and Khan, 2019). This means that continued institutional experimentation via incremental reinterpretations of the rules through soft law is likely.

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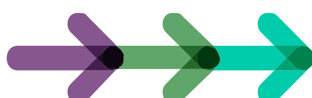

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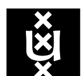

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