Economic Governance in the European Union:
Should Fiscal Stability Outweigh Economic Growth in the Stability and Growth Pact?

Roger J. Goebel*
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Abstract

This Article will initially discuss the genesis of the Stability and Growth Pact (“SGP”) in 1996-1997. The second section will analyze the legal structure of the legislation adopted in 1997 to enforce the stability aspect of the SGP, i.e., the Multilateral Surveillance Regulation (“MSR”) and the Initial Excessive Deficit Regulation (“EDR”). Next, the Article will briefly review the operational disputes over the application of the EDR to France and Germany in 2002-2003, culminating in the impasse at the November 25, 2003 Ecofin Council meeting. The following section will first summarize and then analyze the Court of Justice’s judgment in 2004 in the suit between the Commission and the Council concerning the Ecofin Council’s failure to take further action in the proceedings against France and Germany under the EDR, and the Council’s conclusions taken as an alternative to such action. The principal revisions to the SGP regulations adopted in 2005 will then be briefly described and analyzed. The conclusion will present some reflections on the lessons to be drawn from the story in this Article, particularly on whether fiscal stability and economic growth should properly receive equal weight in the SGP.
ECONOMIC GOVERNANCE IN THE EUROPEAN UNION: SHOULD FISCAL STABILITY OUTWEIGH ECONOMIC GROWTH IN THE STABILITY AND GROWTH PACT?

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INTRODUCTION

Developments in the constitutional and legal structure of the European Community rarely follow a single linear path. The story of the evolution of the Stability and Growth Pact ("SGP"), a key policy within the field of coordination of the economic policies of the European Union ("EU") Member States, during the decade from 1995 to 2005, well demonstrates this.

The SGP represents the confluence of two quite different policy concerns, for fiscal stability on the one hand and economic growth on the other. At the core of the SGP is a strong policy commitment made by the European Council at its summit meeting in Amsterdam in June 1997 at the time when preparations were being made for the commencement of the final stage of Monetary Union in 1999. In accord with the European Community Treaty ("EC Treaty") provisions on the Economic and Monetary Union added by the Treaty of Maastricht in 1993, only Member States that satisfied several crucial economic and monetary preconditions, commonly called the convergence criteria, could join in the final stage of Monetary Union, transfer-

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1. The Treaty of Maastricht, O.J. C 224/1 (1992), signed February 7, 1992 and effective November 1, 1993, inserted Title VII, Economic and Monetary Policy, articles 98 through 124 (initially numbered as articles 102a through 109m), into the European Community Treaty. These provisions have been carried over without change into the current Consolidated Version of the Treaty Establishing the European Community, O.J. C 321 E/37 (2006) [hereinafter EC Treaty].

2. EC Treaty, supra note 1, art. 121, sets out four convergence criteria: a satisfactorily low inflation rate, commonly coupled with low long term interest rates; a stable exchange rate; and the avoidance of excessive budgetary deficits. See generally Roger J. Goebel, European Economic and Monetary Union: Will the EMU Ever Fly?, 4 COLUM. J. EUR. L. 249 (1998) (describing the preparations for Monetary Union and the determination of the eleven Member States that initially qualified to join in the Eurozone).
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ring control of their monetary policy to the European Central Bank ("ECB") and subsequently adopting the Euro as their currency. Already in the summer of 1997 it appeared likely that a large number of Member States would be able to satisfy the convergence criteria. In fact, eleven did so, coming together on January 1, 1999 in the final stage of Monetary Union. This group of Member States is commonly called either the "Eurozone" or the "Euro area." 4

The Economic and Monetary Union is composed of two components: a true Monetary Union, whose Member States transfer control of their monetary policies to the ECB and adopt the Euro as their common currency, and a system of coordination of the economic policies of all Member States, whether part of the Monetary Union or outside of it. The EC Treaty provisions on economic coordination, supplemented by legislation and operational policies, provide for soft law modes of review of national budgetary conditions, supplemented by a mix of hard and soft law rules and procedures intended to enforce fiscal stability at the Member State level.

In 1996-97, the German government of Chancellor Kohl was

3. The European Central Bank ("ECB"), created in May 1998, took over control of the monetary policy of the States joining in Monetary Union on January 1, 1999 in accordance with the EC Treaty, supra note 1, arts. 105, 121(4). The Euro was subsequently introduced on January 1, 2002. This Article concerns only the economic coordination ancillary to Monetary Union and not the Monetary Union itself. Professor Desmond Dinan’s text on the European Union ("EU"), Desmond Dinan, Ever Closer Union: An Introduction to European Integration 481-517 (3d ed. 2005), contains a valuable chapter on the historical evolution of the Monetary Union. The prominent economist, Professor Paul De Grauwe, provides an excellent economic overview in Paul De Grauwe, Economics of Monetary Union (7th ed. 2005). An interesting study of the evolution of Monetary Union, concentrating on the political factors, is provided in Malcolm Levitt & Christopher Lord, The Political Economy of Monetary Union (Neill Nugent et al. eds., 2000). Professor Rosa Lastra provides an excellent current description of Monetary Union and the role of the European Central Bank in Rosa M. Lastra, Legal Foundations of International Monetary Stability 173-295 (2006). René Smits, then General Counsel to the Central Bank of the Netherlands, provides a detailed initial description of the role of the European Central Bank and the evolution of Monetary Union in René Smits, The European Central Bank: Institutional Aspects (1997).

4. The term "Eurozone," or sometimes "Euro area," is commonly used to describe the territory of those Member States, originally eleven in 1998, and presently fifteen, that have joined in the third and final stage of Monetary Union. Until 2007, the Eurozone was comprised of Austria, Belgium, Finland, France, Germany, Greece (since 2001), Ireland, Italy, Luxemburg, the Netherlands, Portugal, and Spain. Slovenia joined the Eurozone on January 1, 2007, while Cyprus and Malta did so on January 1, 2008.
concerned that some States that joined the Eurozone in the final stage of Monetary Union might subsequently adopt lax budgetary policies that would harm the overall monetary stability of the Eurozone. Supported in large measure by the Commission, Germany managed to convince the other States' political leadership to agree upon a policy commitment initially called the Stability Pact,\(^5\) which would reinforce the more generally stated rules and procedures set out in the EC Treaty's economic coordination provisions. The Stability Pact was to be principally achieved through the enactment of strict rules and procedures intended to perpetuate the limits on annual government deficits that represented the key and most difficult condition that States had to fulfill in order to attain the final stage of Monetary Union and join the Eurozone.\(^6\) However, by the time of the June 1997 Amsterdam European Council meeting, the French government, led by President Chirac and the newly elected Socialist Prime Minister Jospin, together with other socialist and liberal political leaders, insisted that the Stability Pact contain a growth component, expressing a policy commitment to spur higher employment and growth. Accordingly, in June 1997 the European Council adopted two distinct resolutions that together constitute the SGP, namely the Resolution on the Stability and Growth Pact\(^7\) and the Resolution on growth and employment.\(^8\) Thus, from its outset the SGP has always represented a somewhat awkward fusion of two different and potentially conflicting policy goals.

Early commentators, undoubtedly influenced by the prevail-


\(^6\) See infra Part I.


ing sentiments among the Ministers of Finance in 1997, stressed the stability aspect of the SGP and made little, if any, reference to the growth aspect.\(^9\) Indeed, Martin Heipertz and Amy Verdun, providing an excellent study of the background of the SGP, conclude that the growth aspect of the SGP had more rhetorical than real value, labeling it a "cosmetic concession" to France.\(^10\) In contrast, this Article will try to demonstrate that at the level of the political leadership of the States represented in the European Council, concerns for growth and employment balanced concerns for fiscal stability in 1997 and thereafter.

In order to give teeth to the stability aspect of the SGP, the Council adopted in June 1997 two regulations: the Multilateral Surveillance Regulation ("MSR"),\(^11\) which provided for a detailed system of economic coordination of all Member States' annual budgets, and the Excessive Deficit Regulation ("EDR"),\(^12\) which established substantive and procedural rules intended to oblige the Eurozone Member States to avoid excessive deficits, together with a threat that recalcitrant States might be subjected to serious economic sanctions. Whether those initial rules were so strict as to be fundamentally flawed and apt to occasional serious difficulties in practice is one of the issues considered in this Article.

After the Monetary Union was launched on January 1, 1999, the Commission, led by President Romano Prodi, with Pedro Solbes serving as the Commissioner responsible for economic and monetary affairs, zealously assumed its role in the process of economic coordination under the two SGP regulations. Not surprisingly, the Directorate General for economic and monetary affairs, headed by Commissioner Solbes, pressed for a strong, and indeed strict, enforcement of the substantive standards and procedural rules set out in the two SGP regulations.

When in 2002-03, France, Germany, and Italy either experienced anemic economic growth or fell into recession, their gov-

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ernments argued for a liberal (or lax) application of the SGP standards and procedures, pleading the growth concerns of the SGP. Nonetheless, the Commission, supported by the governments of several smaller States and by the ECB (although, as we shall see, the ECB has no role in the economic coordination procedures), pressed to enforce the substantive standards of the EDR, emphasizing the stability aspect of the SGP. In a well-publicized impasse in November 2003, the Ecofin Council declined to follow Commission recommendations that would have moved the excessive deficit procedures further along toward sanctions upon France and Germany and instead adopted conclusions that effectively would have permitted France and Germany to progress more slowly toward compliance with the SGP rules. After some internal debate, the Commission decided that it must act to enforce what it considered to be the crucial obligations imposed upon the Council and States by the SGP, and accordingly sued the Council. The Court of Justice’s July 2004 judgment annulled the Council’s November 2003 conclusions, but its doctrinal analysis provided support for the views of both the Council and the Commission. Whether the Council or the Commission gained the most from the Court’s judgment is another topic considered in this Article.

Subsequently, after a period of rethinking both in the Commission and the Council, in June 2005, the Council adopted an Amended Multilateral Surveillance Regulation (“Amended MSR”) and an Amended Excessive Deficit Regulation (“Amended EDR”), which were intended to soften the substantive and procedural rules in the light of the operational experience in 2002-04. Whether the amendments to the MSR and

13. See infra Part III.

14. The Council in the composition of Ministers of Economy and Finance is called the Ecofin Council. The Ecofin Council has jurisdiction over all aspects of economic coordination, including the adoption of economic policy guidelines. See Resolution of the European Council of 13 December 1997 on Economic Policy Coordination in Stage 3 of EMU and on Treaty Articles 109 and 109b of the EC Treaty, O.J. C 035/1, art. 1(6) (Feb. 2, 1998); see also infra text accompanying note 127. For an appraisal of the increased power and influence of the Ecofin Council, see LEVIT & LORD, supra note 3, at 216-20.

15. See infra Part IV.


EDR represent a prudent or an ill-advised compromise, a beneficial move toward a better consideration of relevant economic factors and sensible flexibility in the operational procedure, or rather a dangerous weakening of valuable limits on government profligacy, is a matter of considerable debate among commentators, and will be examined in this Article, but only after a period of experience in practice will it be possible to make a more definitive and pragmatic appraisal of their merits and deficiencies.

This Article will initially discuss the genesis of the SGP in 1996-97. The second section will analyze the legal structure of the legislation adopted in 1997 to enforce the stability aspect of the SGP, i.e., the MSR and the initial EDR. Next, the Article will briefly review the operational disputes over the application of the EDR to France and Germany in 2002-03, culminating in the impasse at the November 25, 2003 Ecofin Council meeting. The following section will first summarize and then analyze the Court of Justice’s judgment in 2004 in the suit between the Commission and the Council concerning the Ecofin Council’s failure to take further action in the proceedings against France and Germany under the EDR, and the Council’s conclusions taken as an alternative to such action. The principal revisions to the SGP regulations adopted in 2005 will then be briefly described and analyzed. The conclusion will present some reflections on the lessons to be drawn from the story in this Article, particularly on whether fiscal stability and economic growth should properly receive equal weight in the SGP.

I. THE GENESIS OF THE STABILITY AND GROWTH PACT

A. Treaty-based Economic Coordination: A Constitutional and Legal Perspective

Because the SGP regulations are based upon the economic coordination provisions of the EC Treaty, we need initially to examine these provisions, which establish the constitutional foundations of the SGP rules. EC Treaty Article 4(1), introduced by the Treaty of Maastricht, states that “the activities of the Member States and the Community shall include . . . the adoption of an economic policy which is based on the close coordination of Member States’ economic policies . . . and conducted in accordance with the principles of an open market economy and free competition.”
In contrast to the federal character of Monetary Union, the so-called economic union is not really a union. The Monetary Union can be said to be a true union with federal features, because the Member States that participate in its final phase yield control of their national monetary policies to the central authority of the ECB and must replace their national currencies with a single currency, the Euro. As the monetary expert Professor Rosa Lastra emphasizes, there is no question but that this cession of control over monetary policy constitutes an important transfer of sovereignty from Member States to the European Community.

During its nine years of operations, the ECB has in general quite successfully set out its basic monetary policies and established monetary control procedures for the Eurozone, while the Euro was successfully introduced in 2002 and has since attained the status of a global currency. The national central banks of the Eurozone States participate in the European System of Central Banks headed by the ECB, but no longer play any autonomous role in governing national monetary policy.

Decidedly in contrast, the EC Treaty only requires the adoption of a Community economic policy and “the close coordination” of national economic policies. Although the adoption of Community-wide economic policy guidelines certainly represents an important innovation with considerable impact in practice, it is nonetheless founded on the coordination of the national policies and does not encompass a centralized governance of national economic policies. In her recent appraisal of the “hybrid” conjunction of Monetary Union and economic coordina-

18. The European Central Bank has as one of its “basic tasks” the control of monetary policy of the Community (actually referring to the States in the Eurozone). EC Treaty, supra note 1, art. 105(2). The EC Treaty grants the ECB the exclusive right to emit banknotes within the Eurozone. EC Treaty, supra note 1, art. 106(1). For a current authoritative description of the role, powers, and operations of the ECB, as well as the legal status of the Euro, see Lastra, supra note 3, at 208-42.

19. See Lastra, supra note 3, at 199-200; see also Goebel, supra note 2, at 254 (“Such a transfer of vital power necessarily diminishes the role of national governments to a significant degree.”).


21. See Lastra, supra note 3, at 208-14 for an analysis of the relationship between the ECB and the national central banks within the European System of Central Banks.
nation, Professor Imelda Maher contrasts the "highly integrated" Monetary Union with the "fragmented system of economic governance whose responsibility lies predominantly at the level of the Member State."  

Indeed, it is difficult to conceive of any truly centralized European Community control over economic policy, in parallel to the ECB's control of monetary policy, because that would require an enormous cession of sovereignty, due to the close links between economic policy and fiscal policy, tax collection, social security and social welfare systems, employment policy, expenditures for national defense and infrastructure, etc. Member States do not make any transfer of their ultimate sovereign control over their economic policies as such, but only accept obligations to abide by operational modes of cooperation specified in the Treaty or in rules established pursuant to Treaty provisions. As we shall see, the Treaty provisions concerning economic coordination provide an important operational role to the Commission, but leave the ultimate decision-making capacity in the hands of the Council, occasionally under the guidance of the European Council. Neither the Parliament nor the ECB have any role to play.

Moreover, the recently signed Treaty of Lisbon, or Reform Treaty, when ratified, would not alter this. The EC Treaty (renamed the Treaty on the Functioning of the European Union) would include a new Article 5 that empowers the Council to adopt "broad guidelines" and other measures in the coor-

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22. Imelda Maher, Economic Governance: Hybridity, Accountability, and Control, 13 COLUM. J. EUR. L. 679, 682 (2007). SMITS, supra note 3, at 66, describes the end result to be a "single economic policy" for the Community, but based upon the coordinated national policies. In a recent re-examination of the role for economic coordination, Jean Pisani-Ferry ascribes the idea of an amorphous economic coordination, in contrast to the centralized monetary policy, to the French government during the planning for EMU. See Jean Pisani-Ferry, Only One Bed for Two Dreams: A Critical Retrospective on the Debate over the Economic Governance of the Euro Area, 44 J. COMMON MKT. STUD. 823, 826-27 (2006).

ordination of Member State economic policies. Noteworthy is the fact that economic coordination is not listed in the new Articles 2-4, which set out both the exclusive fields of competence of the EU, and those shared between the EU and Member States. Economic coordination remains sui generis.

The 1989 Delors Report[24] chaired by Commission President Jacques Delors and consisting of national central bank governors and economic experts, set out the essential features of the future Economic and Monetary Union. The Report principally indicated the necessity for Member States to satisfy serious economic preconditions in order to enter into the ultimate final stage of Monetary Union (i.e., to join the present Eurozone), and then set out the basic features of the operational structure of the Monetary Union. Subsequently, studies by the Commission and the Community's Monetary Committee (principally representing national central bank views) provided suggestions for practical features of both the economic coordination and the Monetary Union aspects of Economic and Monetary Union. The 1990-91 Intergovernmental Conference[25] largely followed the principal structural proposals made in the Delors Report, as supplemented by Commission studies, when drafting the Economic and Monetary Union provisions that the Treaty of Maastricht inserted into the EC Treaty.


Although it emphasized the need for coordination of national budgetary policies, the Delors Report never envisaged a true economic union in tandem with a monetary union. In its coverage of the topic of "economic union" (a rather misleading term), an influential Commission study, "Economic and Monetary Union," commenced by stating that "[t]here does not need to be a single economic policy in the same way as for monetary policy, [so] there is not the same need for institution change[",]" and continued on to say that, in accord with the principle of subsidiarity, "[m]ost economic policy functions will remain the preserve of Member States even in the final stage of economic and monetary union." Both the Delors Report and the Commission study did mention rather briefly that the Council should have an ongoing ability to set some limits on national budgets in order to avoid risks to monetary stability within the Monetary Union once created. Also, in a section on Community and State cooperation, the Commission study called for the Commission to adopt "pluriannual economic policy guidelines" supplemented by "multilateral surveillance of economic policy," thus foreseeing the later role of the Commission under the MSR.

The term "economic union" does not appear in the EC Treaty. Rather, Title VII, "Economic and Monetary Policy," commences with Chapter 1, "Economic Policy." Chapter 1 begins with EC Treaty Article 98 (ex Article 102a), added by the Maastricht Treaty, which imposes a dual obligation on Member States, first to "conduct their economic policies with a view to contributing to the achievement of the objectives of the Community" (which can be seen as an aspect of the general duty of loyalty to the Community set out in EC Treaty Article 10), and sec-

27. Commission Communication, SEC (90) 1659 (Aug. 21, 1990), at 21, pt. 3 (Economic and Monetary Union); see also Delors report, supra note 24, pt. III (steps toward economic and monetary union).


29. Id., SEC (90) 1659, at 23, pt. 3.3 (1990) ("Cooperation").

30. The Treaty of Maastricht's detailed provisions on EMU as inserted in the EC Treaty were all renumbered, without other change, by the Treaty of Amsterdam, O.J. C 340/1 (1997), effective May 1, 1999. For ease in dealing with earlier legislation and commentary on EMU provisions that use the initial article numbers, it is useful practice to add a parenthetical reference to the original article number after the current number.
ondly, to do so "in the context of the broad guidelines" to be set by the Ecofin Council pursuant to Article 99(2). Article 99 (ex Article 103), also added by the Maastricht Treaty, bound Member States to "regard their economic policies as a matter of common concern" and to coordinate them in accordance with guidelines set by the Council, acting by qualified majority.\textsuperscript{31} Thus, the EC Treaty now requires all Member States, whether or not they are included in the final stage of Monetary Union, i.e., in the Euro area or Eurozone, to join in a process of economic policy coordination, a process that certainly influences, and may restrict to some degree, unilateral national economic decision-making. Economic policy coordination is, however, by no means a form of economic union analogous to the Monetary Union. Moreover, although achieving national fiscal discipline in order to avoid adverse effects on the Monetary Union undoubtedly represented the original policy thinking behind the Treaty coverage of economic policy coordination, over time the economic coordination has expanded to advance a number of policy goals, such as the promotion of growth and employment, new research and technology, and other Lisbon agenda initiatives.

Article 99 sets out the essential mode of a system of annual multilateral surveillance of national budgets in order to promote fiscal discipline. Article 99 thus represents the core of the economic coordination aspect of Economic and Monetary Union. An unusual feature of this coordination of national economic policy is that Article 99(2) requires the Ecofin Council to submit its draft guidelines to the European Council for its "conclusion" on them before the Ecofin Council can give its final approval. This is one of the rare instances in which the EC Treaty specifically sets a role for the European Council, presumably both because setting these guidelines in some instances may represent a politically sensitive matter and because the European Council's conclusion adds political weight to the Ecofin Council's guidelines. The European Council itself cannot give final approval to the guidelines because the Treaty on European Union ("EU Treaty") does not give it the capacity to take decisions with legal force, but only to "define the general political guidelines" of the

\textsuperscript{31} For an early analysis of the economic coordination required by the initially numbered Article 103, see Smits, supra note 3, at 64-74.
Union, and hence the Community.\footnote{32} Article 99(3) requires the Commission to prepare regular reports on economic developments in each State, as well as in the entire European Community. Making use of the Commission reports, the Council then is to "monitor" these economic developments and assess each State's performance in the light of the initial guidelines set under Article 99(2). Manifestly, this is only a "soft law" process. As the monetary expert René Smits well observes, the use of the term "guidelines" indicates that these are only recommendations which have no legally binding effect and are not subject to judicial review by the Court of Justice. He views "compliance [as being] assured through the political process where Member States take each other to task for failing to toe the line commonly agreed."\footnote{33} As is typical in decision-making within the Economic and Monetary Union, Article 99(2) stipulates that the Parliament is only to be kept informed by the Council and has no role in the shaping of the guidelines\footnote{34} (although in practice its Economic and Monetary Affairs Committee regularly reviews developments in the economic coordination process). Incidentally, the Treaty of Lisbon would not change this. Its new Article 5 on economic coordination, mentioned previously, accords only the Council the power to adopt guidelines and other measures—the omission of reference to the Parliament is undoubtedly deliberate.

Promptly in 1994, the Community began the coordination of national economic policies. Already in late 1993 the Council had adopted a series of technical regulations and decisions making more precise the application of the Treaty provisions on avoiding excessive government debt and on calculating a State's financial resources.\footnote{35} In 1994, the Council for the first time is-

\footnote{32. Article 4 of the EU Treaty, \textit{supra} note 26, stipulates that the European Council's role is to provide the Union with "general political guidelines."}  
\footnote{33. SMITS, \textit{supra} note 3, at 70.}  
\footnote{34. Professor Jean-Victor Louis has observed that the failure to include Parliament in the process prevents any "effective inter-institutional dialogue for the elaboration of the guidelines." Jean-Victor Louis, \textit{Perspectives of the EMU after Maastricht}, in \textit{FINANCIAL AND MONETARY INTEGRATION IN THE EUROPEAN ECONOMIC COMMUNITY} 1, 7 (Jules Stuyck ed., 1993).}  
sued guidelines to specific Member States for modification of their economic policies. Also, the Treaty ban in Article 104 (ex Article 104c) on direct financing of government deficits by central banks (popularly referred to as the "no bail-out clause") came into effect on January 1, 1994.36

Pursuant to Article 99(2), every year the Commission makes a review of economic conditions in the entire Community, covering a three-year period since 2003. The Commission then recommends guidelines to the Council, which in turn formulates a draft text for the Broad Economic Policy Guidelines ("BEPG"). The Council submits the draft BEPG to the European Council, which gives its "conclusions" on them, after which the Council formally adopts them. Over the last decade, the BEPG have become progressively more comprehensive and detailed. The BEPG not only provide a valuable review of the Community's economic health, growth, and development (rather like an International Monetary Fund ("IMF") or Organisation for Economic Co-operation and Development ("OECD") study), but also set out a series of specific recommendations for the implementation of single market legislation, the promotion of new technology and business entrepreneurship, labor market reforms, etc.37 We shall note later how the BEPG have become linked to the programs to promote employment and job creation. We shall also observe that the Commission evaluations of each State's annual and multi-annual budgetary programs specifically include an examination of their compatibility with, or deviation from, the BEPG.

**B. Treaty-based Rules on Avoiding Excessive Deficits**

The economic coordination provisions of Articles 98-99 are supplemented by Article 104 (ex 104c), which defines the basic

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36. SMITs, supra note 3, at 75-77, describes Article 104 as a critical prohibition of dangerous national government economic behavior. See also LASTRA, supra note 3, at 251-53.

37. For a brief description of this process and the nature of the Broad Economic Policy Guidelines ("BEPG") themselves, see DINAN, supra note 3, at 511, and LASTRA, supra note 3, at 250-51. For a critical view that the BEPG are "fuzzy" and provide "far too many guidelines to deliver a selection of priorities," see Pisani-Ferry, supra note 22, at 836.
nature of an excessive national annual budgetary deficit and then sets out the elements of a procedure for Commission recommendations and Council action to confront any Member State’s excessive deficit, including the possibility of sanctions for States that refuse to comply with Council recommendations aimed at eliminating excessive deficits.

Initially, we should observe that avoidance of an annual excessive deficit constituted the “make or break” condition for a State’s entry into the final stage of Monetary Union, thus becoming a part of the Euro area. The other economic preconditions, or convergence criteria—achieving relatively low inflation and low long term interest rates, and maintaining stable currency exchange rates—were always likely to be capable of attainment by most States, but not this one. EC Treaty Article 104 (ex Article 104c), which obligated Member States to “avoid excessive government deficits,” was supplemented by Article 1 of the Protocol on the Excessive Deficit Procedure, which set the basic standard of a ceiling on the annual deficit at 3% of annual GDP, accompanied by a ceiling on total accumulated governmental debt at the level of 60% of annual GDP. The Protocol target figures were set in October 1991, based upon recommendations from the Monetary Committee, which apparently used the then-prevailing medians for Member State annual deficits and accumulated government debt. There does not appear to be any authoritative economic rationale for selecting either figure. In his economics text on Monetary Union, the leading Belgian economist Paul de Grauwe flatly states that using the 3% 

38. For an initial analysis of the deficit limits and procedure in Article 104 (ex Article 104c), see Smits, supra note 3, at 78-83, and Lastre, supra note 3, at 254-58.
39. See Goebel, supra note 2, at 305-06.
40. The convergence criteria are set out in Article 121(1) of the EC Treaty, supra note 1. Apart from avoiding excessive deficits, they are “the achievement of a high degree of price stability,” established by a low inflation rate; maintenance of stable currency exchange rates for at least two years; and maintaining low long-term interest rate levels. See EC Treaty, supra note 1, art. 121(1). Smits, supra note 3, at 121-27, provides a detailed analysis of the convergence criteria. Goebel, supra note 2, at 303-06, gives a briefer summary. The well-known American economist, Peter Kenen, appraises the convergence criteria in Peter B. Kenen, The Transition to EMU: Issues and Implications, 4 Colum. J. Eur. L. 359 (1998).
41. For an early analysis of Article 104 and the Protocol, see Alexander Italianer, The Excessive Deficit Procedure: A Legal Description, in European Economic and Monetary Union: The Institutional Framework 189 (Mads Andenas et al. eds., 1997).
42. See Goebel, supra note 2, at 305; Italianer, supra note 25, at 82.
figure as a limit for the budget deficits "has no valid scientific basis."  

In point of fact, the decision of the Council in May 1998, in its extraordinary composition of heads of state and government, which concluded that eleven States satisfied the Treaty and Protocol standards, and could therefore join in the launch of Monetary Union in 1999, certainly represented a very liberal (or lax) appraisal. France and Italy narrowly managed to avoid exceeding the 3% annual deficit figure only by extraordinary and somewhat controversial revenue and tax measures, e.g., the famous "Euro-tax," adopted by Prime Minister Prodi's government in Italy as a one-time-only tax to enable Italy to come close to balancing the 1997 budget, and France's inclusion of proceeds from privatization of its state telecommunication company as ordinary government revenue, enabling France barely to hit the 3% deficit target. Moreover, both Belgium and Italy had an aggregate government debt level of over 120% of GDP; several other States had levels considerably in excess of 60%; and Germany's total government debt actually increased in 1997, exceeding the 60% level. Nonetheless, relying upon reports from the Commission and the European Monetary Institute, the Council decision concluded that all were making satisfactory progress toward attaining the Protocol's 60% of GDP target, making use of EC Treaty Article 121(2), which authorizes the Council to use its discretion in assessing each State's satisfaction of the convergence conditions.

In a recent article presenting a decidedly revisionist view to the effect that Germany was continuously outmaneuvered by

43. See De Grauwe, supra note 3, at 243.
46. Dinan, supra note 3, at 500-05, describes the strenuous efforts of France, Germany, Italy, and other States to satisfy the 3% deficit criterion. In fact, France's deficit was marginally above 3%, but still deemed not to exceed the criterion. Also see Levitt & Lord, supra note 3, at 66-71, which notes the Prodi government's extraordinary success in gaining support for its "Euro tax."
47. See Dinan, supra note 3, at 504; see also Beaumont & Walker, supra note 45, at 175. The Netherlands' aggregate debt level was 72% of GDP, while Austria, Ireland, and Spain were in the 66-68% range. See Dinan, supra note 3, at 504.
France in the discussions over the fiscal stability provisions of the Maastricht Treaty, two Dutch academics, Mathieu Segers and Femke Van Esch, argue that France and Italy proposed that the 3% and 60% of GDP standards should not be "applied mechanically," but rather that the Council should be able to use its discretion. The Intergovernmental Conference accepted the French and Italian proposals and drafted accordingly the text of Article 121, as well as Article 104(2), which authorizes the Commission to evaluate whether a State's deficit is "close to the reference value" and its total debt is "approaching the reference value at a satisfactory pace." Segers and Van Esch conclude that "in direct opposition to the wishes of the German financial elite ... the rules [of Article 104] were thus not strictly quantitative, not binding and entirely intergovernmental."\(^{48}\) Certainly it is hard to dispute that the decision of the EU's political leaders, acting through the Council Decision of May 1998, to include so many States in the final stage of Monetary Union represents as much a political determination as one based solely on economic criteria.\(^{49}\)

In view of the decidedly generous determination that so many States could qualify to join in the final stage of Monetary Union, the EC Treaty provisions and subsequent legislation on the avoidance of excessive deficits take on added importance. EC Treaty Articles 104(3) to (13) prescribed a procedure for review by the Commission and the Council of the situation of a State with an excessive deficit, including a Council power to recommend corrective measures, followed by the possible imposition of sanctions on a recalcitrant State.\(^{50}\) Although Article 104 may have been intended to be chiefly applied during the period of progress toward Monetary Union, 1994-98, and then supple-


49. LEWIT & LORD, supra note 3, at 78-79, describes the decision to enable eleven States to commence the Monetary Union as a purely political one intended to avoid rancor and discord by permitting as many States as possible to be included. Political scientist Thomas Willett pithily observes that strict application of the convergence criteria was "abandoned in all but rhetoric," replaced by "numerous 'fiddles,' including by Germany itself." Thomas D. Willett, A Political Economy Analysis of the Masstricht and Stability Pact Fiscal Criteria, in FISCAL ASPECTS OF EUROPEAN MONETARY INTEGRATION, supra note 5, at 40.

50. For an early authoritative analysis of Article 104, see SMITS, supra note 3, at 78-83.
mented by more precise legislative rules, it is worth emphasizing that Article 104 is not limited in time (and indeed was the principal basis for the Court of Justice’s analysis in the 2004 proceeding discussed in Part IV of this Article). Article 104(14) authorizes the Council to adopt measures that could set more detailed rules to supplement the Excessive Deficit Protocol. The Council acts by a qualified majority vote, based on an initial Commission proposal, after consulting the Parliament.

Thus, the roots of the SGP’s provisions on the avoidance of excessive deficits are solidly founded in the EC Treaty itself. This generates an immediate reflection. Cautious lawyers may well be concerned whenever legal rules are adopted to freeze a prevailing economic view into a regulation. Expressing this concern in the related context of the EC Treaty’s enunciation of price stability as the primary objective of the ECB, Bonn Professor Mathias Herdegen has well said:

It is not with great ease that constitutional doctrine approaches principles that place restraints on majority rule in the interest of economic wisdom. Economic wisdom is what economic science in a given moment suggests as economically sound. Freezing institutional rules and substantive principles on this basis implies an obvious risk which is inherent in all dictates of economic wisdom: subsequent falsification by new empirical messages or by scenarios which have not been anticipated.51

Professor Herdegen’s sensible caveat appears to be well-founded also in the context of the SGP. As we have already briefly indicated, the initial SGP regulations largely followed the economic views of the then conservative German government of Chancellor Kohl. The German government presumably expected that its own economic prosperity would continue, while the burden of compliance with the rules would fall principally on the weaker economies of the Mediterranean States. As we will also see, economic conditions radically changed by 2003, when France, Germany, Italy, and other States were experiencing either a recession or quite anemic growth and, not surprisingly, simultaneously were incurring annual budget deficits in

excess of the mandatory limits. This occasioned a political crisis in Community leadership, when the Ecofin Council proved unable to agree upon procedural action to exert further pressure upon France and Germany to reduce their deficits. This political crisis might have been avoided if the initial EDR had been based upon economic views that permitted greater flexibility in the political decision-making process. After a critical reexamination of some of the stricter provisions of the EDR, the Commission and the Council were able to agree upon the adoption of the amended EDR in July 2005. Reflecting a significant shift in economic views, this amended text enables the Commission and the Council to consider many new budgetary and economic factors when providing each one's evaluation of a State's fiscal condition in application of the SGP, and gives the Ecofin Council more flexibility in its decision-making. Altogether, this entire episode provides support for Professor Herdegen's caveat that embodying prevailing economic views into binding legal standards can prove decidedly risky when either factual circumstances or the prevailing views change.

C. The Stability Aspect of the Stability and Growth Pact

Returning to our discussion of the genesis of the SGP, the European Council session at Madrid in December 1995 provided decisive momentum toward achievement of Economic and monetary Union through its decision to adopt a scenario for legal and political action. The European Council instructed the political institutions to adopt in 1996-98 all the legislation necessary to enable the final stage of Monetary Union to commence on January 1, 1999. Accordingly, in 1996-97, the Commission and the Council worked intensively on the legislation to enable the launch of Monetary Union and the Euro, as well as on the SGP legislation.

By the time of the Madrid European Council session, the political leaders of Italy, Spain, Portugal, and Greece had firmly committed their nations to meeting the convergence criteria to enter the final stage of Monetary Union. Consequently, the German government of Chancellor Kohl had to confront the likeli-

hood that the Eurozone would include several States outside the core group of France, Germany, and the Benelux nations that Germany had presumably anticipated in 1990-91. The German Minister of Finance, Theo Waigel, was determined to ensure that legislation be adopted to require States to maintain fiscal discipline after they succeeded in joining the final stage in 1999. The German government’s particular concern was that EC Treaty Article 104 lacked a clear timetable for the procedural steps intended to eliminate a State’s excessive deficit and did not provide for a relatively automatic outcome in the form of a serious sanction for recalcitrant States. The Kohl government was also concerned that the German voting public should not perceive that the cherished Deutschmark would be replaced with a much weaker Euro. Professor Amy Verdun and ECB staff member Martin Heipertz have recently provided a detailed study of the political circumstances in Germany prompting the Kohl government to adopt such a strong line, including the pressure exerted by the Bundesbank, whose views always had a great influence on public opinion.

Finance Minister Waigel launched discussions in the Ecofin Council with a paper, “A Stability Pact for Europe,” in November 1995. The paper included far-reaching proposals, notably the creation of a special European Stability Council with the power to adopt sanctions against States that violated excessive deficit rules, which would have required either amendment of the Treaty or else a separate convention for Eurozone States. Not surprisingly, these were seen as extreme and unrealistic, and

53. See Levitt & Lord, supra note 3, at 71; Smits, supra note 3, at 84-85. The prominent Danish economist, Niels Thygesen, provides an economic argument for the SGP’s establishment of budgetary limits, backed by sanctions, in Niels Thygesen, Fiscal Institutions in EMU and the Stability Pact, in Fiscal Aspects of European Monetary Integration, supra note 5, at 15.

54. See Hahn, supra note 5, at 79.


56. Finance Minister Waigel’s November 10, 1995 paper is summarized in Smits, supra note 3, at 84-86; Hahn, supra note 5, at 80-81; Stark, supra note 55, at 83-87; and Segers & Van Esch, supra note 48, at 1102.
soon abandoned. However, the Council at Florence in June 1996 endorsed an initial Ecofin Council report on the policy approach of a Stability Pact, which then provided the basis for further deliberations.

Influenced by German views, the Commission's initial October 18, 1996 proposal for an excessive deficit regulation to carry out the Stability Pact was relatively rigorous, both in establishing a procedural timetable and in setting the sanctions. However, by that time President Chirac and his then conservative Prime Minister, Alain Juppe, had become greatly concerned about the unpopularity of the austerity measures needed to ensure that France would enter the final stage of Monetary Union. Heipertz and Verdun accurately conclude that the French "public identified the unemployment problem as being caused by the conservative government's stance on fiscal austerity and structural reform" in order to join Monetary Union. Accordingly, the two French leaders did not welcome the strict formulation of the legislative draft. As Professor Dinan has well observed in his excellent text on the EU, "the proposed stability pact caused a political storm." He notes that France and other States were unwilling to accept an excessive deficit regulation that would rigorously enforce budgetary discipline, especially one with large and near-automatic financial sanctions.

The European Council meeting at Dublin in December 1996 managed to achieve a compromise policy solution (for which considerable credit should be given to the Irish presidency). The European Council concluded that the Stability Pact should be transformed into a Stability and Growth Pact, with a

57. See SMITS, supra note 3, at 85-86. Segers and Van Esch indicate that the Dutch Prime Minister Wim Kok, who served as President of the European Council during the final stage of drafting of the Treaty of Amsterdam in early 1997, opposed any treaty revision of this sort. See Segers & Van Esch, supra note 48, at 1102. The Commission also had serious reservations about the German proposals. See Costello, supra note 55, at 107-08.


59. Proposal for a Council Regulation on speeding up and clarifying the implementation of the excessive deficit procedure, O.J. C 368/12 (Dec. 6, 1996).

60. See DINAN, supra note 3, at 499; LEVITT & LORD, supra note 3, at 67.

61. Heipertz & Verdun, supra note 5, at 993.

62. DINAN, supra note 3, at 499.

63. See E.U. BULL., no. 12, pt. I.3 (1996). "France [wanted a] signal that stability would not come at the expense of economic growth, which is why the word 'growth' was
concern for the promotion of economic growth and employment as well as the initial emphasis on continued fiscal and budgetary stability. As we shall see later, the European Council had been concerned with the promotion of faster growth and the reduction in high unemployment levels already for several years. The Dublin European Council issued an important policy declaration in this context, "Growth and Employment in Europe—The Way Forward."  

The European Council also accepted the Ecofin Council's report, which stated that the maximum annual budgetary deficit ceiling of 3% of annual GDP, set in the Protocol on the Excessive Deficit Procedure introduced by the Maastricht Treaty, should continue as the standard with which all Eurozone States must comply. The report followed the approach set out in EC Treaty Articles 104(9) to (11) in stating that the Ecofin Council would have the power to take a decision to impose sanctions, initially a non-interest bearing deposit and ultimately a fine, after the Council itself had made recommendations to a State that failed to meet the standard, without ultimately securing the desired rectification of the deficit. However, there was still no consensus on certain procedural issues, notably on how close to automatic the sanction procedure would become.  

The Commission promptly presented new legislative proposals to achieve the SGP. In the spring of 1997, under the leadership of the Dutch Finance Minister Gerrit Zalm, the Ecofin Council debated the draft EDR and revised it to some extent, notably to delimit more precisely what economic circumstances could excuse an excessive deficit. Some of the key compromises were reached in bilateral negotiations between Germany and France.  

(Incidentally, although the Parliament was consulted upon the EDR, its views were apparently not a significant factor added to the Pact." Heipertz & Verdun, supra note 5, at 990; see also Levitt & Lord, supra note 3, at 72.

64. See E.U. Bull., supra note 63, pt. I.5. This policy declaration is discussed infra in the text accompanying notes 92-94.


66. See Heipertz & Verdun, supra note 5, at 990-91.

67. Parliament's opinion on the initial draft can be found at O.J. C 380/29 (Dec.
in the evolution of the text.) The codecision procedure\textsuperscript{68} employed for most internal market legislation, effectively providing the Parliament with veto power, is not employed for any legislation adopted to create or structure Economic and Monetary Union. Some commentators consider the Parliament’s lack of legislative power within Economic and Monetary Union to be a prime example of the “democratic deficit.” As Professor Christopher Lord has well observed, “[a]ny [European Parliament] views on the economic co-ordination mechanisms that are accepted by the Commission are included only in recommendations to the Council, not in legislative texts that constrain choices available to the Member States.”\textsuperscript{69}

The surprise election of the Socialists in the May 1997 French elections, together with the less surprising decisive victory of the Labor Party in the United Kingdom earlier in the spring, significantly modified the political landscape. Prime Ministers Blair and Jospin influenced the final stage of the Intergovernmental Conference then underway, which ultimately proposed the Treaty of Amsterdam.\textsuperscript{70} Naturally their views also had to be taken seriously into account in the European Council

\begin{flushleft}
\textsuperscript{68} The legislative procedure known as codecision, initially created by the Treaty of Maastricht in 1993, and amended by the Treaty of Amsterdam in 1999, presently gives the European Parliament equal power with the Council in the adoption of legislation in many fields of EC law. The codecision procedure is currently set out in EC Treaty, supra note 1, art. 251. For a description of the codecision procedure, see GEORGE A. BERMANN, ROGER J. GOEBEL, WILLIAM J. DAVEY & ELEANOR M. FOX, CASES AND MATERIALS ON EUROPEAN UNION LAW 97-99 (2d ed. 2002). Obviously, the failure to use codecision in the adoption of economic coordination legislation represents a deliberate decision of the Treaty drafters.


\textsuperscript{70} The Consolidated Version of the Treaty establishing the European Community, after amendment by the Treaty of Amsterdam, but prior to the Treaties of Nice and Athens, can be found at O.J. C 340/173 (1997). The Commission Office for Official Publications published this consolidated version in a brochure in 1997. The influence of the new Labor government in the United Kingdom and Socialist government in France is probably most evident in the addition of the Social and Employment chapters to the EC Treaty. See infra text accompanying notes 79 and 95.
\end{flushleft}
meeting at Amsterdam in June 1997, which concluded the debate on the Treaty of Amsterdam and simultaneously provided the final endorsement of the SGP. Before turning to the two Prime Ministers' impact on the growth aspect, we conclude here the review of the evolution of the stability aspect.

The final text of the EDR, including the ultimate compromise language, is described in Part II of this Article. What needs underlining at this point is that the European Council at Amsterdam provided a powerful policy endorsement for vigorous compliance with the EDR's provisions, in line with a request of the Ecofin Council. The European Council's Resolution on the SGP of June 17, 199771 was obviously intended to be a sort of "soft law" supplement to the EDR.

The European Council Resolution declares at the outset in Article 1 that the ultimate goal is the regular achievement by Member States of annual "budgetary positions of close to balance or in surplus," not simply the avoidance of excessively large annual budget deficits. This is undoubtedly the most important substantive policy position adopted in the Resolution. From an economic point of view, it is manifestly desirable that governments should regularly achieve surpluses in their annual budgets, or incur only modest deficits (as Finland, Ireland, and Luxembourg customarily do), because it reduces the burden of interest on the accumulated government debt, gives greater flexibility in planning, provides reserves to confront emergencies, etc.

The European Council Resolution also sets out a series of commitments, both procedural and substantive, to be made by the Member States as well as by the Commission and the Ecofin Council. Thus, in Articles 3 to 5, the States committed themselves to take "corrective budgetary action" after receiving a Council recommendation to that effect, and to "correct excessive deficits" within one year, while the Council was supposed to be "committed to a rigorous and timely implementation of all elements of the Stability and Growth Pact" and prepared "always to impose sanctions" on any recalcitrant State that would not correct an excessive deficit despite Council recommendations.

In a contemporary appraisal, Professor Hugo Hahn termed the Resolution's commitments to be a "solemn political undertaking," but he immediately added that their weight would depend on the Council's later "common political resolve to vote accordingly." The Commission cited the Resolution's strong language in the 2004 Court proceeding between the Commission and the Council, and the Court of Justice clearly gave due consideration to the Resolution in reaching its judgment.

D. The Growth Aspect of the Stability and Growth Pact

1. The Social and Employment Chapters of the Treaty

We turn now to the evolution of the policy views behind the Growth aspect of the SGP. The roots of this emphasis on the coupling of economic growth with higher employment and strong social cohesion go far back.

The successive Commissions from 1985 to 1995 under President Jacques Delors, himself a committed social activist, always pressed for these goals. We have previously noted that the 1989-92 Commission headed by President Delors prepared detailed studies for Economic and Monetary Union and actively advocated it. Simultaneously that Commission also drafted the Community Charter of Fundamental Social Rights, which was the subject of public commentary and debate throughout 1989. The Charter set out a series of rights and principles for both employees and the self-employed, concentrating on those connected with employment, but also declaring that children, the elderly, and the disabled possessed certain social rights. After the European Council at Strasbourg in December 1989 provided a near-unanimous endorsement of the Charter, this detailed description of the rights of employed and self-employed persons began

72. Hahn, supra note 5, at 84.
73. Jacques Delors, a prominent French Socialist leader, served as Minister of the Economy under President Mitterand before becoming President of the 1985-88 Commission. He then served a second four-year term in 1989-92, and a final shortened term in 1993-95, before the new five-year Commission term was introduced. Professor Desmond Dinan's history of the European Community and European Union, Desmond Dinan, Europe Recast: A History of European Union 206-64 (2004), repeatedly describes the influence of President Delors when discussing the Commission's initiatives during 1985-94.
to exert a strong influence on Community policies.\textsuperscript{75} Thus, the Commission's 1989 Social Action Program\textsuperscript{76} proposed almost twenty new directives in the social and employee rights field, many intended to achieve rights set out in the Social Charter (e.g., appropriate limits on work time duration, protection of pregnant workers and adolescents, employee information, and consultation procedures), almost all of which have subsequently been adopted.

Although the United Kingdom governments of Prime Ministers Thatcher and Major firmly declined to endorse the Charter, Prime Minister Blair's Labor government did so after its election in the spring of 1997. Given this now-unanimous Member State support for the Social Charter, the Treaty of Amsterdam amended the Preamble to the EU Treaty to affirm the EU's commitment to the "fundamental social rights" set out in the Charter,\textsuperscript{77} effectively making it one of the inspirational sources for EU action.

Moreover, the ratification of the Treaty of Maastricht in 1993 marked not only the beginning of efforts to achieve Economic and Monetary Union, but also a heightened priority for action in the fields of social policy and employee rights. A new Social Chapter, intended to facilitate the enactment of social legislation, could not be inserted into the EC Treaty due to opposition by the UK government of Prime Minister Major. Through a crucial compromise, a new Social Protocol was annexed to the


\textsuperscript{77} EU Treaty, \textit{supra} note 26, pmbl.
EC Treaty, authorizing most employee rights and other social legislation to be adopted by the Council through a qualified majority vote.\textsuperscript{78} In an extraordinary device, Article 2 of the Social Protocol permitted the U.K. to opt out of such legislation’s coverage. However, after its election in the spring of 1997, the Blair Labor government accepted the elimination of the Social Protocol, which accordingly disappeared when the Treaty of Amsterdam was adopted.

The Treaty of Amsterdam then inserted a new Social Chapter,\textsuperscript{79} slightly modified from the text of the Social Protocol, into the EC Treaty. Indeed, this revised Social Chapter constitutes one of the most important substantive changes to the EC Treaty achieved by the Treaty of Amsterdam. A senior Commission official, Patrick Venturini, has well observed that “[t]he Union . . . can now come to grips with wide-ranging problems such as the changes resulting from new ways of organizing production and work . . . [as well as issues concerning] workers’ health and safety, working conditions, and the information and consultation of workers.”\textsuperscript{80} Pursuant to the new EC Treaty Article 137, legislation in most of the likely fields of employee rights and other social action can be adopted through a Council qualified majority vote, together with the full participation of the Parliament in the codecision procedure. In practice, a steady flow of important social legislation has been adopted through use of the Social Protocol or the new Social Chapter since the early 1990s, notably the Working Time, Parental Leave, European Works Council, and Employee Information and Consultation directives.\textsuperscript{81}

\textsuperscript{78} The Protocol on Social Policy, annexed to the EC Treaty by the Treaty of Maastricht, permitted all States but the United Kingdom to adopt most types of employee rights legislation by a special qualified majority vote. See Treaty of Maastricht, supra note 1, Protocol on Social Policy, art. 2. For a description of the Social Protocol and its application in 1993-97, see Dinan, supra note 3, at 454-56.

\textsuperscript{79} EC Treaty, supra note 1, arts. 136-45.


After the 1992-94 recession provoked unusually high levels of unemployment in many EU States (notably Finland, France, Germany, and Spain), reaching a high level of 10.9% average unemployment in 1994, efforts to stimulate higher employment moved to the forefront of EU social policy. Professor Catherine Barnard, a leading EU employment law expert, has well observed that the high unemployment levels in the mid-1990s created a new emphasis on growth and employment. In her view, action to reduce unemployment would enable "a significant reduction on the burdens experienced by national social security systems," as well as help support the steady increase in the aging population benefitting from pension and welfare schemes, and promote social cohesiveness, notably by helping to close the gender gap.

Professor Dinan has noted that the severe unemployment in the mid-1990s, close to an 11% average, represented a political as well as an economic problem for the EU. As he remarks, "[a]fter all, the single market program and monetary union had promised to deliver economic growth and jobs. Instead, the post-Maastricht drive toward monetary union was widely seen to have exacerbated unemployment."

In this context the final Delors Commission took the first initiative toward a comprehensive program to promote higher employment and economic growth. The vigorous Irish social policy Commissioner, Padraig Flynn, deserves much of the credit for the final Delors Commission's 1993 "White Paper on Growth, Competitiveness and Employment," which was endorsed by the Brussels European Council in December. This highly influen-
tial study outlined a series of structural factors contributing to high unemployment, such as the poor functioning of the labor market, inflexibility in employment policies, high non-wage costs for employees, and insufficient labor mobility. The Commission urged both national and Community-wide action to reduce legal, fiscal, and administrative burdens on employment, as well as improved vocational education and skills training, and measures to promote labor mobility. Another eminent employment law authority, Professor Roger Blanpain, has emphasized that the European Council's endorsement of the Commission's action plan had "[t]he primary purpose of . . . [reinforcing the] competitiveness of the European economy," enabling adaptation "to a world undergoing unprecedented change in production systems, organization of work and modes of consumption." Commenting on the White Paper's thesis that various structural causes of unemployment needed to be confronted, Siofra O'Leary has observed that the Commission's proposed solutions included both a component of measures to achieve labor flexibility and one of action to deregulate inefficient or costly governmental rules handicapping effective business operations.

Building upon the initial base of the 1993 White Paper, the European Council at Essen in December 1994 mandated a Community-wide cooperative effort by the Member States to promote economic growth and combat unemployment. (Note that the German government of Chancellor Kohl, which held the European Council presidency, was then confronting severe unemployment due in part to the collapse of industry in the recently reunified East Germany.) The Essen summit's priority fields of action included both new initiatives, such as greater investment in vocational training and efforts to provide employment opportunities for women and the long-term unemployed, as well as deregulatory policies, such as the elimination of barriers to occupational flexibility and a reduction in non-wage labor costs.

The March 1996 European Council at Turin followed this by urging the 1996-97 Intergovernmental Conference to include

87. ROGER BLANPAIN, EUROPEAN LABOUR LAW 188 (9th ed. 2003).
90. See BARNARD, supra note 83, at 107-08; BLANPAIN, supra note 87, at 190-94.
the topic in its deliberations. As we previously observed, the Dublin European Council in December 1996 not only confirmed the insertion of growth into the SGP, it adopted another important policy statement, "Growth and Employment in Europe—The Way Forward," declaring at the outset that "[t]he fight against unemployment is the prime responsibility of the Member States but also a priority task of the Union." In its specific "Dublin Declaration on Employment," the European Council initially proclaimed that "[e]mployment continues to be the first priority for the European Union and the Member States," and then linked employment efforts and economic coordination by calling for an "integrated employment strategy, embracing macroeconomic policies and policies of structural reform."4

Thus, when the European Council at Amsterdam in June 1997 endorsed the final Intergovernmental Conference text for the Treaty of Amsterdam, it is not surprising that the EC Treaty was amended to add a new Title VIII on Employment, reflecting the policy approach of the Essen agenda. Indeed, the importance of Community action to promote employment is highlighted through the amendment of EU Treaty Article 2 to insert "a high level of employment" as one of the Union's goals.4

Within Title VIII, Article 125 requires the Community to develop "a coordinated strategy for employment and particularly for promoting a skilled, trained and adaptable workforce and labour markets responsive to economic change." Thus, although the Member States continue to take the measures necessary to promote job training, job placement, and higher employment, the Community is mandated to take a role in developing Community-wide improved employment policies and in coordi-

95. Title VIII of the EC Treaty, supra note 1, regarding employment, was introduced by the Treaty of Amsterdam, supra note 30. O'Leary, supra note 88, at 127, ascribes the initial proposal for an employment chapter to the then-Socialist government of Sweden.
96. EU Treaty, supra note 26, art. 2.
97. EC Treaty, supra note 1, art. 125.
nating State action. To this Article 127(2) notably adds: "the objective of a high level of employment shall be taken into consideration in the formulation and implementation of Community policies and activities." Article 128 requires the Council and Commission to make a joint annual report on employment to the European Council, which shall then adopt conclusions on the basis of which the Council, by qualified majority vote, shall draw up guidelines for Member States. The approach is deliberately analogous to that used in the economic coordination provisions of Economic and Monetary Union. Moreover, by Article 129, the Council and the Parliament are authorized to adopt "incentive measures" (although the text does not authorize the Community to adopt harmonization measures, paralleling the approach in the education, culture, and health fields,\(^9\) where the Community also may only adopt incentive measures). Overall, the effect of Title VIII on employment is to give treaty force to the action plan endorsed by the European Council at Essen in 1994, and continued thereafter.

Commenting on the new Title VIII provisions, Commission employment expert Patrick Venturini observed that Title VIII "acknowledged that Europe's employment problems are common to all Member States . . . [because] European economies are increasingly interdependent."\(^99\) He further noted that the employment guidelines foreseen by Title VIII were to be linked to the coordination of economic policy in Economic and Monetary Union, bringing the Union's "macroeconomic, structural, and labor market policies into a much closer relationship."\(^100\)


It is therefore not surprising that when the European Council in Amsterdam endorsed the SGP, the newly elected Socialist Prime Minister Jospin of France could successfully urge the heads of government to adopt a policy statement concerning the growth aspect of the SGP. As Professor Dinan has observed, "[c]oncern about job losses had reached the top of the EU's political agenda by the time of the Amsterdam summit, as unem-

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98. See id. arts. 149, 151, 152.
99. Venturini, supra note 80, at 97.
100. See id. at 98.
ployment in France and Germany peaked at record levels." He further notes that President Chirac even "sought to outdo Jospin in proclaiming the importance of job creation" and that Chancellor Kohl was becoming increasingly concerned with the topic as Germany's 1998 elections neared.

Accordingly, the European Council adopted a Resolution on Growth and Employment on June 16, 1997. Its first article recalled the Essen European Council conclusions and then stated that it represented "a new impulse" for "keeping employment firmly at the top of the political agenda" and "strengthening conditions for economic growth and employment opportunities." Article 1 of the Resolution also urged that "it should be a priority aim to develop a skilled, trained and adaptable workforce and to make labour markets responsive to economic change," including comprehensive structural reforms. Article 1 further stated that "[e]conomic and social policies are mutually reinforcing," and that the goal should be "an economy founded on principles of inclusion, solidarity, justice and a sustainable environment." The Resolution later declared that the multi-annual employment programs required by the Essen European Council should be treated as a component of the Treaty-based coordination of Member State economic policies through the BEPG.

Although in their study of the evolution of the SGP, Heipertz and Verdun refer to the inclusion of a growth component as essentially rhetorical, citing a number of respondents to their research study as considering it a "cosmetic concession to France," this appraisal does not seem justified. Even conceding the rather natural emphasis by the Ecofin ministers on the stability aspect, which is evident in the European Council's Resolution on the SGP, many of the heads of government certainly were seriously committed to the growth aspect, as is manifested by the progressive evolution of the employment and growth poli-

101. DINAN, supra note 3, at 459.
102. Id.
104. See id. art. 5. Article 6 called for close coordination between the Council's Economic Policy Committee and its new Employment Committee.
105. See Heipertz & Verdun, supra note 5, at 989 n.8.
cies endorsed by the European Council since the Essen summit in 1994.

Notably, a special European Council summit dedicated to employment at Luxembourg in November 1997, popularly called the "Jobs Summit," immediately continued the operational policy emphasis on the growth aspect of the SGP. The Luxembourg European Council agreed to put into effect the provisions of Title VIII, without waiting for ratification of the Treaty of Amsterdam. The European Council mandated the commencement of a more systematic and coordinated Community employment policy, including greater cooperative efforts among the national governments, with annual reviews by the Commission of National Employment Action Plans (commonly referred to by the acronym "NAPs"). This process is obviously similar to that applied in the multilateral surveillance of economic policies.

The Commission presented draft guidelines for the employment policies in the Member States to the Luxembourg European Council to show how it could assist the States in their development of employment policies. The Commission presented four priorities for Member State action, each to be adapted to specific national needs in the annual NAPs. The four priorities were to improve employability, notably by providing job training for younger people; to facilitate entrepreneurship, by removing obstacles to commencing and operating businesses; to encourage job flexibility and adaptability, notably by assisting labor and management to negotiate agreements to modernize work organization; and to strengthen equal opportunities for men and women. Starting in 1998, the Commission commenced its advisory role to assist Member States in developing their annual employment policies, especially by providing specific guidelines. At its Cardiff meeting in June 1998, the European Council endorsed for the first time the NAPs for employment for the Member States, following upon the Commission's guide-

108. BARNARD, supra note 83, at 115-18, and Venturini, supra note 80, at S98-100 provide a detailed summary of this initial Commission contribution to the Jobs Summit.
lines and the Social Affairs Council’s evaluations. The European Council at Cologne in June 1999 formally adopted a European Employment Pact in order to achieve intensification of the coordination process. Subsequently, the December 1999 Helsinki European Council noted the generally successful implementation of the Amsterdam Treaty’s procedure for guidelines for employment policies in each Member State.

In December 1997, shortly after the adoption of the SGP, the European Council in Luxembourg emphasized the necessity for enhanced economic coordination after the start of the final stage of Monetary Union. The European Council urged that the Ecofin Council’s economic policy guidelines should be “more concrete and country specific” and should pay “more attention . . . to improving competitiveness, labour-, product- and services-market efficiency, education and training, and to making taxation and social protection systems more employment-friendly.” (Note that this December European Council came shortly after the November Job Summit’s concentration on employment policy.) Immediately before the launch of the final stage of Monetary Union in the Eurozone States, the European Council at Vienna in December 1998 endorsed an Ecofin Council report on economic policy coordination. This is notable for its addition of further fields for review in the coordination process, including the close examination of [NAPs] and the monitoring of Member States’ structural policies in labour, product and services markets. Thus, the link between the procedures for economic coordination and those intended to promote employment and growth, the two aspects of the SGP, both essentially soft law in character, became well established in the 1998-2002 period.

The now-famous Lisbon agenda for achieving a high level of

111. See E.U. BULL., no. 6, at 111, pt. I.2.4 (1999); see also BARNARD, supra note 83, at 131-32.
115. For a thoughtful appraisal of the soft law economic and employment policy coordination at this time, see Wolfgang Wessels & Ingo Linsenmann, EMU's Impact on National Institutions: Fusion towards a 'Gouvernance Économique' or Fragmentation?, in EUROPEAN STATES AND THE EURO: EUROPEANIZATION, VARIATION, AND CONVERGENCE 53 (Kenneth Dyson ed., 2002).
global competitiveness by 2010, entitled "Employment, Economic Reform and Social Cohesion," adopted by the European Council at its spring meeting in 2000 at Lisbon, also reflects the emphasis on a growth strategy. The European Council declared that it was setting the "strategic goal" for the EU to become "the most competitive and knowledge-based economy in the world, capable of sustainable economic growth," and then continued, "with more and better jobs and greater social cohesion." Although the Lisbon policy program had its principal focus upon enhanced research and technology development, the elimination of regulatory barriers to economic growth and the creation of innovative businesses, and the reform and restructuring of fiscal and social policies, it also included a major component of policy action to modernize "the European social model" and to stimulate greater and better employment opportunities.

The Commission’s Social Policy Agenda for the years 2000-05 included a concentration on achieving employment opportunities in this broader socio-economic context, with particular reference to the challenges represented by the development of a knowledge-based economy, by enlargement, and by economic globalization. Not only did the European Council at Nice in December 2000 endorse the Commission’s Social Policy Agenda, it specifically adopted a policy program called the European Social Agenda, which emphasized the development of a cutting-edge information-based economy, greater labor mobility, improvement in job education and training, and protection against social exclusion.

Thus, at the time of the adoption of the SGP in 1997 and in the years immediately following it, there is abundant evidence

117. Id. pt. I.5. Dinan, supra note 3, at 588-91, describes the political motivations behind the Lisbon strategy and the Commission’s strong support for it.
120. See E.U. Bull., no. 12, Annex I (2000); see also Barnard, supra note 83, at 133-34.
that the European Council was not only committed to the economic policies necessary to underpin the foundation of the final phase of Monetary Union in 1999, but also to a strategy of growth and development, marked both by the Lisbon growth strategy agenda and by ongoing annual and multi-annual policies intended to promote higher employment and better employment opportunities. From 2000 on, the Commission’s annual reports on the activities of the EU include sections documenting the ongoing efforts to achieve the Lisbon agenda (always a principal topic at the annual spring meeting of the European Council), as well as the Community-wide and annual NAPs.121

Since 2002, there has been a deliberate effort to better coordinate the annual employment policy guidelines with the annual economic coordination provided through the BEPG. Currently the Commission and the Council jointly prepare a draft Employment Report each January, drawing upon the Member States’ NAPs and adding a collective report on the employment situation throughout the Community. At the March European Council meeting that reviews the Lisbon strategy progress, the European Council also provides conclusions concerning the European Employment Strategy. Subsequently the Commission reviews the text, picking up suggestions from the Parliament, and produces draft Employment Guidelines. The Social Affairs Council adopts the Employment Guidelines, acting by a qualified majority vote, after the June European Council has provided its endorsement in the form of conclusions. Thereafter, each Member State adopts a new annual NAP to apply the Employ-


ment Guidelines in its national context.\footnote{128} As we shall see in Part II, this procedure parallels that followed in the economic coordination under the MSR.

3. The Role of the Eurogroup

The creation and subsequent operations of the Eurogroup,\footnote{124} composed of the Ministers of Finance of the Eurozone States, is quite relevant to both the stability and growth aspects of the SGP. French Prime Minister Jospin is usually given credit for proposing that the Ministers of Finance of the Eurozone States should hold regular meetings to coordinate policy.\footnote{125} Dominique Strauss-Kahn, the French Finance Minister at the time, described the Eurogroup's purpose as being "to match increased monetary interdependence with closer economic and budgetary co-operation," and bluntly observed that "in the absence of [an alternative] visible and legitimate political body, the ECB might soon be regarded by the public as the only institution responsible for macro-economic policy."\footnote{126}

In December 1997, the Luxembourg European Council authorized the Eurozone Ministers of Finance to meet informally within the structure of Ecofin Council sessions to discuss economic and monetary matters of common concern. However, the Luxembourg European Council also directed that only the entire Ecofin Council could take any binding decisions in the field of economic coordination, stating specifically: "the Ecofin Council is the only body empowered to formulate and adopt the broad economic policy guidelines which constitute the main instrument of economic coordination."\footnote{127} This represented an im-

\begin{footnotes}
\footnote{123. BARNARD, supra note 85, at 110-15, and DINAN, supra note 3, at 461-62, describe the mode of preparation of the Employment Guidelines.}
\footnote{124. Initially referred to as the Euro-X group (X representing the ultimate number of Member States in the Eurozone), this soon became known as the Eurogroup. See DINAN, supra note 3, at 500.}
\footnote{125. Prime Minister Jospin initially wanted an economic governance structure that could watch over ECB operations and policies, but this proposal was not acceptable to Germany and other States. The idea of coordinative meetings at the Council level proved agreeable to the other Eurozone States. See id.}
\footnote{126. Dominique Strauss-Kahn, Op-Ed., We're in This Together, FIN. TIMES (U.K.), Nov. 27, 1997, at 18.}
\footnote{127. E.U. BULL., supra note 113, pt. I.9. Jean Pisani-Ferry observes that the United Kingdom and some other States only "grudgingly" accepted that the Eurogroup could hold meetings provided that they were informal and lacked the power to take decisions. See Pisani-Ferry, supra note 22, at 828.}
\end{footnotes}
portant policy decision, because it meant that the States that would not participate in the third stage of Monetary Union (notably Denmark and the United Kingdom through their opt-out protocols, and Sweden, which has also in effect opted-out, as well as the new Member States from Central Europe) would still participate in the Ecofin Council’s economic coordination process.

Professor Jean-Victor Louis, the eminent Belgian monetary expert, has provided an excellent review of the Eurogroup’s operational role. The Eurogroup meetings are regularly held immediately prior to the formal Ecofin Council sessions (frequently the day before and at the same site). Reportedly, the Eurogroup Ministers discuss issues of growth, promotion of investment and export policies, handling the cost of pension benefits and health care, strategies to reduce high unemployment, etc., all as they concern the Eurozone. The Eurogroup thus effectively pursues a soft law mode of achieving policy coordination within the SGP. As Jean Pisani-Ferry has remarked, the Eurogroup has gradually been “transformed from a mere talking shop into what increasingly looks like a policy-making institution,” whose decisions are usually enforced by the entire Ecofin Council.

Professor Louis has well observed that the Eurogroup meetings have the advantage of being informal, confidential, and comprised of a smaller number of participants than the full Ecofin Council, but can nonetheless be criticized for a lack of transparency. To promote continuity, in August 2004 the Eurogroup chose Prime Minister Juncker of Luxembourg, who also acts as his nation’s Finance Minister, to serve as its President.

At its December 2000 session in Nice, the European Council specifically approved the Eurogroup’s role, declaring that its discussions “enhance the coordination of economic policies [which] will help to boost the growth potential of the Euro


129. Pisani-Ferry, supra note 22, at 840. There have been reports that the Eurogroup discussions the night before Ecofin sessions deprive the Ecofin meetings of lively debate, providing virtually “pre-cooked” conclusions. See Chris Smyth & George Parker, Ministers Seek to Liven Up Ecofin Meetings with Bit of Controversy, FIN. TIMES (U.K.), Apr. 7, 2006, at 5.

area.” 131 The Nice European Council did not, however, change the operational caveat that only the full Ecofin Council can take binding decisions. As Professor Louis has well observed, enabling the Eurogroup to take legally binding decisions is not possible without a modification in “primary Community law,” i.e., a Treaty amendment or protocol, because it would modify the present institutional structure of the Council. 132

Time has brought an evolution of views concerning the operational role of the Eurogroup. The recently signed Treaty of Lisbon, or Reform Treaty, is followed by a Protocol on the Eurogroup, 133 which replicates a draft protocol to the former draft Treaty establishing a Constitution for Europe. 134 The Protocol specifically authorizes informal meetings of the Eurogroup Finance Ministers. Article 2 of the Protocol also provides that the Eurogroup shall elect a President for a term of two and a half years. The Preamble states the motive for the Protocol to be “to promote conditions for stronger economic growth . . . and . . . to develop ever closer coordination of economic policies within the Euro area.” Moreover, the Treaty of Lisbon would amend the EC Treaty to insert a new Article 115 that would enable the Eurogroup Finance Ministers to “adopt measures specific to [their] Member States,” notably to establish their economic policy guidelines and “to strengthen the coordination and surveillance of their budgetary discipline.” 135 For this purpose only Eurogroup Finance Ministers would have the right to vote, and a special form of qualified majority should apply.

In concluding this part of the Article, any appraisal of the genesis of the SGP should recognize that the pact represents a fusion of two separate policy views, one concerned with maintaining fiscal stability within Eurozone States and the other with the promotion of economic growth and high employment. In effect, the strict text of the legislation intended to achieve stabil-

132. See Louis, supra note 128, at 359.
ity, notably the initial EDR, may be considered to be appropriately balanced by a policy to achieve growth, including soft law initiatives and inter-governmental coordination aimed at the stimulation of higher GDP growth and the reduction of high unemployment levels. With this picture in view, it is easier to understand why the political leaders of France, Germany, and Italy in the 2002-03 period felt justified in their continued execution of policies they considered necessary to promote growth and reduce high unemployment, even when that produced annual excessive deficits in violation of the SGP. Before examining these developments in 2002-03, it is essential to obtain a more precise idea of the 1997 legislation that embodied the SGP.

II. THE STABILITY PACT LEGISLATION

The stability aspect of the SGP builds upon the initial economic coordination procedures developed under EC Treaty Articles 98, 99, and 104. Since 1997, the SGP has been embodied in legally binding form in two regulations that are designed to achieve complementary goals. The MSR, foreseen in EC Treaty Article 99, is intended to set out a detailed system of regular economic coordination among all the Member States, both inside and outside of the Eurozone. In contrast, the EDR builds upon the provisions of Article 104 on avoiding excessive government deficits by setting standards for future excessive deficits, a procedure for both Commission and Council review of each State’s budgetary status, coupled with recommendations for the elimination of any deficits assessed to be excessive, and a further procedure for the imposition of serious economic sanctions on recalcitrant States, but in this instance, only those within the Eurozone.

A. The 1997 Multilateral Surveillance Regulation

The MSR, adopted by the Council on July 7, 1997,\textsuperscript{136} represents the fundamental mode of executing the economic coordination mandated by EC Treaty Article 99. The MSR has never occasioned serious criticism from political leaders or even from economists or legal academics, because it is perceived to be pragmatically quite functional. Professors Fabian Amtenbrink

\textsuperscript{136} Council Regulation No. 1466/97, supra note 11.
and Jakob de Haan have provided an excellent analytical appraisal of the initial MSR.\textsuperscript{137} When the MSR was amended in 2005, the modifications were essentially made to complement the amended EDR by requiring the review of more relevant economic data, rather than to remedy any significant operational deficiencies.

The MSR sets out the procedures used by the Commission and the Council to carry out a systematic on-going review of each State’s annual budget and its overall economic performance. The Regulation builds upon the prior system of economic coordination under EC Treaty Article 99 in effect from 1994 to 1998. This process of review of each State’s budgetary position is inextricably linked to the Community’s own BEPG, which the Commission drafts, and the Council ultimately adopts, each spring.\textsuperscript{138} Obviously, when the Commission, and subsequently the Council, reviews each State’s budgetary position in the multilateral surveillance system, it examines the degree to which the State complies with or deviates from the BEPG.

The MSR’s first recital, or “Whereas” clause, states: “Whereas the Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.” Manifestly, this references both the Stability Pact goal of maintaining price stability and the Growth Pact aspect of promoting economic growth and employment. The second recital specifically refers to the European Council’s Resolution on the SGP, emphasizing that each State should achieve “budgetary positions of close to balance or in surplus.”

The MSR sets out the operational surveillance procedures for all of the EU’s Member States. For those States within the Eurozone (currently fifteen)\textsuperscript{139} the regulation requires the adoption and subsequent review of National Stability Programs, while for those outside the Euro area (currently Denmark, the United


\textsuperscript{138} See \textit{supra} note 37 and accompanying text.

\textsuperscript{139} See \textit{supra} note 4.
Kingdom, Sweden, and nine of the twelve new Member States) the Regulation outlines essentially parallel procedures for what are denominated Convergence Programs. In each case, Article 1 declares the goal of the surveillance is "to prevent, at an early stage, the occurrence of excessive general government deficits and to promote the surveillance and coordination of economic policies."

Article 3 of the MSR requires each State to commence the process by submitting an annual Stability Program. The National Stability Programs must incorporate a multi-annual component, covering both the data on the prior budget year and the succeeding three years. Such a medium-term emphasis manifestly promotes better advance planning for a more certain achievement of the goal of "budgetary positions of close to balance or in surplus." Article 3(2) describes the core of the Stability Programs. With regard to the budget planning (annual and multi-annual), the Program is supposed to set a goal of a budget in surplus or slightly under that ("close to balance"), as well as the budgetary and economic policy measures taken or proposed to achieve the goal. The national Program must also indicate "the expected path of the general government debt ratio." There is, however, no express reference to any obligation to reduce the aggregate government debt, nor even an indication that a high level of aggregate government debt is to be avoided.

On the economic side, Article 3 provides that the Program must contain "the main assumptions about expected economic developments and important economic variables," especially GDP growth, employment, and inflation. A critical adjunct to this is a compulsory "analysis of how changes in the main economic assumptions would affect the budgetary and debt position." This is valuable particularly because many governments may be expected to have a tendency toward excessive optimism in their economic forecasts. Article 4 requires that the Stability Programs be submitted annually before March 1, starting in 1999. (In practice, most States prepare their budgets in the fall and submit them for Commission review by the end of the calendar year.) Article 4(2) also requires that these Stability Programs be made public, which ensures that opposition party leaders, financial and business experts, and the media can all review and debate the budgetary policies set out in the government's program.
Article 5 sets out the basic review process. Within two months of receipt of a State's Stability Program, initially the Commission and then the Ecofin Council must provide evaluations of the economic realism of the State's program, with particular attention to whether the program "provides for a safety margin to ensure the avoidance of an excessive deficit." As we observed previously, the Council must evaluate "whether the economic policies of the Member State concerned are consistent with the broad economic policy guidelines." The Council concludes its review with a formal opinion to each State, and may "invite" adjustments to the Stability Program concerned. The use of the word "invite" highlights the soft law character of the Ecofin Council opinions, which are not legally binding, even though they may have considerable political impact.\textsuperscript{140}

Article 6 stipulates that the review process continues during the year with a continued monitoring of each State's program first by the Commission and then by the Council. In practice, this means that the Commission's review occurs biannually, with a second examination in the fall following each State's presentation of updated budgetary data. Following a Commission recommendation, the Council has the power to issue an "early warning" to any State that it perceives to be significantly diverging from the medium-term budgetary objective, with recommendations for corrective measures. The Council may take a decision to make its recommendations public, which obviously is intended to create some pressure on the State government concerned. Note that the Council is not bound to endorse a Commission proposal for an early warning and in fact it has not done so on several occasions, making its own assessment on whether it is necessary or desirable to issue a warning.\textsuperscript{141}

A parallel system operates for the States not in the Eurozone, which must prepare Convergence Programs containing essentially the same budgetary information and policy indi-

\textsuperscript{140} See Amtenbrink & de Haan, supra note 137, at 1085.

\textsuperscript{141} See id. at 1084-85. Amtenbrink and de Haan refer to the Council's refusal to issue early warnings to Germany and Portugal on February 12, 2002, despite the Commission's recommendation to do so. See id. at 1090; see also infra notes 168, 172 and accompanying text. On February 10, 2004, the Council also declined to endorse a Commission recommendation that the United Kingdom receive an early warning due to its projected 3.3% deficit in its 2003-04 budget year. The Council felt that the United Kingdom had sufficient "room for manoeuvre" because of its low aggregate debt. See E.U. Bull., no. 1/2, pt. 1.3.20 (2004).
cations, again to be evaluated by the Commission and the Ecofin Council.\textsuperscript{142} Under Article 10 of the MSR, the Ecofin Council has the power to "monitor the economic policies of non-participating Member States . . . with a view to ensuring that their policies are geared to stability" and may address to them "early warning" recommendations to take "corrective measures." The Council may make these recommendations public. Obviously, for the Central European States desirous of joining the Eurozone in the relatively near future, the preparation and on-going review of Convergence Programs is quite vital.

In their valuable review of economic coordination via the MSR, Professors Amtenbrink and de Haan consider it to constitute a prime example of the "open method of coordination" whose characteristics are: "the recognition of diversity, the broad participation in policy making, the co-ordination of multi-level government, use of information, benchmarking, peer review and peer pressure, the lack of any particular rule or single policy objective, as well as structured but unsanctioned guidance by the Commission and the Council."\textsuperscript{143} Amtenbrink and de Haan accurately observe that it is the Ecofin Council, rather than the Commission, that has the decisive role in evaluating a State’s compliance with the BEPG. Moreover, they also emphasize that the Council is not under any legal obligation to issue an early warning, even despite the hortatory language of the European Council’s Resolution on the SGP.\textsuperscript{144} The MSR remains entirely a soft law instrument.

It is worth noting that the Council adopted the MSR acting through the cooperation procedure with the Parliament, because Article 99(5) required that legislative mode. The cooperation procedure, successfully used in the adoption of most internal market legislation from 1987 to 1993, required the Council to consider very seriously any amendments proposed by the Parliament and endorsed by the Commission in the so-called "second reading" stage of legislative drafting, because the Council could only reject such amendments by unanimous action.\textsuperscript{145}

\textsuperscript{142} See Council Regulation No. 1466/97, \textit{supra} note 11, arts. 7-9.

\textsuperscript{143} Amtenbrink & de Haan, \textit{supra} note 137, at 1079. Professors Wessels and Linsenmann provide a similar view in terming the MSR a form of ‘soft’ coordination." Wessels & Linsenmann, \textit{supra} note 115, at 69-70.

\textsuperscript{144} See Amtenbrink & de Haan, \textit{supra} note 137, at 1084-85.

\textsuperscript{145} EC Treaty, \textit{supra} note 1, art. 252, sets out the cooperation procedure for
The Maastricht Treaty replaced the cooperation procedure in the internal market and most other legislative fields with the codecision procedure,¹⁴⁶ which effectively gives Parliament an equal share in the legislative process, but the cooperation procedure still survives in any legislation adopted pursuant to Article 99(5). Incidentally, we should note that the Treaty of Lisbon would eliminate the cooperation procedure. An amendment to Article 99(5) would require any further legislation concerning multilateral surveillance to be adopted through the codecision procedure (to be renamed the “ordinary legislative procedure”), thus giving Parliament an equal share in the legislative process.

In Part V of this Article, we will review the amendments made to the MSR in June 2005, but it should be stressed again that the MSR has proved to be an extremely valuable instrument toward achieving a substantial degree of Community-wide coordination of national budgetary policies. The existence of a system of critical review of a State’s plans and forecasts by outside experts certainly tends to promote greater realism and objectivity. The importance and value of peer pressure at the level of the Ecofin Council also merits underlining.

B. The 1997 Excessive Deficit Regulation

Before examining the provisions of the EDR, it is worth reflecting on its fundamental nature. Adopted on the legal basis of Article 104(14), the EDR falls within the Treaty chapter on economic policy. The EDR represents a procedure to achieve enhanced economic coordination; it is in no way a constituent part of Monetary Union. As we have previously emphasized, the economic coordination provisions of the Treaty do not represent a cession of sovereignty over economic governance from the Member States to the Community.¹⁴⁷ State governments are bound to submit their annual and multi-annual budgets for review by the Commission and Council, but they retain autonomous control over their budgets and fiscal conditions. The ECB’s autonomous monetary policy making for States within the Euro area may be impacted by actions taken by the Ecofin Coun-

¹⁴⁶. See supra note 68 for a description of the codecision procedure.
¹⁴⁷. See supra text accompanying note 22.
cil in application of the EDR, but the ECB is not even consulted at any stage in the EDR procedure.

However, although the EDR is situated in the sphere of intergovernmental economic coordination, it has some features suggestive of hard law. Professors Amtenbrink and de Haan usefully describe it as a form of "closed coordination," composed of "top-down policy formulation," relatively hard law because it is based on stipulated rules and sanctions. As we shall see, in 2004 the Commission’s suit against the Council required the Court of Justice to examine to what degree the decisions or actions to be taken by the Council pursuant to Article 104 and the EDR were governed by hard versus soft law.

The EDR initially prescribes the mode by which the Commission can evaluate, and the Council can determine, that a State has developed an excessive annual deficit. At the outset, the seventh "Whereas" clause of the EDR’s preamble continues to set the maximum permissible deficit at 3% of annual GDP, in accord with the EC Treaty Protocol on the Excessive Deficit Procedure. (We should underline at once that the EDR does not refer to the Protocol’s other requirement that a Member State’s aggregate government debt should not exceed 60% of its annual GDP, nor does it require any on-going review of whether a State is steadily reducing any excessive aggregate debt to the 60% level, or impose any sanction for exceeding the 60% level.)

Article 2 of the EDR covers the delimitation of the circumstances that might excuse a State’s excessive deficit. Drawing upon language in EC Treaty Article 104(2), a deficit should be excused only if it is “exceptional and temporary.” Article 2(1) of the EDR provides some amplification of the meaning of this language by stating that “an unusual event outside the control of the Member State concerned... which has a major impact on the financial position” of that State would merit an excuse. Although never precisely defined, the language presumably refers to natural disasters, such as earthquakes or floods, or wars or civil wars and insurrections.

The EDR’s second basis for excuse in Article 2(1), namely “a severe economic downturn,” was the subject of a crucial debate in 1996-97. In their historical review, Heipertz and Verdun 148. See Amtenbrink & de Haan, supra note 137, at 1076. Similarly, Wessels & Linsenmann, supra note 115, at 57-58, 68-69, describe it as “‘hard’ coordination.”
observe that Germany wanted a strict definition, while France sought “more political lenience.” The Commission’s October 1996 draft added after “a severe economic downturn” the words “in particular in the case of significantly negative annual real growth.” Germany would not accept this rather vague formulation. In their account of how in their view Germany lost the battle for strict rules in the SGP, Segers and Van Esch state that France and Italy supported the Commission, and that ultimately the European Council in Dublin agreed upon a compromise proposal offered by Belgium. The Belgian compromise kept the basic standard of a 2% downturn in GDP, but permitted the Council to decide that a lesser downturn might still satisfy the “severe economic downturn” standard.

The final wording of EDR Article 2(2) initially looks like Germany succeeded in obtaining a strict rule, because it states that the Commission’s evaluation report should consider “a severe economic downturn to be exceptional only if there is an annual fall of real GDP of at least 2%.” It is worth underlining that a 2% downturn in annual GDP would only occur in a rather severe recession. Indeed, if any one Member State experienced a recession at that level, it is highly likely that other States would also be in a recession as well, either because the recession is being provoked by factors common to several States (such as a sharp increase in energy costs) or because of a ripple effect among closely related trading partners.

However, EDR Article 2(3) then gives discretion to the Ecofin Council to conclude that a fall of less than 2% GDP is “nevertheless exceptional in the light of further supporting evidence, in particular on the abruptness of the downturn or on the accumulated loss of output relative to recent trends.” Thus, although Germany sought a strict standard for a “severe economic downturn,” the compromise text inserted into the EDR provides the Council with a fair degree of discretion in its appraisal. Because Germany was not happy with this formulation, the European Council Resolution on the SGP supplements it by declaring that the Member States will apply Article 2(3) only in a

149. See Heipertz & Verdun, supra note 5, at 990.
150. Proposal for a Council Regulation on speeding up and clarifying the implementation of the excessive deficit procedure, supra note 59, art. 1(2).
151. See Segers & Van Esch, supra note 48, at 1103.
"severe recession," and stipulating further that "in evaluating whether the economic downturn is severe, the Member States will, as a rule, take as a reference point an annual fall in real GDP of at least 0.75%."152 (The rather curious choice of a 0.75% figure represents a compromise between Germany's desire to use 1% and France's proposal of 0.5% of GDP.)153 In their final appraisal of the EDR language, even when supplemented by the European Council Resolution, Segers and Van Esch conclude that Germany's effort to achieve a strict, near-automatic rule had failed, as the ultimate formulation represented only "a gentlemen's agreement—at best—between the Finance Ministers of the Euro area."154 While referring to Article 2(3)'s text as merely a "gentlemen's agreement" is rather an exaggeration, it is certainly true that the Council has considerable discretion in its decision making. As we shall see, this is one of the Court of Justice's key conclusions in the judgment reviewed in Part IV of this Article.

In Articles 3 through 6, the EDR sets out a complicated procedural timetable. It may help to provide a somewhat simplified sequence of progressive stages:

1) Commission evaluation of a Member State budget.

2) Commission opinion that a State has an excessive deficit (EDR Article 3).

3) Ecofin Council opinion that a State has an excessive deficit (EDR Article 3).

4) Ecofin Council recommendations to correct the deficit (based largely on Commission recommendations, but within the Council's discretion) no later than the next fiscal year, with the initial corrective State action to be taken within four months (EDR Article 3).

5) Ecofin Council decision that a State has failed to take effective corrective action within the required time frame, together with further recommendations for corrective action (EDR Article 4).

152. See Resolution of the European Council on the Stability and Growth Pact, supra note 7, Member States pt. 7. For an analysis of how the Commission should react to Member State contentions that a reduction in GDP of less than 2% justifies an excessive deficit, see Antonio J. Cabral, Main Aspects of the Working of the SGP, in The Stability and Growth Pact, supra note 5, at 139, 143-45.

153. See Heipertz & Verdun, supra note 5, at 989.

6) After lapse of a month, an Ecofin Council decision warning that a delinquent State's further failure to take appropriate corrective action will lead to sanctions (EDR Article 5).

7) Ecofin Council decision to impose sanctions (EDR Article 6).

We should immediately note that by virtue of EC Treaty Article 122(5), only the States within the Eurozone, i.e., the Eurogroup Finance Ministers, have the right to vote in taking the decisions to warn of sanctions or impose sanctions.

Now for a more detailed review of the EDR. In the first phase, in Article 3, the Commission is to evaluate the budgetary position of a Member State and give its opinion on whether an excessive deficit exists. This Commission decision naturally flows from its evaluation of a State’s Stability Program pursuant to Article 5 of the MSR, described previously. The Council then reviews the Commission opinion and decides, in its discretion (but presumably intended to be influenced by the Council’s commitments set out in the European Council Resolution on the SGP), whether an excessive deficit exists. Pursuant to EC Treaty Article 104(6), the Council vote to this effect must be taken by the Council’s customary qualified majority vote, without any bar on including the affected Member State’s vote. Article 3 of the EDR further provides that the Council must then recommend corrective action to the Member State concerned, with a deadline of four months for the start of the corrective action. The excessive deficit should be corrected “in the year following its identification unless there are special circumstances.”

Although a State that is deemed to have an excessive deficit may be unhappy with this decision, the adverse consequence, namely the need to commence various forms of corrective action, is not very onerous. Up to this point, the EDR procedure is distinctly soft law, and the procedure is generally applied in practice without any great controversy.

In the second phase, Article 4 of the EDR follows the procedure laid out in EC Treaty Article 104(8). Under Article 4, the Council has the power to decide that the State has taken “no effective action” to correct its deficit and demand corrective action in further recommendations. Further, in a manifest effort to put pressure on the delinquent State, the Council may take a

155. Council Regulation No. 1467/97, supra note 12, art. 3(4).
decision to make its recommendations public. Treaty Article 104(13) requires that in taking the decision to make its recommendation public, the Council may only act by a special two-thirds weighted vote majority, excluding the vote of the delinquent Member State. Presumably the obligation on the Ecofin Council to decide specifically on making public its recommendations before doing so reflects a concern that publication could be embarrassing to a State government. (As a practical matter, however, it would seem more sensible to have opted for transparency at this stage, requiring an automatic disclosure of the Council action, precisely because this would put pressure on the delinquent State to take corrective measures, thus avoiding the necessity to move on in the procedure.) When the Council decides that a State has not taken sufficient or effective action, this obviously substantially increases the peer pressure on the State concerned to act more vigorously. Predictably, this phase of the EDR procedure is apt to become much more contentious, as the State criticized is apt to argue either that its deficit is exceptional and justifiable, or that its proposed corrective measures will be fully effective, or both, while the Commission and some other States' Finance Ministers may strongly disagree.

Under EDR Article 5, if the Council continues to consider that the delinquent State is not taking "effective action" to correct the deficit, the Council can decide to give a final warning "notice" of sanctions. EC Treaty Article 104(9) states that the Council may make recommendations "judged necessary by the Council to remedy the situation," which suggests that the recommendations are intended to be effectively binding on the Member State concerned, which may face sanctions for failure to follow them. Treaty Article 104(13) again dictates that the Council vote in acting under Article 104(9), and hence under EDR Article 5, must be taken by a special two-thirds weighted vote majority, excluding the vote of the delinquent State. Moreover, by cross-reference to EC Treaty Article 122(5), only States in the Eurozone can vote on the decision to give a final warning. At this point the EDR procedure, and its application of Article 104(9), shifts from soft law, in which peer pressure constitutes the principal motive for a State concerned to take corrective ac-

156. See SMITS, supra note 3, at 82.
tion, to the start of the hard law phase, because the final warning notice is a prerequisite for the imposition of sanctions.

The third and final procedural stage covers the imposition of sanctions. EDR Article 6 prescribes that the Council "shall impose sanctions" if a Member State fails to comply with the Council's decision that it should take measures for the deficit reduction. Note that the use of the word "shall" in EDR Article 6 appears to place the Council under a duty to impose sanctions, while EC Treaty Article 104(11), upon which Article 6 is based, only states that "the Council may decide to apply" sanctions. Under Article 6, the Council is supposed to act to impose the non-interest bearing deposit sanction within two months following its prior decision providing its recommendations and giving notice of the risk of sanctions. As before, EC Treaty Article 104(13) stipulates that the Council must act by a special two-thirds majority weighted vote, without counting the vote of the delinquent State. As a procedural alternative to Article 6, EDR Article 9 permits the Council to hold the excessive deficit procedure "in abeyance" if it considers that the delinquent State is taking action to comply with Council recommendations.

EDR Articles 11 and 12 stipulate that the usual sanction which the Ecofin Council may impose on a Member State that fails to correct its excessive deficit is a non-interest bearing deposit equal to 0.2% of the State's GDP. If the State initially sanctioned fails to take appropriate corrective measures to reduce or eliminate its excessive deficit in the next year, EDR Article 12(2) permits the sanction to be increased. The initial 0.2% of GDP deposit can be increased in a variable calculation up to a maximum of 0.5% of GDP, in function of the degree to which the State's most recent annual deficit exceeds 3% of GDP. The text thus fleshes out EC Treaty Article 104(11), which refers only to "a non-interest bearing deposit of an appropriate size." As before, EC Treaty Article 104(13) requires the Council to act to impose this sanction by an exceptional two-thirds weighted vote, without permitting the delinquent State to vote.

Under EDR Article 13, failure of a State to correct its deficit

status within two years after the Council decision imposing the initial sanction could lead to a Council decision to convert the deposit into a fine. After some debate on the issue in spring 1997, the ultimate text of Article 16 prescribes that both the interest on any deposit and any ultimate fine are not treated as Community revenues, as the Commission had initially proposed, but rather are distributed among all the participating States within the Eurozone that do not have an excessive deficit. Under EDR Article 16, the allocation is made in proportion to each State's share in the global GDP of all the eligible States.

Incidentally, it is worth noting that the Treaty of Maastricht's amendment of EC Treaty Article 228 for the first time authorized the Court of Justice to impose financial penalties on a Member State that fails to abide by a judgment in an Article 226 infringement proceeding. Member State acceptance of the principle that financial penalties are appropriate under Article 228 may well have facilitated acceptance of the idea that financial penalties might be imposed under Article 104.

The authors of the EDR undoubtedly intended to make the sanctions of a non-interest bearing deposit and a possible later fine to be so large as to make it highly unlikely that a State would not take the necessary action to correct an excessive deficit. Indeed, some commentators believe that the EDR's penalties may never have been intended to be applied in practice, but only to serve as a deterrent. Professor Imelda Maher colorfully termed the sanctions a "nuclear option . . . little more than symbolic." Early commentators differed on whether the EDR's sanction provisions were intended to be essentially automatic, or subject to political considerations, as well as on the likelihood of their use in practice. Professor Hahn, writing in 1998, emphasized the impact of the commitments made by the Council and Member States in the European Council Resolution on the SGP and

158. See Council Regulation No. 1467/97, supra note 12, art. 16. The Proposal for a Council Regulation on speeding up and clarifying the implementation of the excessive deficit procedure, supra note 59, art. 12, would have included any interest on deposits or fines in general Community resources.

159. Imelda Maher, Economic Policy Coordination and the European Court: Excessive Deficits and Ecofin Discretion, 29 EUR. L. REV. 831, 833 (2004) (citing a House of Lords study). Also rather skeptical is the appraisal of the sanction approach by political scientist Thomas Willett, who concludes that it is "probable that the Stability Pact will be viewed as a symbolic victory for the Germans but one [with] few teeth and . . . relatively little effect on the fiscal behavior of EMU governments." Willett, supra note 49, at 60.
concluded that "the imposition of sanctions definitely enters the realm of probability, and indeed certainty." Professors Wessels and Linsemann contended that the Ecofin Council and Member States would comply with the rules "rigorously, that is, the rules on the timing and the criteria will be interpreted literally . . . even when the Council imposes considerable fines." In contrast, Professors Amtenbrink and de Haan emphasized that Council action under the EDR represents "essentially a political decision rather than an inevitable automatism."

A final important note should be made. By virtue of their Protocols opting out of the final stage of Monetary Union, neither Denmark nor the United Kingdom are subject to the risk of sanctions under the EDR. Furthermore, by virtue of EC Treaty Article 122(3), those States that have not yet satisfied the convergence criteria for entry into the final stage of Monetary Union are also not subject to the risk of sanctions under Treaty Articles 104(9) and (11) and hence under the EDR. Therefore, Sweden and nine of the twelve new Member States are presently excluded from the risk of sanctions. As noted above, the MSR does apply to all EU States. Likewise the EDR's substantive standards for determining whether a State has an excessive deficit, as well as the procedural review in phase one culminating in Council recommendations for corrective measures to end an excessive deficit, do apply to all States in the EU. Thus, after the ten new Member States joined the EU on May 1, 2004, the Commission and the Ecofin Council included them in the regular review of their annual budgetary conditions. After Bulgaria and Romania joined the EU on January 1, 2007 they were likewise included in the review.

Not only are the States that are not presently in the Eurozone free of risk of sanctions, but they are also excluded from voting to impose sanctions. Pursuant to EC Treaty Article 122(5), only the States currently in the Eurozone cast weighted

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160. Hahn, supra note 5, at 96. Writing contemporaneously, economist Niels Thygesen considered that the presence of sanctions would deter States from excessive deficits, but worried that sanctions might not be applied when required. See Thygesen, supra note 53, at 28. Economists Ray Barrell and Karen Dury considered it unlikely that States would in fact breach the SGP excessive deficit rules. See Ray Barrell & Karen Dury, Will the SGP Ever Be Breached?, in THE STABILITY AND GROWTH PACK, supra note 5, at 235.

161. Wessels & Linsemann, supra note 115, at 68.

162. Amtenbrink & de Haan, supra note 137, at 1086.
votes in the procedural decisions taken by the Council to give notice of the prospect of sanctions under EC Treaty Article 104(9) and EDR Article 6, or the actual imposition of sanctions under EC Treaty Article 104(11) and EDR Articles 7 and 11-13. We will see this voting rule in practice when we examine the Ecofin Council's votes at its meeting on November 25, 2003 in the next Part.

III. THE STABILITY AND GROWTH PACT IN OPERATION: 1999-2003

Because all the States within the EU enjoyed moderate economic growth during 1999 and 2000, with either a budget surplus or only a low deficit, no issues arose concerning the application of the SGP during that period. In January 2001, however, the Commission recommended to the Ecofin Council that Ireland be publicly criticized for an excessively expansionary 2001 budget, in view of Ireland's inflation rate of 5.6% in 2000 and a continued strong growth rate forecast for 2001. When on February 12, 2001 the Ecofin Council followed the recommendation and publicly urged Ireland to modify its budget, the Irish media reacted with indignation. Subsequently, on November 6, 2001, the Council concluded, on the basis of a Commission report, that Ireland was largely following its recommendations, but continued to warn the Irish government to exercise vigilance to keep the Irish economy from overheating. Certainly the steady strong economic growth of the Irish economy, which frequently causes Ireland's economic cycle to diverge from that prevailing on the continent, represents a serious operational prob-


164. See E.U. BULL., no. 1/2, pt. 1.3.7 (2001).

165. See id. at 1.3.8; see also Dinan, supra note 3, at 512 (terms criticism of Ireland "bizarre" in view of Ireland's budget surplus of 4.6% at time); Pisani-Ferry, supra note 22, at 837 (also considered Council recommendation to be "misguided" and Irish government's policy to be correct).

166. See E.U. BULL., no. 11, pt. 1.3.3 (2001).
lem for the Irish government in preparing and executing its budgetary policies.

After Ireland, Portugal became the next Eurozone State to receive criticism under the Stability Pact procedures. Concerned by an estimated deficit of 2.2% of GDP in 2001, which would cause the accumulated government debt to rise to 56% of GDP, the Commission recommended that Portugal receive an "early warning" to rein in public spending.167 Because the Portuguese government committed itself to reduce the deficit in 2002, the Ecofin Council on February 12, 2002 merely took note of the situation and Portugal's commitments.168

After an election in April 2002 brought Prime Minister Barroso's Social Democratic party to power, the new Portuguese government revised upward the 2001 deficit statistic to 4.1% of GDP (blaming, quite naturally, the prior government's allegedly excessive spending policy). The new government pledged efforts to reduce spending and keep the deficit below 3% in 2002. On November 5, 2002, the Ecofin Council concluded in Decision 2002/923 that Portugal had an excessive deficit and issued a serious warning that this needed to be remedied rapidly.169 The Council set a deadline of December 31, 2002 for Portugal to take the necessary measures. By the end of 2002, Portugal had made serious efforts to comply, reducing the deficit to around 2.8% of GDP through substantial cuts in government spending. In March 2003, the Ecofin Council recognized Portugal's continued progress toward a likely deficit of 2.4% in 2003, and concluded that Portugal broadly complied with the Stability Pact's requirements.170

Serious strain in the Stability Pact framework began in 2002. As the economy throughout most of the Eurozone deteriorated

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167. See E.U. Bull., no. 1/2, at 24-26, pts. 1.3.15-1.3.16 (2002); see also Paul Meller, Germany and Portugal Face Warnings to Rein in Deficits, N.Y. Times, Jan. 31, 2002, at W1.

168. See E.U. Bull., supra note 16, at 25-26, pt. 1.3.16; see Amtenbrink & de Haan, supra note 137, at 1085; see also supra note 140 and accompanying text (Council is not obliged to provide "early warning" to State when Commission recommends one).


in 2002 (rather in parallel to the situation in the United States), with average annual GDP growth falling to an anemic 0.8%, while average unemployment rose from 8% to 9%.\textsuperscript{171} the strict demands for low deficits imposed by the Stability Pact came under increasing challenge by national governments and the media. On February 12, 2002, the Ecofin Council reviewed Germany's economic situation, based upon its estimated 2001 deficit of 2.6% of GDP and forecasts for an increased deficit in 2002. Although the Commission had recommended an "early warning," the Council took no action,\textsuperscript{172} accepting the Schroeder government's promise to rein in its budgetary expenses, especially social benefits.

However, by fall 2002, the economic situation in Germany, France, Italy and the Netherlands had deteriorated further, approaching a recession. Unemployment rose sharply, especially in Germany, where it passed 10%.\textsuperscript{173} In achieving a narrow victory in the September 2002 elections, Chancellor Schroeder's Socialist—Green government pledged further efforts to stimulate economic growth by lowering tax rates and augmenting various spending programs. Similarly, the Conservative governments of President Chirac and Prime Minister Raffarin in France and Prime Minister Berlusconi in Italy pressed to stimulate their economies through new spending programs and tax reductions without manifesting any great concern about the annual deficit levels.

Predictably, this provoked sharp criticism of these political leaders by Monetary Affairs Commissioner Solbes and critical Commission evaluations of the budgetary conditions in both States.\textsuperscript{174} Surprisingly, however, Commission President Prodi (who, as Prime Minister, had led Italy's successful efforts to meet the convergence criteria in 1997) publicly assessed the Stability Pact on October 18, 2002 as "stupid, like all decisions that are


\textsuperscript{174} See 2002 General Report on the EU, supra note 171, ¶ 63.
rigid" and called for "a more intelligent tool."\textsuperscript{175}

The controversy over the merits of the Stability Pact and over the execution of its procedures and guidelines increased throughout 2003. The economic situation throughout the EU, and particularly in the Euro-area, worsened in 2003 "with mounting unemployment and deteriorating public finances."\textsuperscript{176} Euro-area unemployment averaged 8.9\%, while average deficits were around 2.7\% of GDP.\textsuperscript{177} In 2002, Germany significantly exceeded the maximum 3\% annual GDP deficit level, with a 3.5\% deficit.\textsuperscript{178} France's deficit neared 3\% in 2002.\textsuperscript{179} As both nations fell clearly into recession in the first half of 2003, their governments understandably sought new ways of stimulating economic growth with little concern for the strictures of the Stability Pact.

Nonetheless, the Commission pressed for corrective action by both States, issuing critical evaluatory reports. Accordingly, on January 21, 2003, the Ecofin Council reviewed Germany's status, concluded that Germany's 2003 deficit was likely again to exceed the 3\% level, in part because Germany's GDP growth rate was unlikely even to hit 1.5\% of GDP, and urged structural reforms, "notably of the labor market."\textsuperscript{180} Concluding the procedures set in the first phase of the EDR, the Council adopted a decision under EC Treaty Article 104(6) that Germany had an excessive deficit of 3.8\% in 2002, and then issued recommendations pursuant to Article 104(7) for budgetary revisions to reduce the 2003 deficit to 2.75\% before May 21, 2003\textsuperscript{181} (the four month period within which a State should take corrective action, foreseen in the EDR's Article 3(4)). As indicated in the prior section, Treaty Article 104(6) and the EDR permitted the Ecofin

\begin{itemize}
  \item \textsuperscript{175} Elaine Sciolino, \textit{An Italian Official's Blunt Words Set Off Euro-Mayhem}, N.Y. TIMES, Oct. 19, 2002, at A8. Paul De Grauwe quotes President Prodi with approval, observing that the "idea that countries should comply with a numerical constraint of 3\% irrespective of their debt levels and underlying economic conditions is 'stupid.'" De Grauwe, \textit{supra} note 3, at 239.
  \item \textsuperscript{176} EUROPEAN COMMISSION, \textit{GENERAL REPORT ON THE ACTIVITIES OF THE EUROPEAN UNION 2003}, ¶ 100 (2003).
  \item \textsuperscript{177} See id.
  \item \textsuperscript{178} See E.U. BULL., no. 1/2, at 24-25, pt. 1.3.15 (2003).
  \item \textsuperscript{179} See id. at 29-30, pt. 1.3.19. Final Eurostat statistics indicated that France's deficit in 2002 hit 3.2\%, marginally exceeding 3\%.
  \item \textsuperscript{180} Id. at 24-25, pt. 1.3.15.
  \item \textsuperscript{181} See Council Decision No. 2003/89/EC, O.J. L 34/16 (2003) (on existence of excessive deficit in Germany); see also LASTRA, \textit{supra} note 3, at 268.
\end{itemize}
Council to take the decision that Germany had an excessive deficit by an ordinary qualified majority vote, which would include the vote of Germany. That the Ecofin Council could achieve this majority suggests that in early 2003 the Ecofin Council believed that Germany had a realistic opportunity to reduce its projected 2003 deficit significantly.

With regard to France, the Ecofin Council review of January 21, 2003 concluded that France’s estimate of a 2.6% deficit for 2003 was optimistic and that France might breach the 3% deficit level, and urged in consequence that France should curb health and social security expenditures. The Council accordingly issued an “early warning” to France. On June 3, 2003, when the Council next reviewed France’s status, the Council accepted the Commission’s view that France could now be said to have an excessive deficit, took a decision to that effect under Article 104(6), and set October 3 as the deadline for corrective measures pursuant to Article 104(7) (again, a four month period for corrective action).

After the French economy experienced a 0.3% decline in GDP during the second quarter of 2003, on August 28, 2003, Prime Minister Raffarin asserted that his government’s primary responsibility was to “mobilize all of the strengths of our country for growth and employment,” and urged that the SGP be made more flexible. The French budget presented by the government on September 25, 2003 indicated a 2004 deficit estimate of 3.6%, in part because President Chirac and Prime Minister Raffarin were determined to cut the income tax rate again, in order to increase consumer spending. In Germany, in the

182. See E.U. BULL., supra note 17, at 29-30, pt. 1.3.19.
summer of 2003, Chancellor Schroeder continued to press forward with substantial tax cuts to energize the German economy, now forecasting the 2003 deficit to be substantially in excess of 3%, probably 3.8%. In a public statement, Chancellor Schroeder predicted that Member States would increasingly see it necessary to "interpret [the stability pact] in an economically sensible way." 187 France and Germany now sought a more flexible application of the Pact, to prevent the imposition of the Excessive Deficit Procedure penalties when governments undertake measures to combat unemployment and foster growth during periods of serious economic downturns. 188 At this point not only had Germany suffered a shallow recession in mid-2003, but also the Italian economy went into recession, with the risk that the Italian deficit in 2003 would exceed 3% of GDP. 189 From then on, the Italian government indicated sympathy for the Franco—German position.

Naturally, Economic and Monetary Affairs Commissioner Solbes and the European Central Bank were opposed to any revision in the SGP. The Commission managed to achieve a united front in efforts to keep the Pact in force. In unusual public statements, Commissioners Monti and Lamy supported this view, 190 and President Prodi supported the Pact in a meeting with Prime Minister Raffarin on August 27. 191 Moreover, during this period in the summer and fall of 2003, a number of finance ministers from smaller nations, such as Austria, Belgium, Finland, Ireland and the Netherlands, criticized the Franco-German position and urged that the Ecofin Council proceed to apply the EDR's provisions. 192 Nonetheless there was widespread skepticism that sanctions were either economically or politically possible against


188. See Thomas Fuller, Chirac Urges Easing of EU Budget Rules, INT’L. HERALD TRIB., July 15, 2003, at 1; see also Bertrand Benoit, Schroder Seeks Backing of Blair for Europe Growth Plan, FIN. TIMES (U.K.), Sept. 19, 2003, at 8.

189. See Eric Pfanner, Data Show Recessions in Germany and Italy, N.Y. TIMES, Aug. 15, 2003, at W1.


191. See Fuller, supra note 188.

192. See Daniel Dombey & George Parker, Eurogroup Torn Apart as French Deficit Rouses Anger, FIN. TIMES (U.K.), July 16, 2003, at 6; see also Judy Dempsey, Belgian Premier Stands Firmly in Favour of Europe’s Stability Pact, FIN. TIMES (U.K.), Sept. 26, 2003, at 9;
France or Germany.\textsuperscript{198}

An Ecofin Council meeting on September 12, 2003 urged France to revise its budget policy to reduce the estimated deficit before its next session in October.\textsuperscript{194} Nonetheless, France’s September 25, 2003 estimated budget for 2004 showed a deficit of 3.6\% of GDP.\textsuperscript{195} In mid-October, the Commission reluctantly concluded that it would not recommend that the Ecofin Council begin the next phase in the EDR procedure to impose penalties on France, provided that France would promise to reduce its 2004 deficit by 0.3\% of GDP.\textsuperscript{196} On October 22, however, the French Ministry of Finance rejected this suggestion, contending that such a cut would be “destabilizing” to the French economy.\textsuperscript{197} Meanwhile Germany’s Finance Minister Eichel announced revised budget deficit estimates on October 24, indicating that Germany’s continued anemic economic growth would cause the deficit to stay above the 3\% of GDP ceiling in 2004, marking the third successive annual breach of the rule.\textsuperscript{198} He reduced the forecast for growth in GDP in 2004 from 2\% to 1.7\%.

A \textit{Financial Times} editorial on October 27 declared that “[t]he pursuit of deficit rules of the kind currently operational in Europe is . . . inconsistent with the conduct of sensible economic policies.”\textsuperscript{199} The editorial contended that to oblige France and Germany (as well as the United Kingdom, which also seemed likely to breach the 3\% of GDP deficit ceiling in 2003) to reduce public expenditures or increase taxes currently would be inadvisable, because “the risk of such collective action would

\begin{footnotesize}
\begin{itemize}
\item See E.U. BULL., no. 10, at 31, pt. 1.3.11 (2003).
\item See Graham, Johnson & Parker, supra note 186.
\end{itemize}
\end{footnotesize}
be a Europe-wide recession."\textsuperscript{200}

This background set the stage for a crucial meeting of the Ecofin Council on November 25, 2003. The Commission had recommended on October 21 that the Council should decide that France had not taken any "effective action" in accordance with prior Council recommendations to reduce its deficit, pursuant to EC Treaty Article 104(8) and EDR Article 4, and then recommend to France, pursuant to the notice provision of EC Treaty Article 104(8), that it reduce its estimated 2004 deficit by 1% and that it end its excessive deficit in 2005.\textsuperscript{201} With regard to Germany, the Commission recommended on November 18 that the Council should decide under Treaty Article 104(8) that Germany had not taken any "effective action" in accordance with prior Council recommendations to reduce its deficit, and then recommend under Article 104(9) that Germany reduce its deficit by 0.8% in 2004 and at least 0.5% in 2005.\textsuperscript{202} Note that in its recommendations to both States, the Commission asserted that they would each have an additional year (i.e., until the end of 2005) to bring their deficits below 3%. Nonetheless the Council's endorsement of the Commission recommendations would have moved further along the procedure toward possible sanctions, because the failure by either France or Germany to follow the Council recommendations within specified time periods (either at the end of 2004 or 2005) could have then enabled the Council to move to the next step in the EDR, and actually impose sanctions pursuant to EC Treaty Article 104(11) and EDR Article 6.

The Ecofin Council meeting on November 25 was certain to be both difficult and dramatic. Neither France nor Germany wanted to see the Commission recommendations endorsed by the Council, not only because they did not want to be the subject of a further procedural step towards sanctions, but also because they did not consider the proposed future deficit reduction levels realistic.\textsuperscript{203} On the other side, several smaller Member

\textsuperscript{200} Id.
\textsuperscript{201} See E.U. BULL., supra note 19, at 31, pts. 1.3.10-11.
\textsuperscript{202} See E.U. BULL, no. 11, at 15-16, pt. 1.3.7 (2003); see also Patrick Jenkins & George Parker, Solbes Tells Berlin to Cut €6bn from Budget, FIN. TIMES (U.K.), Nov. 17, 2003, at 7.
\textsuperscript{203} See George Parker, Berlin and Paris Try to Avoid EU Fines, FIN. TIMES (U.K.), Nov. 3, 2003, at 6; George Parker, German Proposal Could Be End of Stability Pact, FIN.
States, notably Austria and the Netherlands, strongly advocated the firm application of the EDR procedures.\textsuperscript{204} Naturally, Commission President Prodi and Commissioner Solbes, responsible for economic affairs, as well as ECB President Trichet, all pressed for favorable Council action.\textsuperscript{205} Media reports indicated that the Ecofin meeting revealed a bitter split. Indeed, Germany’s Finance Minister Eichel apparently became highly emotional in contesting the Commission proposals, because he felt that the German government was already demonstrating political courage in adopting unpopular reforms precisely to improve its long-term fiscal position.\textsuperscript{206}

During its rather ill-fated meeting, the Ecofin Council took votes on the recommendations made by the Commission, but could not adopt a decision in favor by the special qualified majority required.\textsuperscript{207} As previously noted, only the Eurozone States participated in the actual vote on the recommendations under EC Treaty Article 104(9) for corrective budgetary action by France and Germany, pursuant to EC Treaty Article 122(5) read in conjunction with Article 104(13), i.e., a two-third weighted vote majority of the Eurozone States without counting the vote of the State that was the subject of the recommendations. Spain and a few smaller States (Austria, Belgium, Finland and the Netherlands) were willing to vote in favor of the Commission recommendations, while France and Italy opposed the recommendation concerning Germany, and Germany and Italy opposed that concerning France.\textsuperscript{208} The Eurozone Ecofin Council

\textsuperscript{204} See Parker, German Proposal Could Be End of Stability Pact, supra note 203.

\textsuperscript{205} See George Parker, Ministers Conduct Late—Night Burial for EU Fiscal Framework, FIN. TIMES (U.K.), Nov. 26, 2003, at 8 (noting that both Commission President Prodi and ECB President Trichet had argued for application of Stability Pact rules at Ecofin Council dinner).

\textsuperscript{206} See Bertrand Benoit, Surprise Over Eichel’s “Emotional” Response, FIN. TIMES (U.K.), Nov. 26, 2003, at 8. The reporter noted that German Finance Minister Eichel had been irate in contesting the Commission’s recommendations because the German Socialist government of Chancellor Schroeder was at that time adopting highly unpopular economic reform measures to reduce social costs precisely in order to lower the deficit. In that regard, see Tony Major & Hugh Williamson, Berlin Economists Cautiously Optimistic, FIN. TIMES (U.K.), Nov. 13, 2003, at 12; Hugh Williamson, Berlin ‘Struggling to Comply with Stability Pact by 2005,’ FIN. TIMES (U.K.), Dec. 23, 2003, at 6.

\textsuperscript{207} See E.U. BULL., supra note 20, at 16-18, pt. 1.3.8 (Germany) & 18-19, pt. 1.3.9 (France).

\textsuperscript{208} See Bertrand Benoit, Joshua Leviitt, Tony Major & George Parker, Sanctions...
failure to endorse the Commission recommendations is not surprising, because a favorable vote could have led to a subsequent Council decision to impose sanctions if France and/or Germany did not comply with them.\footnote{Deal Leaves Euro Pact in Tatters, FIN. TIMES (U.K.), Nov. 26, 2003, at 1. Professor Jean-Victor Louis has sensibly observed that some States may have declined to vote in favor of the Commission recommendations “in order to avoid a bigger row at a particularly difficult moment . . . [during the] Intergovernmental Conference,” which was then considering the draft Constitution. See Jean-Victor Louis, The Economic and Monetary Union: Law and Institutions, 41 COMMON MKT. L. REV. 575, 579 (2004) [hereinafter Louis, EMU]. Segers and Van Esch conclude that the outcome demonstrates that the excessive deficit rules permit a politically—based determination, rather than the automatic application of the strict fiscal standards sought by Germany. Segers & Van Esch, supra note 48, at 1106.}

Given this vote impasse, the Ecofin Council presumably wanted to do something that could be reported as positive news. Following a compromise proposal presented by Italian Finance Minister Tremonti,\footnote{209. As indicated in the review of the EDR in Part II, EC Treaty, supra note 1, art. 104(b)11, states that the Council “may decide to apply” sanctions if a State does not comply with Council recommendations made when giving the final warning. 210. See Parker, supra note 20. According to this account, Tremonti had prepared his proposals in advance and negotiated with other Ecofin Ministers for their adoption during a midnight to four o’clock in the morning suspension of the meeting.} the Council decided to adopt what it termed “conclusions” concerning France and Germany, citing the “abrupt and unexpected” worsening economic situation in each State, welcoming each one’s “public commitment to implement all the necessary measures to ensure that the deficit will be below 3% of GDP in 2005 at the latest,” accordingly deciding not to act against either State on the basis of the Commission recommendations.\footnote{211. E.U. BULL., supra note 20, at 16-18, pt. 1.3.8. 212. Id. at 18-19, pt. 1.3.9. 213. Id. at 16-18, pt. 1.3.8. With regard to Germany, the Council conclusion noted Germany’s intent to reduce the annual deficit by 0.6% of GDP in 2004, and by a further 0.5% in 2005. 214. Id. at 18-19, pt. 1.3.9. With regard to France, the conclusion noted France’s intent to reduce its deficit by 0.7% of GDP in 2004, and by a further 0.6% in 2005.}

In its conclusions, the Council also agreed “to hold the excessive deficit procedure for [each State] in abeyance for the time being, although warning that it might subsequently take a decision under EC Treaty Article 104(9) if either State failed to honor its new commitments.”\footnote{Segers and Van Esch, supra note 48, at 1106.} The Council specifically recommended that Germany reduce its annual deficit by 0.6% in 2004,\footnote{212. Id. at 18-19, pt. 1.3.9. With regard to France, the conclusion noted France’s intent to reduce its deficit by 0.7% of GDP in 2004, and by a further 0.6% in 2005.} and that France reduce its deficit by 0.8% in 2004.\footnote{Id. at 18-19, pt. 1.3.9. With regard to France, the conclusion noted France’s intent to reduce its deficit by 0.7% of GDP in 2004, and by a further 0.6% in 2005.} (In both cases, this was not as large a reduction in the
deficit as that urged by the Commission in its recommendations.) Following the Ecofin Council statements, the Commission took an extraordinary step, entering into the record its view that the Council rejection of its recommendations occurred “without giving adequate explanation as laid down in the European Council resolution on the Stability and Growth Pact.”

The Ecofin Council’s actions (or non-actions) promptly provoked a storm of criticism from the Commission, the ECB, and government leaders from several smaller States. Pedro Solbes, the economic affairs Commissioner, declared that the Ecofin Council conclusions “do not follow the spirit and rules of the Stability and Growth Pact,”215 while the ECB warned that the Ecofin action risked “undermining the credibility of the institutional framework and the confidence in sound public finances.”216 Gerrit Zalm, the Dutch Finance Minister, declared that the Stability Pact had been shoved “in the refrigerator,” and the Austrian Finance Minister, Karl-Heinz Grasser, complained that Austrians would suffer higher interest rates due to the French and German deficits.217 Rather ironically, former German Finance Minister Theo Waigel, who had essentially proposed the Stability Pact, now expressed his outrage that Germany should disregard it.218 In contrast, Chancellor Schroder called the results a “reasonable compromise” and referred to “phases in the economy when one has to stress growth more than budget consolidation.”219 French Finance Minister Francis Mer stated that the Stability Pact rules were not working, and urged a reexamination to improve them “in a democratic fash-


218. See id.

219. Id.
The views expressed at the time in the media and by economists and academics were also divided. Indeed, although many commentators viewed the Stability Pact as dead, some considered that strict enforcement of the EDR would have proved economically counterproductive. Thus, the eminent Belgian economist, Paul DeGrauwe, declared that the Pact was deservedly dead, because it was “unintelligent” and counter-productive, observing that “during a recession . . . citizens expect the social insurance mechanisms to function [but the] rigidity of the pact was blind to this.”

Financial Times analyst Lionel Barber concurred, contending that “the pact’s provisions made no economic sense. Why should a country face penalties when its budget deficit was going up and its GDP going down?” Financial markets appeared to take with equanimity the Council failure to take action to pressure France and Germany into stronger measures to reduce their deficits. More recent commentators tend to take the view that France and Germany had good economic grounds for resisting the Commission recommendations, which would have been counterproductive and might have significantly worsened the two States’ recessions.

IV. THE COURT JUDGMENT IN COMMISSION V. COUNCIL (STABILITY AND GROWTH PACT)

A. Summary of the Court Judgment

On January 27, 2004, the Commission sued the Council before the Court of Justice, seeking an annulment of its deci-

222. Lionel Barber, Crocodile Tears for the Pact’s Timely Death, FIN. TIMES (U.K.), Dec. 9, 2003, at 15.
225. The Commission apparently was divided on the prudence of suing the Council, but Commissioner Solbes successfully persuaded his colleagues to do so. See Tobias
sions not to adopt the Commission recommendations concerning France and Germany, and of its substituted conclusions concerning the two States, particularly the conclusion to hold the excessive deficit procedure "in abeyance." That the Court of Justice rendered its judgment on July 13, 2004, less than six months after the Commission sued the Council, demonstrates the importance and the urgency of the proceeding. That Michel Petite, Director-General of the Commission Legal Service, and Jean-Claude Piris, Director-General of the Council Legal Service, presented each institution's case in the oral proceedings underlines the commitment of each institution. The Court's judgment, rendered by an experienced Reporting Judge, Claus Gulmann, largely reached the same conclusions as the opinion of Advocate General Antonio Tizzano, although with some differences in analysis.

The Financial Times' front page coverage of the judgment characterized it as "balanced," noting that "both sides claimed victory," and that it would help to enable a new agreement on a "more flexible interpretation of the stability pact." Focusing on the Court's conclusion that the Council had discretion throughout the procedure moving toward sanctions, the German Minister of Finance, Hans Eichel, called the judgment "very wise." Commission President Prodi felt that the Court had


228. It is perhaps necessary to note that a Reporting Judge writes a judgment to reflect the views of the entire Court, not necessarily his personal opinion. Naturally a Reporting Judge's views usually have a strong influence upon the ultimate language of the Court's judgment. Former Judge David Edward describes the deliberative process of the Court in formulating its judgment in David Edward, How the Court of Justice Works, 20 Eur. L. Rev. 539, 555-57 (1995).


231. Id.
confirmed "the central role of the Stability and Growth Pact," although he added that it was now necessary to move forward with compromises with France and Germany.\textsuperscript{232} Even the ECB noted the judgment with "satisfaction," calling for the Stability Pact rules to be "fully applied."\textsuperscript{233}

The most immediate importance of the Court's rather balanced judgment lies not so much in its analysis of the legality of the Council action, and non-action, at its November 25, 2003 meeting, but rather in the judgment’s implications for the virtually inevitable amendment of the EDR, described in Part V infra. Implications drawn from the Court’s judgment may also have a longer term influence on the respective roles of the Commission and the Council in the application of the SGP procedures, as we will consider later.

Fundamentally, the Commission’s arguments to the Court rested on the view that the Ecofin Council’s votes, which did not attain the required majority, upon the Commission’s recommendations that the Council decide that neither France nor Germany had taken effective measures to correct their excessive deficits in 2003, and the further recommendations that France and Germany be told to make specific percentage reductions of their excessive deficits in 2004 and 2005, constituted in each case a negative decision with regard to the recommendations, and thus an act subject to judicial review. The Commission relied heavily on the strong language in the European Council Resolution on the Stability and Growth Pact by which the Council was to be "committed to a rigorous and timely implementation of all elements of the Stability and Growth Pact" and "invited always to impose sanctions" on a State unwilling to correct an excessive deficit despite Council recommendations.\textsuperscript{234} The Commission naturally further maintained that the Council "conclusions," especially the one placing the entire sanction procedure "in abeyance," had no legal foundation and indeed were "\textit{sui generis} measures whose main legal effect is to free the Council and the

\textsuperscript{232} Id.


\textsuperscript{234} Council Resolution on the Stability and Growth Pact of 17 June 1997, O.J. C 236/1, at 3 (1997); see also supra text accompanying note 71.
Member States concerned from the binding legal framework" of Article 104 and the EDR.  

For its part, the Council denied that it had any legal duty to act on the Commission recommendations and further maintained that its votes could not be considered to be judicially reviewable decisions because they did not represent any definitive acts. Rather, the Council maintained that it had discretion to act, or not, as it saw fit. Furthermore, the Council regarded its "conclusions" to represent "texts of a political nature [without] legal effects," essentially de facto presentations that "record the situation." As such, they would not represent any judicially reviewable decisions.

It is important to note at once that the Court judgment concentrated upon the interpretation and application of Article 104, making references to EDR provisions as essentially only subordinate supplements to Article 104. The judgment accordingly has a constitutional character, in contrast to one of legislative interpretation.

The Court first dealt with the Ecofin Council’s votes upon the two Commission recommendations with regard to France and Germany which in each case failed to achieve the requisite majority vote in favor. In the Court’s view, the Council’s vote that did not attain the requisite qualified majority set by EC Treaty Article 104(13) did not constitute a "decision" for the purpose of either Article 104(8) or (9). Consequently, the Council vote in itself did not constitute an act that can be challenged under EC Treaty Article 230 before the Court of Justice. Moreover, the Court held that neither Treaty Article 104(9) nor the EDR procedure set a definitive deadline by which the Council must act upon a Commission recommendation to request a State with an excessive deficit to take any particular corrective measures. The Council, therefore, could not be considered to be in legal default, because nothing would prevent the Council from taking up the issue at a future date and then taking the requisite vote in favor. Indeed, the Court considered that to conclude that the Council could not later resume the procedure and take action on the Commission recommendations would

236. Id. ¶ 37.
237. Id. ¶ 31.
militate against the Council's ability to "ensure expeditious and effective implementation of the excessive deficit procedure." Although, in contrast, Advocate General Tizzano analyzed the Council votes as "the adoption of a (negative) position" upon the Commission recommendations, he then further reasoned that the Council votes did not constitute any reviewable acts because they were not definitive in nature, inasmuch as the excessive deficit issues remained before the Council, which could yet adopt the Commission's recommendations.

In this portion of the proceeding, the Council accordingly won a significant victory. The Court effectively enhanced the Council's level of discretion at this stage in the excessive deficit regulatory procedure. The Council does not have to act immediately to evaluate a State's corrective measures as insufficient, when it previously decided that a State has an excessive deficit, merely because the Commission recommends a finding that the affected State's measures are insufficient. The Council can choose to wait before taking any further decision at this stage in the EDR procedures. As Professor Maher has observed, the Court has enabled the Council to act (or, indeed, not to act) taking into account "the reality of changing economic circumstances in the euro-area," giving it more "flexibility" in applying the rules. However, it is also important to note that the Court did characterize the "seriousness of an excessive deficit" as one calling "for urgent action." Moreover, the Court added an implicit warning to the Council by remarking that the Commission might ultimately have recourse to a suit under EC Treaty Article 232 against the Council for a failure to act when it has a

238. *Id.* ¶ 33. Professor Doukas finds the Court's reasoning to contain "a striking contradiction" because the Court relied upon the Council's duty to execute the procedure expeditiously while failing to limit the Council's discretion to delay taking necessary action. *Doukas, supra* note 22, at 301.


240. *Id.* ¶¶ 30-50. The Advocate General observed that during the Court's oral hearing even the Commission had accepted that the Council could still act on its recommendations. *Id.* ¶¶ 42, 49.

241. *Maher, supra* note 159, at 837. Professor Doukas describes the Council as having "considerable room for manoeuvre, given its prerogative to assess in a different manner the relevant economic data." *Doukas, supra* note 22, at 303.

duty to act under the Treaty.\textsuperscript{243}

In the second part of its judgment, the Court assessed the nature of the Council's "conclusions." The Court rejected the Council contention that these merely constituted a recognition of a \textit{de facto} situation. Rather, the Court held that the Council "conclusions" effectively put back the deadline for compliance given to France and Germany in its prior decisions that each had an excessive deficit, and accordingly produced legal effects. Indeed, the Court considered that the Council had effectively replaced the prior commitments which France and Germany had made in line with the earlier Commission and Council recommendations with new unilateral commitments made by France and Germany, thus intending to modify the basis upon which future action by the two States to reduce their excessive deficits should be appraised.\textsuperscript{244} As such, the Council "conclusions" constituted legally effective acts or decisions that the Commission could challenge under Article 230.

Turning to the issue of the legality of the "conclusions," the Court initially presented its view of "the broad logic of the excessive deficit procedure" in the light of Article 104.\textsuperscript{245} The Court's analytical starting point was its view of the purpose of EC Treaty Article 104, which was "to encourage and, if necessary, compel the Member State concerned to reduce [an excessive] deficit."\textsuperscript{246} The Court then emphasized the political force of the 1997 European Council Resolution on the Stability and Growth Pact, which had committed the Council "to a rigorous and timely implementation of all elements of the Stability and Growth Pact."\textsuperscript{247} (Of course, the European Council Resolution cannot legally bind the Council, because, as we have previously noted, under EU Treaty Article 4, the European Council may only provide policy guidelines and not take decisions with legal force.) Consequently, the Court proclaimed that the budgetary discipline rules ought to be made fully effective, in view of "the importance that the framers of the Treaty attach to observance

\begin{itemize}
\item \textsuperscript{243} See SGP Judgment, [2004] E.C.R. I-6649, \textsection\ 25.
\item \textsuperscript{244} See id. \textsection\ 48. The Council accepted specific commitments by France and Germany to lower their deficits in 2004 by a percentage less than that recommended by the Commission. See supra text accompanying notes 213-15.
\item \textsuperscript{245} See SGP Judgment, [2004] E.C.R. I-6649, \textsection\ 68-82.
\item \textsuperscript{246} Id. \textsection\ 70.
\item \textsuperscript{247} Id. \textsection\ 72.
\end{itemize}
of budgetary discipline." 248 The Court then emphasized that the "responsibility for making the Member States observe budgetary discipline lies essentially with the Council." 249

Examining the procedural stages laid out in the EDR, the Court declared that in each stage the Commission makes recommendations which constitute the basis for the Council's decision. However, the Court immediately emphasized that "the Council has a discretion" and is not bound to follow Commission recommendations for enforcement action, but may even "modify the measure recommended" in the light of its own "different assessment of the relevant economic data." 250 Nonetheless, the Council cannot set up its own alternative procedure and "break free from the rules laid down by Article 104." 251 In particular, the Council could not in this case take a decision placing the procedure against France and Germany "in abeyance." In this regard, the Court again rejected the Council's contention that its "conclusions" represented merely a political statement or a description of the factual situation. Looking at the Council's declaration that it would hold the EDR procedure in abeyance so long as France and Germany fulfilled their new unilateral commitments, the Court held that the Council had effectively limited its discretionary power to give a warning notice under Article 104(9), which meant that the Council's conclusions that placed the procedure in abeyance violated Article 104. 252

Furthermore, the Court held that the Council conclusions that had purported to make new recommendations for corrective action by France and Germany were invalid, because they constituted modifications of the Council recommendations to each adopted earlier in 2003 pursuant to Treaty Article 104(7). The Court limited the extent of the Council's discretion by hold-

248. Id. ¶ 74.
249. Id. ¶ 76.
250. Id. ¶ 80; see also Doukas, supra note 22, at 307 (discussing the Council's discretionary ability to modify its prior recommendations).
252. SGP Judgment, [2004] E.C.R. I-6649, ¶¶ 82-89. The Court also noted that the Council power to place the procedure "in abeyance" under the Treaty existed only under EDR Article 9(1), clearly not relevant here. See id. at ¶¶ 85-85. Advocate General Tizzano suggested that the Council might have the power to place the procedure in abeyance due to unexpected circumstances. See AG Tizzano Opinion, SGP Judgment, Case C-27/04, [2004] E.C.R. I-214, ¶ 132.
ing that the Council cannot unilaterally modify its prior recommendations "without a fresh recommendation from the Commission since the latter has a right of initiative in the excessive deficit procedure."

The Court also held that the Eurogroup Ecofin Ministers, who had purported to accept the new commitments made by France and Germany at the time of the meeting, did not have the power to modify the prior recommendations made to France and Germany which had been made by the full Ecofin Council acting pursuant to Article 104(7).

B. Reflections Upon the Court of Justice's Judgment

We observed previously that because the Court's 2004 judgment was "Solomonic," permitting both the Commission and the Council to claim a victory on certain issues, its immediate consequence was to increase pressure for the two institutions to settle their differences through amended regulations. The eminent Belgian monetary expert Professor Jean-Victor Louis has sensibly observed that the "judgment encouraged those who pleaded for a change in . . . the Council regulations, and not for the adoption of political commitments, in order to remedy the shortcomings of the Pact." The Court's conclusions do however also have important consequences long-term. Overall, the Court obviously gave comfort both to the Commission and the Council. The Court's rejection of the Commission's view of the near-automatic nature of the EDR procedure provides the Council with a much broader level of discretion in view of the sensitive character of each stage in the EDR procedural progress toward ultimate sanctions. The Council's discretion enables it not only to act to en-

254. *Id.* ¶ 95. As we have seen in the text at notes 176-79 *supra*, the earlier Jan. 21, 2003 Council recommendations to Germany and June 3, 2003 Council recommendations to France were adopted by the entire Ecofin Council. Pursuant to Article 104(7), the Eurogroup Finance Ministers may act in lieu of the entire Ecofin Council in taking decisions pursuant to Article 104(9) and 104(11) concerning sanctions, but not otherwise. Note that Advocate General Tizzano contended that the Council did have the power to modify its prior recommendations made pursuant to Article 104(7), but could only do so by action of the full Council, and not just the Eurogroup of Finance Ministers. *See AG Tizzano Opinion, SGP Judgment, Case C-27/04, [2004] E.C.R. I-214, ¶¶ 142-52.*
dorse Commission recommendations, but also to modify the Commission recommendations in light of its own assessment of the economic situation, and even, to take no action for at least a reasonable period of time (which might even prove to be a relatively long period of time). In the long term, this may prove to be the most important consequence of the Court's judgment in terms of the relationship between the Council and the Commission during the various stages of the excessive deficit procedure. On the other hand, the Court's appraisal of the "logic" of the SGP certainly has also great consequence for the long term, because it places upon the Council the ultimate responsibility for rigorous enforcement of the substantive excessive deficit rules. Indeed, the Court's dicta concerning the possibility of Commission recourse at some point to an Article 232 proceeding against the Council for an alleged failure to act when the Council has a duty to act, intimates that the Council may not stall indefinitely the EDR procedural steps toward the imposition of sanctions.

Moreover, the Court also emphasized the Commission's power of initiative throughout the process, which the Council must respect, not being able to "break free from the rules" by taking some unilateral action. As Professor Maher has observed, the Court rejected the view that the excessive deficit procedure represented "just a political process that can be by-passed" and augmented the Commission's procedural power to some degree because "the agenda-setting role of the Commission is enhanced" when the Council cannot act unless and until the Commission provides its recommendations. Professor Jean-Victor Louis struck a similar note in remarking that the "judgment made clear that the Council... could not substitute agreements between a majority of its members for the acts provided by the Treaty." Which institution can be said to have gained the most from the judgment? Arguably, it is the Council. The Court held that the Council had a discretionary role in the excessive deficit procedure when deciding whether a State has incurred an excessive deficit under Article 104(6), or when making recommendations for corrective action under Article 104(7), or when deciding whether to give notice of the risk of sanctions under Article

256. Maher, supra note 159, at 839.
257. Louis, supra note 25, at 87.
104(9), and in each case could make its own assessment of the economic factors involved which might differ from that of the Commission. The Court thus effectively confirmed that the Council is ultimately the master of the decision-taking process within the different phases of the excessive deficit procedure. Professor Doukas has rightly stated that the Court recognized "the predominant role of the Council" in budgetary surveillance and "confirmed the wide discretion and the assessment prerogative vested in the Council."258

Certainly the Court did grant the power of initiative to the Commission, with the consequence that the Council cannot take a decision at any stage in the procedure unless and until the Commission has made a recommendation for action or a decision. Concentrating upon this aspect of the Court's judgment, Professor Schelke considers that the Court "found largely in favor of the Commission."259 However this power of initiative of the Commission, its "agenda setting ability," does not detract from the Council's ultimate decisive role in determining whether or not to take a decision, or to propose any particular recommendation to a Member State which is the target of an excessive deficit procedure. The Commission's power of initiative in this procedure is analogous to the Commission's right of legislative initiative—although it is true that only the Commission can propose an initial draft proposal for legislation under EC Treaty Articles 251 and 252, what is ultimately decisive is that only the Council (or the Parliament and the Council acting jointly in the codecision procedure) can adopt legislation.

That the Council is ultimately the master of the excessive deficit procedure is constitutionally only appropriate. As we emphasized in Part I.A, the Treaty provisions on economic coordination within the Economic and Monetary Union do not constitute a transfer of sovereignty to the European Community, comparable to the transfer of monetary policy control to the ECB in Monetary Union. EC Treaty Article 4(1) prescribes the "close coordination of Member States' economic policies," but does

258. Doukas, supra note 22, at 308. He characterizes the Court's judgment as "a Pyrrhic victory for the Commission." Id.

not transfer to the Commission any power to coordinate. It is the Ecofin Council, representing the Member State governments, which has the final power to determine the degree to which State economic policies ought to be coordinated. Consequently, once the EDR structurally organized the excessive deficit procedure, it properly remains the Ecofin Council's prerogative to exercise its discretion in adopting decisions or making recommendations at the various stages. Some commentators would like to see the Commission exercise independently some degree of enforcement power in the procedure in order to make it a more effective limit on State budgetary deficits, but that is not constitutionally possible absent either a Treaty amendment (as the Treaty of Lisbon would do to some degree by its amendment giving the Commission an "early warning" power), or a (reversible) delegation from the Council.

To what degree does the Council have a duty to act to fulfil its responsibilities under the EDR? The Court's comments on the Council's duty to act in light of the overall purpose of the excessive deficit procedure, together with its citation of the European Council Resolution on the Stability and Growth Pact, is dicta, but important dicta. The Court need not have made these statements in order to reach its holding. That it did so makes the Court's emphasis on the high level of the Council's duty to ensure the effectiveness of the procedure a warning to the Council that it does not have unlimited discretion, and can ultimately be called to account before the Court if it can be said to violate a duty to act. The Commission's ability to take action to enforce this duty of the Council is certainly not guaranteed, because historically the Court has been reluctant to conclude that the Council has failed to act, in violation of Treaty Article 232, when the Council has a broad discretion to appraise economic circumstances. In this regard, Professor Doukas has sensibly ob-

260. The American economist, Barry Eichengreen, has well observed that although in theory the Commission could be given the power to act autonomously in the excessive deficit procedure in order to improve its enforceability, governments would never do this, because the Commission is "only loosely accountable to the European public." Barry Eichengreen, *Europe, The Euro and the ECB: Monetary Success, Fiscal Failure*, 27 J. POL'Y MODELING 427, 434-35 (2005).

261. The leading precedent is still Parliament v. Council, Case 13/83, [1985] E.C.R. 1513, where the Court declined to find that the Council had failed to act to adopt a Common Transport Policy, despite the importance of the sector and the Council's long delay in taking any appropriate action.
served that in view of "the complexity of economic growth factors and the fact that the ECJ cannot substitute its own evaluation for that of the Council," a proceeding to attack the Council for failure to act is unlikely to succeed. At least the Court has admonished the Council that it cannot refrain from acting to enforce the rules in circumstances where the facts suggest a manifest abuse of its discretion if it fails to act.

Do the amendments to the regulations reduce the risk of another Court battle? Objectively speaking, the substantial increase in the number and types of elements that would require discretionary appraisal by the Council strongly suggests that the Commission would find it even more difficult to challenge a Council decision, or failure to act. Moreover, as we shall see in the next Part, the recitals to the amended SGP regulations expressly cite the need for "close and constructive collaboration" between the Commission and the Council, which presumably represents an implied admonition that the two institutions should preferably conciliate their differences, rather than creating the severe stress to inter-institutional relations necessarily engendered by a Court proceeding.

V. THE REVISED STABILITY AND GROWTH PACT
REGULATIONS: LESS EMPHASIS ON STABILITY, MORE ON GROWTH

A. The Background of the Revised Rules

By late 2004, the political controversy over the proper mode of application of the SGP rules had cooled considerably. Economic conditions improved in France, Germany and Italy and indeed in general throughout the EU. By the end of 2004, the average growth rate in the Eurozone hovered around 2% of GDP, with France achieving a healthy 2.5% increase in GDP growth, while both Germany and Italy at least managed a 1% gain in GDP. Improved economic conditions naturally re-

262. Doukas, supra note 226, at 303-04; see also Maher, supra note 22, at 699 (observing that "judicial review" is of limited value in this economic governance, because of "policy learning (and change) over time").

263. See 2004 GENERAL REPORT ON THE EU, supra note 121, pt. 44. Final Eurostat figures found the average Eurozone growth rate to be 2.1% of GDP, that for the entire EU to be 2.5%, while France's growth rate was 2.5% of GDP, Germany's 1.1% and Italy's 1.2%.
duced political tensions between the Commission and the three States.

Even before the Court issued its judgment, the mood had clearly shifted toward a desire to reach a compromise position. The "Solomonic" character of the judgment provided added motivation, because neither the Commission nor the Council could claim a decisive victory, and neither wanted further controversy. Under the skillful leadership of Prime Minister Bertie Ahern, the Irish Presidency had managed to obtain a consensus in the European Council in its June 2004 meeting for the adoption of the draft Treaty establishing a Constitution for Europe. Obviously, as the political leaders of Europe sought to achieve the ratification of the draft Constitutional Treaty, no one was keen to continue a fairly fruitless controversy over whether the initial excessive deficit rules and procedures permitted a flexible, or only a strict application.

The inauguration in November 2004 of the new Commission headed by President Jose Barosso, the former Prime Minister of Portugal, naturally enabled a re-thinking of Commission views and policies. The Barosso Commission immediately gave the promotion of the success of the Lisbon agenda a key place in its agenda, pressing for the revitalization of efforts to achieve the agenda in its spring 2005 mid-term review of the program.264 The Barosso Commission's emphasis on promoting the Lisbon agenda may well have inclined it to consider more favorably some revisions to the SGP rules in the direction of greater flexibility and concern for growth. Moreover, after the surprise victory of the Socialists in Spain in March 2004, the new Prime Minister Zapatero named Commissioner Solbes as his Finance Minister. Joaquin Almunia, who succeeded him as Commissioner for economic and monetary affairs in the spring, and retained the post in the Barosso Commission, was naturally in a position to re-examine more neutrally the Commission policy concerning the operational efficacy of the SGP rules.

In June 2004, the European Council specifically requested the Commission to study the SGP, and in its request emphasized

that the SGP was based both upon raising growth potential and
securing sound budgetary positions. Accordingly, in one of
the final acts of the Prodi Commission Presidency, the Commis-
sion presented a Communication on September 3, 2004,
"Strengthening economic governance and clarifying the imple-
mentation of the Stability and Growth Pact," generally
deemed to represent particularly the views of Commission Presi-
dent Prodi and Commissioner Almunia. The Commission’s
Communication reflected its reconsideration of the budgetary
review process in the light of its accumulated experience, and
built upon earlier studies that dealt with the SGP, especially one
in November 2002 on “Strengthening the coordination of budg-
etary policies.”

The Commission’s September 2004 Communication began
with the frank observation that its goal was to “respond to the
shortcomings experienced so far [in the SGP] through greater
emphasis to economic developments in recommendations and
an increased focus on safeguarding the sustainability of public

(Strengthening economic governance and clarifying the implementation of the Stabil-
ity and Growth Pact). The European Council request was triggered by its endorsement
of the draft Constitution at its June 2004 session, as a Declaration annexed to the draft
Constitution referred to a desire to have the Commission produce proposals for
"strengthening and clarifying the implementation of the SGP." See Louis, supra note
255, at 86.

266. Commission Communication, supra note 265, COM (2004) 581 Final, sum-
marized in E.U. BULL., no. 9, at 10, pt. 1.3.1 (2004).

267. See Ralph Atkins & George Parker, EU Critics Claim ‘Cop-out’ as Prodi Eases

268. Commission of the European Communities, Stengthening the Co-ordination
the Co-ordination of Budgetary Policies], cited in E.U. BULL., no. 11, at 13, pt. 1.3.5
(2002). Probably the most significant of the new Commission views in this Communi-
cation was that States should continuously strengthen, and not weaken, their budgetary
condition in good economic times. Specifically the Commission proposed that any
State that had a significant annual deficit, even if not exceeding the 3% ceiling, should
improve its budgetary position by reducing its deficit each year by at least 0.5%. The
Commission also indicated that more concern should be given to a State’s rate of pro-
gress in reducing its aggregate debt down to the 60% of GDP ceiling when the State’s
debt exceeds that level. The Commission emphasized that budgetary policies should
contribute to growth and employment, absorbing the Lisbon strategy into economic
coordination. For an overall appraisal of this Communication, see Amtenbrink & de
Haan, supra note 137, at 1096-1100. The Commission’s views were largely reiterated in
Final (June 2004).
The Commission also stated the need for a better linking of "fiscal policy to economic growth and [to the support of] progress towards realising the Lisbon strategy." Thus at the outset the Commission was implicitly recognizing that the MSR and EDR ought to be reexamined in order to introduce a better appreciation for the growth aspect of the SGP.

Probably the most important Commission proposal for substantive change was to revise the multilateral surveillance process to concentrate upon "more country-specific circumstances" in order to improve the "economic rationale." The Commission even accepted that "country-specific circumstances" could include "the impact of structural reforms," and that the EDR's acceptance of excessive deficits in exceptional circumstances should be modified to accommodate the needs of States encountering periods of prolonged sluggish growth. The Commission also accepted that longer deadlines for a State's actions to correct an excessive deficit might be appropriate.

Altogether the report marked a shift toward Commission willingness to cooperate with the Council in amending the Multilateral Surveillance and Excessive Deficit Regulations, based upon its own reconsideration of the budgetary review process and its accumulated experience. The Commission may well also have pragmatically realized that the Ecofin Council, and key Member States, were simply unwilling to apply the strict current rules. Certainly some of the Communication's proposals reflect the Commission's acceptance of several of the requests for policy changes made by France, Germany and Italy, notably an acceptance of the desirability of favorably considering the impact of structural reforms that promote growth.

Beginning in September 2004, the Ecofin Council, under its then President Gerrit Zalm, the Finance Minister of the Nether-

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271. Id. at 4, pt. 2(ii).

272. Id.

273. Id. at 5-6, pt. 2(iii).
lands, commenced debate on possible amendments to the EDR, but without any initial accord.274 Not surprisingly, France, Germany and Italy called for radical revisions in the substantive and procedural rules.275 Thus, in January 2005, Chancellor Schroeder contributed an unusual Op-Ed article to the Financial Times, contending that States should be permitted to exceed the 3% GDP deficit ceiling in order to pursue “a sound policy for growth and employment,” in times of economic stagnation (even when the stagnation does not constitute a “severe economic downturn”), or when burdened by expensive structural reforms, such as the labor market and tax reforms comprised within his government’s “Agenda 2010” program.276 Chancellor Schroder also contended that “intervention by European institutions in the budgetary sovereignty of national parliaments [should be] permitted only under very limited conditions” and warned against “imposing mandatory requirements and sanctions too mechanically.”277 However, Austria, Denmark, Finland and the Netherlands were reluctant to weaken the EDP standards,278 while ECB President Trichet was openly critical of any proposals to do so.279

274. See George Parker, Ministers Agree on Stability Pact Reform—But Not on the Extent, Fin. Times (U.K.), Sept. 11, 2004, at 7; George Parker, Ministers Reject Move to Loosen Budget Deficit Rules, Fin. Times (U.K.), Nov. 17, 2004, at 10. Note that the Dutch Finance Minister Zalm had been deeply involved in the drafting of the initial MSR and EDR during the Dutch presidency in early 1997, and was not favorably inclined to any significant revision.


277. Schroder, supra note 276.


After difficult debates, the Ecofin Council reached a consensus agreement upon a crucial report on March 20, 2005, "Improving the implementation of the Stability and Growth Pact," which provided the basis for the drafting of the amendments to the MSR and EDR. By a fortuitous coincidence, Prime Minister Juncker of Luxembourg, who also serves as Luxembourg's Finance Minister, was both the current President of the Ecofin Council and the President of the Eurogroup (as well as President of the European Council). His patient diplomacy was widely hailed as crucial in achieving the final compromises. France's Finance Minister Breton proclaimed the revision "a historic agreement," while Austrian Chancellor Schussel took comfort in the compromise as one that "prevented deficits of five or six or seven [percent of GDP] being considered tolerable." Not surprisingly, the ECB indicated its serious concern with the revisions, fearing they might undermine confidence in public finances.

When the March 20, 2005 European Council meeting endorsed the Ecofin Council's March 20 Report, the European Council specifically declared the Report to be a component of the policy statements and regulations comprising the SGP. This certainly greatly enhances its importance in indicating the policy views which underlie the later amended MSR and EDR. The European Council's conclusions also contained a declaration of policy that undoubtedly influenced the ultimate text of the amendments to the SGP regulations, reiterating that deficits should exceed the 3% of GDP ceiling only "exceptionally and temporarily," but then adding: "The Member States are expected to reduce any deficits during periods of growth, whilst some flexibility is allowed in times of economic difficulty. Moreover, the pact should help to boost growth and employment by


281. See Bertrand Benoit, Christopher Condon, & George Parker, Juncker Achieves 'Small Miracle' as Deal Is Written, Fin. Times (U.K.), Mar. 22, 2005, at 6; see also George Parker, Stability Pact Deal Set for DIY List of Excuses, Fin. Times (U.K.), Mar. 17, 2005, at 36 (describing Juncker's role in proposing an approach permitting greater flexibility in the evaluation process).


taking greater account of spending on research, development
and innovation."285

The Council’s March 2005 Report called for improvement
of the SGP rules, notably to enhance their “economic rationale”
in order to improve their credibility, to better accept the role
of national policy makers, to stress the need to improve budgetary
positions in periods of growth, to take better account of “periods
when economies are growing below trend,” and to better appraise
the impact of “debt and sustainability.”286 The Report re-
affirmed the key role of the SGP in securing low inflation, but
also cited the Lisbon strategy goals of “job creation, structural
reforms and social cohesion.”287

Because most of the key conclusions of the Council’s March
2005 Report provided the basis for the amended SGP regula-
tions, there is no need to review them here. However, the initial
section of the Report, which deals with improving governance, is
not specifically replicated in the revisions, but merits mention-
ing as an important policy supplement to the amended regula-
tions. The Report cited the Commission’s role in exercising its
right of initiative and responsibility for acting as “guardian of the
Treaty,” but then emphasized that the Commission and the
Member States must respect the Council’s ultimate “responsibil-
ity for the coordination of economic policies.”288 The Report
stressed the “commitment” of the States, the Commission and
the Council “to act in close and constructive cooperation in the
[surveillance process, including] full and timely communication
among [them].”289 Another important feature of the report
was the stress upon “improving peer support and applying peer
pressure,” to be achieved within the Eurogroup for States in the
Euro area.290 The Report also referred to the on-going effort to
improve the governance of the European statistics system, cru-
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B. The Amended Multilateral Surveillance Regulation

Because the purpose of this Article is to consider the shifting balance between stability and growth in the SGP, we will presently only note some of the important revisions to the regulations that highlight the reduced emphasis on fiscal stability and the enhanced willingness to endorse efforts to improve economic growth.

The amended MSR's most important structural revision to the initial MSR is the addition of a new section 1.A Medium-Term Budgetary Objectives.292 By virtue of a new Article 2a, “[e]ach Member State shall have a differentiated medium-term objective for its budgetary position” which shall be “country-specific.” The language reflects the policy shift that both the Commission and the Council had made when calling for more “country-specific” and “differentiated” evaluations in their prior reports. The approach responds to the desire of those Member States that wanted a better focus on individual national economic situations, but at the same time realizes the operational value of more than a short term appraisal. Note that it is the State which initially sets a specific three or four year medium-term period (e.g., 2005-09) and the desired budget objective at the end (e.g., a balanced budget, a surplus, or only a low deficit), which the Commission and Council subsequently evaluate.

In a noteworthy policy change, Article 2a permits a State’s medium-term objective to diverge from the fundamental policy goal of a budget “close to balance or in surplus position” in the initial MSR and the European Council’s Stability and Growth Pact Resolution, but with the caveat that there must be “a safety margin with respect to the 3% of GDP government deficit ratio.”

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Again, this reflects the Council’s new policy view expressed in its March Report. This provision would appear to permit a State to incur low deficits, for a year or even conceivably several years within its medium-term policy objective, provided that the Commission and the Council accept that there are justifiable economic grounds for this (for example, when a State undertakes structural reforms of its pension or health programs that require high short-term costs but anticipate major long-term savings). Overall, in view of the new policy approach in Article 2a, it is hard to disagree with Professor Jean-Victor Louis’ comment that “[t]he uniform obligation for all the Member States to adhere to the medium-term objective of ‘close in balance or in surplus’ . . . does not exist any more.”

Accepting in large measure the requests made by France, Germany and Italy for greater flexibility in examining each State’s budgetary position, the amended MSR gives greater leeway to the Council in its evaluation of each State’s medium-term budgetary objective and the State’s current budgetary “adjustment path” toward the objective—although it should not be forgotten that the Council evaluation must take the Commission’s assessment as the initial basis in its own evaluation.

This is spelled out in a new MSR Article 5(1). The text of Article 5(1) sets out three important shifts in policy. First, the evaluation of whether a State is appropriately following its “adjustment path towards the medium-term budgetary objective” should take an annual improvement in its budgetary position of 0.5% of GDP as the customary “benchmark” for justifiability.

Second, the Council is admonished to distinguish between “economic good times” when a State should make “a higher adjustment effort,” and “economic bad times” when the effort may be more limited. (There is no attempt to provide content to the

293. Louis, supra note 253, at 92.
294. As the Court’s Judgment made quite clear. See supra notes 242, 258 and accompanying text.
296. Whereas 6 in the Preamble to the amended MSR relates to this part of article
meaning of good versus bad times.) The Council is authorized to permit a State to undertake a temporary deviation from its medium-term objective, provided there exists "an appropriate safety margin" below the 3% GDP deficit reference level. Third, the Council is authorized to "take into account the implementation of major structural reforms which have direct long-term cost-saving effects, including by raising potential growth." A specific reference is then made to pension reforms that may require a mandatory fully funded plan as an example of such a major structural reform. This provision not only responds to the strongly-expressed desire of Chancellor Schroeder's government to give it credit for "Agenda 2010," its unpopular structural reform of unemployment benefits and taxation, but also implicitly recognizes that some States (notably Greece, Italy and several Central European States) need to undertake their own structural reforms, especially to revise and reform their traditional extremely costly state pension policies, and ought to be able to escape the strict rules of the Stability Pact while doing so. Note, however, that in order to enable the Council to make its evaluation of the justifiability of accepting the impact of major structural reforms, an amendment to Article 3(2)c requires any Member State implementing such structural reforms to provide a "detailed cost-benefit analysis" to the Commission.

Naturally, the new policy approach of Article 5(1), which applies to the evaluation of the Stability Programs of States within the Eurozone, is paralleled by a new Article 9(1) that applies to the States adopting Convergence Programs toward eventual membership in the Euro-zone.

Because the revisions to the MSR principally enable the Commission and the Council to consider more budgetary and economic data in the surveillance process, strictly a soft law process, the Amended MSR as such has not proved particularly controversial. The Commission itself considers the review of more

5(1), calling for a "more symmetrical approach to fiscal policy" (a phrase taken from the Council Report) by "enhanced budgetary discipline in economic good times" which would then help States "to deal with normal cyclical fluctuations."

297. Whereas 8 in the Preamble to the amended MSR supports this policy in article 5(1) by referring to "structural reforms that unequivocally improve the long term sustainability of public finances."

298. See Schroder, supra note 276.

299. The Council March 2005 Report contained a sub-section 3.4 on considering the cost of pension reforms. See E.U. BULL., supra note 280, pt. 3.4.
data to improve the "flexibility and economic rationale" of the SGP framework. Obviously, however, controversy commences when the evaluation of data in the MSR procedure leads to consequences in the excessive deficit procedure.

C. The Amended Excessive Deficit Regulation

A review of the text of the Amended EDR, as adopted on June 27, 2005, makes it clear that the policy views expressed both in the Commission's September 3, 2004 Communication on improving the SGP and the Council's March 2005 Report have been melded into the revised Regulation. The text certainly reflects a pragmatic rapprochement between the Commission, now led by President Barosso and economic affairs Commissioner Almunia, and the Ministers most active within the Ecofin Council on this project, led by Prime Minister Juncker of Luxembourg. Most of the commentary on the Amended EDR has been provided by economists and political scientists. Professor Jean-Victor Louis has provided the most valuable legal review to date of the Amended EDR and its impact.

Before examining the EDR's substantive provisions, certain key language in the recitals merit underlining. In the third "Whereas" recital, the Commission and the Council are committed to "close and constructive cooperation" in the execution of the procedures. The wording deliberately echoes language in the governance section of the Council's March 2005 Report, mentioned previously. It takes on particular significance given the European Council's endorsement of the Report as an inte-

302. The Journal of Common Market Studies devoted its November 2006 issue to the topic, "Economic Governance in EMU Revisited," consisting of nine articles by economists and political scientists. See 44 J. COMMON MKT. STUD. 669-864; see also Eichengreen, supra note 260; Maher, supra note 22; Schelkle, supra note 224.
303. See Louis, supra note 255; see also Doukas, supra note 226; René Smits, Some Reflections on Economic Policy, 34 LEG. ISSUES ECON. INTEGRATION 5 (2007).
The reference represents an admonition that the two institutions should avoid the sort of divisive political controversy that occurred in late 2003 and was such an unwelcome distraction during the final negotiations over the text of the draft Constitutional Treaty.

The third "Whereas" clause also marks the role of "peer support and peer pressure" to promote Member State compliance with Council recommendations. This reference echoes the emphasis on "peer support and peer pressure" not only in the Council Report, but also to some degree in the Commission 2004 Communication.\(^{305}\) It clearly represents a policy shift to more of a soft law approach to compliance, as opposed to a hard law use of sanctions, or threat of sanctions.

Professor Louis appraises "peer support and peer pressure" as now being "at the centre of the coordination process," apt to become the principal mode of enforcing the excessive deficit rules.\(^{306}\) Based upon interviews of a number of senior finance ministry officials, Professor Schelkle has observed that the Eurogroup ministers increasingly feel a definite sense of belonging to a club, with the "capacity to reinforce or undermine each other politically."\(^{307}\) In this context, finance ministers who have successfully dealt with the need to adopt unpopular policies, particularly in achieving Lisbon agenda or other structural reform programs, may be able to persuade colleagues in other States to exert a similar degree of political courage in confronting analogous issues. As for peer support, the European Council has recently endorsed the approach of a regular exchange of best practices and successful policies and programs intended to achieve the Lisbon agenda or other structural reforms.\(^{308}\) The Commission's recent annual report, "Public Finances in EMU — 2007," with the sub-title, "Ensuring the effectiveness of the preventive arm of the Stability and Growth Pact," observes that the revised SGP's preventive arm "focuses mainly on medium-term

\(^{304}\) See supra note 284 and accompanying text.

\(^{305}\) See supra note 290 and accompanying text.

\(^{306}\) Louis, supra note 255, at 101. However, Professor Louis expresses a concern that finance ministers will not always be capable of exerting peer pressure upon a colleague if they feel that their own States may have to confront similar economic issues in the future.

\(^{307}\) Schelkle, supra note 224, at 713.

\(^{308}\) E.U. BULL., no. 3, at 7-8, pt. 1.3 (2007).
planning, peer support and pressure and exchanges of best practices," but notes that these require "a strong political commitment."\textsuperscript{309} Over time, the reliance upon peer pressure and peer support rather than the threat of (probably unrealistic) sanctions may prove to be one of the most important operational improvements in the application of the amended rules, if indeed such "peer pressure and support" do prove effective in specific cases.

Undoubtedly the Amended EDR's most crucial substantive change is to provide far more leeway for a State to claim that a severe economic downturn justifies its breach of the 3% of GDP deficit ceiling set in EC Treaty Article 104. The initial EDR standard for a severe economic downturn, which generally required an annual fall of GDP by 2%, was deleted. (Apart from the ECB and the Bundesbank, few are apt to mourn the elimination of this rigid standard.) The new language of Article 2(2) enables the Commission and the Council to find that a severe economic downturn occurred whenever there exists "a negative growth rate" or even a drop in output "during a protracted period of very low growth relative to potential growth." This new standard for a severe economic downturn follows the approach set in the Council's Report.\textsuperscript{310} Presumably, if this standard had been in effect earlier, Germany's deficit of 4% of GDP in 2003 might have been excused because it suffered a 0.2% downturn in annual GDP, while France's 2003 deficit of 4% might have been excused because estimates at the time projected an anemic 0.1% growth in annual GDP. Given the size of the deficits, the Commission would probably still have evaluated both States as having an excessive deficit, but it is conceivable that the Council might have exercised its discretion in the application of Treaty Article 104(6) and never formally decided that an excessive deficit existed in either State.

Moreover, not only has the standard been appreciably softened, but the Commission's report evaluating a State's annual compliance with budgetary discipline must consider a number of listed factors, many of which might well exculpate a State


\textsuperscript{310} E.U. BULL., supra note 280, at Annex II, pt. 1.33.
from a Commission determination that it should be considered to have an excessive deficit. Among the most notable are “developments in the medium term economic position,” which can include “prevailing cyclical conditions” as well as “policies to foster research and development and innovation.” The reference to “prevailing cyclical conditions” is not surprising, because both the Commission in its September 2004 study and the Council’s March 2005 Report pointed toward acceptance of this exculpatory factor, but the specific acceptance of research and development expenses as a possible justification for higher deficits demonstrates that France, Germany and Italy prevailed in the debate on this issue despite strong opposition from other States. Likewise, “developments in the medium term budgetary position (in particular, fiscal consolidation efforts in ‘good times,’ debt sustainability, public investment and the overall quality of public finances)” are to be taken into consideration. (All were cited in the Commission Communication.) A specific paragraph 5 calls for the Commission and Council “to give due consideration to the implementation of pension reforms.” Indeed, the amended Article 2(3) even requires the Commission to consider whether a State is subject to the adverse impact of “high level financial contributions to fostering international solidarity and to achieving European policy goals.” This presumably is intended to cover a State’s extraordinary expenses in providing civil or military support for U.N., North Atlantic Treaty Organization or EU foreign policy or security actions, such as in the South Balkans or Afghanistan.

Naturally, the Council’s assessment of whether it considers


312. It is clear from the serious concern in general for the cost of coping with “aging populations,” in the Commission’s terminology, that the specific short-term adverse budgetary impact of pension reforms is bound to be a future factor of considerable importance in the evaluation of virtually all the Member States. As René Smits has well observed, “the prospect of a graying population will make it harder for governments to balance their books in the future with increased social security and pension spending, thus requiring even greater efforts at fiscal prudence now.” Smits, supra note 303, at 13.


314. Professor Louis interprets this rather cryptic phrase as intended to cover primarily “development cooperation and humanitarian aid,” as well as some military operations in that context, and observes that some Member States were opposed to any reference to German unification costs. See Louis, supra note 255, at 98.
that a State has an excessive deficit must also take account of all of these factors. Indeed, in view of the Court of Justice’s conclusion that the Council has a discretionary power to assess economic circumstances in a different manner than the Commission,\textsuperscript{315} it is conceivable that the Ecofin Council might be willing to accept that certain budgetary costs put forward by a State as incurred to achieve a structural reform are justifiable even though the Commission evaluation rejects them or gives them only minor weight.

It should immediately be stressed that the list of factors that should be appraised by the Commission and the Council in evaluating whether a State has incurred an excessive deficit, or is at serious risk of doing so, in no way represents an automatic exclusion of the budgetary expenditures related to any specific factor. As Professor Louis rightly emphasizes, “the relevant factors will be examined in the preparation of the report . . . [n]o expenses are excluded as such.”\textsuperscript{316} Either the Commission or the Council may take purported costs of structural reforms or other factors in the list into account in the evaluation process, but each institution has discretion in this decision, and may conclude that they do not justify a deficit.

With regard to the procedural stages set in the initial EDR, the Amended EDR’s principal impact is to extend the time period for each stage in the process. As we previously noted, even the Commission had accepted that the initial EDR’s deadlines needed to be lengthened to take into account the different economic circumstances of different States. Thus, in the first procedural stage, set out in EDR Article 3(3), a State which is the subject of an initial Council conclusion that an excessive deficit exists will have six months, rather than four months, to start taking effective corrective action.\textsuperscript{317} Moreover, the original EDR’s Article 3(4) required the affected State to correct the excessive deficit in the fiscal year immediately following the one with the excessive deficit, but the Council now has the discretion to postpone the time-frame for the correction by a further year (i.e., allowing two years for the period of correction) whenever “unexpected adverse economic events with major unfavorable conse-

\textsuperscript{315} See supra notes 241, 258 and accompanying text.
\textsuperscript{316} Louis, supra note 255, at 96-97.
\textsuperscript{317} For a review of all the lengthened time periods, see id. at 98-99.
quences for government finances” should occur.\textsuperscript{318}

Overall, the revisions move the EDR, and the entire excessive deficit procedure, away from the rigid rules of the initial EDR in the direction of a greater scope for economic evaluation, more respect for national idiosyncrasies, and greater flexibility in application, both by the Commission and the Council. Certainly some observers will applaud the softening of hard law aspects and praise the more flexible approach.\textsuperscript{319} Thus Jean Pisani-Ferry appraises the revised rules as placing the “emphasis on economic assessment,” and concludes that, based on the initial application of the rules up to May 2006, there is “no empirical basis for the claim that the Pact is dead.”\textsuperscript{320} In contrast, other commentators view the revisions as an abandoning, or at least a radical weakening of the dike against floods of red ink.\textsuperscript{321} Taking the latter view, the American economist Barry Eichengreen has remarked, “[i]n principle these reforms are a sensible step in the direction of greater flexibility. But in practice . . . [they] all but eliminate the possibility that the pact will be effectively enforced.”\textsuperscript{322}

It is certainly quite possible that application of the Amended EDR will reduce the number of occasions in which the Commission, and subsequently the Council, would evaluate a State as violating the Treaty prohibition of excessive deficits, and require corrective budgetary measures to reduce the deficit, particularly because a fairly long list of structural reforms and other exculpatory economic circumstances may be taken into account in the budgetary evaluation process. (Critics of this amendment to the EDR are prone to call it the “DIY” or Do-It-Yourself list, due to the option that each State has to cite and rely upon one or another item on the list.)\textsuperscript{323} In addition, the lengthened


\textsuperscript{319} Louis, supra note 255, at 104-05, notes the difference of views of initial commentators, and some of their reasoning. He also calls attention to the “optimistic official view of the Commission.” For a current thoughtful analysis generally approving the revisions, see Maher, supra note 22. For an appraisal suggesting that Article 104 sanctions should be eliminated and an exclusively soft law approach used, see Henrik Enderlein, Break It, Don’t Fix It, 42 J. COMMON MKT. STUD. 1039 (2004).

\textsuperscript{320} Pisani-Ferry, supra note 22, at 839.

\textsuperscript{321} See the sharply critical view of Buiter, supra note 259.

\textsuperscript{322} Eichengreen, supra note 260, at 438.

\textsuperscript{323} The DIY characterization originated at the time of the Ecofin Council debates.
timetable for corrective measures should also reduce considera-
ably the risk that any Commission pressure for rapid correction of
an excessive deficit will lead to another difficult debate within
the Ecofin Council in the future in the event that a State proves
unable for more or less plausible economic reasons to eliminate
an excessive deficit for an extended period of time.

Undeniably, the EDR sets lower standards and a longer pro-
cedural timetable, but they may well be seen as justifiable, repre-
senting a pragmatic realization that strict compliance rules are
apt to be seriously counterproductive when a State falls into a
recession or near-recession. Also, the revisions can be consid-
ered to be worthwhile if their application avoids another politi-
cal crisis such as the one that confronted the leaders of Europe
in November 2003, precisely when they were trying to construct
a new constitutional structure for the Union. The Amended
EDR certainly marks a shift in enforcement away from a sanction
regime to one relying heavily upon peer support and peer pres-
sure, but is this to be regarded as a radical watering down of
the SGP, or merely a realization that peer pressure is a more
pragmatic and effective manner of enforcement? As we previ-
ously noted, the Commission currently appraises peer pressure
and support as one of the key aspects of the preventative arm of
the SGP. However, there is good reason to feel that the
Amended EDR does have one definite deficiency, namely the
continued deliberate omission of any substantive obligation on
States whose total government debt exceeds 60% of GDP to take
on-going annual corrective measures to reduce the debt below

in March 2005 and has been used ever since by critics of the revised rules. See Parker, supra note 279; see also Doukas, supra note 226, at 311.

324. See Professor De Grauwe’s analysis of why the initial rules were counter-
productive and apt to intensify recessions in DE GRAUWE, supra note 3, at 238-99.

325. In November 2003, the Intergovernmental Conference preparing the text for
the draft Constitution was unable to reach agreement on several key issues, notably the
voting system for the Council, which were accordingly being held for resolution for the
December European Council meeting, where the debate on these issues in fact proved
both bitter and inconclusive. Further enforcement action in the excessive deficit proc-
dure against France and Germany, both deeply concerned by the unresolved Constitu-
tion issues, can certainly be considered to be an unwelcome distraction.

326. Both the Commission Communication, supra note 265, COM (2004) 581 Fi-
nal and the Council in its Report, discussed at supra note 290 and accompanying text,
relied heavily on this soft law mode of enforcement. Commentators are agreed that
peer support and peer pressure are crucial in the Amended EDR’s enforcement proce-
dure, whether or not they agree on its likelihood of success. See Louis, supra note 255, at
101, 105-06.
Overall, the Amended EDR unquestionably softens considerably the rigorous application of substantive standards and procedures set out in the initial 1997 EDR. Whether this represents a step forward or backward, and whether the potential benefits outweigh the risks, is, of course, a subject of a decided difference of opinion. The initial appraisal in this Article is that the revisions are on the whole decidedly beneficial, both improving the future application of the SGP rules and bringing about a better balance between fiscal stability and economic growth concerns. In any event, a more definitive appraisal of the merits and deficiencies of the revised rules should certainly examine the operational experience in 2005-07, which considerations of length do not permit in the present Article.

CONCLUSION

One of the goals of this Article was to support the thesis in Part I that the European Council, and hence the political leaders of the EU, did indeed intend the SGP to serve to achieve both stability and growth interests. Finance Ministers may often emphasize the stability aspect, as obviously the ECB and national central bankers would, but Presidents and Prime Ministers (not to mention Employment Ministers) are naturally more apt to see the attainment of both as valid concerns, and even stress economic growth and the promotion of employment at times. The description of events in 2002-04 in Part III describe the circumstances leading to the bitter conflict between the Commission on the one hand, supported by the Central Bank and some Member States, and France, Germany and Italy on the other, a conflict largely occasioned because the initial EDR set such a premium on stability and did not permit sufficient flexibility when the political leaders of the States concerned felt that they had to promote their economic growth and combat unemployment at a time of recession or anemic growth.

Conflicts between the Commission and the Council are always unfortunate in any field, but this is particularly true in that

327. Louis, supra note 255, at 93-94, observes that the size of the total government debt is a factor in the surveillance process, but the Amended EDR "failed to concretize [any] obligations" to reduce the debt, presumably due to the opposition of "a minority of influential Member States."
of economic coordination, given the impact of national economic conditions upon overall political views and indeed the opinions of the people at large concerning the role and value of the Community. Moreover, the timing was particularly unfortunate, because the 2003 conflict brought serious stress in relations among Member States precisely at the time that their political leaders had sharp differences of views on provisions in the draft Constitution, notably the system of voting in the Council. For this reason, this Article has stressed the importance of the reconciliation represented by the compromise between the Commission and the Council in the drafting of the text of the amended regulations and by the policy emphasis upon "close and constructive cooperation between the two institutions."

The analysis of the Court’s 2004 judgment in the proceeding between the Commission and the Council notes the beneficial doctrinal examination made by the Court of EC Treaty Article 104 and the SGP. This Article contends that the Council gained the most from the judgment, because the Court recognized the Council’s ultimate decision-making discretion in the various phases of the excessive deficit procedure. It is certainly true that the Council must commence its review of any State’s budgetary condition upon the basis of the Commission’s evaluations and recommendations, which gives the Commission a crucial role, particularly because of its greater capacity to provide expert appraisals. Ultimately, however, the Council has discretionary autonomy in its decisions, which may be founded on its own assessment of the economic facts as well as relevant political considerations. The analysis in Part IV also emphasizes that the Court’s judgment rests on its examination of the Treaty, and hence is constitutional in nature, in contrast to one based on the interpretation of the EDR, which is only secondary legislation. The Article also takes the view that this appraisal of the Council role is quite warranted, because the excessive deficit procedure falls within the economic coordination provisions of the Treaty, and hence is ultimately inter-governmental in character.

In Part V, the Article examines the revisions to the SGP regulations, together with policy features found in the March 2005 Council Report. Generally speaking, the initial analysis of the revisions is favorable. Expanding the types of data relevant to the budgetary process that States must provide, and the Commission and Council evaluate, in the soft law surveillance procedure
certainly does seem to be sensible and apt to improve the process. The amendments to the EDR are undoubtedly controversial, and some may prove in practice to be undesirable, but the Article’s initial appraisal is that they represent overall a beneficial increase in flexibility in the SGP rules and provide a basis for improved economic analysis. Even more important, some of the key revisions significantly shift the balance in the SGP rules to permit a greater recognition of the importance of economic growth and employment concerns, and reduce the prior one-sided pressure for fiscal stability above all, even in times of recession or anemic growth. Only over time as the revised rules are tested in periods of anemic growth or recession will it be possible to reach a more definitive appraisal, but at this point the Article’s conclusion is that the revised SGP rules do properly put growth back into the SGP and provide for a much better balance between fiscal stability and economic growth concerns.