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## OPINION OF THE LEGAL SERVICE<sup>1</sup>

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Subject: Communication from the Commission to the European Parliament, the Council, the European Central Bank, the Economic and Social Committee, the Committee of the Regions and the European Investment Bank making the best use of the flexibility within the existing rules of the Stability and Growth Pact  
- Legal remarks

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### I. INTRODUCTION

1. The chair of the EFC has requested the views of the Council Legal Service on some legal aspects of the Communication from the Commission on making the best use of the flexibility within the Stability and Growth Pact (hereinafter, the Communication)<sup>2</sup>.

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<sup>1</sup> This document contains legal advice protected under Article 4(2) of Regulation (EC) No 1049/2001 of the European Parliament and of the Council of 30 May 2001 regarding public access to European Parliament, Council and Commission documents, and not released by the Council of the European Union to the public. The Council reserves all its rights in law as regards any unauthorised publication.

<sup>2</sup> COM(2015) 12 final/2 - doc. 5375/1/15 REV 1.

2. The present opinion aims at explaining the legal framework and at providing some general interpretative criteria for the application of some elements of flexibility in the Stability and Growth Pact (S&GP), it being understood that it is not for the Council Legal Service to assess the legality of instruments, such as the Communication, that express the interpretation of the Commission on the law of the Union and that, as such, are not draft measures called to become Council acts. It is recalled in this connection that the Council would be ultimately competent to apply the vast majority of flexibility elements to which the Communication refers, both in the preventive and in the corrective arm of the S&GP. This opinion does not prejudice any possible examination by the Council Legal Service of the legality of the particular application by the Council of the said elements of flexibility. It is also underlined that it belongs to the Court of Justice of the EU to interpret, in last instance, the law of the Union.
3. This opinion shall concentrate on a number of sections of the Communication that have deserved special consideration in past discussions of the Council (Ecofin) and of the EFC and the EWG. It will in particular deal with the following two issues,
  - a) Public investments (either at the level of the European Fund for Strategic Investments - EFSI - or in general); and
  - b) Structural reforms (both under the preventive and corrective arms of the S&GP).

## II. FACTUAL AND LEGAL BACKGROUND

### 1) Preventive arm of the S&GP

4. Article 5(1) of Regulation (EC) No 1466/97<sup>3</sup> (also known as the "flexibility clause") reads as follows, "*When defining the adjustment path to the medium-term budgetary objective for Member States that have not yet reached this objective, and in allowing a temporary deviation from this objective for Member States that have already reached it, provided that an appropriate safety margin with respect to the deficit reference value is preserved and that the budgetary position is expected to return to the medium-term budgetary objective within the programme period, the Council and the Commission shall take into account the implementation of major structural reforms which have direct long-term positive budgetary effects, including by raising potential sustainable growth, and therefore a verifiable impact on the long-term sustainability of public finances* » (emphasis added).
5. The Specifications on the implementation of the Stability and Growth Pact (also known as the Code of Conduct), further qualify the flexibility clause of Regulation 1466/97. However, neither Regulation 1466/97 nor the Code of Conduct lay down a definition of the concept of "major structural reforms". The Code of Conduct provides some examples of said reforms by stating that they include "*(...) reforms with direct long-term cost-saving effects and reforms raising potential growth. For instance, major health, pension and labour market reforms will be considered*"<sup>4</sup>. The Code of Conduct further adds that « *only adopted reforms should be considered* » (emphasis added).
6. Pursuant to Article 2a of Regulation 1466/97 « *The medium-term budgetary objectives shall ensure the sustainability of public finances or a rapid progress towards such sustainability while allowing room for budgetary manoeuvre, considering in particular the need for public investment* ». Such a room of manoeuvre is however limited by the Code of Conduct to Member States with relatively low debt.

<sup>3</sup> OJ L 209, 2.8.1997, p. 1.

<sup>4</sup> See point 2 of the Code of Conduct, at page 5.

7. Finally, under Regulation 1466/97, the determination of the medium term objective as well as the assessment of the adjustment path towards it is founded on structural terms, hence examining whether the Member State concerned pursues an appropriate annual improvement of its cyclically-adjusted budget balance net of one-off and other temporary measures (Articles 2a, second subparagraph, 5(1), second subparagraph and 9(1), second subparagraph)<sup>5</sup>.

2) Corrective arm of the S&GP

8. Although Regulation (EC) No 1467/97<sup>6</sup> does not contain any specific reference to the manner how public investments or structural reform may influence the excessive deficit procedure, it grants the Commission and the Council a margin of discretion to take into account “relevant factors” in the implementation of that procedure:

- First, the Commission, when preparing a report under Article 126(3) TFEU, shall take into account all “*relevant factors*” in so far as they significantly affect the assessment of compliance with the deficit and debt criteria (Article 2(3) of Regulation 1467/97). The Code of Conduct further specifies that the Commission shall take due account of the relevant factors that, according to the Member State concerned, are relevant for assessing compliance with the deficit and debt criteria, including “*budgetary efforts towards (...) achieving Union policy goals*” (section B)1) of the Code of Conduct at page 10).
- Second, when opening an excessive deficit procedure, the Commission and the Council, shall make a balanced overall assessment of all the “*relevant factors*”, specifically, the extent to which they affect the assessment of compliance with the deficit and/or the debt criteria as aggravating or mitigating factors (Article 2(4) of Regulation 1467/97).
- Third, once an excessive deficit procedure is open, the Council shall take into account in all the subsequent steps any “*relevant factors*” as they affect the situation of the Member State concerned (Articles 2(6), 3(5) and 5(2) Regulation 1467/97).

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<sup>5</sup> See, likewise the “fiscal compact” rule under Article 3(1) of the Treaty on Stability, Coordination and Convergence.

<sup>6</sup> OJ L 209, 2.8.1997, p. 6.

- Finally, the Council shall require that the excessive deficit is corrected in the year following its identification “*unless there are special circumstances*” (Article 3(4) Regulation 1467/97).

### III. LEGAL ANALYSIS

9. It is necessary to make a number of preliminary remarks concerning the role of the Code of Conduct as the commonly agreed interpretation of the S&GP.
  - A. Preliminary remarks
    10. Both the so-called multilateral surveillance procedure and the excessive deficit procedure are further specified by means of secondary legislation (notably and respectively, through Regulations 1466/97 and 1467/97). Both Regulations contain a large number of undetermined legal concepts for which application and interpretation the Council and the Commission hold a large margin of discretion.
    11. As a matter of practice, though, the interpretation of some key elements of the S&GP has been reflected in the Code of Conduct. The Code of Conduct is an atypical act of the Union that reflects the common understanding of all the Member States on the scope, content, objectives and application of some of the provisions of Regulations 1466/97 and 1467/97. It is prepared by the EFC and, typically, endorsed by the Council (Ecofin) by means of conclusions adopted by consensus of all the 28 members of the Council. Because the Code of Conduct is elaborated by the EFC, the Commission and the ECB, as members of that Committee, are strongly associated to its preparation.
    12. The Council Legal Service recalls that, although it is the Commission’s right to establish its own understanding on the law of the Union through instruments such as communications, the Code of Conduct remains the fundamental tool of interpretation of the S&GP of which Member States dispose, as the subjects and the addressees of the economic coordination laid down in the Treaties (see Articles 5(1), 119 and 121 TFEU).

13. Special regard should be had to the fact that, even if the Council holds the capacity to adopt, not to adopt or to amend the S&GP recommendations and proposals put forward by the Commission - that are most likely to reflect the latter's interpretation on flexibility as contained in the Communication -, a number of measures have been agreed during the last years to the effect of reinforcing the Commission's power of initiative in this particular field, thus making it more difficult to the Council to oppose or to modify the Commission's recommendations and proposals. This is notably the case of the "comply or explain" rule (laid down in Articles 2ab(2) of Regulation 1466/97 and 2a(1) of Regulation 1467/97)<sup>7</sup> and, more importantly, of the reverse qualified majority for the adoption of decisions in the excessive deficit procedure, laid down in Article 7 of the Treaty on Stability, Coordination and Governance<sup>8</sup>.
14. Under this institutional set-up, that privileges the Commission's power of initiative, the latter's interpretation on the S&GP enjoys a high likelihood of becoming the final decision of the Council. This fact underpins further the need to safeguard the central role of the Code of Conduct, or of any other tool of interpretation commonly agreed by Member States, as the instrument par excellence where the interpretation of the key elements of the S&GP (including the flexibility clauses examined in this opinion) should be codified.

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<sup>7</sup> According to which the Council is expected to, as a rule, follow the recommendations and proposals of the Commission or explain its position publicly.

<sup>8</sup> According to which "(...) the Contracting Parties whose currency is the euro commit to supporting the proposals or recommendations submitted by the European Commission where it considers that a Member State of the European Union whose currency is the euro is in breach of the deficit criterion in the framework of the excessive deficit procedure. This obligation shall not apply where it is established among the Contracting Parties whose currency is the euro that a qualified majority of them (...) is opposed to the decision proposed or recommended"

**B. On public investments**

*i) Contributions from Member States to the EFSI*

15. First, as stated in the Communication (on page 7), contributions of Member States to the EFSI can be legitimately labelled as one-off or temporary measures that have no impact in the determination of the MTO or in the assessment of the adjustment path towards it, as referred to above in paragraph 7.
16. Second, as stated by the Communication (also on page 7), the Commission enjoys a wide margin of discretion to consider contributions to the EFSI as “*relevant factors*” for the purposes of elaborating the report that precedes the opening of an excessive deficit procedure (see above paragraph 8). Actually, as referred to previously (paragraph 8), budgetary efforts towards achieving Union policy goals (such as contributions to the EFSI) are qualified by the Code of Conduct as a relevant factor. The Code of Conduct specifies that such relevant factor be invoked by the Member State concerned.

*ii) Public investments in general*

17. The Communication considers that “*some investments equivalent to major structural reforms*” may qualify for the application of the “flexibility clause” under Article 5(1) of Regulation 1466/97 (quoted at paragraph 4 above), hence justifying a temporary deviation from the MTO of the concerned Member State or from the adjustment path towards it. The Communication sets out the conditions under which the deviation may be subject to Article 5(1) of Regulation 1466/97 in a manner that largely follows the letter and spirit of that provision.
18. However the question whether public investments can be equated to major structural reforms, and then be subject to the flexibility clause, deserves special consideration. The Communication lays down that national expenditure on projects co-funded by the EU under the Structural and Cohesion Policy, Trans-European Networks and Connecting Europe Facility (TEN/CEF), and to national co-financing of investment projects within the EFSI, is eligible for the flexibility clause.

19. The Council Legal Service has already considered in an opinion of 19 April 2013 the application of the flexibility clause to public investment and, in particular, whether the type of eligible expenditure identified by the Communication falls within the scope of application of that provision<sup>9</sup>. In that opinion the Council Legal Service made clear a number of criteria that remain of relevance (see points 12 to 19 thereof):

- First, under Regulation 1466/97 "major structural reforms" and "public investment" are used as two different concepts in different contexts – see, in this sense, the distinct use of both terms in Articles 2a and 5(1) of Regulation 1466/97, referred to above in paragraphs 4 and 6.
- Second, conceptually, public investments cannot be assimilated "tout court" as structural reforms, unless it is duly shown that they are instrumental to the achievement and implementation of the said reforms.
- Third, it cannot be excluded that some of the expenditure associated to Cohesion and Structural Funds, TEN/CEF policies and EFSI is instrumental to a calendar of structural reforms that are at the core of the economic policy of the Union. Any such expenditure would hence qualify for the application of the flexibility clause (as long as, of course, the conditions laid down by Article 5(1) were to concur).
- Fourth, in spite of the above, investments eligible for the flexibility clause referred to by the Communication (Cohesion and Structural Funds, TEN/CEF and EFSI associated national expenditure) correspond to a very large number of priorities and of projects of a very heterogeneous nature. It is therefore not legally feasible to establish ex ante on the basis of rough presumptions, as the Communication does, that all co-financing expenditure by Member States in those projects amounts to structural reforms and that such expenditure then qualifies for the application of Article 5(1) of Regulation 1466/97. A case-by-case examination, where consideration is given to whether the priority or project in question aims at, or is ancillary to, the implementation of structural reforms, should be made in order for the flexibility clause to be applied.

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<sup>9</sup> See Council doc. 8706/13.



**C. On structural reforms**

20. The Communication clarifies the treatment of major structural reforms under the preventive and corrective arms of the Pact.
- i) Preventive arm of the S&GP*
21. A question deserves special consideration in this context, namely what has to be the particular status of the major structural reforms in order to qualify for the application of the flexibility clause: in order to take them into account, i) does it suffice that structural reforms are planned, announced or proposed? or, ii) is it necessary that they are formally adopted through national laws and regulations? or, iii) that they are effectively executed in a manner such that they bring about the budgetary effects sought?
22. The Communication is rather ambiguous in its formulation. Whilst, on the one hand, it recalls that reforms should be "fully implemented", it recognises that "the effective implementation of adopted reforms may take time and may be subject to delays and setbacks", whilst stating that the criteria related to the implementation of reforms is fulfilled when "*the Member State presents a medium-term structural reform plan (...)*" (see page 10 and 11 of the Communication).
23. Article 5(1) Regulation 1466/97 refers to the "*implementation*" of major structural reforms; the Code of Conduct further clarifies that "*only adopted reforms should be considered*" for the application of that provision (see above, paragraph 5). In view of the Council Legal Service, both Regulation 1466/97 and the interpretation reflected in the Code of Conduct presuppose a form of implementation of the major structural reforms in question, in order for the flexibility clause to be applied. This would require their adoption by the national authorities through provisions of binding force, whether legislative or not, in accordance with the applicable domestic laws and procedures. A plan announcing upcoming reforms, as a simple manifestation of political intentions or of wishes, would therefore not fulfil the requirements for the application of Article 5(1) of Regulation 1466/97, as interpreted by the Code of Conduct.

However, nothing in the letter of Article 5(1) of Regulation 1466/97 or of the Code of Conduct would require to wait up to the effective execution of the reforms, i.e. the actual verification that they deploy the positive budgetary effects sought, for the flexibility clause to be applied.

ii) Corrective arm of the S&GP

24. For the sake of consistency between the two arms of the S&GP, the same reasoning should be applied when it comes to considering major structural reforms under the corrective arm of the S&GP, in spite of the fact that nothing is established in this particular respect in Regulation 1467/96 or in the Code of Conduct.

25. As put forward by the Communication, the Commission and the Council may take into account major structural reforms throughout the different stages of the excessive deficit procedure as "*other relevant factors*" (report of the Commission under Article 126(3) TFEU, decision of the Council to open the excessive deficit procedure, deadline for the correction to take place: see, in this sense, paragraph 8 above and page 13 of the Communication). The said major structural reforms would qualify as "other relevant factors" as long as they were adopted by the national authorities through provisions of binding force, whether legislative or not, in accordance with the applicable domestic laws and procedures.

**IV. CONCLUSION**

26. The Code of Conduct remains the fundamental tool of interpretation of the S&GP of which Member States dispose, as the subjects and the addressees of the economic coordination laid down in the Treaties. The new institutional set-up of the S&GP, that privileges the Commission's power of initiative and restricts the margin of discretion of the Council, underpins the need to safeguard the central role of the Code of Conduct, or of any other tool of interpretation commonly agreed by Member States, as the instrument where the interpretation of the key elements of the S&GP (including the flexibility elements examined in this opinion) should be codified.

27. Contributions of Member States to the EFSI can be legitimately labelled as one-off or temporary measures that have no impact in the determination of the MTO or in the assessment of the adjustment path towards it. Moreover, the Commission enjoys of a wide margin of discretion to consider contributions to the EFSI as “*relevant factors*” for the purposes of elaborating the report that precedes the opening of an excessive deficit procedure.
28. Public investments cannot be assimilated to "major structural reforms" - that fall within the scope of application of the flexibility clause -, unless it is duly shown that the said investments aim at, or are instrumental to, the achievement and implementation of the said reforms. A case-by-case examination of the particular priority or project under the Cohesion and Structural Funds, TEN/CEF policies and EFSI, where consideration is given to whether a particular project aims at, or is ancillary to, the implementation of structural reforms, should be made in order for the flexibility clause to be applied to national expenditure associated to those EU funds.
29. Regulation 1466/97 as interpreted by the Code of Conduct presupposes that major structural reforms are adopted by the national authorities through provisions of binding force, whether legislative or not, in accordance with the applicable domestic laws and procedures, in order for the flexibility clause to be applied to those reforms, as well as for them to be taken into account in the application of the excessive deficit procedure.

