

Economic governance in Europe

Presentation before the Winter 2012 meeting of the International Monetary Law Committee of the International Law Association (MOCOMILA), Saudi Arabia Monetary Agency, Riyadh, Saudi Arabia, Saturday 7 January 2012

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Fiscal discipline

- Necessary: unbalance and market confidence
- Long-term prospects: graying population
- But: all 17 (27) contracting means recession
- Wolfgang Munchau (FT): euro zone leaders have small economy mindset whilst, collectively, EU is largest economy in the world

EDP map of EU

Blue: excessive deficit (> 3% GDP)
Black: high excessive deficit (> 6% GDP)
Green: surplus or low deficit (< 3% GDP)

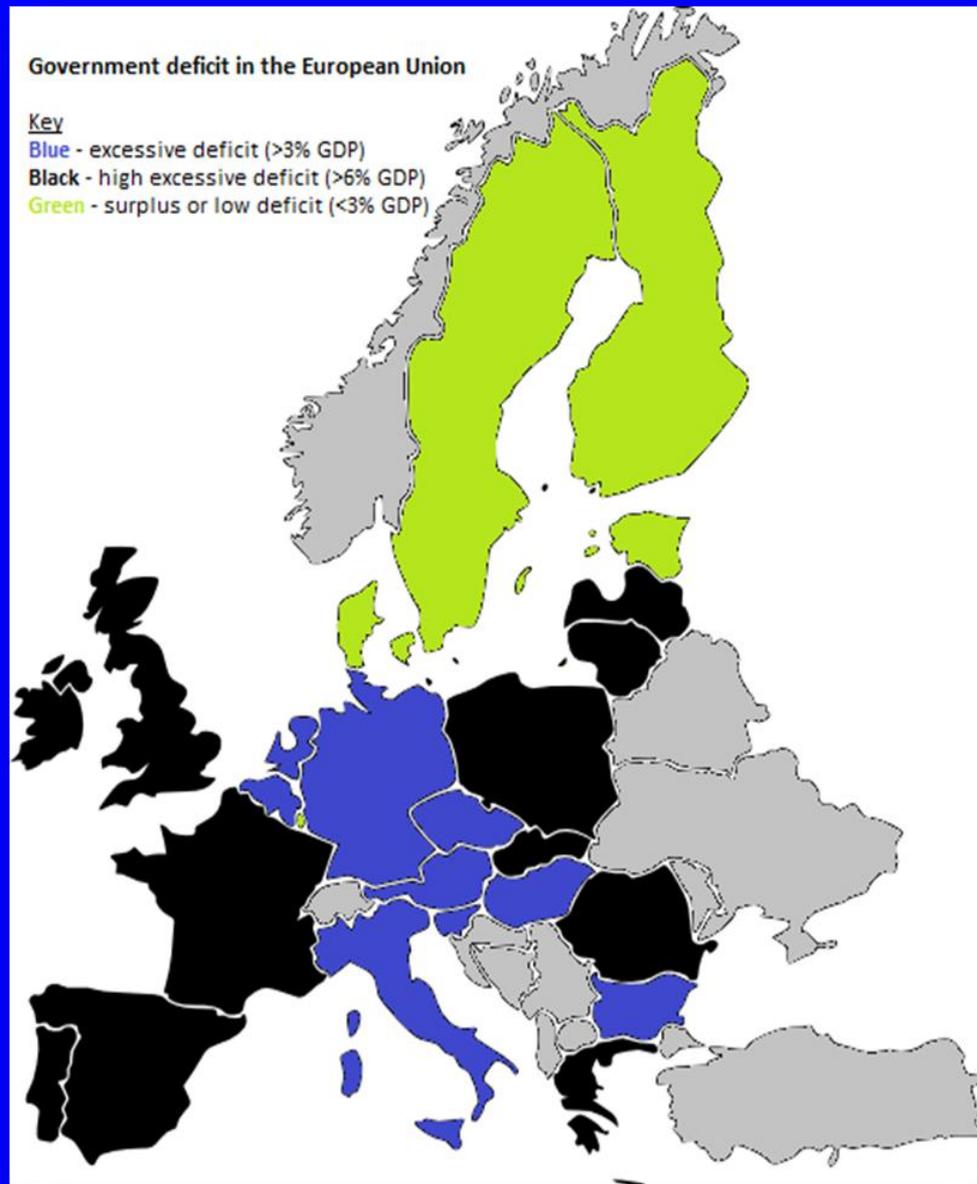
Sources:

Eurostat, Euroindicators news release, 21 October 2011

and

European Commission Economic and Financial Affairs website

http://epp.eurostat.ec.europa.eu/cache/TY_PUBLIC/2-21102011-AP/EN/2-21102011-AP-EN.PDF



‘E’ in the current Treaty - 1

Article 119 (1) TFEU:

“(...) the activities of the Member States and the Union shall include, as provided in the Treaties, the adoption of an economic policy which is based on the close coordination of Member States’ economic policies, on the internal market and on the definition of common objectives, and conducted in accordance with the principle of an open market economy with free competition.”

Article 119 (3):

“These activities of the Member States and the Union shall entail compliance with the following guiding principles: stable prices, sound public finances and monetary conditions and a sustainable balance of payments. ”

‘E’ in the current Treaty - 2

Article 120 TFEU

Member States shall conduct their economic policies with a view to contributing to the achievement of the objectives of the Union, as defined in Article 3 of the Treaty on European Union, and in the context of the broad guidelines referred to in Article 121(2). The Member States and the Union shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 119 ”

Coordination / economic policy

- Multilateral surveillance procedure
 - Broad Economic Policy Guidelines (BEPGs)
(Art. 121 TFEU)
// Employment Guidelines (Art. 148 TFEU)
- Excessive deficit procedure
(Art. 126 TFEU)
- Specific coordination among € area States
(Art. 136 TFEU - new since 'Lisbon')
- Own economic policy measures of the EU
and EU financial assistance to MS
(basis for strategic reserves of oil and gas)
(Art. 122 TFEU)

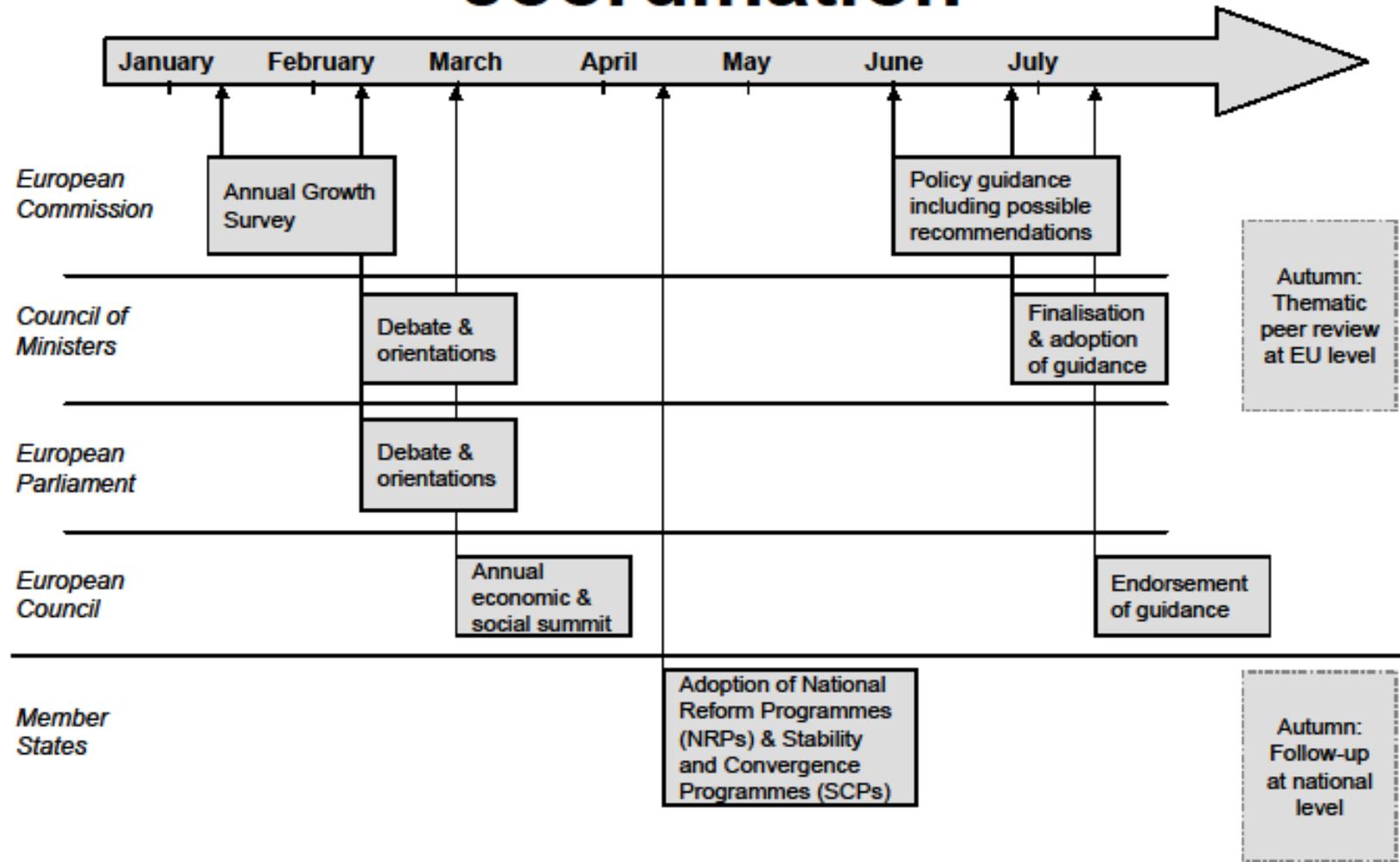
Stability and Growth Pact

- Amsterdam European Council, 1997
- Narrowing down options under Art. 99 + 104 EC [121 + 126 TFEU]
- Medium-term budgetary objective (MTBO) of positions close to balance or in surplus
- European Council Resolution (not binding)
- Regulation 1466/97: ‘preventive arm’
 - amended by Regulation 1055/2005stability and convergence programmes
- Regulation 1467/97: ‘corrective arm’
 - amended by Regulation 1056/2005definitions, speeding up procedure, abeyance, sanctions

‘Six-pack’: background

- Acknowledgment of failure to recognize imbalances beyond budgetary realm
- Too limited application of EDP/SGP
 - focus on deficit, not on debt reference value
- Sanctions not applied thus far
- ‘Deauville’ overturned by EP (supported by ECB): from Council control to reverse QMV – Commission recommendations are deemed adopted unless Council rejects them within 10 days by QMV

European semester of policy coordination



‘Six-pack’ and more: overview

Adopted:

- Directive ex 126 (4) TFEU requirements for MS budgetary frameworks
- Regulation ex 121 (6) TFEU prevention and correction of macro-economic imbalances
- Regulation ex 136 / 121 (6) TFEU on enforcement measures to correct macro-economic imbalances in euro area
- Regulation amending Reg. 1467/97 (corrective arm of SGP)
- Regulation amending Reg. 1466/67 (preventive arm of SGP)
- Regulation effective enforcement of budgetary surveillance in euro area

Newly proposed:

- Regulation on monitoring and assessing draft budgets and ensuring correction of excessive deficits
- Regulation on strengthening of economic and budgetary surveillance of States in difficulties

Regulation on prevention and correction of macro-economic imbalances - 1

Preamble

- An alert mechanism for early detection of emerging macro-economic imbalances
- Scoreboard with limited set of economic, financial and structural indicators with indicative thresholds
- Economic judgment rather than immediate conclusions (no ‘mechanical reading of the scoreboard indicators’)
- Persistent large current-account deficits *and accumulation of large current-account surpluses* (Germany!) targeted – different wording (recital 17)

Regulation on prevention and correction of macro-economic imbalances - 2

- ‘Imbalance’: trend giving rise to macro-economic developments (potentially) adversely affecting proper functioning of MS economy, of EMU, or of EU as a whole
- ‘Excessive imbalance’: severe imbalances, including those that (potentially) jeopardise proper functioning of EMU
- Commission: public scoreboard with indicators
- Internal & external imbalances
- Choice of indicators and thresholds to be conducive towards promoting competitiveness
- ESRB’s work input for scoreboard

Scoreboard

- o current account balance
- o net international investment position
- o export market shares
- o nominal unit labour costs
- o real effective exchange rates
- o the evolution of unemployment
- o private sector debt
- o private sector credit flow
- o house prices
- o the general government sector debt

Regulation on prevention and correction of macro-economic imbalances - 3

- Commission: in-depth review of each MS with imbalance – to be made public
- Council recommendations ex Article 121 (2) possible
- Council recommendation declaring existence of an EI and recommending corrective action
- MS to submit corrective action plan
 - sufficient? > Council endorsement
 - insufficient? > Council recommendation for new corrective action plan (< 2 months)
- Commission monitors implementation

Regulation on prevention and correction of macro-economic imbalances - 4

- Council to assess corrective action taken in accordance with its recommendation
- If MS has not taken recommended corrective action, Council – on Commission *recommendation* – adopts *decision* declaring non-compliance and *recommendation* setting new deadlines
 - deemed adopted unless rejected by QMV within 10 days of adoption of Commission recommendation
- MS concerned does not vote in Council

Regulation on enforcement measures to correct macro-economic imbalances in euro area - 1

Preamble

- Stronger Commission role in surveillance
- Guiding principles: stable prices, sound and sustainable public finances and monetary conditions and a sustainable balance of payments (cf. Art. 119 TFEU – no ‘sustainable’)
- Achieving and maintaining dynamic single market element of proper and smooth functioning of EMU

Regulation on enforcement measures to correct macro-economic imbalances in euro area - 2

- Applicable to euro area MS only
- Sanctions: interest-bearing deposit, yearly fine
- 0.1 of Member State's GDP in preceding year
- Commission – on grounds of exceptional economic circumstances [same definition as in EDP (Article 126 TFEU and Reg. 1467/97)] or following timely (10 days after non-compliance!) request by MS – may '*propose*' ['recommend'?] to reduce or cancel deposit or fine

Regulation on enforcement measures to correct macro-economic imbalances in euro area - 3

- Adoption: Commission *recommendation* > Council *decision* – deemed adopted unless rejected by QMV within 10 days of adoption of Commission recommendation
- Timeline: Commission recommendation within 20 days after conditions for imposition of interest-bearing deposit or yearly fine are met
- Only euro area MS vote
- Relevant MS does not vote

Regulation on enforcement measures to correct macro-economic imbalances in euro area - 4

- Interest-bearing deposit: Council concludes that MS has not taken recommended corrective action following a recommendation
- Yearly fine:
 - two successive Council recommendations in same EIP where Council considers MS has submitted insufficient corrective action plan
 - two successive Council recommendations in same EIP where Council declares non-compliance
(interest-bearing deposit converted into yearly fine)

Regulation amending Reg. 1466/97 (preventive arm of SGP) - 1

New elements:

- Revenue windfalls to go to debt reduction
- Government expenditure growth \leq medium-term rate of potential GDP growth
- Emphasis on debt reduction: $> 0.5\%$ GDP annually
- Statistics authorities' independence

Regulation amending Reg. 1466/97 (preventive arm of SGP) - 2

Articles 3-6: euro area MS // Articles 7-10: non-euro area MS

- Stability programme based on most likely macro-fiscal scenario or a more prudent scenario
- MS with debt $> 60\%$ GDP “or with pronounced risks of overall debt sustainability”: **annual improvement $> 0.5\%$ GDP**
- MS that have not yet reached their MTBO: “discretionary reductions of government revenue are matched by either expenditure reductions or by discretionary increases in other government items or both”
- Unusual event outside control MS and severe economic downturn for euro area or EU temporary departure from adjustment path towards MTBO allowed provided medium-term fiscal sustainability is not endangered

Regulation amending Reg. 1466/97 (preventive arm of SGP) - 3

Articles 3-6: euro area MS // Articles 7-10: non-euro area MS

- Significant observed deviation from adjustment path towards MTBO: Council shall address warning ex Art. 121(4) [‘may’ says the provision itself] – within 1 month Council shall adopt recommendation ex 121(4) with deadline of ≤ 5 months (3 months if Commission’s early warning considered situation particularly serious and warranting early action) for addressing deviation
- No action by MS? Commission to recommend immediately Council decision that no effective action has been taken – if Council fails to act, second such recommendation within 1 month for a Council decision which is deemed adopted unless reversed by QMV - only euro area MS vote if euro area MS is concerned – State concerned has no vote [not foreseen in Article 121 TFEU!]

Regulation amending Reg. 1466/97 (preventive arm of SGP) - 4

- Commission missions institutionalised
- Principle of statistical independence
- Professional independence of statistical authorities, minimally:
 - transparent recruitment and dismissal solely based on professional criteria
 - annual or multi-annual budget allocations
 - publication date key statistics designated significantly in advance

Regulation amending Reg. 1467/97 (corrective arm of SGP) - 1

Preamble

- “Experience gained and mistakes made during the first decade of functioning of [EMU]”
(as in preamble to regulation amending Reg. 1467)
- Non-compliance with numerical benchmark for debt reduction insufficient for establishment of excessive deficit – Art. 126(3) factors to be taken into account (investment expenditure and other factors)
- Stepping up application of financial sanctions “so that they constitute a real incentive for compliance”

Regulation amending Reg. 1467/97 (corrective arm of SGP) - 2

- Definitions of “exceptional” and “temporary” excess over 3% reference value - Art 126(2) terms
- Definition of “sufficiently diminishing and approaching” 60% reference value - Art. 126(2) term: differential to 60% decreased over 3 years (or 2 years + forecast) on average by 1/20 per year
- Commission to take many factors into account, including “financial contributions to fostering international solidarity and to achieving the Union policy goals”, debt incurred in euro area bail-outs or in financial stabilisation in crises

Regulation amending Reg. 1467/97 (corrective arm of SGP) - 3

- Fine:
 - fixed component 0.2% of GDP
 - variable component 1/10 difference between actual deficit and reference value (3%) or, when debt criterion is included, general government balance that should have been achieved
 - upper limit of fine: 0.5% of GDP

Regulation effective enforcement of EDP/SGP in euro area - 1

Preamble

- Stronger role for Commission
- Fine to be imposed for misrepresentation of government deficit and debt data
- Delegated powers for Commission for investigation of statistics

Corrective arm:

- Interest-bearing deposit for MS even with deficit below 3% reference value if insufficient progress towards MTBO

Preventive arm:

- Non-interest bearing deposit for MS in excessive deficit

Regulation effective enforcement of EDP/SGP in euro area - 2

- Interest-bearing deposit of 0.2% of GDP of preceding year imposed quasi-automatically when Council adopts recommendation to address observed deviation from adjustment path towards MTBO
(Art. 6 (2), 2nd subparagraph, Reg. 1466/97)
- Commission recommendation within 20 days, Council decision deemed adopted unless rejection by QMV within 10 days

Regulation effective enforcement of EDP/SGP in euro area - 3

- Non-interest-bearing deposit of 0.2% of GDP of preceding year if Council decides an excessive deficit exists and either interest-bearing deposit already lodged or particularly serious non-compliance identified
- Commission recommendation within 20 days, Council decision deemed adopted unless rejection by QMV within 10 days

Regulation effective enforcement of EDP/SGP in euro area - 4

- Fine of 0.2% of GDP of preceding year if Council decides that MS has not taken effective action to correct excessive deficit (Art. 126 (8))
- Commission recommendation within 20 days, Council decision deemed adopted unless rejected by QMV within 10 days
- Note that fine is imposed before ‘notice’ (Art. 126 (9)) - Treaty system reversed for € area MS !
Is this legally possible? Art. 136 gives *carte blanche*.

Regulation effective enforcement of EDP/SGP in euro area - 5

- Effective, dissuasive and proportionate fine $\leq 0.2\%$ GDP may be imposed on MS “that intentionally or by serious negligence, misrepresents [relevant] deficit and debt data”
 - Investigations by Commission: requests for information, on-site inspections, access to all government entities (including social security)
 - If required by MS law, judicial authorisation of on-site inspections
 - MS to be heard – rights of defense of MS to be fully respected
 - Commission to adopt delegated acts: fining guidelines, procedures for investigation
 - Unlimited jurisdiction of the ECJ
- PM All fines under this regulation “are of an administrative nature”

Directive on requirements for budgetary frameworks of Member States - 1

- Against “biased and unrealistic macro-economic and budgetary forecasts”: transparency extending to methodologies, assumptions and relevant parameters
- Explanation required of significant differences between ‘chosen macro-fiscal scenario’ and Commission forecast
- Monitoring by independent body with functional autonomy vis-à-vis fiscal authority
- Regional and local governments / funds to be included, and contingent liabilities: government guarantees (EFSF!)
- as well as government participation in corporations

Directive on requirements for budgetary frameworks of Member States - 2

- National budgetary frameworks for compliance with TFEU requirement on ED – in place by end-2013
- Commission to make public its own methodology, assumptions and relevant parameters for macro-economic and budgetary forecasts
- State-specific numerical fiscal rules must be in place promoting over the years compliance with the Treaty's reference values on deficit and debt
- Credible, effective medium-term budgetary framework – multi-annual fiscal planning perspective
- New governments may update medium-term budgetary framework to reflect new policy priorities

Economic dialogue

- Economic dialogue between EP and Council, Commission, European Council, Eurogroup
- Member State concerned may be invited before European Parliament (!)

Allocation of fines

- Interest received on deposits and fines constitute ‘other revenue’ and to be assigned to EFSF
– or to another stability mechanism to provide financial assistance “created by Member States whose currency is the euro” (ESM)
- Previously: interest and fines were supposed to be distributed among participating Member States without excessive deficit in proportion to their share in total GNP of eligible Member States

Critical assessment

- Same old mechanisms, strengthened but...
- Will peer group pressure work?
- Will sanctions be effective or counterproductive?
- No joint economic policy making (Article 122 (1) TFEU)
- Economic stabilisers (EU partially funding national unemployment schemes) / joint issuance of bonds with varying interest rate levels
- Labour market does not work in States / across EU
- Euro's cultural dimension: language, common bond

Own perspective

- Joint issue of eurobonds with strengthened incentives for budgetary convergence (variable interest rate reflecting budgetary balance)
- Joint supervision (and resolution) of EU financial institutions; proposed Treaty changes at ECB seminar: http://www.ecb.europa.eu/events/conferences/shared/pdf/reg_fs/session1_topic1_smits.pdf
- Stimulate economy, target crises (solar energy), give hope to austerity-stricken people, “a common economic policy” is more than threats to impose sanctions
- Take away voting rights rather than impose fines

Leadership crisis in Europe

De leiderschapscrisis in Europa

René Smits

maandag 12 december 2011, 10:48



René Smits

De bijeenkomst van de Europese Raad op 8 en 9 december 2011 laat zien hoezeer in Europa sprake is van een leiderschapscrisis **The European Council meeting of 8 and 9 December 2011 reveals the extent to which Europe suffers from a leadership crisis.**

Open Letter to Herman Van Rompuy

Open letter to Herman Van Rompuy

Dear Mr. Van Rompuy,

Happy New Year

I wish you, wholeheartedly, happiness and success in the New Year. After an exhausting 18 months in which, despite your tireless efforts, European leaders failed to solve the crisis that began as a localized fire in Greece and now seems to affect the entire Eurozone, I think you, as [President of the European Council](#), deserve a quieter year. I suspect you will not have one.

Treaty change desires

You will receive advice from many sources. Nevertheless, I venture to contribute as well. I am fully aware of the fact that I am not in the midst of the political arena and hence able to submit proposals that are 'politically unrealistic'. Yet, you know that results which were completely out of sight before the crisis broke out, have in the meantime become reality. I point at the [strengthened economic governance](#) to be applied as of 2012.

Firmer budgetary surveillance

On fiscal discipline, the Heads of Government may have done enough by now. Some further strengthening of supervision may still be called for, such as a stronger role for the Commission in assessing whether national budgets adequately take into account the Community environment. In plain language: whether national Ministers of Finance are sufficiently aware of the fact that we share a common currency when they draw up frameworks for government spending.

Issuing Eurobonds

A new treaty, whichever form it will take, should enable the joint issuance, in due course, of government bonds. This is the vexed issue of Eurobonds. You are familiar with the [various proposals](#), including [one that I co-authored](#). The European Commission's consultation on "[Stability Bonds](#)" is still ongoing. Joint borrowing by European governments puts the volatility of the markets out of the way. At the same time, Eurobonds can strengthen the signals that currently only come from the financial markets, if the funds jointly borrowed from the markets are transmitted to the individual Member States at interest rates that increase in line with these States' lack of fiscal discipline.

Effective uniform supervision of European financial sector

Precisely on the issue on which the others fell out with the United Kingdom during the latest European summit, the Eurozone should take a step forward. After all, the crisis results from a combination of government indebtedness and instable financial institutions. Uniform effective supervision of banks and other financial institutions operating at the level of the Union is needed. Similarly, we require a

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European mechanism to take insolvent financial institutions out of the market in an orderly fashion. After all, the State guarantees issued to quell the financial crisis seriously threatened public finances. And the national interests undermined the single financial market. A further step towards federal banking supervision and European resolution of insolvent financial institutions is required, instead of a step backwards. Speaking at the ECB in October, I submitted specific [proposals](#) for Treaty provisions.

Automatic stabilisers: a European fiscal policy

Ultimately, a vital monetary union is impossible without "a common economic policy". The Heads of Government acknowledged as much in their latest [conclusions](#). Such a policy requires more than just repression if budgets get out of hand or the economy gets out of sync. It is time for automatic stabilizers to start working at the European level. Economic growth in one region will then attenuate decline in another area of the Eurozone by means of automatic public spending. Probably, basic spending on State unemployment benefits can already be funded by the Union on the basis of the current [Treaty](#). The Treaty also gives the Union its own resources. These revenues should be increased with the proceeds of a financial transaction tax and higher VAT remittances.

Perspective

A long wish list, I admit. But without the prospect of a properly functioning EMU we cannot overcome the crisis. The Heads of Government should not only focus on Treaty change but also provide a perspective to the Union's citizens, notably those in Greece, Portugal and Ireland, by stimulating their economies. They could do this by dealing more creatively with the multiple crises we are faced with, including an energy and environment crisis. This includes European support for solar energy and expanding the interconnection between energy markets in Europe. As a poet, Mr. Van Rompuy, my request not to forget the cultural dimension of our (monetary) Union will appeal to you: leaders should show adherence to our common values and unity, instead of continuous bickering, and they should strengthen our ability to understand each other. Encouraging language skills and the development of European platforms of debate, rather than national ones, will both facilitate cross-border labour mobility and lead to shared feelings of participation in the joint European project.

I wish you much wisdom and success.

Kind regards,

René Smits

Professor of the Law of the Economic and Monetary Union, University of Amsterdam

31 December 2011

