10th EUROFRAME CONFERENCE

Towards a better governance in the EU

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Parallel session:

EU Governance

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Adoption of the Stability Treaty

The European Council meeting on December 9, 2011 discussed the incorporation of aspects of a reinforced SGP rules into the EU Treaties. Only the United Kingdom was openly opposed to the proposal, but this veto effectively blocked the incorporation of the reinforced SGP rules into the EU Treaties, as unanimous support from all Member States is required to bring about treaty change. This gave rise to the adoption on 2 March 2012, by 25 Member States (in addition to the UK, the Czech Republic opted out) of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (SCG)

The Treaty came into force on 1 January 2013 for the Countries having ratified it.

Main features of the Stability Treaty

- The budgetary position of a “contracting party” must respect a country-specific medium-term objective as defined in the SGP with a lower limit of a “structural deficit” of 0.5% of GDP but with the time-frame fixed with due account of country-specific sustainability risks.
- The lower limit for the structural deficit may be increased to 1% once the public debt is lower than 60% of GDP.
- The speed of reduction of the deficit is fixed at one twentieth of the gap between the actual deficit and the limit.
- In the case of failure on behalf of a contracting party to comply with the recommendation a procedure may be launched with the Court of Justice which can impose a sanction not exceeding 0.1% of the GDP of the country in excessive deficit.

What is really new in the SCP as compared to the SGP?

1. More precise definition of the « annual structural balance of general government » as « the annual cyclically–adjusted balance net of one-off and temporary measures »
2. Exceptional circumstances as « the case of an unusual event outside the control of the contracting party »
3. Recourse to the Court of Justice

Reason for the adoption of the SCG

- Judicial void due to the cancellation by the Court of the Council's decision of 23 Nov. 2003 to « hold in abeyance for the time being » the EDP against Germany and France launched in 2003.
- Consequently it proved in practice impossible to obtain a qualified majority in the Council for applying the sanctions foreseen in the SGP.

The judgment of the CoJ

- Only the Commission has the competence to make recommendations concerning the EDP
- The Council does not have competence to modify the recommendations without being prompted by the Commission
- However, the Council may not actually be in a position to achieve a qualified majority in support of any recommendation from the Commission in which case there may be a stalemate.

Why did the EU adopt the SGP in the first instance?

- The Protocol to the Maastricht Treaty, art. 1 stipulates that the « reference value for the launching of the excessive deficit procedure is 3% for the government budget deficit and 60% for the government debt.
- However, whereas the Maastricht Treaty does outline excessive-deficit procedures it does not envisage sanctions.
- Consequently, some Member States became worried about this relative lax approach and insisted on a more rigorous procedure and the possibility of adopting sanctions. These MS obtained adoption of the SGP and the objective of a medium-term government budget balance of « close to balance or in surplus »

Coordination or policy competition: Current crisis = an ancient dichotomy brought into the open

Should monetary union be accompanied by 'economic governance" (= Council competence in fiscal matters)?

- Yes: Werner Plan (1971), the Delors Report (1989)
- Consistence necessary but may be brought about by the market: Padoa-Schioppa Report, European Commission original EMU outline (no bail out, no monetary financing of budget deficits by the ECB enough)
- No: Many EU member states (subsidiarity principle), many academics (Vaubel, Minford)…… but also against EMU in general (preference for competition of systems)
- Measures may be needed to counter asymmetrical shocks (Padoa-Schioppa Report, Delors Report, many others)

The sustainability conditions

- A key objective of article 104 is to ensure a sustainable level of general government **debt** (limited at 60% of GDP).
- However, changes in the level of debt depend both on the deficit and the growth of nominal GDP.
- So it is essential also to look at the latter before assessing sustainablity

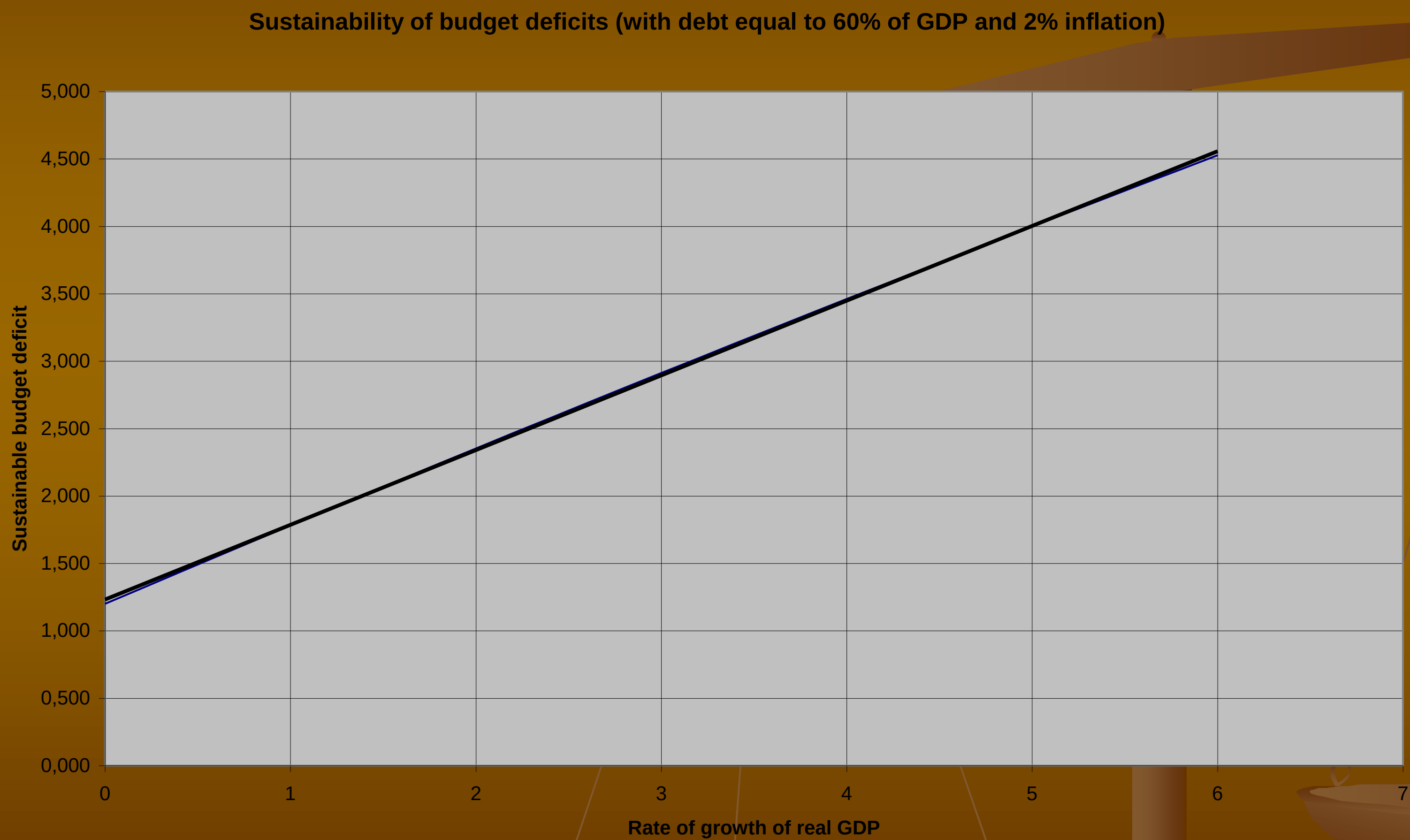
The elementary relation

$$d(t) = d(t-1)*(1/(1+g)(1+i)) + b(t)$$

By assuming a constant debt/GDP ratio d(t) must be equal to d(t-1) and the equation can be reduced to:

$$b(t) = d(t)*(1-(1/(1+g)*(1+i)))$$

The elementary relation



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The Maastricht Treaty and the « excessive deficit procedure »: The main EMU issues and the references

- « One market – one money » (Commission report)
- Can monetary integration be a « vehicle » for further economic and social integration (Jean Monnet)?
- Are budgetary and monetary policy independant instruments (OECD discussion)?
- Are financial and credit markets efficient and transparent?
- Can monetary integration function without social and economic integration?
- Can a monetary union function without full harmonisation of financial market regulation?

One Market, One Money (1992)

The overall results of the benefit-cost analysis of the Community facing the prospect of EMU may therefore be summarized as follows. Old economic theory guiding judgment on the formation of monetary unions might have suggested, for the Community, that the trade-off between the two arguments then considered relevant were of uncertain advantage. New economic theory and particular features of the Community's actual structure and situation add seven further arguments, all pointing to benefits for EMU in the Community. On these grounds the economic case becomes strongly advantageous. Political union objectives may further be added. But the case can stand powerfully on economic criteria alone.

Are market discipline and peer pressure sufficient?

- A fundamental problem of the Maastricht Treaty was its over-reliance on the assumption that market discipline and peer pressure would provide sufficient incentives for national policy-makers to conduct sound fiscal and economic policies. This did not prove to be the case.
- As Jacques de Larosière, the former IMF Managing Director, once remarked, what was supposed to be a system of 'peer pressure' too often turned into a system of 'peer concessions' or 'peer arrangements'. (quoted by Benoît Coeuré of the Banque de France)

Budgetary-monetary policy mix

- Already in the 1980s a long debate in the OECD concluded that monetary and budgetary policy could not be considered to be two independent policy instruments. Monetary policy could not be expected to be unaffected by budgetary policy and the latter would therefore be one of the basic drivers of monetary developments.

Are financial and credit markets efficient and transparent?

At some of our most sophisticated financial firms, risk management systems did not keep pace with the complexity of new financial products. The lack of transparency and standards in markets for securitized loans helped to weaken underwriting standards.

Market discipline broke down as investors relied excessively on credit rating agencies.

Compensation practices throughout the financial services industry rewarded short-term profits at the expense of lon-term value.

(Quoted from a US Treasury paper on Financial Reform)

Paul Pierson (Harvard, 1996)

Observers of the European Community have criticized "intergovernmentalist" accounts for exaggerating the extent of member-state control over European integration. This article grounds these criticisms in a historical institutionalist analysis, stressing the need to study European integration as a process that unfolds over time. Losses of control result not only from the autonomous actions of supranational organizations, but from member-state preoccupation with short-term concerns, the ubiquity of unintended consequences, and the instability of member-state policy preferences. Once gaps in control emerge, change-resistant decision rules and sunk costs associated with societal adaptations make it difficult for member states to reassert their authority. Brief examination of the evolution of EC social policy suggests the limitations of treating the EC as an instrument facilitating collective action among sovereign states. Rather, integration should be viewed as a path-dependent process producing a fragmented but discernible multi-tiered European polity.

Can a monetary union function without full harmonisation of financial market regulation?

- Integration of capital markets introduces a more complex and less well understood policy linkage than trade in goods and services.
- It is clear that integration on financial markets requires revision of the regulatory framework. Without such revision, captal flows will be motivated more by a search for loopholes than a search for real opportunities, and reduce welfare instead of increasing it.
- Poul Krugman: *Economic Integration: Some Conceptual Issues, Annex to the Padoa-Schioppa Report (1987)*

Oh, I forgot the Banking Union

The European Commission in September 2012 put forward a proposal for a “banking union” with the declared aim of placing the banking sector on “a more sound footing and restore confidence in the Euro as part of a longer term vision for economic and monetary integration”.

The two regulations proposed involve in particular the creation of a single supervisory mechanism for eurozone Member States and to be run by the European Central Bank.

The subsequent debate has, however, raised an issue as to whether the creation of such an additional mechanism would require changing the Treaty. The creation of the banking union was therefore still pending in April 2013

European Commission: *A Roadmap towards a Banking Union,* Communication from the Commission to the European Parliament and the Council, COM(2012)510 Final 12 September 2012.

Tentative conclusion

- The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union does not seem to offer a definitive solution to the problem of finding the appropriate budgetary-monetary policy mix in the EMU already well identified in the Delors report in 1989, regularly emphasised ever since and now seriously aggravated due to the Crisis.
- Furthermore, the implementation of this Treaty may under certain circumstances contribute to an increase in the uncertainties as regards the distribution of the competences between the European Parliament and national parliaments and between the former and the Commission and the Council.
- So the struggle is likely to go on and we cannot exclude the emergence of more conflicts and uncertainties.

Tentative conclusion (2)

- And let me add that the creation of the EMU is not in any way the cause of the current crisis.
- However, the existence of the EMU has created a need for specific responses, taking account of the existence of the EMU.
- Therefore the responses of non-EMU countries (notable the US and the UK) can and have in effect been different from those of the eurozone.

Taxonomy and vocabulary

And let me add also that one basic problem is that our categories, taxonomy and vocabulary are too rigid and poor to correctly grasp the economic, social and financial complexity of the world of the third millenium. This is true for scientific research but even more serious and misleading as regards economic « journalism ».

- I have told my story
- Thank you for your attention