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Enhanced economic governance in the EU: alternative to a political union?[1]

Abstract

In reaction to the sharp deterioration of fiscal positions and a sovereign debt crisis in the majority of EU member states, EU leaders have been strengthening the EU economic governance framework, in particular for the eurozone member states. This has been reflected mainly through a reinforcement of the Stability and Growth Pact (SGP) within the so-called six-pack and through the recent adoption of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG).

The objective of this paper is to present the main decisions taken to address intensifying problems in the EU and assess them from the point of view of stability of the eurozone. The paper argues that the recent adoption of the six-pack and of the TSCG has created a legal basis for more effective governance structure that is much stronger than previously, and closer fiscal coordination among EU member states in order to ensure public finance sustainability. The practical results will depend, however, on the political willingness of countries to accept the new rules and rigorous enforcement of those rules.

Most of the new solutions continue the previous approach: stricter preventive and punishing rules, and their more rigorous application. TSCG has adopted a new element: parallel to EU rules, there should be enhanced national rules (possibly in the form of constitutional commitments) and national institutions responsible for fiscal discipline. This approach implies that international rules are not strong enough for sovereign countries, which agree to be subject to democratically elected national authorities but do not want to follow decisions by "outside" institutions. In addition, reverse voting in the Council encourages for more pragmatic, economically justified use of the modified SGP. In view of a lack of political will to move forward into a political union, this seems the only realistic approach to ensure fiscal stabilization and keep the eurozone alive in the short and medium run.

Two main research methods have been applied:

(a) Statistical analysis of data on changes of the public finances in the EU member states (budgetary deficit and public debt),

(b) comparative analysis of successive EU documents on strengthening economic governance and identification of strong and weak aspects of the new documents from the point of view of stability of the eurozone.

The main conclusion is that in a situation of a lack of political will to move forward into a political union, the only realistic approach to ensure fiscal stabilization and keep the eurozone alive in the short and medium term seems to be to enforce rigorously the recently adopted new commitments aiming at better fiscal control of euro area members.

Keywords: economic governance, Economic and Monetary Union (EMU), Stability and Growth Pact (SGP), fiscal policy, six-pack, Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG)

Introductory remarks and research questions

The original rules of the Economic and Monetary Union (EMU), as specified in the Maastricht Treaty of 1992 and later elaborated in the Stability and Growth Pact (SGP) of 1997, were adopted under the assumption that governments would conduct responsible economic policies. Surveillance and the risk of fines were expected to be sufficient to force countries to ensure fiscal discipline. Practice has shown that such an idealized approach has not been working. The financial crisis that started in fall 2008, followed by a sovereign debt crisis and deep recession in many countries in subsequent years, has revealed major macroeconomic imbalances between the EU economies. Those huge imbalances have threatened the economic and financial stability of the EMU and the EU as a whole. In early 2010, when the risk of sovereign insolvency in several EU member states started to be perceived as serious, EU leaders decided to react. Under pressure from financial markets, and in order to avoid panic and a broader contagion effect, EU leaders first approved ad hoc rescue packages of a financial character to be offered to member states in trouble. It was soon obvious the ad hoc measures were insufficient as the crisis intensified, and more ambitious and substantial changes were necessary.

The recent experience of EMU has shown that a combination of a centralized monetary policy with decentralized responsibility for most economic policies, albeit subject to constraints as regards national budgetary policies, cannot ensure effective functioning of the EMU. The optimal solution from the theoretical point of view would be a political union with stricter fiscal discipline at the EU level and a significant transfer of spending and taxing powers to a central EU government and parliament. A higher level of EU involvement in national budgetary affairs is, however, unrealistic for the foreseeable future. Today, the EU budget represents about 1% of EU GDP and proposals to increase it by even 0.1 percentage point have consistently been attacked in recent years by several strong EU members.

With the lack of political will to make any step towards political union, the crises exposed the need for reinforced economic governance in the EMU [MEMO/10/455, 2010]. From today's perspective we can identify several stages of proposals and successive actions aimed at achieving this goal: from ad hoc financial bailout for indebted eurozone members, closer coordination of national economic policies via European Semesters, and undertaking additional policy commitments in the Euro Plus Pact, to implementing six legislative changes to strengthen the EU economic governance (commonly referred to as the six-pack) and the recent entering into force of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union – TSCG (the so-called fiscal compact)[2].

The objective of this paper is to present the main decisions taken to address intensifying problems in the EU and assess them from the point of view of the stability of the eurozone. The paper argues that the recent adoption of the six-pack and the TSCG has created a much stronger legal basis for more effective governance structure and closer fiscal coordination. The crucial element to reduce deficits and to restore confidence of financial markets, however, will be proper enforcement of the new laws, as provided for by the six-pack and the TSCG as well as by national laws of EU member states to be modified in line with the TSCG requirements. The paper begins with a presentation of basic statistics of EU member states on their net budgetary spending and debt positions. Thereafter, the main reasons of the fast worsening of the fiscal positions of EU members are discussed. This is followed by the presentation and critical assessment of successive actions undertaken at the EU level to address the crisis situation. Next, the prospect of other solutions to stabilize the eurozone is briefly examined.

Changes in fiscal situation of EU member states in 2008-2011

Since 2008, a substantial deterioration in a current fiscal positions and increases in government debt have been recorded in majority of EU member states (table 1).

In the EU-27, the government deficit-to-GDP ratio increased from –2.4% in 2008 to -6.5% in 2010 and decreased to -4.4% the following year. In 2008–2011, the analyzed indicator deteriorated in almost all member states. In 2011, the deficit ratios were higher than the reference threshold of -3% of GDP in 17 of the member states. The highest government deficits (as a percentage of GDP) in 2011 were recorded by Ireland (-13.4%), Greece (-9.4%), Spain (-9.4%), and the United Kingdom (-7.8%). A total of 25 member states reported their government deficit (in relation to GDP) reduced, or saw their government surplus expand in 2011 compared with 2010. Only three countries, Hungary, Estonia, and Sweden, registered a government surplus in 2011. There were seven member states, namely Bulgaria, Denmark, Germany, Luxembourg, Malta, Austria, and Finland, which recorded deficits in 2011 that were lower than the -3% threshold.

TABLE 1. Changes in government deficit and government debt situation of the EU member states in 2008-2011 (% of GDP)

Country	Government deficit/surplus (% of GDP)				General government gross debt (% of GDP)			
	2008	2009	2010	2011	2008	2009	2010	2011
EU 27	-2.4	-6.9	-6.5	-4.4	62.2	74.6	80.0	82.5
Belgium	-1.0	-5.5	-3.8	-3.7	89.2	95.7	95.5	97.8
Bulgaria	1.7	-4.3	-3.1	-2.0	13.7	14.6	16.2	16.3
Czech Rep.	-2.2	-5.8	-4.8	-3.3	28.7	34.2	37.8	40.8
Denmark	3.2	-2.7	-2.5	-1.8	33.4	40.6	42.9	46.6
Germany	-0.1	-3.1	-4.1	-0.8	66.8	74.5	82.5	80.5
Estonia	-2.9	-2.0	0.2	1.1	4.5	7.2	6.7	6.1
Ireland	-7.4	-13.9	-30.9	-13.4	44.5	64.9	92.2	106.4
Greece	-9.8	-15.6	-10.7	-9.4	112.9	129.7	148.3	170.6
Spain	-4.5	-11.2	-9.7	-9.4	40.2	53.9	61.5	69.3
France	-3.3	-7.5	-7.1	-5.2	68.2	79.2	82.3	86.0
Italy	-2.7	-5.4	-4.5	-3.9	106.1	116.4	119.2	120.7
Cyprus	0.9	-6.1	-5.3	-6.3	48.9	58.5	61.3	71.1
Lathvia	-4.2	-9.8	-8.1	-3.4	19.8	36.7	44.5	42.2
Lithuania	-3.3	-9.4	-7.2	-5.5	15.5	29.3	37.9	38.5
Luxembourg	3.2	-0.8	-0.8	-0.3	14.4	15.3	19.2	18.3
Hungary	-3.7	-4.6	-4.4	4.3	73.0	79.8	81.8	81.4
Malta	-4.6	-3.9	-3.6	-2.7	62.0	67.6	68.3	70.9
Netherlands	0.5	-5.6	-5.1	-4.5	58.5	60.8	63.1	65.5
Austria	-0.9	-4.1	-4.5	-2.5	63.8	69.2	72.0	72.4
Poland	-3.7	-7.4	-7.9	-5.0	47.1	50.9	54.8	56.4
Portugal	-3.6	-10.2	-9.8	-4.4	71.7	83.2	93.5	108.1
Romania	-5.7	-9.0	-6.8	-5.5	13.4	23.6	30.5	33.4
Slovenia	-1.9	-6.0	-5.7	-6.4	22.0	35.0	38.6	46.9
Slovakia	-2.1	-8.0	-7.7	-4.9	27.9	35.6	41.0	43.3
Finland	4.4	-2.5	-2.5	-0.6	33.9	43.5	48.6	49.0
Sweden	2.2	-0.7	0.3	0.4	38.8	42.6	39.5	38.4
United Kingdom	-5.1	-11.5	-10.2	-7.8	62.3	67.8	79.4	86.0

Source: http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_dd_edpt1&lang=en and http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&plugin=1&language=en&pcode=tsdde410

The situation with the public debt has also worsened. The government debt-to-GDP ratio in the EU-27 increased from 62.2% in 2008 to 80.0% in 2010 and 82.5% in 2011. Fourteen member states had a debt ratio above 60% of GDP in 2011. At the end of 2011, the lowest ratios of government debt-to-GDP were recorded in Estonia (6.1%), Bulgaria (16.3%), and Luxembourg (18.3%). In 2011, government debt-to-GDP ratios increased in 21 EU member states when compared with 2010, while the same indicator decreased in six member states: Germany, Estonia, Latvia, Luxembourg, Hungary, and Sweden.

TABLE 2. **Overview of ongoing excessive deficit procedures**

Country	Date of the Commission report (Art. 126.3)	Council Decision on existence of excessive deficit (Art. 126.6)	Current deadline for correction*
Denmark	12 May 2010	13 July 2010	2013
Cyprus	12 May 2010	13 July 2010	2012
Austria	7 October 2009	2 December 2009	2013
Belgium	7 October 2009	2 December 2009	2012
Czech Republic	7 October 2009	2 December 2009	2013
Italy	7 October 2009	2 December 2009	2012
The Netherlands	7 October 2009	2 December 2009	2013
Portugal	7 October 2009	2 December 2009	2014
Slovenia	7 October 2009	2 December 2009	2013
Slovakia	7 October 2009	2 December 2009	2013
Poland	13 May 2009	7 July 2009	2012
Romania	13 May 2009	7 July 2009	2012
Lithuania	13 May 2009	7 July 2009	2012
France	18 February 2009	27 April 2009	2013
Latvia	18 February 2009	7 July 2009	2012
Ireland	18 February 2009	27 April 2009	2015
Greece	18 February 2009	27 April 2009	2016
Spain	18 February 2009	27 April 2009	2014
UK	11 June 2008	8 July 2008	financial year 2014/15
Hungary	12 May 2004	5 July 2004	2012

* Deadlines for 2012 corrections have not been abrogated by the EU until the beginning of March 2013.

Source: http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/index_en.htm (March 2, 2013).

The highest increases of debt ratios from 2010 to 2011 were observed in Greece (22.3 percentage points), Portugal (14.6 points), Ireland (14.2 points), and Cyprus (9.8 points). Thus, contrary to the government deficit situation, which improved slightly in 2011 in most EU countries, public debt increased (relative to GDP) in a majority of EU member states. In 14 countries, the 60% ceiling of debt-to-GDP ratio has not been exceeded.

As a result of these developments, the majority of EU countries were put into the excessive deficit procedure (EDP) – see table 2. Twenty EU member states were subject to this procedure in 2012, and twelve countries in 2011.

Origins and causes of the deterioration of fiscal accounts of EU member states

A number of factors caused the unprecedented deterioration of fiscal accounts in most developed countries [Dąbrowski, 2012; Overbeek, 2012]. The following ones are usually mentioned:

1. The deep banking sector crisis in 2007-2008 resulted in large rescue programs and high costs for the national budgets of some countries (e.g. Ireland) to finance those rescue programs[3].
2. The recession of 2008-2009 induced some governments to introduce support programs resulting in increased expenditures from public budgets. Some countries have accumulated large current account deficits (table 1) and experienced losses in competitiveness as a result of irresponsible macroeconomic policies.
3. An important role in increasing deficits was due to poor enforcement of Maastricht rules (or rather the Stability and Growth Pact - SGP - rules) before the crisis[4]. According to SGP rules, after entering the eurozone, a member country should continue to observe both fiscal criteria (a budget criterion and a gross government debt criterion, which are assessed against the reference values of 3% and 60% of GDP respectively), subject to the Excessive Deficit Procedure (EDP) as established by Article 126 of the TFEU and further detailed in the SGP of 1997 in order to "maintain sound and sustainable public finances". However, the EDP procedure has never been used in practice despite the fact that fiscal rules were violated many times.
4. Since the launch of the EMU, it has been clear that the monetary union was suboptimal from the theoretical point of view and did not meet all criteria necessary to conduct single monetary policy addressing properly the needs of all parts (member states) of the single currency area. In particular, the conditions of flexibility of the labor market (via reduction of real salaries in case of worsened competitiveness or via increased outflow of unemployed workers) and use of fiscal transfers to address problems have not been met [Mundell, 1961, p. 509-517].

5. A related reason for the weakness of economic governance in the eurozone has been the lack of mechanisms for financial and anti-cyclical discipline. This weakness has been profoundly exposed during recent crises. The EU does not have any budget that would be able to absorb such shocks. The EU general budget is small, inflexible and serves mainly implementation of EU common policies, not addressing temporary shocks via fiscal transfers. The ad hoc support offered by European Financial Stability Facility (EFSF) to Greece, Ireland and Portugal was too weak at the time and too delayed in timing (see next chapter).
6. A one-sided framework of monetary policy in the eurozone is responsible for part of the crisis. Under the Treaty on the Functioning of the European Union (TFUE), monetary policy is conducted at the supranational EU level, while fiscal and structural policies have largely remained in the hands of the national governments. Monetary policy focused on price stability does not take into account other goals, among them economic growth. Any increase of interest rates by the EBC – justified to avoid higher inflation - is harmful for indebted countries, increasing the costs of servicing their debt. A price stability-oriented monetary policy alone is not sufficient for a proper functioning of the EMU and needs to be accompanied by sound policies in other domains, in particular by EU-wide fiscal policy. A majority of EU member states are, however, against such a policy. For this reason, the Treaty and the SGP stipulate that eurozone member states have the obligation to avoid excessive government deficits which, however, has not proved successful.

Concrete factors played different roles in successive stages of the crisis situation and not all problems had a fiscal origin (though they might end up as public debt). In the wake of the 2007-2009 crisis, two factors contributed to the dramatic deterioration of fiscal balances. These were the costs of financial sector rescue packages and of counter-cyclical fiscal policy, both largely underestimated by policymakers. The current round of the global financial crisis has fiscal origins and is related mostly to huge excessive public spending (public debt burden) that has been built up in the EU over recent years[5]. Some EU member states have accumulated large current account deficits and experienced losses in competitiveness and faced insolvency. Most economists agree that the present situation reflects the sovereign debt of many EU members but is not a euro crisis itself [Lane 2012, p. 49–68; Brender, Pisani, Gagna 2012].

Ad hoc support for indebted countries in EU: financial support

In view of increasing public debts and unrest on financial markets, EU leaders took a number of decisions to reduce fiscal imbalances and increase the confidence of investors.

a) Several ad hoc packages of financial support (bailouts) for the first “troublemakers” (starting with Greece) were adopted and implemented[6]. The first bailout package was accepted for Greece in May 2010 by EMU members and the IMF, conditional on the implementation of harsh austerity measures. The support for Greece was followed by a rescue package for Ireland in November 2010 and for Portugal in May 2011, plus a second package for Greece in July 2011.

b) With the development of financial tensions and a risk of the contagion effect from excessive debts of other countries, temporary financial backstop mechanisms were set up to guarantee the stability of the euro area as a whole and assist individual member states in financial difficulties and/or under serious market pressure**.** The European Financial Stability Facility (EFSF) and the European Financial Stabilization Mechanism (EFSM) were created by the euro area member states following the decisions taken on 9 May 2010. Both instruments provide financial assistance to EU member states in financial difficulties, albeit the role of EFSF is much greater, mainly because of the larger pool of money it oversees[7]. In reaction to the intensifying sovereign debt crisis, EU and euro area leaders decided to improve economic and budgetary surveillance and enforcement, and in October 2010 the decision was taken to create a permanent rescue mechanism, the European Stability Mechanism (ESM). The ESM has assumed the tasks currently fulfilled by the European Financial Stability Facility (EFSF) and the European Financial Stabilization Mechanism (EFSM).

Permanent stability mechanism – European Stability Mechanism (ESM)

The ESM was established as an intergovernmental organization under public international law. According to the treaty on ESM, the purpose of the mechanism is "to mobilize funding and provide stability support under strict conditionality, appropriate to the financial assistance instrument chosen, to the benefit of ESM Members which are experiencing, or are threatened by, severe financing problems, if indispensable to safeguard the financial stability of the euro area as a whole and of its member states" (art. 3)[8]. Thus, ESM member states can apply for an ESM bailout if they are in financial difficulty or their financial sector is in need of recapitalization. Although the treaty was signed by the 17 euro area countries, the ESM is also open to non-euro area EU countries for ad hoc participation in financial assistance operations, after meeting some criteria[9].

Initially, it was to become operational on 1 July 2013 but with the accelerated entry into force, the ESM has been operating since 8 October 2012 alongside the EFSF and EFSM, and later will supersede both mechanisms. All new programs, as a rule, are financed by the ESM. This mechanism will be globally the largest international financial institution with a strong capital base of €700 billion and lending capacity of €500 billion of which €80 billion will be paid in by early 2014[10].

The legal basis of the ESM has two different aspects. First, in order to create ESM, it was necessary to set up a legal basis of such an instrument in the TFEU. On 17 December 2010, the European Council agreed that the Treaty on the Functioning of the European Union (TFEU) should be amended in order to create a permanent mechanism - the European Stability Mechanism - to be established by the eurozone member states to safeguard the financial stability of the euro area as a whole. The amendment (in Article 136 of the Treaty) was adopted by the European Council on 25 March 2011[11], on the basis of a "simplified revision procedure." It was the first time this procedure was used. The amendment has to be ratified by EU member states. It is to enter into force in the middle of 2013 provided that the ratification process is completed[12].

Second, the ESM itself is legally based on a separate international agreement – the treaty establishing the ESM. The treaty was originally signed by finance ministers of the 17 euro area countries on 11 July 2011. However, a modified version of the treaty, incorporating amendments aimed at improving the effectiveness of the mechanism, was signed in Brussels on 2 February 2012. The ESM Treaty entered into force on 27 September 2012 and the European Stability Mechanism was inaugurated on 8 October 2012 following ratification by all 17 euro area member states. Its entry into force was conditioned upon depositing no less than 90% of the total subscriptions by signatories who ratified the treaty.

ESM seems to be a useful and promising solution. It should allow the eurozone to pool resources and to act quickly in a crisis situation. Financial support from this fund for countries in trouble can help introduce necessary adjustments. However, the practical importance of ESM and its role as a mechanism for providing stability support will depend first of all on concrete conditions that will be formulated for countries applying for this financial mechanism. The treaty on ESM elaborates on "stability support under strict conditionality" (art. 3 of the ESM Treaty). Moreover, the ESM can be helpful for a few countries but cannot solve the underlying problems in the whole euro area, where many governments are struggling to cut public debt during a deepening economic recession. It's just another big step to defy the euro area crisis, but the crisis is not over yet.

Economic surveillance: European Semesters

A new approach towards economic surveillance and a new policy-making timetable, based on the European Council conclusions of 17 June 2010, was introduced later in the year. EU leaders realized that financial support is important but not sufficient and macroeconomic ex ante policy adjustments were necessary to reduce public finances tensions and ensure long-term stability. As a result, the different strands of economic policy coordination have been integrated in a new surveillance cycle, the so-called European Semesters. The European Semester comprises a timetable that applies to all elements of surveillance, including fiscal, macroeconomic and structural policies. The timing of the various surveillance processes is aligned to ensure consistency, while they remain legally and procedurally separate. This new instrument has brought together the previous processes under the Stability and Growth Pact and the Broad Economic Guidelines, including the simultaneous submission of the Stability (or Convergence) Programes and the National Reform Programes[13]. The aim is to ensure that all policies are analyzed and assessed together and that policy areas which previously were not systematically covered by economic surveillance – such as macroeconomic imbalance and financial sector issues – are included. European Semesters have become an instrument for ex ante economic policy coordination since 1 January 2011. Since then, EU-level discussions on fiscal policy, macroeconomic imbalances, financial sector issues, and growth-enhancing structural reforms have been taking place jointly during the European Semester and before governments draw up their draft national budgets and submit them to national parliamentary debate in the second half of the year (the "national semesters") – see box 1. This "upstream" policy coordination should make the implementation of policy guidance more effective and help embed the EU dimension in national policy-making. Thus, the intention is to agree upon coordinated actions by EU members before national decisions are taken.

Box 1. Mechanism of European Semesters

The European Semester is held in the first half of the year and is followed by a national semester in the second half of the year. The annual cycle begins with the Commission's Annual Growth Survey, which gives broad guidance on priority actions to be taken at the EU and national level. Member states then submit Stability or Convergence Programes on their fiscal plans and National Reform Programes on structural reforms and measures to boost growth and jobs. The Commission assesses these reports based on an integrated analysis covering fiscal, macroeconomic, and structural policies and on that basis proposes concrete policy recommendations for each country. In June the European Council discusses the recommendations and the Council adopts them.

In autumn governments present their draft budgets to national parliaments for debate in line with established national practice.

Source: http://ec.europa.eu/europe2020/europe-2020-in-a-nutshell/priorities/economic-governance/index_en.htm

The Euro Plus Pact - setting of economic priorities

European Semesters have integrated the Euro Plus Pact[14] signed in March 2011 by 23 member states, including six outside the eurozone (Bulgaria, Denmark, Latvia, Lithuania, Poland, and Romania). The Euro Plus Pact is to give further impetus to the governance reforms. The pact commits signatories to even stronger economic coordination for competitiveness and convergence, as well as in areas of national competence, with concrete goals agreed on and reviewed on a yearly basis by heads of state or government [Conclusions of the heads of state…, 2011]. The Commission monitors implementation of the pact commitments. The Euro Plus Pact builds on the existing framework of economic priorities agreed at EU level under the Europe 2020 strategy for "smart, sustainable and inclusive" growth. The strategy sets targets in the fields of employment, innovation, climate/energy, education and social inclusion. The pact focuses primarily on areas that fall under national competence and are key to increasing competitiveness and avoiding harmful imbalances. In the chosen policy areas, common objectives are agreed upon at the head of state or government level. Participating member states pursue these objectives with their own policy mix, taking into account their specific challenges (see box 2).

Box 2. Ways of implementing the Euro Plus Pact

Each year, concrete national commitments are agreed upon by heads of state or government to be achieved within the next 12 months. The selection of the specific policy measures to be implemented remains the responsibility of each country, but the choice is guided by considering in particular the commonly agreed broad issues considered as crucial from the point of view of competitiveness and stability of the EU economy. Member states individually decide upon the measures to achieve agreed objectives (commitments). The adopted commitments are included in the yearly National Reform and Stability Programs; they are subject to regular monitoring and surveillance in the context of European Semesters. The monitoring is done by the Commission, by the Council and the Eurogroup.

Progress towards the common objectives has been politically monitored by the heads of state or government on the basis of a series of indicators covering competitiveness, employment, fiscal sustainability and financial stability. Countries facing major challenges in any of these areas are identified and have to commit to addressing these challenges in a given time frame.

Source: [Conclusions of the European Council, March 2011].

Apart from measures to foster competitiveness and employment and to enhance the sustainability of public finances, the pact provides for the possibility of tax policy coordination. The fiscal statements are the most controversial elements of the Euro Plus Pact. The document recognizes that "direct taxation remains a national competence"[15] but "Pragmatic coordination of tax policies is a necessary element of stronger economic policy coordination in the euro area to support fiscal consolidation and economic growth. In this context, member states commit to engage in structured discussions on tax policy issues, notably to ensure the exchange of best practices, avoidance of harmful practices and proposals to fight against fraud and tax evasion." In particular, "developing a common corporate tax base could be a revenue-neutral way forward to ensure consistency among national tax systems while respecting national tax strategies, and to contribute to fiscal sustainability and the competitiveness of European businesses". Some commentators consider these statements as an important step to reach closer real fiscal integration. Others are more cautious and see such a possibility only in the longer term, if at all.

Altogether, the pact is an instrument of coordination of national policies and not of their harmonization. Its commitments are of a political character and not legally binding. They are implemented mainly in the framework of European Semesters. In the medium and longer term their implications can be, however, far reaching. One cannot exclude that coordination will lead to much closer cooperation and harmonization in new areas. It may be that a formal, fully voluntary process will take place under peer pressure and will induce countries to adopt new commitments, e.g. in the fiscal area. Therefore, for the eurozone applicants, it seems better to be inside this process to monitor changes and gradually integrate closer with other eurozone members.

Surveillance of economic and fiscal policies: revised Stability and Growth Pact (six-pack)

A much stronger impetus to EU governance reforms was created by the modification of the Stability and Growth Pact (SGP) and adoption by the European Parliament and the Council of six legislative proposals put forward by the Commission in September 2010 (see box 3). The six-pack was adopted on 23 November 2011 and entered into force on 13 December 2011 with a new set of rules for economic and fiscal surveillance. They aim at strengthening the rules of the pact, first of all by adopting a quasi-automatic procedure for imposing penalties in case of breaches of either the deficit or the debt ceilings.

Box 3. Acts constituting the six-pack

Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the Euro Area

Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the Euro Area

Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies

Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances

Council Regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure

Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States

Source: Official Journal, L 306, Volume 54, 23 November 2011.

The legislative package has several main components which are presented below[16]:

a) Stronger preventive action. Member states are required to make significant progress towards country-specific, medium-term budgetary objectives (MTO) for their budgetary balances to ensure public finance sustainability. The new rules define a new "expenditure benchmark" to help assess progress towards these MTOs. This expenditure benchmark places a cap on the annual growth of public expenditure according to a medium-term rate of growth. For member states that have not yet reached their MTO, the rate of growth of expenditure should be below this reference rate in order to ensure adequate progress.
b) Stronger corrective action: The launch of an Excessive Deficit Procedure (EDP) can now result not only from government deficit developments (as it was in practice before) but also from breaching the government debt ceiling: In other words, the six-pack has put the debt criterion on an equal footing with the deficit criterion. Both criteria are now applicable and equal: an EDP can be launched if either criterion is breached. Member states with debt in excess of 60% of GDP should reduce their debt in line with a numerical benchmark[17]. Progressive financial sanctions kick in at an earlier stage of the EDP. A non-interest-bearing deposit of 0.2% of GDP may be requested from a euro area country that is placed in EDP on the basis of its deficit or its debt. Also, failure of a euro area country to comply with recommendations for corrective action will eventually result in imposing a fine (see table 3).
c) Minimum requirements for national budgetary frameworks: Member states should ensure that their fiscal frameworks are in line with minimum quality standards and cover all administrative levels. National fiscal planning should adopt a multi-annual perspective, so as to attain the medium-term budgetary objectives (among them, structural deficit not higher than 1% of GDP). Numerical fiscal rules should also promote compliance with the treaty reference values for deficit and debt.
d) Member states reducing macro-economic imbalances over the past decade have registered serious gaps in competitiveness and major macroeconomic imbalances. A new surveillance mechanism aims to identify, prevent and correct such divergences. It relies on an alert system that uses a scoreboard of indicators and in-depth country studies, strict rules in the form of a new Excessive Imbalance Procedure (EIP) and better enforcement in the form of financial sanctions for member states that do not follow up on recommendations.
e) Rigorous enforcement. A strengthened enforcement regime has been established for eurozone countries. It consists in form of "reverse qualified majority" voting. Under this voting system, a Commission recommendation or proposal to the Council is considered adopted unless a qualified majority of member states vote against it (in the Council). Sanctions can also be imposed for failing twice to submit a sufficient corrective action plan.

Table 3 summarizes the set of financial sanctions created by the six-pack which can be applied in the euro area to ensure fiscal surveillance for a member state in an excessive deficit procedure. They are provided for by one of the laws of the six-pack (Regulation 1174/2011).

TABLE 3. **The set of financial sanctions created by the six-pack (for the euro area)**

Type of activity	Legal reference	Sanction	Adoption
Preventive arm of the SGP			
Adjustment towards the MTO/expenditure rule not respected	Council decision establishing failure to take action in response to a Council recommendation under Art. 121(4).	Interest-bearing deposit 0.2% of GDP	Reverse Qualified Majority Voting
Corrective arm of the SGP			
Opening of the EDP (if serious non-compliance or interest-bearing deposit already lodged)	Council decision based on Art. 126(6) of the Treaty	Non-interest-bearing deposit 0.2% of GDP	Reverse Qualified Majority Voting
Failure to take effective action to correct the excessive deficit under Art. 126(7)	Council decision based on Art. 126(8) of the Treaty	Fine 0.2% of GDP	Reverse Qualified Majority Voting
Repeated failure to take effective action to correct the excessive deficit	Council decision based on Art. 126(11) of the Treaty	Fine 0.2% of GDP + variable component	Qualified Majority Voting

Source: Based on [MEMO/11/898, 2011] and [Gras (2012)].

The revised SGP represents the most comprehensive reinforcement of economic governance in the EU and the eurozone since the launch of the Economic Monetary Union 20 years ago. The new instrument providing for monitoring of public finance sustainability should improve the budgetary planning and outcomes of member states by ensuring that expenditure plans are adequately resourced by equivalent permanent revenues. It applies to all 27 members of the EU with some more demanding rules for eurozone member states, especially regarding financial sanctions. The strong elements include the following ones [ECB, Monthly Bulletin, 2012, p. 84–85]:

a) The six-pack covers not only fiscal surveillance, but also macroeconomic surveillance under the new macroeconomic Excessive Imbalance Procedure (EIP). The EIP adds a new element to overall policy coordination framework and increases the probability that member states conduct their economic policies with a view to avoiding excessive macroeconomic imbalances.

b) The six-pack reinforces both the preventive and the corrective arm of the Growth and Stability Pact, i.e. the EDP, which applies to member states that have breached either the deficit or the debt criterion.
c) The six-pack ensures stricter application of the fiscal rules by defining quantitatively what a "significant deviation" from the MTO or the adjustment path towards it means in the context of the preventive arm.
d) The "reverse qualified majority" voting procedure makes the enforcement of the rules stricter and more automatic, therefore more dissuasive and credible.

There are also weak points of six-pack [ECB, Monthly Bulletin, 2012, p. 82]:

– the large number of exceptional situations and factors that can be considered when deciding whether a deficit or debt-to-GDP ratio is excessive. This weakens the application of the rules.
– the enhanced fiscal framework still lacks sufficient automaticity in case of non-compliance with the rules.
– the effectiveness of the reinforced fiscal framework still depends heavily on a strict and rigorous application of the rules by the Commission. For example, the Commission plays a decisive role in the assessment of the existence of an excessive deficit or of whether member states have taken effective action to correct an excessive deficit.
– the reinforced fiscal governance framework is more complex, which may reduce its transparency as well as enforceability and, in turn, complicate accountability. In particular, the assessment of member states' progress towards their respective MTOs requires a more complex analysis.
– finally, the agreed benchmarks for national budgetary frameworks are insufficient.

The strengthening of the national fiscal frameworks will largely depend on the countries' political will to implement sound fiscal rules.

Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG)

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union – TSCG (the fiscal part of the TSCG is referred to as a "fiscal compact" but sometimes the whole treaty is referred to as a "fiscal compact") was signed on 2 March 2012 by all member states of the EU except the UK and the Czech Republic. The main goal of the fiscal compact is to foster fiscal discipline, notably in the euro area, building on and enhancing the reinforced SGP. Apart from the fiscal compact, the treaty includes a fostering of economic policy coordination and convergence as well as measures related to euro area governance (for a summary of the main elements see table 4). As two member states were not willing to adopt the TSCG, the new rules took the form of an intergovernmental agreement among contracting parties[18].

The treaty entered into force on 1 January 2013: it required at least 12 contracting parties whose currency is the euro to have deposited their instrument of ratification[19]. The treaty is open to accession by member states of the European Union other than the contracting parties. The intention is to incorporate the substance of the TSCG into the EU treaties within five years following its entry into force[20].

The fiscal compact contains two main modules[21]: one relates to a balanced budget rule including an automatic correction mechanism, and the second one involves strengthening the excessive deficit procedure.

The fiscal part of the TSCG requires contracting parties to respect/ensure convergence towards the country-specific medium-term objective (MTO), as defined in the revised SGP, with a lower limit of a structural deficit (cyclical effects and one-off measures are not taken into account) of 0.5% of GDP. When such criteria are met, the budgetary position of the general government of a contracting party is considered to be balanced or in surplus. The contracting parties "shall ensure rapid convergence" towards their respective medium-term objective.

A higher structural deficit of at most 1% is only allowed if the government debt-to-GDP ratio is significantly below 60% and risks to long-term fiscal sustainability are low. The balanced budget rule must include a correction mechanism, which is automatically triggered in the event of significant observed deviations from the MTO or from the adjustment path towards it. Escape clauses for exceptional circumstances are provided for. Compliance with the rule should be monitored by independent institutions. These budget rules shall be implemented into the national laws through provisions of "binding force and permanent character, preferably constitutional" (Art. 3(2).

The European Court of Justice (CJ) may impose financial sanctions (0.1% of GDP) if a country does not properly implement the new budget rules in national law and/or fails to comply with a CJ ruling that requires it to do so (thus, a fine can be imposed by CJ in two situations). In the case of euro area member states, sanctions would be channeled to the ESM, in the case of "non-euro area member states", the money would be attributed to the EU budget.

Other issues covered by the TSCG relate to the economic governance in the euro area, e. g. euro summits that are to take place at least twice a year. The comparison of the TSCG with the SGP is presented in table 4.

The reforms provided for by both sets of laws (six-pack and TSCG) should result in a substantial reinforcement of the mutual surveillance framework of EU member states. Some solutions are stricter under the TSCG, e.g. an automatic correction mechanism, lower structural deficit ceiling, risk of the Court of Justices fines. Both legal acts are focused on the prevention and the correction of macroeconomic imbalances. Thus countries should pay more attention to the sound situation in their public finances. But for countries which are already indebted or close to that – and this is the situation of many EU countries – reduction of high deficits and debts can be a big challenge. It's not only

TABLE 4. Comparison of the preventive arm of the reinforced Stability and Growth Pact with the balanced budget rule of the fiscal compact of TSCG

	Reinforced Stability and Growth Pact (preventive arm)	Fiscal compact (balanced budget rule)
Legal basis	Secondary EU law	Primary law (intergovernmental and national level).
Budgetary objective	Country-specific MTO: maximum structural deficit of 1% of GDP for euro area countries.	Balanced or in surplus. Country-specific MTO: maximal structural deficit of 0.5% of GDP (or at most 1% if debt-to-GDP ratio is below 60% and long-term risks to fiscal sustainability are low).
Escape clauses	Severe economic downturn in Euro Area or EU as a whole. Unusual event outside the control of the government with major financial impact. Implementation of structural and/or pension reforms (under strict conditions).	Replicates reinforced SGP (without explicit reference to structural and/or pension reforms).
Convergence to budgetary objective	Assessed on the basis of the structural balance and expenditure rule. Benchmark: annual improvement of structural balance of 0.5% of GDP (higher in economic good times and/or if debt-to-GDP ratio exceeds 60% or if there are pronounced risks to the sustainability of overall debt; might be lower in bad economic times).	Rapid convergence to MTO (details to be proposed by the Commission) taking sustainability risks into consideration. Evaluation of progress as in the reinforced SGP.
Assessing compliance	Significant observed deviation (for a member state that has not reached its MTO) in case of simultaneous breach of the two following criteria (or breach of one and limited compliance with the other): • Structural deficit criterion: exceeding adjustment path to MTO by at least 0.5% in one or 0.25% on average in two consecutive years; • Expenditure criterion: negative impact of expenditure developments (net of discretionary revenue measures) on adjustment path of government balance of at least 0.5% of GDP in one or cumulatively in two consecutive years.	Assessment of "significant observed deviations from the MTO or the adjustment path towards it" follows the reinforced SGP Common principles on the role and independence of national monitoring institutions to be proposed by the Commission.

Correction mechanism	In case of a significant observed deviation from the adjustment path towards the MTO: warning by European Commission Council recommendation for the necessary policy measures on the basis of a Commission recommendation (deadline of not more than 5 months (3 months in particularly serious cases) for addressing the deviation).	To be triggered automatically in the event of significant observed deviations from the MTO or its adjustment path (including obligation to implement measures to correct the deviations over a defined period of time). Implemented at the national level on the basis of common principles to be proposed by the Commission that concern, in particular, the nature, size and time frame of the corrective action to be undertaken also in the case of exceptional circumstances. Correction should include the cumulated impact of past deviations on government debt dynamics.
Enforcement	Commission can propose financial sanction (interest-bearing deposit of 0.2% of GDP) if no effective action has been taken. Automatic approval (of the sanction) – unless the Council rejects the Commission recommendation by qualified majority of Euro Area member states excluding the country concerned.	In addition to the reinforced SGP, financial sanctions can be imposed by the European Court of Justice if the balanced budget rule and the correction mechanism are not properly implemented in national law

Source:[ECB, Monthly Bulletin, 2012, p. 89].

a financial challenge, to find ways to reduce deficits. It's first of all an economic policy question: how to do it without killing growth, especially in the present situation of sluggish economic growth or even a risk of recession. The risk is high, taking into account that the main way to reduce deficits is to reduce expenses; the ways for income increases are very limited (see box 4).

What next can we expect in the shorter and longer run?

There is a common understanding that in order to survive, the EMU needs more fiscal discipline at the national level[22]. In this context, the efforts to strengthen fiscal surveillance rules under the revised Stability and Growth Pact and TSCG as well as other decisions presented above and reinforcement of both "preventive" and "corrective" arms (including automatic and meaningful sanctions) under those laws are usually assessed as going in the right direction. A few economists, including C. Wyplosz, argue, however, that such solutions will never work efficiently. The reason is that "fiscal discipline is and remains a deep-seated national prerogative of each national government and parliament. … The pact never worked and cannot work because it presupposes that a sovereign government can be told what to do with its budget. Eurozone governments should not waste time trying to strengthen the Stability and Growth Pact. Strengthening means adding sanctions but sanctions cannot be really imposed on democratically elected governments" [Wyplosz, 2010, p. 35]. According to C. Wyplosz, fiscal discipline should be enforced by new national institutions. The responsibility of national institutions and laws for observing the fiscal discipline has been included in the recently signed fiscal compact and is already in force as a constitutional requirement in several countries (as a constitutional ceiling for government debt together with automatic mechanisms to correct divergences from these rules): e.g. in Poland since 2007[23], in Germany since 2009, and in Slovakia since 2011.

Instead of strengthened national rules, some economists propose constraints on fiscal discretion imposed, monitored, and enforced by an independent fiscal policy council [Fatás, Mihov (2010), p. 69]. They argue that governments are unable to maintain fiscal discipline because either they abandon the rules due to political demands or produce highly pro-cyclical policy during downturns and further exacerbate the reduction of demand during recessions. Independent fiscal policy council would act as an anchor that helps governments ensure sustainability.

Others argue for the necessity of closer political union, which implies a significant transfer of spending and taxing powers to a central EU government and parliament. At the same time they usually admit that a full political union seems unrealistic in the short and medium term. In this context, a more pragmatic approach has been presented by P. de Grauwe, who argues that "the survival of the eurozone depends on its capacity to embed itself into a political union. … But a full political union seems unrealistic for the foreseeable future, as it would imply a significant transfer of spending and taxing powers to a central EU government and parliament”[24]. In such a situation, enforcing the SGP may be a necessary condition for preventing future crises, but it is far from sufficient. According to Prof. de Grauwe, “The domain of the Stability and Growth Pact must be broadened: it must include the monitoring of private debt developments as well as public debts”. This would be the minimum ingredient of a political union that can keep the eurozone alive in the long run.

Assessing the successive agreements aimed at stronger governance in the eurozone and in the EU as a whole, it is vital to recognize that no law adopted so far does chart a path out of the crisis. In particular there is no strategy for achieving faster growth through higher (public and private) investment[25]. On the contrary, rigorous fiscal adjustments – as recommended by EU and IMF – may delay the pickup of growth and keep unemployment unacceptably high for the foreseeable future. Concerns about the credibility of fiscal policies, the stability of the financial sector and the longer term economic growth conditions in the eurozone countries have remained, and market tensions in a number of countries have been continuing. In this context it is important to stress once again that the austerity measures implemented by most European countries to counter the debt crisis are not sufficient and their continuation may worsen the situation. This is partly related to the unclear sensitivity of GDP changes to fiscal instruments (via the mechanism of the so-called fiscal multiplier – see box 4). A mix of enforcement of recently adopted laws and the right macroeconomic solutions might be necessary. In parallel to measures to restore confidence to the market of sovereign debt, new efforts are indispensable to speed up economic growth.

Box 4. Effects of the fiscal consolidation on GDP changes

In January 2013, on the basis of a publication by O. Blanchard, chief IMF economist, and his associate D. Leigh, a heated debate started on the so-called fiscal multiplier and the effects of fiscal consolidation upon aggregate output. The fiscal multiplier is usually defined as the change in real GDP that is produced by a shift in fiscal policy equal to 1% of GDP. Most economists prior to this paper assumed the fiscal multiplier to be about 0.5. This would mean that government spending cuts equal to 1% of GDP would reduce actual GDP in the coming year by about 0.5%. According to findings of the two authors, based on data for 28 economies, actual multipliers in several recent years were higher, in the range of 0.9 to 1.7. Thus, the conclusion should be that with such high fiscal multipliers, the fiscal adjustments (in the form of deep budgetary cuts and taxes increases) suggested by the IMF and applied by a number of countries (i.e. in Greece and Portugal) could not improve the economic situation. On the contrary, they have resulted in a deeper production decrease and unemployment increase. The authors say that more work is needed to examine the causes of this failure of multiplier assumptions. They also add that their results need to be interpreted with care. As suggested by both authors, theoretical considerations and the evidence in empirical papers show that there is no single multiplier for all times and all countries. There is no doubt that this paper has intensified the earlier discussion whether tight fiscal adjustments contribute to economic recovery or rather result in deeper recession through the effects of the fiscal multiplier.

Source: [Blanchard and Leigh (2013)].

In November 2012 the European Commission presented the document "Blueprint for a Deep and Genuine Economic and Monetary Union" [Communication from the Commission (2012)], which describes the necessary elements and the steps towards a full banking, economic, fiscal and political union, including a concept of a euro area budget: "In the long term (beyond 5 years), based on the progressive pooling of sovereignty and thus responsibility as well as solidarity competencies to the European level, the establishment of an autonomous euro area budget providing for a fiscal capacity for the EMU to support Member States in the absorption of shocks should become possible." [Communication from the Commission (2012), p. 12][26]. Any such decision, however, will be difficult politically, taking into account high national averseness of member states to the EU fiscal federalism.

The crisis is far from being resolved and has the potential to deepen and spill over through the entire global economy if the worst-case scenario (i.e. spreading of problems and disintegration of the eurozone) materializes. The collapse of the eurozone is not in the interest of any country as it would involve costs for everybody, including all EU member states and the outside world. For this reason, disintegration does not seem the most likely scenario and the eurozone is destined for further reforms.

Another risk for the EU itself, apart from the risk of slowdown or stagnation of the European economy, is that different EU actions to increase credibility of fiscal policies and to enhance stability of the financial sector of the EU member states have resulted in fragmentation of the EU or in several speeds of the EU. Successive laws cover different groups of EU member states (in particular the Euro Plus Pact and fiscal compact) and provide for different solutions for individual groups of EU countries. Also, the very fact that their legal basis is not the same (EU treaties versus intergovernmental legal basis) makes the future of the EU more unpredictable.

Conclusions

In reaction to the sharp deterioration of fiscal positions and sovereign debt crisis in majority of EU member states, EU leaders have been strengthening the EU economic governance framework, in particular for the eurozone member states. This has been reflected mainly through a reinforcement of the Stability and Growth Pact (SGP) within the so-called six-pack and through the recent adoption of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG). The assumption is that the entry into force of all above-mentioned laws will improve economic and budgetary discipline and its surveillance and ensure longer-term fiscal sustainability.

Most of the new solutions continue the previous approach: stricter EU rules and their more rigorous application. TSCG has adopted a new element: in parallel to EU rules, there should also be enhanced national rules (possibly in the form of constitutional commitments) and national institutions responsible for fiscal discipline. This approach implies that international rules are not strong enough for sovereign countries that agree to be subject to democratically elected national authorities but do not want to follow the decisions of "outside" institutions.

There are divergent opinions on the efficiency of the economic governance initiatives and actions adopted recently by the EU or eurozone members. Some observers consider them as the right solution, sufficient to ensure stability of the eurozone - under the condition that the new mechanisms are observed rigorously. Others criticize those solutions from two opposite angles: either they call for more stringent rules of the SGP, including external independent control of the application of the SGP, or they argue for giving up SGP rules as politically unworkable and for the adoption of stronger national institutions to effectively control national fiscal discipline.

Even those who accept the recent strengthening of economic governance in the EU are aware of the fact that there is no guarantee the new solutions will work better than the previous laws. The tricky issue is that the final decisions, including those under the TSCG, are still subject to political considerations to be taken into account by the Council. Much will depend as well on the progress of implementing and applying the national constitutional requirements as provided for in the TSCG. Also, reverse voting in the Council provides a chance for a more pragmatic, economically justified use of the modified SGP. Faced with a lack of political will to move forward into a political union, the new governance mechanism and their rigorous enforcement seem the only realistic approach to ensure fiscal stabilization and keep the eurozone alive in the short and medium run.

ANNEX. Signatories to agreements discussed in the paper (situation as of 1.02.2013)

	Members of eurozone	European Stability Mechanism signatories	European semesters coverage	Euro Plus Pact coverage	Six-pack coverage (financial sanctions apply to Euro area members only)	TSCG signatories	TSCG ratification completed (full application in non-euro members only after adoption of the euro)
Austria	+	+	+	+	+	+	+
Belgium	+	+	+	+	+	+	+
Bulgaria			+	+	+	+	
Cyprus	+	+	+	+	+	+	+
Czech Rep.			+		+		
Denmark			+	+	+	+	+
Estonia	+	+	+	+	+	+	+
Finland	+	+	+	+	+	+	+
France	+	+	+	+	+	+	+
Germany	+	+	+	+	+	+	+
Greece	+	+	+	+	+	+	+
Hungary			+		+	+	
Italy	+	+	+	+	+	+	+
Ireland	+	+	+	+	+	+	+
Lithuania			+	+	+	+	+
Latvia			+	+	+	+	
Luxembourg	+	+	+	+	+	+	
Malta	+	+	+	+	+	+	
Netherlands	+	+	+	+	+	+	
Poland			+	+	+	+	
Portugal	+	+	+	+	+	+	+
Romania			+	+	+	+	+
Slovak Rep.	+	+	+		+	+	+
Slovenia	+	+	+	+	+	+	+
Spain	+	+	+	+	+	+	+
Sweden			+		+	+	
UK			+		+		

Source: Lists prepared by the author, based on different official EU documents.

Notes

[1] The paper has been prepared under the Jean Monnet multilateral research project "European Research Study Group on the Political Economy of the EMU" conducted in 2012-2014.

[2] The signatories to all those agreements are listed in Annex at the end of the paper.

[3] Professor P. De Grauwe argues that the real problem in the eurozone was a rise in private debt, not public debt [De Grauwe, 2010a].

[4] In one of its recent Communications, the European Commission has admitted "The SGP was insufficiently observed by the member states and lacked robust mechanisms to ensure sustainable public finances. The enforcement of the preventive arm of the SGP, which requires that member states maintain a strong underlying budgetary position, was too weak and member states did not use periods of steady growth to pursue ambitious fiscal policies. At the same time, the debt criterion of the treaty was not rendered operational in practice in the corrective arm of the SGP" [Communication from the Commission, 2012, p. 2].

[5] M. Dąbrowski argues that the negative fiscal trends in all major economies started earlier - either at the beginning of the 2000s (in the USA) or as far back as in the 1990s (Japan, and part of the EU) [Dąbrowski, 2012].

[6] Ad hoc rescue packages provided to EU member states in trouble were de facto against the Treaty's no bail-out principle. Only the second rescue package for Greece from March 2012, has included the mechanism of de facto partial sovereign default (dressed up legally as voluntary debt restructuring, so-called Private Sector Involvement, (PSI)) [Dąbrowski, 2012].

[7] The European Financial Stabilization Mechanism (EFSM) is based on guarantees from the Community budget up to €60 billion, while the European Financial Stability Facility (EFSF) is an inter-governmental body providing up to €440 billion in guarantees from the euro area member states. To fulfill its mission, EFSF issues bonds or other debt instruments on the capital markets. The proceeds of these issues are then lent to countries under the program. The EFSF may also intervene in the primary and secondary bond markets, act on the basis of a precautionary program and finance recapitalizations of financial institutions in non-program countries through loans to governments. In 2013, the funding of €4.7 billion is foreseen, completing the EFSM program. The IMF decided to complement these mechanisms with a potential financial support to euro area countries of up to €250 billion.

[8] On the text of the Treaty see: http://www.esm.europa.eu/pdf/esm_treaty_en.pdf.

[9] "Membership in the ESM shall be open to the other member states of the European Union as from the entry into force of the decision of the Council of the European Union taken in accordance with Article 140(2) TFEU to abrogate their derogation from adopting the euro." (art. 2 of the Treaty establishing the ESM).

[10] http://www.eurozone.europa.eu/eurozone-issues/esm.

[11] http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/120296.pdf.

[12] On 23 January 2013, the ratification process of amendment of art. 136 TFEU was completed and ratification document was then deposited at the EU Council by all EU member states with the exception of the Czech Republic (the document was, however, approved by both chambers of the Czech Parliament, see: http://www.europarl.europa.eu/webnp/webdav/site/myjahiasite/users/fboschi/public/esm%20tscg/art.%20136%20ESM%20fiscal%20compact%20ratprocess.pdf

[13] In the past, the EU institutions discussed economic policies in the spring and examined fiscal policies and developments separately in the autumn.

[14] Originally, the Euro Pact (initially called the Competitiveness Pact) was the German-French proposal to cover only eurozone members. On the initiative of Poland and several other countries – being afraid of deepening the two-speed European integration – the initiative has been converted into the Euro Plus Pact, open to all EU members that endorse the objectives of the agreement.

[15] This citation and the next one come from the Annex I to A Pact for the Euro Stronger Economic Policy Coordination for Competitiveness and Convergence annexed to Conclusions of the Heads of the State or Government of the Euro Area, 2011.

[16] http://ec.europa.eu/economy_finance/economic_governance/index_en.htm.

[17] If the 60% reference for the debt-to-GDP ratio is not respected, the member states concerned will be put in excessive deficit procedure (even if its deficit is below 3%). This will take place after taking into account all relevant factors and the impact of the economic cycle, if the gap between its debt level and the 60% reference is not reduced by 1/20th annually (on average over 3 years). Given that most member states are already in excessive deficit procedure, and therefore have to comply with agreed fiscal consolidation paths, a transitional period is foreseen in the amended legislation to ensure no abrupt change in these agreed paths. Accordingly, each member state in excessive deficit procedure is granted a three-year period following the correction of the excessive deficit for meeting the debt rule. This does not mean that the debt rule does not apply at all during this period as the amended regulation foresees that member states should make sufficient progress towards compliance during this transitional period. A negative assessment of the progress made towards compliance with the debt benchmark during the transition period could lead to the opening of an excessive deficit procedure.

[18] The TSCG also plays an important role for the European Stability Mechanism (ESM). As of 1 March 2013, the granting of financial assistance in the framework of new programs under the ESM is conditional on the ratification of the TSCG by the contracting party concerned and, as soon as the transposition period of at most one year has expired, on an adequate introduction of a number of key elements of the fiscal compact into national legislation.

[19] By the end of 2012 is has been ratified by Austria, Cyprus, Germany, Denmark, Estonia, Spain, France, Greece, Italy, Ireland, Lithuania, Latvia, Portugal, Romania, Finland, and Slovenia; see more [PRESSE 551, No. 18019/12, 2012].

[20] The TSCG needs to respect the EU Treaties and must be applied and interpreted in conformity with EU law.

[21] Six-pack? Two-pack? Fiscal compact? A short guide to the new EU fiscal governance, see at: http://ec.europa.eu/economy_finance/articles/governance/2012-03-14_six_pack_en.htm.

[22] The problem does not exist at the EU level because the EU has run a balanced budget since its beginnings.

[23] This constitutional rule is one of the reasons Poland has avoided breaching the 60% if GDP ceiling for public debt, despite regular political pressures to increase public expenditure in order to "support economic growth".

[24] The latter must imply some transfer of sovereignty in macroeconomic policies and the organization of automatic solidarity between member states, see: [De Grauwe, 2010, p. 29].

[25] A very general Strategy Europe 2020, with no binding financial or other instruments, cannot play this role.

[26] Also, a banking union has been suggested by the Commission. Such a union "would be able to end the disintegration of the EU's financial market and ensure reasonably equal financing conditions for households and business across the EU; it would help sever the negative feedback loops between Member States and banks" [Communication from the Commission (2012), p. 12].

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