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A New Framework for Fiscal Policy Consolidation in Europe

Current developments in Greece make clear that the rules of the European Stability and Growth Pact (SGP) were neither strict enough nor enforced strictly enough. To deal with the ongoing exit from the fiscal crisis and its related phenomena, we propose a new framework for fiscal policy consolidation in Europe. The centrepiece is a European Consolidation Pact to supplement the SGP which would supply loan guarantees in exchange for a fee and stricter budget consolidation measures. The new framework also spells out the details of an orderly government default.

Eighty-one years after Gustav Stresemann raised his voice in front of the League of Nations to call for a European currency, the object of his wish is in a devastating state. When the euro's predecessor, the ECU, was introduced 50 years after Stresemann's speech, it took about a decade until the members of the European Monetary System found themselves in choppy waters, with Italy deciding to devalue the lira and the United Kingdom leaving the exchange rate mechanism. When the euro superseded the ECU in 1999, it once again took about a decade until Europe found itself in choppy waters. The plot of the current crisis resembles the 1992 one: markets spotted potentially unsustainable developments in some member countries and put additional pressure on the weak spots. As with the previous crisis, the countries in trouble face twin deficits, and reactions by other EU members and the European Commission have not given the impression of being in control of the situation – at least not until 9 May 2010.

The European Stabilisation Mechanism (ESM) that was adopted on that day, together with the supporting measures of the European Central Bank (ECB), represent significant steps towards a solution to the current crisis. Together they reduce the pressure that financial markets can put on the crisis countries, and they make self-fulfilling speculation improbable. Of course, these steps do come at a cost: a decline in reputation in the case of the ECB and a weakening of incentives for fiscal consolidation in the case of the ESM. While only time and good conduct will help the ECB regain its former reputation, the incentive problem can be addressed institutionally. To that end, we propose a European Consolidation Pact (ECP). This pact takes up elements of the Greek rescue package and the ESM, but places them within a consistent, systematic framework for the long run. Why build another pact after the existing one – the Stability and Growth Pact – has proven ineffective? The next section gives four reasons for an additional measure.

The Stability and Growth Pact has Proved to be Inadequate in Periods of Crisis

It has become obvious that the stipulations of the Stability and Growth Pact (SGP) did not deter EU member states from unsustainable fiscal policies. Neither the preventive arm of the stability and convergence programmes nor the dissuasive arm of the excessive deficit procedure (EDP) gave the right signals that would have led governments to strict fiscal consolidation. The EDP itself is rather opaque for outside observers (see chart). After its changes in March 2005 – initiated by Germany and France – it essentially became a closed loop procedure that has thus far never reached steps six and seven, which would have allowed for sanctions. In the current crisis period, there are four aspects that make the pact inadequate.

First, the pact's EDP has a narrow focus on deficits. Deficit targets are formulated as percentages of GDP, but GDP itself endogenously reacts to the consolidation measures. Given the harsh tax increases and expenditure cuts under the current special circumstances, GDP growth will be substantially lower than it would have been without these measures, as shown in Table 1 and dramatically dem-

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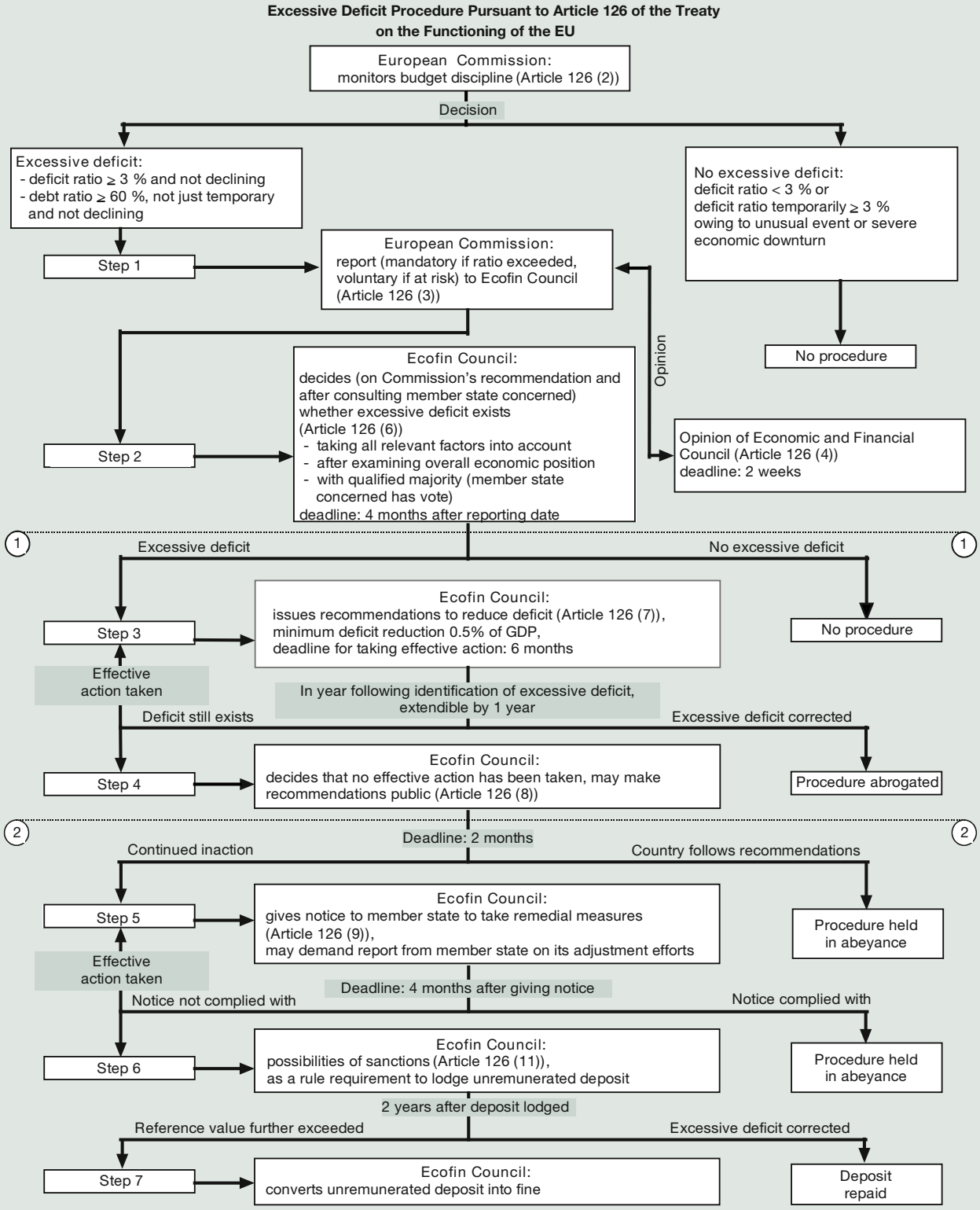

(1) On European Commission's recommendation and with qualified majority, meaning 255 of 345 votes, half of all member states and 62% of EU population; if decision is taken other than on the Commission's proposal, two thirds of all member states are required (member state concerned not entitled to vote).

(2) Applies only to euro area states; on European Commission's recommendation and with qualified majority (member state concerned not entitled to vote).

Table 1
Real GDP Forecasts for 2010[1]

Country	Nov 09	Dec 09	Jan 10	Feb 10	Mar 10	Apr 10	May 10
Greece	+0.8	+0.2	–0.1	–0.4	–1.3	–2.6	–3.6
Portugal	+0.4	+0.7	+1.0	+0.7	+0.6	+0.5	+0.4
Ireland	–1.1	–1.2	–1.0	–1.1	–1.2	–1.1	–1.0
Spain	–0.5	–0.4	–0.4	–0.4	–0.4	–0.4	–0.4
Italy	+0.7	+0.9	+0.9	+0.8	+0.8	+0.8	+0.8
Germany	+1.5	+1.7	+1.8	+1.7	+1.7	+1.6	+1.6
France	+1.2	+1.5	+1.4	+1.4	+1.4	+1.4	+1.5
Euro area	+1.2	+1.3	+1.3	+1.3	+1.1	+1.2	+1.1

[1] Published at the given date.

Source: Consensus Economics.

onstrated by the experience of the Latvian deficit target for 2009 and the evolution of its GDP forecasts. Relying on structural instead of actual deficit ratios is even more problematic, as potential GDP forecasts become more uncertain in times of crisis. Owing to the complex calculation method, the EDP is pretty much a black box for both the general public and policymakers alike.

Second, there is no coordination of national consolidation efforts. In a phase of high co-movement in which nearly all member states simultaneously post large deficits, there is the problem of structuring the required consolidation steps so that they do not hamper Europe's economic progress. According to the current Stability Programmes, the average structural deficit reduction in the euro area between 2010 and 2013 will be about 0.6 percentage points (Table 2). In view of past fiscal consolidation experience during the run-up to monetary union between 1995 and 1999, when the average annual structural deficit reduction was about 0.8 percentage points, the current aggregate consolidation plan seems to be manageable. To make sure that this plan works out, international coordination is a prerequisite, not least to shun contagion and the adverse effects of foreign policies.

Third, the SGP does not spell out mechanisms for mutual support. While Article 122 of the Treaty on the Functioning of the EU (TFEU) allows for the possibility of mutual support, it is not clear how this interacts with the often perceived prohibition of a bail-out in Article 125 TFEU. While this "no bail-out clause" actually only says that (a) a country cannot rely on a bail-out and (b) a bail-out is not the rule and does not happen in a majority of cases, the case for a singular mechanism for mutual support is still very much unclear. The pure risk of contagion makes the "no help policy" derived from this no bail-out clause unrealistic, and the current record shows that a spelled-out mechanism is needed.

Fourth, there is no mechanism for government insolvency. If the treaty intended to provide no support to troubled countries, then a path to deal with government insolvency should have been laid out as well. Then again, if limited, conditional and exceptional support was foreseen, the possibility of failure should still have been taken into account. Leaving out default regulations may be viewed uncritically in normal times, but in extraordinary times like these, it is a source of uncertainty and hence possibly irrational exuberance by the markets.

Summing up, one can say that the silence regarding mutual support and sovereign default increases market uncertainty to an unnecessary degree. What is needed now is a framework that extends the SGP regulations to times of crisis and delivers a consistent and binding set of rules not only for the fiscal exit from the extraordinary and highly expansionary fiscal policies employed during the financial crisis, but also with regard to the 60 per cent debt level relative to GDP that was written into the Maastricht Treaty. While extending the existing SGP framework to cover support and default issues seems impossible, coordination and overall debt issues may be improved via the SGP. With respect to these, the European Commission proposed new measures on 12 May 2010. We examine these proposals below.

A New Framework for Fiscal Policy Consolidation

To deal both with the ongoing as well as future fiscal crises, we propose a new framework for fiscal policy consolidation in Europe. At its centre is a European Consolidation Pact (ECP) that supplements the SGP in times of crisis. This pact may be used as common ground for the consolidation conditions currently imposed on crisis countries in an ad-hoc manner in return for a rescue package or the European Stabilisation Mechanism. There are at least three angles from which to view this proposal: an economic angle focussing especially on incentives, a legal angle focussing especially on compatibility with current laws, and a procedural angle focussing on the roadmap of practical implementation. Below, each angle will be addressed.

Economic Aspects

The ECP has five distinguishing features. First, participating countries are obliged to detail a path to balancing their budgets, including a concrete course to cutting non-cyclical government expenditure and a binding roadmap for planned changes to tax legislation. All pact members co-

Table 2
GDP, General Government Balance and Debt in Selected Member States of the European Union

	2009		2010		2011		2012		2013	
	COM Apr 2010[1]	SP 2010[2]	COM Apr 2010[1]	SP 2010[2]	COM Apr 2010[1]	SP 2010[2]	COM Apr 2010[1]	SP 2010[2]	COM Apr 2010[1]	SP 2010[2]
					Austria					
GDP growth[3]	- 2.0	- 3.4	1.1	1.5	2.3	1.5	…	1.9	…	2.0
Cyclically adjusted balance[4]	- 3.1	- 2.7	- 3.8	- 3.9	- 3.4	- 3.3	…	- 2.7	…	- 2.2
Debt-to-GDP ratio	69.1	66.5	71.5	70.2	72.5	72.6	…	73.8	…	74.3
					France					
GDP growth[3]	- 1.2	- 2.3	- 0.3	1.4	1.5	2.5	…	2.5	…	2.5
Cyclically adjusted balance[4]	- 14.1	- 6.5	- 8.2	- 6.8	- 8.2	- 4.9	…	- 4.0	…	- 2.8
Debt-to-GDP ratio	115.1	77.4	124.9	83.2	133.9	86.1	…	87.1	…	86.6
					Germany					
GDP growth[3]	- 4.1	- 5.0	0.9	1.4	1.5	2.0	…	2.0	…	2.0
Cyclically adjusted balance[4]	- 4.8	- 1.9	- 5.1	- 4.4	- 4.8	- 4.1	…	- 3.1	…	- 2.3
Debt-to-GDP ratio	79.2	72.5	85.2	76.5	89.1	79.5	…	81.0	…	82.0
					Greece					
GDP growth[3]	- 5.0	- 1.2	1.4	- 0.3	2.0	1.5	…	1.9	…	2.5
Cyclically adjusted balance[4]	- 1.8	- 12.5	- 3.6	- 7.6	- 3.5	- 4.4	…	- 1.9	…	- 1.5
Debt-to-GDP ratio	73.2	113.4	78.8	120.4	81.6	120.6	…	117.7	…	113.4
					Ireland					
GDP growth[3]	- 3.1	- 7.5	1.1	- 1.3	1.7	3.3	…	4.5	…	4.3
Cyclically adjusted balance[4]	- 4.5	- 8.9	- 3.7	- 8.6	- 4.0	- 8.2	…	- 6.3	…	- 4.7
Debt-to-GDP ratio	96.7	64.5	99.0	77.9	100.9	82.9	…	83.9	…	83.3
					Italy					
GDP growth[3]	- 3.6	- 4.8	- 0.3	1.1	1.8	2.0	…	2.0	…	…
Cyclically adjusted balance[4]	- 9.6	- 3.2	- 7.8	- 3.2	- 7.0	- 2.7	…	- 1.9	…	…
Debt-to-GDP ratio	53.2	115.1	64.9	116.9	72.5	116.5	…	114.6	…	…
					Netherlands					
GDP growth[3]	- 3.9	- 4.0	2.5	1.5	3.0	2.0	…	2.0	…	…
Cyclically adjusted balance[4]	1.2	- 3.4	- 1.4	- 4.8	- 1.9	- 3.9	…	- 3.5	…	…
Debt-to-GDP ratio	14.5	62.3	19.0	67.2	23.6	69.6	…	72.5	…	…
					Portugal					
GDP growth[3]	- 4.0	- 2.7	1.5	0.7	2.0	0.9	…	1.3	…	1.7
Cyclically adjusted balance[4]	- 3.6	- 8.3	- 4.9	- 7.5	- 4.0	- 5.9	…	- 4.1	…	- 2.5
Debt-to-GDP ratio	60.9	77.2	66.3	86.0	69.6	89.4	…	90.7	…	89.8
					Spain					
GDP growth[3]	- 7.5	- 3.6	- 1.3	- 0.3	3.3	1.8	…	2.9	…	3.1
Cyclically adjusted balance[4]	- 11.4	- 9.9	- 8.7	- 7.9	- 10.2	- 6.1	…	- 4.6	…	- 2.9
Debt-to-GDP ratio	64.0	55.2	77.3	65.9	87.3	71.9	…	74.3	…	74.1
					Euro area (16)					
GDP growth[3]	- 4.1	- 4.0	0.9	1.1	1.5	2.1	…	2.3	…	2.5[a]
Cyclically adjusted balance[4]	- 4.8	- 4.8	- 5.1	- 4.4	- 4.8	- 4.1	…	- 3.4	…	- 2.5[b]
Debt-to-GDP ratio	78.7	78.8	84.7	84.2	88.5	87.4	…	87.3	…	81.9[b]

[1] Source: Commission service Spring 2010 forecasts (COM). [2] Source: Stability programme (SP). [3] Year-on-year change of real GDP. [4] Output gaps and cyclically adjusted balances from the programmes as recalculated by Commission service on the basis of the "information" in the programmes. Source: AMECO.

[a] Without Belgium and Italy. [b] Without Belgium, Italy, Malta, the Netherlands and Slovakia.

ordinate and decide on their national efforts together. Decisions shall be in line with those of the excessive deficit procedure of the SGP but could possibly go beyond them.

This path could be set up by adopting and adapting the route plan concept of the stability and convergence programme which all EU member states have to draw up annually pursuant to Article 121 TFEU under the preventive (rather than dissuasive) arm of the fiscal provision. It requires plotting an adjustment path for the current year and at least the three following years detailing how a country will progressively align its revenues and expenditures with the medium-term goal of a close-to-balance budget. In contrast to the SGP's excessive deficit procedure, which aims merely to push the deficit down to 3 per cent, the stability programme aims to pull it down to zero over the medium term. Given the present large structural deficits, however, it would be more conducive to consolidation to insist that every country chart its path right up to full attainment of a balanced budget, meaning that the national consolidation programmes could extend further along the time axis than the national stability programmes.

To achieve greater transparency, each country's consolidation path, rather than merely projecting the revenue and expenditure ratios, has to define a binding medium-term expenditure path for non-cyclical spending. The track record of expenditure rules in European countries (Netherlands, Finland, Sweden) as well as in the United States (Budget Enforcement Act of 1990, Balanced Budget Act of 1997) is generally assessed positively in the literature.[1] Their key advantage compared with a deficit target is that most expenditure components are little affected by cyclical developments, so that a rule for non-cyclical spending can instil effective fiscal discipline. Any deviations from this predefined expenditure path can be identified relatively easily and, to boot, can clearly be laid at the politicians' door. Looked at from another angle, it gives politicians a positive incentive to earn themselves a reputation as fiscal champions by sticking to the proclaimed expenditure path.

However, an expenditure rule is likely to succeed only if the revenue trend, too, evolves as projected in the consolidation programme. A credible consolidation strategy thus also requires countries to commit to a detailed roadmap over the consolidation horizon listing all planned tax law changes that will affect revenue. This would facilitate an easy and timely assessment of whether a country is indeed taking the promised consolidation steps.

The Commission should make a twice-yearly assessment of the expenditure paths and the changes to tax legislation in all member states and identify – and publicly name and shame – countries that systematically deviate from their targets. Such a cross-country report would make an important contribution to enhancing the transparency of European fiscal policy.

Why would a country be willing to participate in such a pact? There are two perspectives. For a low-deficit, low-debt country, the ECP offers strict consolidation rules for all members. Given the European economies' interdependence, it would be highly beneficial if fiscal consolidation were organised as a disciplined march of the whole troop rather than a courageous foray by the vanguard. At the same time, the other EU member countries, too, should have an incentive to gain the confidence of market players through a credible commitment to budgetary discipline as an essential prerequisite for low long-term interest rates.

Second, countries willing to participate in the ECP are obliged to implement an automatic tax increase law in their national legislation. This states that the tax rate of a specific ECP member country will automatically rise by a certain amount if that country strays from the defined path ("debt surcharge"). The resulting tax receipts remain completely with the straying country to enable it to improve its fiscal stance. This element serves a special purpose, namely to make clear to the voters of a country that it is in their hands to deal with excessive deficits. This should give incentives to both voters – to carefully decide about which fiscal policy proposal to vote for – and governments – to make sure every fruitful opportunity other than the automatic tax increase is used.

Third, every country participating in the pact may apply for ECP guarantees for each new issuance of government debt that is in line with the specified path to balancing its budget. This implies that the soundness of fiscal policies has to be monitored before and after each new government bond issue that applies for the guarantee. The monitoring could be accomplished by either the European Commission or by independent ECP staff members – in case the pact evolves into an independent organisation. While a consolidation path and an automatic tax increase law fall under the stick category, guarantees serve as carrots that make the ECP attractive to the country in difficulty. The increased credibility of a lasting consolidation effort that is to be expected for ECP members serves as another carrot.

1 J.D. Savage, A. Verdun: Reforming Europe's Stability and Growth Pact: Lessons from the American Experience in Macrobudgeting, http://www.unc.edu/euce/eusa2007/papers/savage-j-09b.pdf, 2009; T. Dabán Sánchez, E. Detragiache, G. di Bella, G.M. Milesi-Ferretti, S. Symansky: Rules-Based Fiscal Policy in France, Germany, Italy and Spain, IMF Occasional Paper 225, 2003.

The form of guarantees is already being used in the ESM via a special purpose vehicle (up to an amount of €440 bn). Guarantees have the advantage that no direct money flow from the ECP to the country in difficulty is necessary; in the current context they are also proposed by e.g. K. A. Konrad[2], though his proposal may also include the old stock of debt. From a macroeconomic perspective, a similar approach was advocated by George Soros under the heading International Credit Insurance Corporation.[3] As an alternative to guarantees, one could also consider a direct line of credit from the ECP to the country in difficulties. In this case, all elements of the financial transaction with the creditor country would be with the ECP, which then of course would have to be financed accordingly. In contrast to that, our envisioned guarantees transfer only the credit default risk to the ECP – for a commensurate fee. All other elements of the interest-bearing transaction, i.e. the direct flow of money, the riskless real rate paid to compensate for intertemporal substitution, and the respective premiums paid for the risks originating from inflation, liquidity and maturity, would be borne by the markets, which are well-trained to handle them.

Fourth, each guarantee issued is paid for with a percentage fee to the ECP as a compensation for the risk taken. The fee is to be distributed among the pact members. The size of the fee should be such that there are gains for both sides: on the one side, the ECP has to be compensated for bearing the default risk of that specific tranche of government debt, while on the other side, for the good of all pact members, there should be a positive effect of the guarantee in terms of credit costs. This implies that the percentage fee should have a positive size bounded from above by the interest rate spread that the markets (at that time) demand for a government bond without guarantee relative to a benchmark bond like the 10-year Bund. For example, the fee could be set at 150 basis points, which in the case of a direct credit translates to 150 basis points above the average interest rate that ECP members have to pay for their own debt. With this fee, the moral hazard of obtaining a guarantee is addressed.

Fifth, non-compliance with the automatic tax increase law or voluntary exit from the consolidation pact leaves future government bond issues without ECP guarantees: either the country is in good health and does not need the guarantee any longer or it is willing to default. As argued before, the monitoring could be done by either the European Commission or ECP staff or by finance ministers of the pact members. Our preference is for a strong and independent organisation, be it the Commission or an ECP that evolves into a kind of fiscal mirror image of the European Central Bank.

Given the ECP, it is clear that a default would have nothing to do with illiquidity but would be freely chosen after a government did all necessary pondering of the immediate and permanent pros and cons of either servicing high levels of debt or declaring insolvency. As this decision would remain in the hands of the sovereign country, the ECP would have to respect the decision. Nonetheless, an orderly government default can be of high value to both the debtor and the creditors. The role of the ECP should be that of a mediator between creditors and debtor and encompass three main tasks. It should increase the efficiency of renegotiations, improve information on both sides and serve as a commitment device, as it is much more influential on the debtor country than any particular creditor.[4]

Finally, the ECP works as a coordination device for the consolidation efforts of the pact members and therefore within the EU. As the pact members jointly decide the path to balancing their budgets, the overall applicability and the spill-over effects can be taken into account and dealt with. For example, it might be to the benefit of all pact members to allow some of them to postpone a full-speed consolidation if the resulting relative growth effect is positive for the sum of the pact members.

Legal Aspects

The Treaty of the European Union (TEU) and the accompanying Treaty on the Functioning of the European Union (TFEU) provide the current legal framework for the EU. After the Treaty of Amsterdam came into force in 1999 and the Treaty of Nice in 2003, the Treaty of Lisbon was developed in reaction to the failed attempt to ratify the European Constitution that was agreed upon by the heads of state in 2004. The Treaty of Lisbon was signed in December 2007 and finally came into force on December 1, 2009. Taking into consideration the long and arduous ratification process, not to mention the difficulty of coming to a single joint position between 27 EU members, we take the stand that the Treaty of Lisbon should be the legal basis for the new framework for fiscal policy coordination described here.

2 K.A. Konrad: Rettung durch eine beschränkte Garantie, in: Wirtschaftsdienst, Vol. 90, No. 3, 2010, pp. 143-147.

3 G. Soros: The Crisis of Global Capitalism: Open Society Endangered, Public Affairs Press, New York 1998; for critical assessments see J.A. Frenkel: Soros' Split Personality, in: Foreign Affairs, Vol. 78, No. 2, 1999; and K. Rogoff: International Institutions for Reducing Global Financial Instability, in: Journal of Economic Perspectives, Vol. 13, No. 4, 1999, pp. 21-42.

4 U. Panizza, F. Sturzenegger, J. Zettelmeyer: The Economics and Law of Sovereign Debt and Default, in: Journal of Economic Literature, Vol. 47, No. 3, 2009, pp. 651-698.

That said, the new framework could be integrated within the Treaty of Lisbon as part of an enhanced corporation along Article 20 TEU in connection with Articles 326 to 334 TFEU. As the Treaty states, "enhanced cooperation shall aim to further the objectives of the Union, protect its interests and reinforce its integration process" (Art. 20 TEU). While this point seems to be fulfilled easily, the more complex demand is formulated in Art. 326 TFEU: "Any enhanced cooperation shall comply with the Treaties and Union law." One aspect of the new framework described above is the most critical candidate for a conflict with Union law: the mutual support of government debt guarantees. As mentioned above, Art. 125 (1) TFEU precludes a general bail-out: "The Union shall not be liable for or assume the commitments of central governments." Restrictions similar in spirit are formulated in Articles 123, 124 and 125 (2). On the other hand, Art. 122 (2) TFEU says that "where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned." The proposed mutual support framework should therefore rely on Art. 122 (2), but should not violate Art 125 (1). As the legal literature points out,[5] this possibility exists: as a last resort, without establishing a legal claim to it, as an exception to the general "no bail-out" clause, and under Council conditions, mutual support may be provided.

Another question is which and how many countries should form the ECP. For the countries outside the euro area, financial "balance of payment" assistance is already possible through Art. 143 TFEU, so prima facie the ECP may not be necessary for these countries. If all euro area member countries are willing to participate, Art 136 TFEU may be the basis for the ECP. This article allows the Council to adopt measures for the euro area members "to strengthen the coordination and surveillance of their budgetary discipline" (Art 136 (1a) TFEU). If not all euro area members but at least nine EU member states are willing to form the ECP, it may be based on enhanced cooperation along Art. 20 TEU.

Procedural Aspects

For the time being, the Greek crisis is being handled via the concerted action of the European Council and the International Monetary Fund (IMF), together with the European Commission and the ECB. This "rescue package", specified on 25 March 2010, probably further clarified on 2 May 2010 and approved on 8 May 2010, features credit to Greece under ad hoc conditions for the necessary reduction of the country's deficit over the years 2010 to 2012. The European Stabilisation Mechanism adopted on 9 May 2010 extends these ad hoc measures to other countries. It allows for credit and guarantees to all other member states in need through a comparable procedure. Assuming – and hoping – that this package and the fulfilment of the conditions prove successful, the Greek drama will have passed its climax. But it is another question whether the dénouement will be complete after 2012.

To make sure that this drama leads to a catharsis, a positive long-run consolidation effect is needed, with close to balanced budgets. This is the final and pivotal element of dénouement in the current drama. Setting up the ECP will be a major step towards getting there. And in case the current drama has a new scene with rising action, politicians may choose to rely either on ad hoc EU-IMF credit within the ESM or on the ECP's guarantee within the new framework.

Alternatives Discussed Thus Far

In addition to the European Consolidation Pact, there are a number of alternative concepts to deal with future crises comparable to the current one.

The European Stabilisation Mechanism and the Current EU-IMF Support Programme for Greece

The Greek support programme of the EU and the IMF and the subsequent European Stabilisation Mechanism can be seen as initial attempts by the EU to independently solve the European liquidity crisis. These attempts have been made under the supervision and with the help of the experienced and respected IMF. Nonetheless, both the measures and the conditionality have been set up in an ad hoc fashion and without cross-European coordination. Hence, it does not seem to be suited to grow into a future resolution regime for liquidity crises in EMU.

The European Commission's Proposal "Reinforcing Economic Policy Coordination"

To improve on the existing SGP within the current treaty, the European Commission proposed measures on 12 May 2010 to reinforce compliance with the SGP, to broaden surveillance, to increase coordination and to

5 U. Häde: Haushaltsdisziplin und Solidarität im Zeichen der Finanzkrise, in: Europäische Zeitschrift für Wirtschaftsrecht, 12/2009, pp. 399-403; M. Herdegen: Was die EU-Verträge wirklich zum Bail-out sagen, in: Handelsblatt, 17 March 2010.

build a "robust framework for crisis management".[6] With respect to the first three goals, most measures – the "European semester" for fiscal policy coordination, the call for national laws on sound fiscal policies (like the German "debt brake"), the increased emphasis on the debt criterion and fiscal sustainability, the views on macroeconomic imbalances – go in the right direction. Only the issue of sanctions remains problematic. The Commission's proposals – interest-bearing deposits for the preventive arm of the SGP as well, suspension of the Cohesion Fund, conditionality of the use of EU budget expenditures – all have the effect of punishing a country in trouble, which increases the trouble rather than putting the country back on track. Hence these sanctions are no more credible than the existing sanctions have proved to be.

With respect to the fourth goal, the call for a "robust framework for crisis management" has so far gone unanswered; only in the "medium-to-long term" does the Commission intend "to make a proposal for a permanent crisis resolution mechanism". Given the current amount of uncertainty in the markets on this issue, the need for such a framework might be more urgent than anticipated.

"Constructive Ambiguity"

Going back to Henry Kissinger and the foreign policy field, this concept has proved fruitful in the field of economics as well. Ambiguity constrains excessive risk-taking, as mutual support is ambiguous. Much of the European statements on Greece prior to 25 March 2010 – especially those of the Germans – can be seen as following this concept. But there are times when this kind of ambiguity becomes destructive, as market fears abound. Political ambiguity then becomes an invitation for speculation, and "rules rather than discretion" should become the guiding principle in this field.

An IMF Programme

There are strong arguments in favour of a single IMF programme to deal with this kind of crisis. Indeed, this is what the IMF was made for, and every EU member is also a member of the IMF, making it eligible for IMF help. The IMF has some credibility for demanding strict consolidation and enforcing its terms and conditions. So why is there an interest in solving an intra-EMU crisis without the IMF (or IMF dominance)? In our view, the strongest argument is a feeling of European federalism that would be violated once the IMF interferes: since the IMF is not called when California has liquidity problems, it should not be called when Greece does either. While this comparison is legally wrong, it contains a chance for political progress in Europe that we do not want to diminish.

Euro Bonds

De Grauwe and Moesen[7] propose issuing common euro bonds that may well solve liquidity problems for single EMU members. The interest rates that each government has to pay for the bond should be exactly the rate that it pays on its national bonds. Leaving out a broader discussion of the concept supplied in the articles following the original paper in the same journal number, this concept has much in common with the ECP's guarantee and fee concept. It is relatively simple and easy to implement. What is missing, though, is both a strong support element and the conditionality that leads to fiscal consolidation. Both features could be added, such that e.g. euro bonds could be used instead of guarantees within the ECP framework. As long as the supportive element is applied sufficiently infrequently, this concept should also be legally viable.

A European Monetary Fund

The basic idea of a European Monetary Fund (EMF) is intriguing: an independent institution to deal with liquidity and insolvency problems for the EMU countries. Gros and Mayer's proposal[8] has many similarities with the ECP, such as the strong conditionality of a line of credit, a possible funding cut off in case of consolidation misconduct and regulations for an orderly default. Gros and Mayer are also indifferent as to whether the EMF should offer direct credit or "provide a guarantee for a specific issuance of public debt". The major difference is the financing mechanism of the EMF, which implies a direct penalty payment for countries with an excessive debt or deficit ratio. As Häde[9] points out, this mechanism is probably in conflict with the excessive deficit procedure laid out in Art. 126 TFEU, as this article clearly states under which conditions penalty payments are foreseen.

Compared to the EMF, the ECP has several advantages. First, it can be implemented on short notice. As the ECP functions with just nine members within the EU's enhanced cooperation framework, this pact can be used immediately,

6 European Commission: Reinforcing economic policy coordination. Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the Economic and Social Committee and the Committee of the Regions, 12 May 2010.

7 P. De Grauwe, W. Moesen: Gains for All: A Proposal for a Common Euro Bond, in: Intereconomics, Vol. 44, No. 3, 2009, pp. 132-135.

8 D. Gros, T. Mayer: How to deal with sovereign default in Europe: Towards a Euro(pean) Monetary Fund, CEPS Policy Brief, No. 202, February 2010; D. Gros, T. Mayer: How to Deal with the Threat of Sovereign Default in Europe: Towards a Euro(pean) Monetary Fund, in: Intereconomics, Vol. 45, No. 2, 2010, pp. 64-68.

9 U. Häde: Legal Evaluation of a European Monetary Fund, in: Intereconomics, Vol. 45, No. 2, 2010, pp. 69-72.

e.g. to help Portugal in case of urgent need. Second, there is no need to change or amend the Lisbon Treaty because of the ECP. Third, in the medium to long run, the ECP may be used as a nucleus for the evolution of an independent institution similar to a "European Monetary Fund". Like the Schengen-Acquis that started in 1985 and was incorporated into the Treaty of Amsterdam to become European law in 1997, an institutionalised and extended ECP may perhaps become part of a new or amended EU Treaty in the future. 29 of the current 186 member countries signed the International Monetary Fund's Articles of Agreement in 1945. In our view, the best way to achieve a European institution with comparable tasks is to rely on a similar evolutionary process.

Though it references the EMF, the mutual fiscal insurance fund proposal by Buiter[10] is perhaps closer to the ECP than to Gros and Mayer's EMF. It foresees funds that would be provided conditional upon macroeconomic and structural reforms, together with the option of sovereign default. Together with a proposed financial institution recapitalisation fund, it is worth a second look.

10 W. Buiter: Global Economics View. Sovereign Debt Problems in Advanced Industrial Countries, Citigroup Global Markets, 26 April 2010.

Conclusions

On 12 May 2010, the European Commission demanded "reinforcing economic policy coordination" in the euro area.[11] It proposed important measures to improve on the existing Stability and Growth Pact, like a strengthened role for the debt criterion and a "European semester" for the coordination of fiscal policies. This is exactly what the German Council of Economic Experts had in mind when it published its proposal for a European Consolidation Pact in November 2009. But as things have dramatically changed in the past months, there is a need for a new, broader framework for fiscal policy coordination in Europe that includes measures for stricter consolidation and its control, for mutual support and for government insolvency. This new framework has been described here. We hope that, as with the European Monetary System crisis of 1992/93, the choppy waters of the European Economic and Monetary Union crisis of 2009/10 will give rise to policies that make Europe stronger and more stable. We presume that a European Consolidation Pact may be a valuable measure in the process towards the next stage of European development.

11 European Commission, op. cit.