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PRESS RELEASE

New developments in the economic governance of the European Union

In the past few years it has become painfully clear that the financial markets' loss of confidence confronting certain euro area countries can swiftly spread to other Member States, ultimately threatening the orderly functioning and stability of the euro area as a whole.

Back in 2007, before the financial crisis, vulnerable positions had become apparent within the euro area. In the absence of adequate fiscal discipline, the initial budgetary position of several euro area countries was not very strong. Moreover, there were wide divergences in competitiveness and domestic demand within the euro area, and the situation in some Member States had become particularly fragile owing to structural losses of competitiveness or property market bubbles combined with the accumulation of household debts, or because of the vulnerable state of the banking sector. Decision makers and financial markets have long underestimated the importance of these macroeconomic imbalances. The coordination of economic policies fell short of the ambitions: the way in which the fiscal rules were interpreted and applied was too flexible, and the macroeconomic surveillance of structural policy was insufficiently rigorous, as the recommendations were not binding and there were no effective instruments for checking compliance with the rules. However, following the financial crisis of 2008-2009, it became apparent that these imbalances had a destabilising effect.

Aware of the seriousness of the situation, the European Council had already at the beginning of 2010 decided to strengthen the economic governance of the European Union (EU), including its fiscal rules. The Van Rompuy task force was set up, and the European Commission (EC) drafted six legislative proposals which were formally approved in amended form by the European Parliament and the Ecofin Council in the autumn of 2011 (the "Six-Pack"). Four of the six legislative texts concern public finances. They make fundamental changes to both the preventive and the corrective rules specified by the Stability and Growth Pact. In addition, the decision-making procedures were adapted, and minimum requirements were imposed regarding the national budgetary frameworks of the EU Member States. Two of the six texts concern the new macroeconomic imbalance procedure. This concerns, on the one hand, the identification, prevention and correction of macroeconomic imbalances, and on the other hand, a system of sanctions. A key innovation of the Six-Pack is that it aims to make decisions more automatic on the basis of the reverse qualified majority rule.

At the end of November 2011, the EC then proposed two additional regulations to ensure more rigorous budgetary surveillance (the "Two-Pack"). They are likely to be finalised and to enter into force in the summer of 2012 at the earliest.

In addition, the EU Member States – except for the United Kingdom and the Czech Republic – concluded a new intergovernmental treaty on stability, coordination and governance in the Economic and Monetary Union. This contains a new "fiscal compact" and closer coordination of their economic policies. Its main provision stipulates that the general government budget must be in balance or in surplus. It also contains a correction mechanism that may be activated automatically. The new rules are to be transposed into national law, preferably in the constitution or in another law guaranteeing that they will be fully respected. The new treaty will enter into force on 1 January 2013, provided it is ratified by at least twelve euro area Member States.

Furthermore, the timetables for the existing procedures as laid down by the Stability and Growth Pact and the Broad Economic Policy Guidelines are now harmonised in the European semester, and the Member States which have signed the Euro Plus Pact agree to take concrete measures every year, to be applied in the ensuing twelve months.

In parallel with these measures to strengthen governance within the EU, various mechanisms have been set up since the beginning of 2010 to contain the debt crisis, and a number of Member States have received emergency funding from the EU and the International Monetary Fund.

Only part of the new governance framework has come into force. It is therefore too soon to arrive at an overall judgment. In any case, the new fiscal rules in the "Six-Pack" are a step in the right direction. Regarding the macroeconomic imbalances, there was an urgent need for better regulation at European level. However, this is not the "quantum leap " required to minimise the risk of further macroeconomic derailments. The application of the new governance framework will now determine its credibility. Strict implementation of the procedures should contribute to that. National ownership, notably by the parliaments of the Member States, is another key element.

The regulations have also become much more complicated, and that may hamper the effectiveness and speed of application; an increase in the number of rules does not necessarily lead to more consistent and more coherent surveillance. Moreover, the initiatives overlap to some extent, deploying not only Community methods but also intergovernmental ones, further augmenting the complexity.