New developments in the economic governance of the European Union

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Introduction

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

In 2007, before the financial crisis erupted, vulnerable positions had already become apparent within the euro area. In the absence of adequate fiscal discipline, the initial budgetary position in several euro area countries was not very favourable. 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 following 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), its fiscal rules included. 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). After that, the EC proposed two additional legislative texts to ensure even more rigorous budgetary surveillance (the Two Pack). 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. 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 (IMF).

This article presents the initiatives taken at EU institutional level since the start of the debt crisis in the euro area.

1. Macroeconomic imbalances in the euro area

1.1 Institutional organisation of the Economic and Monetary Union

The institutional organisation of Economic and Monetary Union (EMU) among the euro area countries is unique,

since monetary policy is unified whereas fiscal policy is still largely decentralised.

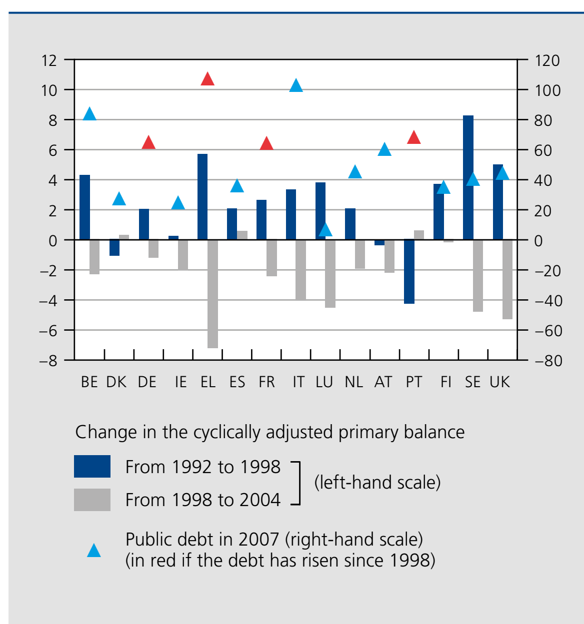
However, when the institutional framework of EMU was designed, there was an awareness of the need to keep watch over the sustainability of public finances and to arrange binding policy coordination. Fiscal policy coordination and the surveillance of public finances were laid down in binding rules, partly in the articles of the EU Treaty concerning the need to avoid excessive government deficits and in the excessive deficit procedure, and partly in the provisions of the Stability and Growth Pact.

Structural policy, like fiscal policy, remained the responsibility of the Member States. While there was some policy coordination in this sphere, it was a "soft" form of coordination, with no binding rules. It was organised via the broad economic policy guidelines and the employment policy guidelines which, from 2005, were amalgamated in the integrated guidelines and which, since 2010, have played an important role in the implementation of the Europe 2020 strategy.

The Member States' stability and convergence programmes and their national reform programmes put this fiscal and macroeconomic framework into practice.

CHART 1 FISCAL FATIGUE FOLLOWING THE DECISION TO INTRODUCE THE EURO

(in % of GDP)



Source : EC.

1.2 Fiscal fatigue in the initial years following the introduction of the euro

In principle, fiscal discipline was to be reinforced once the euro was introduced since – under the provisions of the Stability and Growth Pact, in force since 1999 – the remaining public deficits were to be eliminated. Yet the reality was very different. Once the countries which would first adopt the euro had been named in 1998, there was a marked relaxation of fiscal discipline. This fiscal fatigue was fairly widespread : with a few exceptions, the cyclically adjusted primary balance of the Member States deteriorated significantly from 1998 to 2004. In many cases, the budgetary efforts made in the preceding six years in order to satisfy the Maastricht criteria and eliminate the excessive deficits were largely or even entirely cancelled out.

Regarding the reasons for this failure to apply the fiscal rules, the first which come to mind are the unreliability of the budget statistics in certain countries (notably Greece) and over-optimistic growth forecasts, implying underestimation of the structural deficits. In addition, there were loopholes in the rules, as the initial Stability and Growth Pact does not clearly specify the time allowed for correcting the remaining deficits. Finally, there were doubts (quite rightly) about the proper application of the EU fiscal rules, in view of the Ecofin Council's extensive powers in that regard [1].

Just after the start of the new millennium, when economic conditions deteriorated, this lack of fiscal discipline in the initial years of the euro led to a first (in retrospective rather small) wave of excessive budget deficits. However, the implementation of the excessive deficit procedure, especially in regard to the large member countries, was systematically watered down, as the Ecofin Council did not actually follow the EC's recommendations in certain cases, even though they were often very flexible. In November 2003, when the Council did not implement the EC's recommendations that France and Germany should be officially ordered to take measures to correct their excessive deficits, the two institutions became embroiled in a legal dispute via proceedings before the European Court of Justice, which meant *de facto* suspension of the excessive deficit procedure against those two Member States – and more generally, all implementation of the Stability and Growth Pact, pending a revision of the rules.

In 2005, the Stability and Growth Pact underwent formal revision. The ESCB's concern regarding that revision was in stark contrast to the favourable view taken by other

(1) For a more detailed analysis, see the article entitled "The Stability and Growth Pact : an eventful history" (G. Langenus (2005), NBB, Economic Review, June).

European authorities, including the EC, which stated that the pact was being made "more intelligent" and "more flexible". The main points of concern for the European monetary authorities were the increased complexity of the new rules (numerous exceptions and general lengthening of procedures) and the marked increase in the Council's scope for interpretation.

In practice, the new "flexibility" was amply exploited, notably in setting the deadlines for eliminating excessive deficits. The financial penalties available under the rules were not even mentioned for any of the Member States. The budget position of most of the euro area countries was therefore not very strong at the start of the recent Great Recession. Thus, in 2007, the average cyclically adjusted budget deficit in the euro area countries was 1.9 % of GDP, while the average public debt still stood at around 66 % of GDP.

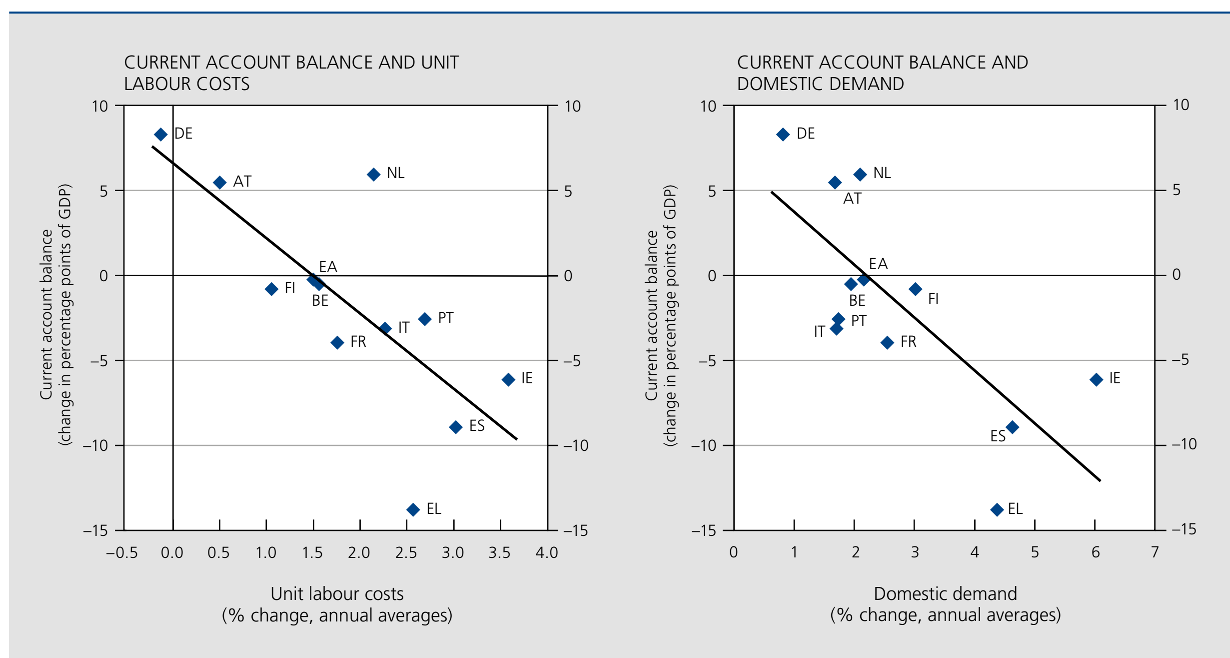
This also illustrates that budget positions (especially in nominal terms) cannot be the only indicators of European governance: for example, in Ireland and Spain – two Member States which were severely affected by the sovereign debt crisis – the public debt was well below the reference value in 2007 [1]. Nonetheless, there were other macroeconomic imbalances in those two countries.

(1) In this regard, it should be noted that Ireland's cyclically adjusted deficit was already at 1.5 %, while Spain's fiscal policy was to be eased substantially in the ensuing year (with the cyclically adjusted primary balance falling by almost 6 % of GDP in 2008), notably as a result of large tax cuts.

1.3 Persistent internal and external macroeconomic imbalances

In 2007, there were wide divergences in competitiveness and domestic demand within the euro area, with some countries becoming particularly vulnerable owing to persistent macroeconomic imbalances. Since the introduction of the euro, unit labour costs in certain euro area Member States had risen sharply in relative terms, gradually eroding those countries' competitiveness. At the same time, domestic demand recorded a marked rise in some of those countries – notably Ireland, Spain and Greece – often triggered by strong expansion of lending to households and a surge in household debt against the background, especially in the case of Ireland and Spain, of soaring house prices. In addition, financial institutions often underestimated the credit risks; in some countries such as Ireland, the banking system had become particularly fragile. Conversely, other euro area Member States, particularly Germany, recorded substantial competitiveness gains, while the growth of domestic demand and household lending had remained very moderate. These developments were reflected in contrasting current account balances across the various euro area countries.

CHART 2 MACROECONOMIC IMBALANCES IN THE EURO AREA IN THE PERIOD 1999-2007 [1]

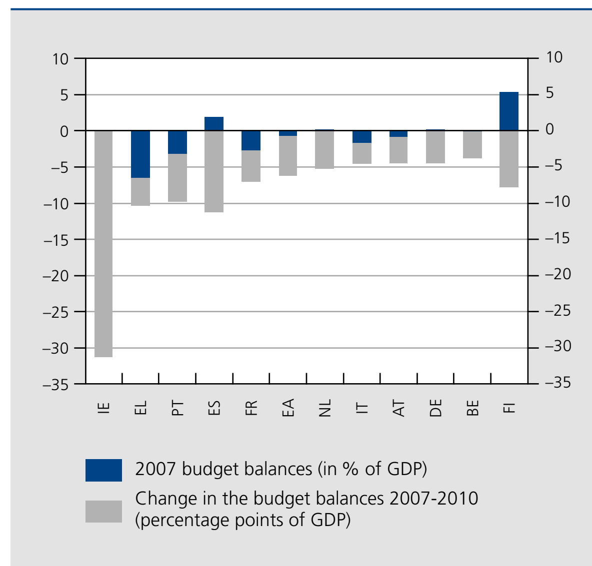


Source : EC.
(1) Only the eleven euro area Member States with the biggest GDP in 2011 are represented individually.

It was assumed that effective adjustment mechanisms were operating within the euro area which would lead to correction of these imbalances. Thus, the presumption was that the effects of excessive domestic demand, associated with high inflation and current account deficits, would eventually be corrected by the negative impact on growth of a loss of competitiveness. However, it subsequently emerged that the operation of these adjustment mechanisms was too weak, and came too late, so that the macroeconomic balance in a number of euro area Member States was persistently disrupted.

Structural policy was incapable of preventing or, if necessary, correcting these serious internal and external macroeconomic imbalances within the euro area. At EU level, the coordination methods proved too "soft": the recommendations were not binding and the institutional framework offered too few surveillance instruments, and was insufficiently focused on the emergence of macroeconomic imbalances and their potential spillover effects to other countries. In the wake of the financial crisis, it became clear that the ensuing benign neglect could put the euro area's stability at risk.

CHART 3 IMPACT OF THE FINANCIAL CRISIS ON BUDGETS IN THE EURO AREA (1) (2)



Source: EC.
(1) Only the eleven euro area Member States with the biggest GDP in 2011 are represented individually.
(2) The countries are ranked in order of the size of their budget deficit in 2010.

1.4 Impact of the financial crisis

The crisis which had set in by mid-2007 and turned into a global crisis in September 2008 triggered an adjustment process in the countries where expansion had been based to an excessive extent on debt; this led to a weakening of domestic demand and a reduction in the current account deficits, but at the cost of a marked slowdown in growth. Some euro area governments also had to take significant fiscal measures owing to the crisis, in order to contain the seriousness of the recession. Impressive recovery plans supplemented the automatic stabilisers, to prevent the collapse of economic activity. In some countries, especially Ireland, where the financial sector was seriously exposed to risks, the government had to intervene to support the banks. All this had a very detrimental impact on the budget position, which was already not very favourable from the start in several countries.

The financial markets reacted to the dramatic deterioration in public finances in a number of euro area Member States by increasingly questioning the sustainability of the budget positions. This led to a marked upward revision in the risk associated with sovereign debt, inflating the yields on government bonds of several countries. From the start of 2010 there was a significant widening of the spreads on the public debt of certain countries in relation to the German Bund, against the backdrop of mounting concern about the reliability of the statistics and the sustainability of the Greek public debt. The nervousness then spread to other vulnerable euro area countries which, in varying degrees, combined a high public debt with chronic current account deficits or a banking system which had become particularly fragile.

From May 2010 onwards, various mechanisms were therefore established to contain the debt crisis and prevent the spread of such crises in the future. Apart from the emergency funding which enabled Greece to borrow € 110 billion under a three-year programme, May 2010 also saw the creation of the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF). Originally set up for a period of three years (up to June 2013), these mechanisms aimed to grant conditional financial assistance to countries facing difficulties in raising finance. Altogether, the lending capacity of these two mechanisms totalled € 500 billion. The IMF was closely associated with this financial assistance, taking part in drafting the lending conditions and in supervising the rescue plans, and contributing an additional € 250 billion. Ireland and Portugal received support funding via these new mechanisms in November 2010 and May 2011 respectively. Initially, a permanent mechanism – the European Stability Mechanism (ESM) – was to take over the role of the EFSF and the EFSM from July 2013 in granting financial assistance to euro area Member States. However, in December 2011,

the euro area Heads of State or Government decided to bring forward the date of entry into force, with July 2012 as target date. At the end of March 2012, the ceiling on the joint lending capacity of the EFSF/ESM was raised to € 700 billion.

The cross-border contagion shows that the lack of confidence prevailing on the financial markets was not confined to the sustainability of public finances, but that there were also doubts about the smooth functioning of EMU itself. In fact, the policy coordination at European level had not been able to prevent or correct a number of diverse imbalances, and the financial crisis showed that, in view of the close economic and financial integration in the euro area, one country's instability could rapidly spread to others, thus damaging the cohesion and stability of the entire euro area.

2. Strengthening of economic governance in the EU

Realising the seriousness of the situation, the European Council and the euro area Heads of State or Government have taken a number of important initiatives since March 2010. Concerned about public finances, which had to be restored to a sustainable level, they decided that the coordination of economic policies had to be reinforced.

For that purpose, a task force was set up, directed by the permanent President of the European Council, and was therefore generally known as the Van Rompuy task force. Working closely with the EC, it developed proposals for consolidating the European fiscal rules and extending the European surveillance and macroeconomic coordination procedures. It also proposed better management of the timetables of the national reform programmes and the stability and convergence programmes in a European Semester.

At the end of September 2010, the EC had already formulated six legislative proposals (five regulations and one directive) – subsequently known as the Six Pack – intended to modify the regulatory framework. On the basis of those proposals and the final report of the Van Rompuy task force, and following intense negotiation between the EC, the Council and the European Parliament (the "trialogue"), the European Parliament approved the new Six-Pack legislation on 28 September 2011, while the Ecofin Council endorsed it on 4 October. Formal approval by the Council followed on 8 November. Since the rules entered into force on 13 December 2011, they were already being applied under the 2012 European Semester. Although this represents progress in the coordination of European policies, it should be noted that the Council greatly watered down the initial proposals during the lengthy negotiation process.

A crucial political decision in this respect was the agreement concluded by the German Chancellor and the French President on 18 October 2010 in Deauville, providing for restrictions on the automatic application of the sanctions as the Van Rompuy task force had planned and wished to propose to the European Council. Like Germany before, the EC and the European Central Bank had declared their support for more automatic sanctions. The European Central Bank was therefore disappointed at a number of the features of the Deauville agreement. The European Parliament was likewise disappointed, but was able to make some adjustments during the trialogue.

However, as the debt crisis worsened, the EC and the Council quickly concluded that it was desirable to go farther in reforming economic governance.

By the end of November 2011, the EC proposed two new legislative texts (dubbed the Two Pack) for further strengthening budgetary surveillance in the euro area. When this article went to press, those texts were still being negotiated in the trialogue between the Council, the European Parliament and the EC.

With the exception of the United Kingdom and the Czech Republic, the EU Member States also concluded a new intergovernmental treaty: the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. The treaty aims to reinforce fiscal discipline further by introducing more automatic sanctions and stricter surveillance (the Fiscal Compact), and to step up the coordination of the Member States' economic policies. If sufficient numbers of Member States ratify the treaty, it will enter into force on 1 January 2013.

2.1 New Six-Pack regulations

2.1.1 Stronger fiscal discipline

Four of the six legislative texts comprising the new rules on the governance of the EU introduced by the Six Pack concern public finances. There have been fundamental changes to both the preventive rules and the corrective measures specified by the Stability and Growth Pact. In addition, the decision-making procedures have been modified, and minimum requirements have been imposed regarding the EU Member States' national budgetary frameworks.

a) Preventive rules of the Stability and Growth Pact

One of the main problems which emerged in the implementation of the Stability and Growth Pact was that the preventive rules – aimed at achieving a budget position "close to balance or in surplus" (before the 2005 reform) or the medium-term objective set for each country [1] ("MTO" since the 2005 reform) – gave the Member States insufficient incentive to respect fiscal discipline.

The obligation to achieve a "safe" medium-term objective for each country is maintained, as is the definition of the appropriate speed for reaching that objective (the benchmark is an annual improvement in the structural balance amounting to 0.5 % of GDP, or more than 0.5 % of GDP for countries whose public debt exceeds 60 % of GDP or which present greater risks to their debt sustainability). However, from now on, progress towards the medium-term objective will be assessed in a broader framework ("overall assessment") in which, though the change in the structural balance remains the reference point, expenditure growth will also be taken into account. The concept of "prudent expenditure growth" was introduced in that regard.

A reference rate for potential GDP growth in the medium term is used in this connection, but a distinction is made between Member States which have already achieved their medium-term objective and those which have not yet done so. For the first group, spending growth must not exceed potential GDP growth ; for the others, expenditure growth must be lower than potential GDP growth, the downward deviation being aligned with the pace of convergence required to achieve the medium-term objective. In both cases, adjustments are made to take account of the budgetary impact of the measures taken at the level of revenues : for example, tax increases permit stronger expenditure growth, while measures to reduce public revenues further curtail the growth of spending.

However, the expenditure concept used for this new spending rule is defined in restrictive terms. It takes no account of interest charges, the cyclical component of unemployment expenditure, or all the spending relating to the European programmes financed by EU funds.

In principle, any deviation from the adjustment path towards the attainment of the medium-term objective specific to each country triggers a warning and, if appropriate, subsequent sanctions (see below), but only if they are significant. The definition of a "significant" deviation takes account of a numerical criterion – a budgetary impact of at least 0.5 % of GDP over a given year, or at least 0.25 % of GDP per annum on average over two consecutive years (in the case of deviations concerning the reduction in the structural deficit or expenditure growth) – while leaving some scope for interpretation. Thus, it is possible to make allowance for unusual events beyond the Member State's control, having a major impact on the budget position, and for a severe economic recession. In addition, the deviation is not classed as significant (and therefore has no institutional consequences) if the budget position was already better than the medium-term objective and if the attainment of that objective at the end of the period covered by the stability or convergence programme is not compromised. Member States which have already created some budgetary scope in relation to the medium-term objective can therefore use it to ease their fiscal policy. Finally, account is also taken of structural reforms which, in the short term, could have a negative impact on budget positions but which, in the long term, improve the sustainability of public finances, so long as a safety margin is maintained in relation to the limit of 3 % of GDP which the budget deficit must not exceed, and the deviation from the adjustment path towards attainment of the medium-term objective is temporary and is limited to the direct budgetary impact of the reform. In this connection, there is a particular focus on pension reforms (e.g. the switch to funded schemes) but reforms designed to enhance potential economic growth also receive attention, though without further details.

b) Corrective rules of the Stability and Growth Pact

In regard to the corrective arm of the Stability and Growth Pact, the principal – or at least the most striking – modification is the operationalisation of the debt criterion, which supplements the deficit criterion. In reality, even before the Stability and Growth Pact, the debt criterion was already part of the EU governance framework, being one of the convergence criteria under the Treaty on European Union (Maastricht criteria) : if the public debt exceeds the reference value of 60 % of GDP, the debt ratio must decline sufficiently and approach that reference value at a satisfactory pace. In principle, the excessive deficit procedure could be initiated against Member States which did not satisfy this criterion, even if their budget deficit was below 3 % of GDP. However, there was never any definition of the decline considered "sufficient" and the convergence classed as "satisfactory", so that this criterion remained unworkable.

(1) That objective is proposed by the Member States themselves, but must satisfy three requirements : it must 1) maintain a safety margin in relation to the maximum deficit of 3 % of GDP (on the basis of minimum benchmarks calculated by the EC) ; 2) guarantee rapid progress towards a sustainable budget position (while also taking account of the budgetary impact of ageing) ; and 3) provide sufficient scope in the budget, e.g. for public investment.

The new rules now put a figure on the pace of convergence required to achieve the reference value: it is necessary to achieve an average annual reduction in the debt ratio of one-twentieth of the excess over the reference value of 60 %. This reduction must take place either during the last three years for which data are available, or during the latest year for which data are available and during the two subsequent years (according to the EC's estimates).

However, failure to respect this quantified debt rule does not automatically trigger an excessive deficit procedure. Just as in cases where the budget deficit exceeds 3 % of GDP, the EC has to produce a report assessing the situation. First, it has to take account of the impact of the business cycle on the debt reduction, as weaker nominal growth hampers debt reduction. In addition, a list of "relevant factors" is taken into account, explicitly referring to such aspects as the adjustment path followed in order to achieve the medium-term objective, the primary balance, the sustainability of the public debt, the quality of the national budgetary framework, the existing guarantees and the level of the financial assets (notably those formed in connection with operations designed to support other Member States or the financial sector). The Member State concerned can itself put forward other factors "relevant" for the assessment of compliance with the criteria concerning the budget deficit and the public debt.

c) Decision-making procedures and sanctions

Apart from the changes made to the preventive and corrective arms of the Stability and Growth Pact, the decision-making procedures and sanctions were also adjusted to improve the application of the fiscal rules. The main problem which had arisen so far was not in fact the inadequacy of the fiscal rules or their lack of clarity, but – as already stated – the shortcomings in their application. As before, any financial sanctions only concern euro area countries and not the other Member States.

One of the general aims of the new governance framework is to make the procedures more automatic. To do that, a new voting procedure was introduced for actually and formally imposing sanctions, whereby the Council has only a very brief period (ten days) in which it can reject the EC's recommendations by a qualified majority, whereas previously the recommendations had to be adopted by a qualified majority. This reverse qualified majority voting appears once in the preventive arm of the pact and in two provisions of its corrective arm.

As mentioned earlier, it is now possible to impose effective sanctions on Member States which do not respect the rules set out in the preventive arm of the pact, which was not the case previously. Moreover, the power to decide on early warnings concerning budgetary slippages now rests with the EC, even though this only concerns the launch of a procedure which has to be pursued by the Council. In principle, the imposition of any sanctions under the preventive arm begins with such a warning, i.e. if the EC considers that convergence towards the medium-term objective is inadequate, with expenditure growth also being taken into account. The fact that the EC can itself decide to initiate such a warning is a modest but, in our opinion, important adjustment to the previous system whereby the EC could only recommend that such a warning be given, after which the Council had to explicitly adopt that recommendation, which it sometimes did not do.

Within a maximum of one month of this warning, the Ecofin Council has to examine the situation and make a recommendation to the Member State concerned so that the latter takes the necessary measures. The time allowed for remedying the situation is explicitly set at a maximum of five months, and it may be reduced to three months if the EC considers the situation to be particularly serious and urgent. During this period, the Member State must report to the Council on the measures taken.

If the Member State does not apply this Council recommendation – or, for example, if it fails to implement the measures announced – the Council may, on the EC's recommendation, find by a qualified majority that no effective action has been taken. In that case, the EC has 20 days to recommend that the Council impose a sanction in the form of an interest-bearing deposit equal to 0.2 % of the previous year's GDP. The Council can only reject that recommendation by the reverse qualified majority voting procedure mentioned above. It may also amend the recommendation by a qualified majority[1]. If the Council decides, on the EC's recommendation, that the budget overrun has been eliminated, the deposit and the accrued interest are returned to the Member State.

As regards the corrective arm of the pact, the sanctions regime has likewise been adjusted. Sanctions may range from a non-interest-bearing deposit to an actual fine, the maximum once again being set at 0.2 % of the previous year's GDP in both cases.

Within a maximum of twenty days of the Council's decision – on the EC's recommendation – that there is an excessive deficit, the EC must recommend the Council to impose a non-interest-bearing deposit. Once again, that recommendation can only be rejected by a reverse

(1) Following the Council's adoption of the recommendation in accordance with these procedures, the EC may, however, at the reasoned request of the Member State, recommend a reduction in the amount of the deposit, or even its cancellation.

qualified majority. At this stage, if the preventive arm of the Pact was effective, an interest-bearing deposit will already have been imposed on the Member State concerned, as the latter had failed to respond to the EC's warning. In that case, the interest-bearing deposit is converted to a non-interest-bearing deposit. If there has been no decision to impose an interest-bearing deposit, it is possible to impose a non-interest-bearing deposit immediately if the failure to respect the fiscal rules is "particularly serious".

The procedure for imposing the possible subsequent fine is largely the same as under the previous rules. The only difference is that, in regard to the actual imposition of the fine – on the EC's recommendation no later than 20 days following the Council's decision, again on the EC's recommendation, that the Member State has not taken effective action to correct its excessive deficit –, there is provision for another reverse qualified majority vote [1]. If the Council concludes, upon the EC's recommendation, that the excessive deficit has been eliminated, the deposit is returned to the Member State.

An initial, crucial stage in the procedure, which may possibly lead to the formation of compulsory deposits or the imposition of a fine, is the finding that the Member State concerned has failed to take effective action in response to the Council's recommendations, or that there is an excessive deficit. The Council still has some discretion, especially in assessing the actual measures taken by the Member State. Without these preliminary stages, no deposit or fine can be imposed. It is in regard to this decision that the Council's power has only been partially modified compared to the previous rules (interest-bearing deposit under the preventive arm) or has not changed at all (non-interest-bearing deposit and fine under the corrective arm). This is one of the main criticisms of the new rules.

The new regime introduces another new sanction: the fine for statistics that misrepresent the data on the budget deficit or the public debt. This fine is also limited to 0.2 % of the previous year's GDP, and can only be imposed after detailed investigations by the EC, during which the Member State concerned must be given a hearing. The budget figures need not have been deliberately manipulated. In principle, serious negligence may also lead to a fine. These fines are imposed via the "old" voting procedure – and therefore not by the reverse qualified majority vote: an EC recommendation on the subject has to be explicitly adopted by the Ecofin Council deciding by a qualified majority.

(1) Here, too, at the reasoned request of the Member State, the EC may, however, recommend a reduction in the amount of the deposit or the fine, or even its cancellation.

(2) The provisions on numerical fiscal rules do not apply to the United Kingdom.

d) National budgetary frameworks

Finally, a new EU Directive imposes certain minimum requirements on national budgetary frameworks. Though relatively vague, they aim at greater consistency between national and European rules and institutions; the principles of the European rules (such as multi-annual planning, numerical fiscal rules, etc.) must thus be reflected to a sufficient degree in the national institutional framework. This mainly concerns the following aspects of the national budgetary framework:

- First, sufficient reliable statistics must be available in good time to permit monitoring of the implementation of the budget (aspect monitoring). These budget figures must cover the entire public sector, to ensure that budget problems do not arise in government subsectors without being noticed. These statistics must also be subject to internal control and independent audits. Note that, following the many problems encountered in regard to the accuracy of the budget figures of the Member States, Eurostat has already had extended auditing powers in this matter since July 2010.

- Member States must also introduce "appropriate" numerical fiscal rules concerning the deficit and/or the debt, with provision for corrective mechanisms if the rules are broken [2]. There is no obligation regarding the legal basis of these rules (constitution, ordinary law, current government guidelines). Nonetheless, it is stipulated that independent bodies (or bodies with functional autonomy vis-à-vis the government) must verify that these rules are respected; this is an implicit reference to the budget councils which exist in a good many countries. However, there are no additional obligations, e.g. regarding the method of appointing the members and the exact powers of these budget councils.

- Member States must also draw up detailed plans, if they have not already done so, for the attainment of the medium-term objective specified in the stability or convergence programme. Those plans must imply a commitment; they must be based on realistic estimates of the main revenue and expenditure categories, and must also indicate how the measures to be taken will influence the sustainability of public finances in the long term.

- Budgetary procedures must also fulfil certain requirements, particularly in regard to the underlying macroeconomic and budgetary estimates. The latter must be realistic or prudent. Clear reasons must be given for any significant differences in relation to the EC's estimates, and the methodology used must be transparent and subject to regular technical consultation with the EC.

- Finally, the said Directive provides that the countries must set up adequate coordination mechanisms across all general government sub-sectors. These must concern all relevant aspects of fiscal planning, ranging from the budget estimates themselves to compliance by the general government as a whole with the said fiscal rules.

In principle, the adjustments to the national budgetary frameworks must have been made by the end of December 2013.

2.1.2 Surveillance of macroeconomic imbalances : the macroeconomic imbalance procedure (MIP)

In order to prevent, and if necessary correct, macroeconomic imbalances in the EU in the future, the economic surveillance and policy coordination, which used to be geared essentially to fiscal policy, had to be widened to include a new formal surveillance framework.

The new macroeconomic imbalance procedure is based on two of the six legislative texts contained in the Six Pack, one concerning the identification, prevention and correction of macroeconomic imbalances, and the other concerning a system of sanctions.

As in the case of the fiscal rules, the aim is for decisions to become more automatic, on the basis of the reverse qualified majority rule. The application of the two Regulations will be assessed initially after three years, and then every five years thereafter.

The Regulation on the prevention and correction of macroeconomic imbalances applies to all European Union Member States, but with a distinction between the euro area countries and the other EU Member States. The second Regulation, which concerns the sanctions, applies only to euro area countries.

Some Member States had insisted that only countries with a current account deficit on the balance of payments should be subject to closer surveillance. However, the European Parliament made the mechanism more symmetrical. Nevertheless, it is specified that policy action is particularly necessary in Member States recording persistent balance of payments deficits and losses of competitiveness, even though Member States accumulating large current account surpluses also need to take measures to help strengthen domestic demand and growth potential. Moreover, the Ecofin Council on 8 November 2011 explained that, unlike deficits, "large and sustained current account surpluses do not raise concerns about the sustainability of external debt or financing capacity that affect the smooth functioning of the euro area", and that such surpluses would not give rise to sanctions.

Imbalances will be dealt with in phases : first, the detection of imbalances (alert mechanism) and preventive measures to avoid a serious imbalance ; and next, if serious imbalances nevertheless develop, corrective measures by application of the excessive imbalance procedure. If necessary, as stated in the second Regulation, sanctions may be imposed.

a) Preventive arm of macroeconomic surveillance

The early detection of imbalances operates via an alert mechanism. This is based on a "scoreboard" comprising thresholds. However, the results cannot be interpreted mechanically but must be combined with an assessment by the EC, which, if necessary also takes account of other relevant information, and not just the scoreboard. If the thresholds are exceeded, that therefore does not necessarily imply the existence of macroeconomic imbalances. Every year, the EC has to produce an Alert Mechanism Report (AMR), presenting the results of the scoreboard and of its assessment.

The EC's annual Alert Mechanism Report and its discussion by the Ecofin Council and the Eurogroup are part of the annual multilateral surveillance under the European Semester.

The scoreboard comprises a small number of macroeconomic and macrofinancial indicators accompanied by thresholds which are meant to reveal imbalances, not only those that emerge in the short term but also those due to structural and long-term trends. The scoreboard undergoes regular assessment. If need be, the indicators and thresholds are adjusted in the light of any changes which have occurred in the nature of the macroeconomic imbalances.

The indicators first concern internal imbalances, notably those which relate to the debts of the government and the private sector, and developments concerning the housing market, private sector credit and unemployment. It must also be possible to detect external imbalances such as those relating to movements in the balance of payments current account, the net investment position, the real effective exchange rate, export market shares and competitiveness.

Regarding the current composition of the scoreboard and the thresholds, see the assessment presented in this article of the EC's first Alert Mechanism Report, which formed the starting point for the macroeconomic imbalance

procedure under the 2012 European Semester (see below). This shows that, following the compromise between the Council and the European Parliament on symmetrical treatment, both lower and upper alert thresholds are applied to the balance of payments current account and the real effective exchange rate. Differentiation between the euro area countries and the other EU Member States is reflected in the different thresholds used for the real effective exchange rate and for nominal unit labour costs.

If, following discussions on the Alert Mechanism Report in the Ecofin Council, or in the Eurogroup in the case of euro area countries, it emerges that there are potential or actual macroeconomic imbalances in certain countries, or in the event of unforeseen significant economic developments calling for urgent analysis, the EC prepares an in-depth review of the countries concerned. This study has to take account of the conditions specific to each country and be based on a broad range of economic variables.

Should, on the basis of the in-depth review, the EC identify macroeconomic imbalances, the Council may – on a recommendation from the EC – address a recommendation to the Member State on the required preventive policy response. The latter must be monitored under the European Semester.

b) Corrective arm of macroeconomic surveillance : the excessive imbalance procedure (EIP)

If, following its in-depth review, the EC finds "excessive" imbalances, the Council may – on a recommendation from the EC – address a recommendation to the Member State establishing the existence of an excessive imbalance and advocating corrective action as well as a deadline by which the Member State must submit its corrective action plan.

Following the submission of the plan, the Council has two months in which to assess it on the basis of a report by the EC. If the plan is satisfactory, it is approved and a surveillance timetable is drawn up. However, if the Council decides that the measures or the implementation periods are not satisfactory, the Member State has to submit a new corrective action plan, within two months as a rule.

The Member State must present regular reports on the progress of its corrective action. The EC monitors its implementation. On the basis of the EC's report, the Council makes an assessment.

- If the Council decides that the Member State has taken the necessary corrective action, the excessive imbalance procedure is considered to be on track and is held in abeyance. However, the monitoring continues in accordance with the set timetable.

- If the Member State has not taken the necessary corrective action, the Council, acting on a recommendation from the EC and by a reverse qualified majority, shall adopt a decision establishing "non-compliance" with the corrective action and address a recommendation to the Member State specifying new deadlines for corrective action.

If the Council decides that there is no longer an excessive imbalance in the Member State concerned, the excessive imbalance procedure is closed.

c) Sanctions

Decisions on sanctions are taken by the Council on the basis of an EC recommendation, acting by reverse qualified majority.

The sanctions are as follows :

- An annual fine if, during the same excessive imbalance procedure, the Council has issued two successive recommendations stating that the corrective action plan is insufficient.

- An interest-bearing deposit if the Council decides that the Member State has not taken the necessary corrective action.

- An annual fine if, during the same excessive imbalance procedure, the Council has on two successive occasions found "non-compliance", implying that the Member State has not taken the necessary corrective measures. More specifically, the interest-bearing deposit which had been imposed earlier under the procedure is converted into a fine.

In principle, both the interest-bearing deposit and the fine represent 0.1 % of the previous year's GDP of the Member State concerned.

2.2 The European Semester

One of the first recommendations by the Van Rompuy task force was to align the timetables for the national reform programmes and the stability and convergence programmes under the European Semester. The first European Semester was launched in 2011.

The European Semester implies that the surveillance of budgets and other macroeconomic and structural developments will from now on form part of a cycle of closer *ex-ante* policy coordination. Even where the existing procedures, such as those under the Stability and Growth Pact and the broad economic policy guidelines, remain legally separate, their timetables are now harmonised.

Regarding the timetable, the European Semester cycle begins with a horizontal review : the Annual Growth Survey which identifies mutual economic challenges and determines the strategic policy stance. That document is then approved at the spring European summit. In the spring, the Member States draw up their stability and convergence programmes and their national reform programmes, taking account of these strategic decisions. Their programmes are submitted in April and are then assessed by the EC and the Council in June and July. That implies that these two institutions issue their guidelines at a time when the main fiscal measures are still being prepared in most countries. That will improve the synchronisation of surveillance within the European Union with national budgetary procedures.

The new macroeconomic imbalance procedure forms part of the European Semester timetable. The EC publishes its Alert Mechanism Report in February. Next, the Economic Policy Committee (EPC) prepares the discussions to be conducted in the Council. In mid-May the EC publishes its in-depth review.

2.3 The Euro Plus Pact

In March 2011, the Heads of State or Government of the euro area and of six other EU Member States reached agreement on the Euro Plus Pact. This pact aims to strengthen further the economic pillar of EMU and enhance the quality of economic policy coordination. The pact's main objective is to boost competitiveness and, in so doing, to achieve a higher degree of convergence.

The Member States which signed the pact agree to take concrete measures every year which will be implemented in the subsequent twelve months. These measures are also presented in the stability and convergence programmes and in the national reform programmes. The purpose of the Euro Plus Pact is to secure concrete commitments from the Member States, since the measures announced in the national reform programmes were often vague and non-committal.

2.4 The Two Pack

The term "Two Pack" refers to two Regulations proposed by the EC on 23 November 2011, intended to strengthen further fiscal surveillance in the euro area countries. Following an examination conducted under the trialogue procedure between the Council, the European Parliament and the EC, the two Regulations are likely to be finalised and to enter into force at the earliest during the summer of 2012.

The first proposal for a Regulation aims to strengthen and harmonise the budgetary procedures in the euro area countries, and to impose additional surveillance and reporting obligations in the case of an excessive deficit. In particular, in regard to the first point, a common budgetary timetable must be respected : draft budgets including the main parameters of the budgets of lower levels of government must, in principle, be produced by 15 October in the preceding year, then submitted to the EC which has to examine them before the end of November ; the EC's assessment is discussed in the Eurogroup and may also be presented to the parliament of the Member State in question if such a request is made. The budgets have to be approved by no later than the end of December of the preceding year, though emergency procedures must be in place in case that does not happen for reasons beyond the control of the government concerned. The budgets must also be based on independent macroeconomic estimates ; autonomous budget councils are accorded a key role in checking compliance with the numerical fiscal rules, and an *ex-ante* reporting obligation vis-à-vis the EC and the Eurogroup is introduced for the issuance of debt certificates.

The second proposal for a Regulation provides for a closer surveillance regime in euro area countries which request financial assistance from the European emergency funds or which, in the EC's opinion, face serious financial stability problems which could have negative contagion effects on other euro area countries or on the euro area as a whole. The current approach being followed for countries receiving assistance from the EU funds (Greece, Ireland and Portugal) is largely institutionalised. Among the key features : one of the articles of this draft Regulation states that any euro area country which has "insufficient capacity" or which experiences significant problems in implementing the adjustment programme imposed must seek the "technical assistance" of the EC which may, for that purpose, set up a group of experts in collaboration with other Member States and international institutions, which may be based permanently in the country concerned. This appears to be a first step towards the possible abolition of the national sovereignty of a euro area Member

TABLE 1 OVERVIEW OF THE NEW EU GOVERNANCE FRAMEWORK

	Six Pack	Two Pack	TSCG [1]
What ?	5 EU Regulations and 1 EU Directive	2 EU Regulations (currently being negotiated)	International treaty
Who ?	EU-27 (with some distinction between the euro area countries and the others)	Euro area countries	EU-25 (excluding UK and CZ)
Date of entry into force	13 December 2011	expected : summer 2012 (after the trialogue procedure)	after ratification by at least 12 euro area countries (target : January 2013)
Content	• stricter and broader fiscal surveillance (e.g. operational debt criterion and expenditure rule) • broader macroeconomic surveillance • new decision-making procedures • minimum requirements for national budgetary frameworks	• more advanced fiscal surveillance and coordination in the euro area • independent national institutions responsible for monitoring compliance with the fiscal rules • precise timetable for the annual budget and preliminary review by the EC • tougher surveillance regime for countries with financial difficulties (automatic for those receiving assistance)	• limit on the structural deficit, preferably enshrined in the constitution • the euro area countries commit to accepting in principle the EC's recommendations regarding the excessive deficit procedure [2] • role for the European Court of Justice • provides for enhanced coordination

Source : NBB.
(1) Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. The term "fiscal compact" is often used to refer to the fiscal issues which it includes.
(2) The euro area countries agree to accept any EC recommendation concerning the existence of an excessive deficit unless the recommendation is rejected by a qualified majority.

State pursuing a policy that has adverse effects on other Member States and incapable, for any reason, of implementing an international adjustment programme.

2.5 The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union

At the European summit on 8 and 9 December 2011, all the EU Member States with the exception of the United Kingdom declared their willingness to conclude a new Fiscal Compact and to achieve even closer coordination of their economic policies. The new pact aims to enhance fiscal discipline by providing for more automatic sanctions and stricter surveillance. In addition, the Member States will coordinate their economic policies. These agreements are defined in a new intergovernmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, signed at the beginning of March 2012, in the margins of the European Council meeting, by 25 EU Member States (all the Member States except the United Kingdom and the Czech Republic). It will enter into force on 1 January 2013 so long as it is ratified by at least twelve euro area Member States. It will only be binding for the euro area countries (that have ratified it) ; for the other Member States it will be binding once they introduce the euro, or before then at their request.

The Fiscal Compact is the fiscal part of the new treaty. Its main provision specifies that the budgetary position of the general government must be in balance or in surplus. That condition is deemed to be met if the annual structural budget balance is at the level of the medium-term objective specific to each country, on the understanding that the lower limit for this balance is a deficit of 0.5 % of GDP [1]. It is important to converge rapidly towards the medium-term objective specific to each country, the adjustment path for that purpose being proposed by the EC.

If the annual structural budget balance deviates significantly from the medium-term objective or the adjustment path towards that objective, a correction mechanism will be activated automatically, obliging the Member State concerned to correct the deviation within a well-defined period. Only "exceptional circumstances" may justify a – temporary – deviation from the said objective or the adjustment path. Any dispute between the EC and a

(1) For countries whose public debt is significantly lower than 60 % of GDP and which face a low risk to the sustainability of their public debt, that limit is lowered to a deficit of 1 % of GDP.

Member State has to be settled by the European Court of Justice.

These new rules must be transposed into national law – preferably in the constitution or in another law guaranteeing compliance in all respects – and be implemented by no later than one year after entry into force of the intergovernmental treaty. If a Member State signatory to the treaty finds, independently or on the basis of a report on the subject by the EC, that a country has not incorporated the new rules appropriately in its national law, it may bring proceedings before the European Court of Justice. The Court's judgment is then binding, and the Court may impose the necessary measures. If a Member State then finds, independently or on the basis of a report on the subject by the EC, that the measures imposed by the European Court of Justice have not been respected, it may bring another action before the Court and apply for financial sanctions. In that case, the Court may impose a fine of up to 0.1 % of GDP.

The treaty also repeats that if the public debt exceeds 60 % of GDP, it must be reduced each year by one-twentieth of the difference between the actual debt level and 60 % of GDP.

Member States subject to an excessive deficit procedure must set up a fiscal and economic partnership programme comprising the measures to be implemented in order to ensure the lasting correction of their excessive deficit. The presentation of this programme to the EC and to the Council, and its monitoring, take place in the context of the existing surveillance procedures under the Stability and Growth Pact. In addition, the rules on the excessive deficit procedure have been tightened up for euro area Member States. The latter undertake to support any recommendation submitted by the EC concerning the existence of an excessive public deficit unless that recommendation is opposed by a qualified majority. The measures and sanctions proposed or recommended by the EC are supported unless they are opposed by a qualified majority.

To improve the coordination and planning of public debt security issues, the Member States have to report in advance to the EC and the Council.

Apart from the Fiscal Compact, the new treaty also comprises a section on economic policy coordination and governance in the euro area, providing for additional "Euro summits" to be held at least twice a year.

Finally, the preamble to the new treaty also stipulates that the financial assistance given under the European Stability Mechanism will be conditional upon ratification of the new treaty and the transposition of the budgetary measures concerned into national law within the specified periods.

In the absence of unanimity among the Member States, the new intergovernmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union therefore does not imply any revision of the EU Treaty. However, the aim is that, within five years of its entry into force, the necessary measures to incorporate this intergovernmental treaty in the legal framework of the EU will have been taken. That should prevent the establishment of new institutional frameworks and parallel policy coordination outside the EU Treaty. Moreover, it is necessary for the EU institutions which the new intergovernmental treaty entrusts with important tasks, in this case the EC and the European Court of Justice, to represent the EU as a whole on the basis of European legislation, and not just certain Member States.

3. Assessment of the new rules on economic governance

Only part of the new governance framework has entered into force. It is therefore too soon to make an overall assessment. The next section presents a series of general considerations concerning the Six Pack, applicable since the end of 2011, and the new Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, before examining the conclusions of the first Alert Mechanism Report.

3.1 Initial considerations concerning the Six Pack and the TSCG

The new fiscal rules set out in the Six Pack are in any case a step in the right direction. The more binding character of the preventive arm of the Stability and Growth Pact, including the provisions on possible sanctions, and the greater attention to the national budgetary frameworks and the accuracy of the budget statistics are particularly positive features. In regard to macroeconomic imbalances, as already stated, there was an urgent need to have better rules at the European level. However, this is not the "quantum leap" required to minimise the risk of further macroeconomic and budgetary slippages.

Thus, it must be said that the more automatic character of the new fiscal rules is actually rather disappointing. It is doubtful that the limited transfer of decision-making powers from the Ecofin Council to the EC will mean better application of the rules in all cases.

As already mentioned, regarding the fiscal rules, the reverse qualified majority voting procedure was introduced solely for the purpose of the formal stage relating to the imposition of a sanction. Conversely, the Ecofin Council's powers relating to the necessary prior decision (no effective policy response or existence of an excessive deficit) remain more or less unchanged. Only the assessment of whether a Member State has actually complied with the Council's recommendations under the preventive arm of the Stability and Growth Pact gives rise to a new, complex voting procedure. During the trialogue negotiations, the European Parliament had argued for much more extensive use of the reverse qualified majority voting procedure than that advocated by the EC and the Council, but in the end only limited changes were made to the existing voting procedure. This concerns a double vote. First, the Ecofin Council must – as before – adopt by a qualified majority the EC's recommendation that no effective action has been taken to comply with the Council's recommendations following a warning. If the Council does not adopt it, and if the EC stands by its view that the recommendations have not really been implemented, it may, after one month, address a second recommendation to the Council which is considered to be adopted unless the Council, acting by a simple majority, explicitly rejects it within ten days (reverse simple majority voting).

In regard to the other two decisions which must precede any sanction, the procedure is unchanged : the Ecofin Council must explicitly adopt an EC recommendation on the subject by a qualified majority, otherwise no sanction can be imposed. It therefore does not seem unreasonable to suspect that the Ecofin Council will prove to be even more "prudent" when it comes to taking these prior decisions, knowing that the subsequent progress of the procedure is more automatic in character.

Under the macroeconomic imbalance procedure, reverse qualified majority voting is likewise reserved primarily for the imposition of sanctions : reverse qualified majority voting is not specified for the Council's decision on the existence of excessive imbalances, nor for the preventive arm of the macroeconomic imbalance procedure. In contrast to what applies to the fiscal rules, reverse qualified majority voting is mandatory if it is found that the corrective measures have not been implemented.

The rules are also being made far more complicated, which 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. More specifically in regard to the macroeconomic imbalance procedure, the extensive range of issues surrounding the imbalances must be taken into account. The imbalances cover numerous aspects of the economy which interact. In view of the complexity of the question, it was not in fact desirable to confine the assessment of any imbalances to an automatic reading of the scoreboard. Conversely, the current legislation leaves the door open to interpretation, and has ended up relatively complicated.

Moreover, the new rules also raise some specific questions. In regard to the preventive arm of the fiscal rules, for example, there are still no specific details on the way in which the new rules on expenditure will be applied. Thus, the estimate of potential economic growth presents a considerable technical problem when it comes to estimating the structural budget balances and hence judging the adjustment path towards the medium-term objective. Moreover, it will be far from being a simple matter for the EC to analyse accurately and objectively the budgetary impact of the measures concerning revenues, necessary to determine the permissible expenditure growth. As interest charges are excluded from the expenditure rule, compliance with the rule might not always lead to the required elimination of the structural deficit.

In regard to the corrective arm of the fiscal rule, there remains the question as to what precise added value the debt rule will bring. Of course, it is perfectly reasonable to require countries saddled with heavy debts to make a greater budgetary effort. However, opting to do that by imposing a new direct numerical limit on the movement in the debt (and not a stricter limit on the budget balance) brings its own set of problems. The movement in the consolidated gross debt (a concept derived from the Maastricht Treaty) is in fact determined not only by the budget balance but also by nominal GDP growth and by adjustments between the deficit and the debt (such as changes in financial assets, exchange rate fluctuations, divergences between cash flows and revenue and expenditure according to the ESA 95 methodology, etc.). In principle, all these factors should be taken into account when assessing the movement in the debt : for example, how will compliance with the debt criterion be assessed if the reduction in the debt is due essentially to the sale of financial assets (something which does not influence either the net debt or the sustainability of public finances) ? The list of "relevant factors" – which goes far beyond the business cycle and the said adjustments between the deficit and the debt – does not facilitate consistent application of the debt criterion : far from it. In general, under normal economic circumstances and in the case of normal adjustments between the deficit and the debt, it is likely that a budget

balance close to the medium-term objective, as defined in the preventive arm of the Stability and Growth Pact, will automatically lead to the required debt reduction. The value added of this new rule concerning the debt is therefore relative.

Finally, it must be said that the requirements imposed in the said Directive concerning national budgetary frameworks remain vague in many respects. A number of Member States go much farther in strengthening their national fiscal rules and budgetary institutions.

Regarding the new Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, it largely follows – and even overlaps with – the Stability and Growth Pact as amended under the Six-Pack legislation; nonetheless, it does reinforce it. Thus, the medium-term objectives for structural budget balances and the automatic correction mechanism have to be enshrined in national law, at constitutional or comparable level. In addition, the provision whereby the Member States must abide by the proposals and recommendations of the EC under the excessive deficit procedure unless they are opposed by a qualified majority is stricter than the comparable provisions of the Six Pack. Conversely, the Fiscal Compact under the new treaty appears to have the drawback of further increasing the complexity of the rules on governance.

3.2 The first Alert Mechanism Report, February 2012

In February 2012, the EC published its first Alert Mechanism Report, the first stage in the macroeconomic imbalance procedure. As already mentioned, this report is based on a series of relevant indicators and thresholds which make up the scoreboard.

3.2.1 Findings of the first Alert Mechanism Report

The first scoreboard is based on data from the end of 2010. For many Member States, it indicates the following principal problems: large current account balances (even if they have recently been corrected to some extent), the still substantial level of the net external debt, loss of export market shares and the debt levels of households and businesses as well as governments. Property price bubbles were also identified among the problems facing a number of countries, although a correction is in progress on this point.

Several indicators exceed the thresholds and are thus highlighted in red for many countries:

- 15 of the 27 Member States record a net international investment position which is too negative as a percentage of GDP, or a loss of export market shares, or a too high private sector debt as a percentage of GDP; in a number of cases, these three imbalances are combined;
- in 14 Member States, the public sector debt exceeds 60 % of GDP;
- in 11 Member States the current account imbalance is highlighted in red, 9 recording a deficit which exceeds the threshold of –4 % of GDP, and 2 recording a surplus which exceeds the threshold of +6 % of GDP;
- apart from these common imbalances, a substantial change in the real effective exchange rate, in nominal unit labour costs and in the unemployment rate are mentioned a number of times, while property price rises and private sector credit flows are in red in one or two cases.

On the basis of this scoreboard, the EC selected 12 Member States for an in-depth review. The programme countries [1] – Ireland, Greece, Portugal and Romania – were excluded as they are already under closer surveillance. The countries selected for an in-depth review include seven euro area Member States (Belgium, Cyprus, Finland, France, Italy, Slovenia and Spain) and five which are not in the euro area (Bulgaria, Denmark, Hungary, Sweden and the United Kingdom).

All these countries exceed at least three thresholds, or two if the excess is very substantial. Excluding the programme countries, it is Spain and Cyprus that exceed the largest number of thresholds, namely six.

Luxembourg and Sweden both have a current account surplus which exceeds the upper threshold of 6 % of GDP, but – in accordance with the conclusions of the Ecofin Council on 8 November 2011 – this was not considered to be an aspect likely to raise "concerns about the sustainability of external debt or financing capacity that affect the smooth functioning of the euro area".

3.2.2 Assessment of the scoreboard and of the first Alert Mechanism Report

While it is always possible to criticise the selection of the indicators and the method of calculating the thresholds, that debate took place before the scoreboard was first applied. It has now been approved by the Council and by the

(1) The programme countries receive support from the EFSF, the EFSM or bilateral loans (Greece, Ireland and Portugal), or balance of payments support from the EU (Romania).

TABLE 2 ALERT MECHANISM REPORT: THE 2010 SCOREBOARD

	External imbalances and competitiveness					Internal imbalances				
	3 year average of current account balance as % of GDP	Net international investment position as % of GDP	% change (3 years) of real effective exchange rate with HICP deflators	% change (5 years) in export market shares	% change (3 years) in nominal unit labour cost	Year-on-year % change in deflated house prices	Private sector credit flow as % of GDP	Private sector debt as % of GDP	Public sector debt as % of GDP	3 year average of un-employment
Thresholds	–4 / +6 %	–35 %	±5 % & ±11 % (1)	–6 %	+9 % & +12 % (1)	+6 %	15 %	160 %	60 %	10 %
BE	–0.6	77.8	1.3	–15.4	8.5	0.4	13.1	233	96	7.7
BG	–11.1	–97.7	10.4	15.8	27.8	–11.1	–0.2	169	16	7.5
CZ	–2.5	–49.0	12.7	12.3	5.1	–3.4	1.7	77	38	6.1
DK	3.9	10.3	0.9	–15.3	11.0	0.5	5.8	244	43	5.6
DE	5.9	38.4	–2.9	–8.3	6.6	–1.0	3.1	128	83	7.5
EE	–0.8	–72.8	5.9	–0.9	9.3	–2.1	–8.6	176	7	12.0
IE	–2.7	–90.9	–5.0	–12.8	–2.3	–10.5	–4.5	341	93	10.6
EL	–12.1	–92.5	3.9	–20.0	12.8	–6.8	–0.7	124	145	9.9
ES	–6.5	–89.5	0.6	–11.6	3.3	–3.8	1.4	227	61	16.5
FR	–1.7	–10.0	–1.4	–19.4	7.2	5.1	2.4	160	82	9.0
IT	–2.8	–23.9	–1.0	–19.0	7.8	–1.4	3.6	126	118	7.6
CY	–12.1	–43.4	0.8	–19.4	7.2	–6.6	30.5	289	62	5.1
LV	–0.5	–80.2	8.5	14.0	–0.1	–3.9	–8.8	141	45	14.3
LT	–2.3	–55.9	9.1	13.9	0.8	–8.7	–5.3	81	38	12.5
LU	6.4	96.5	1.9	3.2	17.3	3.0	–41.8	254	19	4.9
HU	–2.1	–112.5	–0.5	1.4	3.9	–6.7	–18.7	155	81	9.7
MT	–5.4	9.2	–0.6	6.9	7.7	–1.6	6.9	212	69	6.6
NL	5.0	28.0	–1.0	–8.1	7.4	–3.0	–0.7	223	63	3.8
AT	3.5	–9.8	–1.3	–14.8	8.9	–1.5	6.4	166	72	4.3
PL	–5.0	–64.0	–0.5	20.1	12.3	–6.1	3.8	74	55	8.3
PT	–11.2	–107.5	–2.4	–8.6	5.1	0.1	3.3	249	93	10.4
RO	–6.6	–64.2	–10.4	21.4	22.1	–12.1	1.7	78	31	6.6
SI	–3.0	–35.7	2.3	–5.9	15.7	0.7	1.8	129	39	5.9
SK	–4.1	–66.2	12.1	32.6	10.1	–4.9	3.3	69	41	12.0
FI	2.1	9.9	0.3	–18.7	12.3	6.8	6.8	178	48	7.7
SE	7.5	–6.7	–2.5	–11.1	6.0	6.3	2.6	237	40	7.6
UK	–2.1	–23.8	–19.7	–24.3	11.3	3.4	3.3	212	80	7.0

Source: EC.
(1) For euro area and other EU countries respectively.

Parliament even though, as already mentioned, the list of indicators and the thresholds may be revised in the future. Moreover, the choice of indicators is not the only important aspect; their precise definition is just as important.

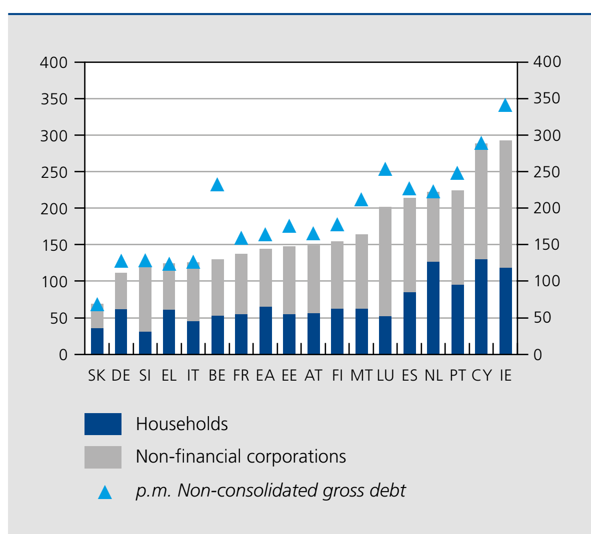
Thus, the data on private debt may be extremely misleading if they are based on non-consolidated data, as is currently the case. In certain countries, such as Malta, Luxembourg and Ireland, but especially in Belgium, the non-consolidated data differ greatly from the consolidated data.

For Belgium, for example, this difference is due to the strong presence of multinationals which manage their internal financial flows from this country. The non-consolidated debt of the non-financial corporations sector is therefore very high in Belgium. It came to 180 % of GDP at the end of 2010, compared to 78 % of GDP on a consolidated basis.

Non-consolidated data are useful for gaining an idea of the sector's financing structure. Inter-company loans – especially within the same group – are generally more stable than bank lending and the associated risk is lower.

However, a consolidated indicator does seem more relevant for analysing the potential risks inherent in macroeconomic imbalances, and that should be the aim of the

CHART 4 CONSOLIDATED GROSS DEBT OF THE NON-FINANCIAL PRIVATE SECTOR (1)
(data at the end of 2010, in % of GDP)



Source: EC.
(1) Households and non-financial corporations, total loans and securities excluding shares.

MIP. On the basis of the consolidated data, the debt ratio of non-financial corporations is more or less the same in Belgium as in the euro area. The corresponding debt ratio for the non-financial private sector as a whole in Belgium is only 131 % of GDP, compared to an average of 147 % in the euro area.

Another point to be treated with caution is that the selection of the Member States subject to an in-depth review may be considered arbitrary: some countries exceeding the threshold for two indicators are selected, whereas others need to have four indicators highlighted in red. Eight Member States have three indicators in red, but Belgium is the only one selected for an in-depth review. Of course, the EC conducts an overall assessment in which it need not assign the same weighting to all the overruns.

Finally, the 2012 Alert Mechanism Report uses data from the end of 2010, which may therefore no longer be up to date at the time of the assessment. The use of 2011 data rather than 2010 data is already revealing notable improvements in certain Member States at the level of the current account deficit (Malta, Slovakia and Spain) and changes in unit labour costs (Austria, Estonia, Greece, Italy and Slovakia). Conversely, other indicators have deteriorated in certain countries, such as the unemployment rate in Spain. This situation clearly shows that the scoreboard is only a snapshot. The rules therefore provide for it to be interpreted in a broader framework.

At the end of May 2012, the EC presented its in-depth reviews on twelve Member States. It concludes that there are macroeconomic imbalances requiring preventive treatment and careful monitoring. It also finds that these imbalances are already being corrected, as is evident from the shrinking of current account deficits, the convergence of unit labour costs, the decline in excessive lending and the house price correction. In a number of cases, however, the cumulative internal and external imbalances still present a major challenge, e.g. as regards private and public sector debt.

Although, according to the EC, excessive imbalances are not present in any of the twelve Member States, it nevertheless makes a distinction between these twelve countries. Spain and Cyprus are among the most worrying cases, followed by France, Hungary, Italy and Slovenia. Among the twelve Member States undergoing an in-depth review, Belgium is classed among the least worrying countries; the main point noted in Belgium's review is the loss of competitiveness and the high level of public debt, while the review rightly states that the high non-consolidated private sector debt does not indicate any risk because the consolidated debt is relatively low.

Conclusion

The macroeconomic imbalances which have accumulated since the introduction of the euro in some Member States were never adequately counteracted by the previous Stability and Growth Pact and the structural economic policy.

Those imbalances grew larger, culminating in the May 2010 crisis when Greece effectively lost access to the financial markets and the country had to resort to international financial assistance. The EU was forced to opt swiftly for bilateral public funding of the Greek sovereign debt and the creation of two temporary financial support mechanisms which, from mid-2012, will be succeeded by the permanent European Stability Mechanism, the ESM.

At the same time, it was decided at the highest political level to strengthen the economic policy coordination framework within the EU.

The aim was to prevent macroeconomic imbalances or eliminate them faster and more vigorously in all EU Member States, and especially in the euro area, with the aid of a series of automatically binding rules. December 2011 saw the new Six-Pack rules enter into force, not only strengthening the previous Stability and Growth Pact but also introducing the key macroeconomic imbalance procedure.

During the decision-making process, owing to national political considerations, the original proposals for more automatic decision-making procedures under the Six Pack were weakened to some extent, although the European Parliament partly corrected that. There were other initiatives, such as the Euro Plus Pact and, more importantly, the new Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, which includes the Fiscal Compact. Two new Regulations are also being discussed in the trialogue procedure between the Council, the European Parliament and the EC, namely the Two Pack, whereby euro area Member States must submit their draft budgets to the EC, which would be entitled to assess them in the light of the European fiscal rules.

In contrast to the 2005 reform of the Stability and Growth Pact, the recent and current changes to the EU's governance framework are clearly a key step in the right direction. On the other hand, the rules have become much more complicated, and an increase in the number of regulations 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 adding to the complexity.

The way in which the new governance framework will be implemented will now determine its credibility. Strict implementation of the procedures and of the sanctions, where applicable, may make a contribution here. National ownership, notably by the parliaments of the Member States, is another key factor for credibility.

In the past two years, the EU has made more progress in further developing the "economic pillar" of EMU than in the past decade. As a result, we are moving closer to the EMU proposed by Pierre Werner in his 1970 report. But there is still a long way to go. Significant new steps will be needed, and must be accompanied by greater transfer of sovereignty to the European level in order to give it the power to prevent and combat the imbalances which led to the debt crisis in the euro area.

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Summaries of articles

Economic projections for Belgium – Spring 2012

The current economic situation in the euro area is causing serious concern. While the measures adopted by the European authorities since the end of 2011 did temporarily ease the uncertainty and financial tensions at the beginning of 2012, renewed nervousness on the sovereign debt markets and among the economic agents has emerged in recent months, owing to the very worrying situation in the countries undergoing significant budgetary adjustments and/or radical restructuring of their economy. The resulting contagion is affecting financial institutions in the euro area.

The projections for 2012 and 2013 presented in the article are based on the assumption that these tensions will ease, on the premise that the euro area crisis does not grow any worse and does not have irreparable repercussions on systemic financial institutions. External demand is assumed to strengthen gradually, with interest rates remaining low, while the oil price is expected to record a modest fall.

In the euro area, the economic situation should gradually improve in the second half of 2012, and the recovery should strengthen in 2013. Significant divergences between countries are expected to persist. Inflation is projected to decline gradually, the main factor being the expected fall in oil prices.

Since mid-2011, the Belgian economy has felt the effects of the worsening financial tensions and deteriorating economic situation in the euro area. GDP growth is forecast to reach just 0.6 % in 2012, rising to 1.4 % in 2013. The outlook is slightly more favourable than for the euro area as a whole. In the absence of any adjustment having a major impact on domestic demand, activity in Belgium, in Germany's wake, continues to exhibit some resilience, as was the case during the 2008-2009 recession.

The slowdown in activity in 2012 followed by a moderate revival in 2013 should be directly reflected in the employment market, where only 3 300 additional jobs are forecast to be created in net terms in 2012, and just over 27 000 in 2013. The weakness of job creation is also due to the budget restraint which the new government has introduced for the federal authorities and health care. Unemployment is expected to rise to 7.5 % in 2012 and 7.7 % in 2013.

Since peaking in mid-2011, inflation has fallen steadily in Belgium and should continue to ease, averaging 2.6 % in 2012 and 1.5 % in 2013, the main factor being the expected fall in oil prices. Before subsiding in 2013, underlying inflation is set to remain high in 2012 owing to the effect of the increase in certain indirect taxes and the rise in labour costs, which should still be strong.

The general government deficit is projected to fall to 2.8 % in 2012, deteriorating slightly thereafter, and rising to 3.1 % in 2013. The public debt is set to rise significantly in 2012, to 98.9 % of GDP, owing to exogenous factors relating to the Greek rescue package and participation in the European Stability Mechanism, and is projected to record a smaller increase in 2013 to reach 99.2 % of GDP.

JEL codes : E17, E25, E37, E66

Key words : Belgium, macroeconomic projections, Eurosystem

What can we and can't we infer from the recourse to the deposit facility ?

In the wake of the two longer-term refinancing operations with a maturity of three years conducted in December 2011 and February 2012, amounts placed on the Eurosystem's deposit facility surged to unprecedented high levels of around € 800 billion. The article clarifies how this high recourse to the deposit facility should be interpreted.

First, daily changes in the amounts being placed on the deposit facility should not necessarily be interpreted as daily changes in stress on the interbank market as there is a seasonal pattern in the use of the deposit facility. That seasonal pattern stems from the fact that Eurosystem counterparties have to meet a reserve requirement on an average basis. Hence, it is better to watch the money market liquidity surplus, defined as the sum of the recourse to the deposit facility and the current account holdings in excess of the required reserves, as a proxy for the central bank's intermediation role on the money market.

Second, high recourse to the deposit facility is an automatic corollary to increased central bank liquidity provision because the relationship between the central bank and commercial banks can be seen as a closed system. Hence, as illustrated by some examples, large amounts being placed on the deposit facility are not informative as to whether or not the liquidity is actually "being put to use", for instance, to grant credit to the non-financial sector or to pay back maturing bank debt. A number of examples illustrate this.

JEL codes : E52, E58

Key words : Eurosystem, deposit facility, monetary policy implementation

Monetary policy in the US and the euro area during the crisis

The article aims to present and analyse the policy responses of the Federal Reserve and the Eurosystem during the various stages of the economic and financial crisis that began in the summer of 2007. It also looks at the relationship between monetary policy and budgetary policy, and attempts to shed some light on the challenges of conducting monetary policy at the present time.

In the context of the crisis, the Federal Reserve and the Eurosystem made profound changes to the conduct of their monetary policy. In order to prevent the collapse of the financial system and to support economic activity, they decided on rapid and substantial cuts in their key interest rates, which reached historic lows. Moreover, they adopted numerous non-standard measures to provide liquidity and purchased assets on a massive scale, broadening their role as intermediary and considerably expanding the size of their balance sheets. Whilst each of the central banks significantly revised the operational framework of its monetary policy, the initial circumstances of how monetary policy was conducted and the predominance of the non-banking financial sector in financing the economy in the United States resulted in more substantial changes in the case of the Federal Reserve.

The scale of the crisis and the rapid progression of events justify to a great extent the unprecedented extension of central banks' activities during the last few years. It should be borne in mind, however, that monetary policy has its limits. Whilst the high level of excess liquidity at the present time is not a direct threat to price stability, conducting an accommodating monetary policy over a long period may in fact entail numerous risks.

JEL codes: E44, E52, E58, E61, E63

Key words: monetary policy, budgetary policy, Federal Reserve, Eurosystem, economic and financial crisis, sovereign debt crisis, non-standard measures, euro area, United States, independence

Reform of the Special Finance Act for the Communities and Regions

On 10 October 2011, eight parties with a special majority in the federal parliament concluded an agreement on the sixth reform of the Belgian State. The article presents the two most important aspects of the reform from an economic and budgetary point of view, namely the transfer of new powers from federal level to the federated entities, and the revision of the Special Finance Act for the Communities and Regions of 16 January 1989. The agreement on the revision of the Finance Act mostly concerns principles and mechanisms.

The powers transferred represent around 4.4 % of GDP. These transfers come under social security rather than federal government, and more powers are devolved to the Communities and Community Commissions – institutions with no fiscal powers of their own – than to the Regions.

For the Regions, one of the main changes pursuant to the new draft Finance Act concerns the greater fiscal autonomy accorded to them in regard to personal income tax. For their new powers, the Regions also receive additional resources allocated according to a fiscal key. Finally, a national solidarity allowance is maintained, but the detailed arrangements are modified.

Likewise, the Communities receive additional resources for their new powers, but they are allocated on the basis of demographic keys. The resources available to the Communities for their old powers are being restructured.

There is also a transitional mechanism to neutralise the effects of the reform for the various entities when it comes into force, and to limit the scale of the effects during the first decade. Separately from this mechanism, the Brussels institutions are to be refinanced and the agreement includes a higher contribution from the federated entities towards the budgetary cost of ageing.

As it stands, the agreement on State reform does not solve the issue of the various entities' participation in the necessary consolidation of Belgian public finances. It is therefore important to determine the sharing of the consolidation efforts needed to restore a balanced budget in Belgium by 2015, to specify the arrangements for the participation by the federated entities and, in that connection – as stipulated by the agreement – to finally set certain Finance Act variables, such as the reference amounts for the transfer of powers and their variation parameters.

Jel codes: H11, H70, H74

Key words: public finance, fiscal, Belgian State reform, Special Finance Act, Communities and Regions

Asset formation by households during the financial crisis

The article presents a microeconomic analysis of asset formation by Belgian households and the impact which the financial crisis has had on that. For the first time, data from a survey of households' financial behaviour are used. The survey data are a useful addition to the existing macroeconomic information. During the crisis, many households deserted equities in favour of bank accounts, and bank accounts in favour of real estate. On the other hand, there were some households which actually invested more in equities during this period. Many households also transferred funds between various bank accounts, and some households avoided particular assets altogether. The survey offers direct information on households' attitudes to financial risk and demographic and socio-economic characteristics that play a role in these movements. Some specific portfolio choices which households have made since the beginning of the financial crisis can be pointed up. First, there were noticeably large numbers of transfers between accounts with financial institutions, probably partly owing to the mounting mistrust of such accounts and of certain financial institutions in particular. Secondly, positions in equities and equity funds were reduced in many cases, whereas there were still some households wanting to invest more in these assets. Therefore, not all Belgian investors were averse to (calculated) financial risk. Real estate continues to play a clear role as a safe haven. Many households withdrew cash from bank accounts in order to invest in real estate, and it seems that few households intend to retreat from it.

JEL codes : D14, G11

Key words : household finance, asset formation, financial crisis, household survey

New developments in economic governance in 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. 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"). The EC then proposed two additional regulations to ensure more rigorous budgetary surveillance (the "Two-Pack"). 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. 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.

Key words: economic governance in the EU, stability and growth pact, macroeconomic imbalance procedure

JEL codes: E61, E62

Abstracts from the Working Papers series

218. Economic importance of air transport and airport activities in Belgium – Report 2009, by X. Deville, S. Vennix, December 2011

The study assesses the economic importance of air transport and airport activities in Belgium in terms of employment, value added and investment over the period 2007-2009. The sector considered embraces not only business directly connected with air transport, but also all the activities which take place on site at the six Belgian airports (Antwerp, Brussels, Charleroi, Kortrijk, Liège, Ostend). The direct and indirect effects of the sector are estimated respectively on the basis of microeconomic data (mainly obtained from the Central Balance Sheet Office) and macroeconomic data (from the National Accounts Institute). The study also includes an analysis of the social balance sheet and certain ratios on the basis of Central Balance Sheet Office information.

In 2009, the air transport sector thus defined generated over € 6.1 billion in direct and indirect value added (or 1.8 % of Belgium's GDP), and provided direct or indirect employment for 80 300 people in full-time equivalents (or 2 % of domestic employment in FTE). Brussels Airport was the most affected by the decline in global traffic in 2009, as a result of the economic crisis : in that year, it ceased to be Belgium's principal cargo airport, ceding that position to Liège Airport. However, the national airport still ranks first in the passenger market, accounting for almost three-quarters of traffic in 2010, despite the exponential growth of traffic at Charleroi Airport. Together, these two airports accounted for almost 97 % of passenger traffic passing through Belgium in 2010.

219. Comparative advantage, multi-product firms and trade liberalisation : An empirical test, by C. Fuss, L. Zhu, January 2012

The paper investigates how economies of scope in multi-product firms interact with comparative advantage in determining the effect of trade liberalisation on resource reallocation, using Belgian manufacturing firm- and firm-product-level data over the period 1997-2007. The authors first provide evidence on industry integration induced by multi-product firms producing simultaneously in multiple industries and on the extent to which industry integration occurs between industries that have different degrees of comparative advantage. They then examine the impact of opening up trade with low-wage countries on both inter- and intra-industry resource reallocation, taking into account heterogeneity in the integration rate across sectors and industries. Their results indicate that, within more closely integrated sectors, trade liberalisation with low-wage countries leads to less reallocation from low-skill-intensity (comparative-disadvantage) industries to high-skill-intensity (comparative-advantage) industries, both in terms of employment and output. More integrated

industries experience less skill upgrading after trade liberalisation with low-wage countries. Furthermore, within sectors with a low integration rate, trade liberalisation with low-wage countries induces relatively more aggregate total factor productivity (TFP) and average firm output growth in comparative-advantage industries than in comparative-disadvantage industries, in line with the prediction made by Bernard, Redding and Schott (2007), while the opposite is true in highly integrated sectors. Decomposition of the industry-level aggregate TFP changes reveals that the result is mainly driven by reallocation between incumbent firms within industries. Overall, the results are highly consistent with the predictions of the Song and Zhu (2010) model.

220. Institutions and export dynamics, by L. Araujo, G. Mion, E. Ornelas, February 2012

The authors study the role of contract enforcement in shaping the dynamics of international trade at the firm level. They develop a theoretical model to describe how agents build reputations to overcome the problems created by weak enforcement of international contracts. They find that, all else equal, exporters start their business activities with higher volumes and remain as exporters for a longer period in countries with better contracting institutions. However, conditional on survival, the growth rate of a firm's exports to a country decreases with the quality of the country's institutions. These predictions are tested using a rich panel of Belgium exporting firms from 1995 to 2008 to every country in the world. The authors adopt two alternative empirical strategies. In one specification, firm-year fixed effects are used to control for time-varying firm-specific characteristics. Alternatively, selection is modelled more explicitly with a two-step Heckman procedure using "extended gravity" variables as exclusion restrictions. Results from both specifications support the predictions. Overall, the findings suggest that weak contracting institutions cannot be regarded simply as an extra sunk or fixed cost to exporting firms; they also significantly affect firms' trade volumes and have manifold implications for firms' dynamic patterns in foreign markets.

221. Implementation of EU legislation on rail liberalisation in Belgium, France, Germany and The Netherlands, by X. Deville, F. Verduyn, March 2012

The study provides a detailed and easy-to-read overview of railway liberalisation in Belgium and the three neighbouring countries. The European Union's liberalisation Directives are often complex and implemented in very specific ways in the different Member States. The analysis goes into some detail about the Commission's underlying motives and economic theories for letting network industries, which had previously been regarded as natural monopolies, convert into competitive enterprises with the separation of infrastructure from operations.

The study takes a look at the impact of the European rail liberalisation Directives in Belgium and its neighbours – France, Germany and the Netherlands. There are considerable variations in the way in which the Directives are applied. This is reflected in the way in which the infrastructure was separated from the transport services within the railway companies, and in the degree of market opening in freight and passenger transport.

The analysis shows that the dominance of the former monopolists in the different Member States means that private rail operators still face major obstacles. The financial analysis of the railway companies reveals wide variations in economic performance. The combination of better balance sheet figures and a bigger domestic market means that some major players in Europe are financially better off, giving them superiority over the smaller railway companies. This raises the question whether these circumstances will ultimately lead to distortion of competition.

222. Tommaso Padoa-Schioppa and the origins of the euro, by I. Maes, March 2012

Tommaso Padoa-Schioppa was one of the great architects of the euro. He is remembered in particular as co-rapporteur for the Delors Committee and as a founding member of the European Central Bank's Executive Board. For Padoa-Schioppa, becoming Director-General of the European Commission's DG II (from 1979 to 1983), was a defining moment in his career and life. This period is the main focus of this paper. At the Commission, Padoa-Schioppa's main priority was the European Monetary System, which was launched in March 1979. He was closely involved in several projects to strengthen the EMS, to improve economic policy convergence and the position of the ECU. The other main objective for Padoa-Schioppa was the strengthening of DG II's analytical capacity, especially its model-building capacity and its links with the academic world. As such, he played a crucial role in the professionalisation of economics at the Commission and in preparing DG II for the important role it would play in the EMU process. At the Commission, Padoa-Schioppa also became immersed in several European networks. Of crucial importance here were his contacts with Jacques Delors. This would be of major importance for his further career, becoming one of the architects of the single currency.

223. (Not so) easy come, (still) easy go? Footloose multinationals revisited, by P. Blanchard, E. Dhyne, C. Fuss, C. Mathieu, March 2012

The paper revisits the hypothesis surrounding the "footloose" nature of multinational firms (MNFs). Using firm-level data for Belgium over the period 1997-2008, the authors rely on a Probit model and take into account the endogeneity of the determinants of firm exit. Their results may be summarised as follows. First, the unconditional exit probability of MNFs is lower than that of domestic firms. Second, controlling for firm and sector characteristics – firm age, total factor productivity, sunk costs, size, competition on the product market, sector-level value added growth, and sector dummies – the difference between the exit probability of MNFs and domestic firms becomes positive. Third, the results show that MNFs are less sensitive to sunk costs and size than domestic firms, which may be interpreted as lower exit barriers due to greater possibilities of relocating tangible and intangible assets to foreign affiliates.

224. Asymmetric information in credit markets, bank leverage cycles and macroeconomic dynamics, by A. Rannenberg, April 2012

The paper adds a moral hazard problem between banks and depositors, along the lines of Gertler and Karadi (2011), to a Dynamic Stochastic General Equilibrium (DSGE) model with a costly state verification problem between entrepreneurs and banks as in Bernanke, Gertler and Girlchrist (1999, BGG). This modification amplifies the response of the external finance premium and the overall economy to monetary policy and productivity shocks. It enables the model to match the volatility and correlation with output of the external finance premium, bank leverage, entrepreneurial leverage and other variables in US data better than a BGG-type model. A reasonably calibrated simulation of a bank balance sheet shock produces a downturn of a magnitude similar to the "Great Recession"

Conventional signs

e.g.	for example
i.e.	id est
p.m.	pro memoria
$	US dollar
€	euro
%	per cent

List of abbreviations

Countries or regions

BE	Belgium
DE	Germany
EE	Estonia
IE	Ireland
EL	Greece
ES	Spain
FR	France
IT	Italy
CY	Cyprus
LU	Luxembourg
MT	Malta
NL	Netherlands
AT	Austria
PT	Portugal
SI	Slovenia
SK	Slovakia
FI	Finland
EA	Euro area
BG	Bulgaria
CZ	Czech Republic
DK	Denmark
LV	Latvia
LT	Lithuania
HU	Hungary
PL	Poland
RO	Romania
SE	Sweden
UK	United Kingdom
EU-25	European Union, excluding United Kingdom and Czech Republic
EU-27	European Union
US	United States

Others

ABCP	Asset-Backed Commercial Paper
ABS	Asset-Backed Securities
AIG	American International Group
AMLF	Asset-Backed Commercial Paper Money Market Fund Liquidity Facility
AMR	Alert Mechanism Report
BIS	Bank for International Settlements
CMBS	Commercial Mortgage-Backed Securities
CPFF	Commercial Paper Funding Facility
CPI	Consumer Price Index
CREG	Commission for Electricity and Gas Regulation
DGSEI	Directorate General for Statistics and Economic Information Belgium
EC	European Commission
ECB	European Central Bank
EDP	Excessive deficit procedure
EFSM	European Financial Stabilisation Mechanism
EFSF	European Financial Stability Facility
EIP	Excessive imbalance procedure
ELA	Emergency Liquidity Assistance
Eonia	Euro Overnight Index Average
EPC	Economic Policy Committee
EMU	Economic and Monetary Union
ESA	European System of Accounts
ESCB	European System of Central Banks
ESM	European Stability Mechanism
EU	European Union
Euribor	Euro Interbank Offered Rate
FOMC	Federal Open Market Committee (United States)
FPB	Federal Planning Bureau
FPS	Federal Public Service
GDP	Gross domestic product
GSE	Government-Sponsored Enterprises
HICP	Harmonised index of consumer prices
IMF	International Monetary Fund
Libor	London Interbank Offered Rate
LSAP	Large-Scale Asset Purchases
MBS	Mortgage-Backed Securities
MFI	Monetary Financial Institutions
MIP	Macroeconomic Imbalance Procedure
MTO	Medium-term objective
NAI	National Accounts Institute
NATO	North Atlantic Treaty Organization

NBB	National Bank of Belgium
NBER	National Bureau of Economic Research
NEO	National Employment Office
NSSO	National Social Security Office
OECD	Organisation for Economic Cooperation and Development
OIS	Overnight Index Swap
PDCF	Primary Dealer Credit Facility
PSI	Private Sector Involvement
Q&A	Questions and answers
QE	Quantitative Easing
SMP	Securities Markets Programme
SNB	Swiss National Bank
TAF	Term Auction Facility
TALF	Term Asset-Backed Securities Loan Facility
TSCG	Treaty on Stability, Coordination and Governance in the Economic and Monetary Union
TSLF	Term Securities Lending Facility
VAT	Value added tax

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