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The European "Fiscal Compact": a goal or a starting point?

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Since its signature on 1st March 2012, the so-called "Fiscal compact" (in reality, the Treaty on Stability, Coordination and Governance in the EMU or "TSCG"[1]) has triggered criticism of a dimension that is inversely proportionate to the length of the document (16 fairly short articles). Most of these criticisms arise from the fact that this treaty is often perceived as an isolated act, as a goal in itself. Indeed, if seen as an isolated act, the added value, impact and contribution of the TSCG is very questionable. The only way to see the TSCG as a positive contribution is by conceiving it as the central piece of a bigger puzzle, as an instrument to attain a broader political compromise to resolve the current crisis and to put the basis of a better functioning of the Economic and Monetary Union.

Let me develop this idea in more detail by assessing the value and impact of the Treaty from both a political and economic point of view, underlining that:

1. The TSCG is a key political instrument at the service of the solidarity-responsibility dialectic;
2. The "TSCG" is an insufficient economic contribution, which needs to be completed in at least three directions.

1. The "TSCG" is a key political instrument at the service of the solidarity-responsibility dialectic

1.1. The legal added value of the "TSCG" is limited and even uncertain

If we look at the "TSCG" from a strictly legal standpoint, we would note that its added value with regard to community law is quite limited. Most of its provisions already appear in secondary legislation texts that have recently been adopted (the "Six-Pack"), in the process of being adopted (the example of the "Two-Pack") or which could have been adopted with no need of a new Treaty. So it is primarily for symbolic and political reasons that the Treaty has been drafted.

Concerning the monitoring of budgetary policies, we can of course note that the Treaty imposes the introduction of a sort of "golden rule" at the national level. This is however an innovation whose legal and practical effect is still a bit vague at this stage, as are the provisions stipulating the strengthening of the European Court of Justice's powers.

Concerning the surveillance of economic policies, the fourth part of the "TSCG" brings very little progress by comparison with the "Euro Plus Pact". This is in part logical, given the lack of legitimacy for the EU to interfere in member states' economic and social policy choices – with the exception of

[1] *The underlined words refer to documents available on the website of* Notre Europe *(www.notre-europe.eu).*

those countries having concluded and aid and adjustment programmes with the EU (Greece, Ireland, Portugal).

1.2. The TSCG basically responds to a political goal: to re-establish "the pact of trust" between member states

This pact of trust has been eroded over the past years, as a result of frequent infringements to the "housekeeping rules" adopted in Amsterdam 15 years ago and, more recently, as a result of the extraordinary acts of solidarity that the crisis has forced member states to make (despite the fact of being ruled out "*de jure*").

Re-establishing the pact of trust between member states requires finding the right balance between national responsibilities and European solidarity: the "TSCG" is the instrument to assure the "national responsibilities" part of the pact. For this reason, it is linked from both a political and legal point of view to the Treaty establishing the European Solidarity Mechanism (ESM) which will assure, on a permanent basis, the "European solidarity" part. The fact that the "TSCG" is popularized like the "Fiscal Compact" treaty confirms if needed that its main aim is to formalize member states' desire to be "serious" in terms of fiscal discipline (that is, to strengthen the "responsibility" pillar of the couple solidarity-responsibility) while proposing a slightly strengthened coordination of national economic policies.

This message about responsibility is targeted in particular at countries like Germany. This is on the one hand because they are those making the greatest efforts of solidarity in the sovereign debt crisis and want the structural causes of this crisis to be dealt with beyond the short-term rescues; and on the other hand, because they have doubts about the credibility of their partners – whether helped or not – and need to be reassured about their long-term commitment. Such a message is also targeted at the European Central Bank (ECB). The latter has rightly pointed out that its purchases of sovereign debt on the secondary market (about 220 billion euro) and the high levels of liquidity granted to banks (approximately 1 trillion euro through its long-term refinancing operation) cannot have real effects unless accompanied by resolute action from national authorities.

It is hard to wish for more solidarity from Germany and welcome the activism of the ECB without understanding the political logic that led to the signing of the "TSCG": only by ensuring an adequate balance between solidarity/responsibility we will be able to forge the needed political compromise to resolve this crisis.

1.3. The adoption of the TSCG could help deepening the solidarity-responsibility dialectic, on the way to a "Fiscal Union"

The adoption of the "TSCG" would be all the more welcome if it were not seen just as a tool of compensation for the solidarity that has already taken place, even if it had been substantial. Since 2010, the European Financial Stability Fund has already engaged around 200 billion euros to Ireland, Greece and Portugal, and we must welcome the Eurogroup decision to allow the European Financial Stability Facility (EFSF) to engage in new programmes after the entry into force of the ESM. This will ensure a full fresh EU lending capacity of 500 billion euro, under a current overall ceiling for ESM/EFSF lending raised to 700 billion euros. We can naturally wonder if the current EU solidarity mechanisms would be totally sufficient if several big EU countries – such as Italy or Spain – need EU help, but it's important to underline the amount of solidarity delivered this way (even if it's often overestimated by the public opinions and media of the donor countries[2]).

It is also fair to note that these actions of solidarity have been complemented by an adequate dose of responsibility at the national level. Greece, Ireland and Portugal have passed extremely painful

[2] Sofia Fernandes, Eulalia Rubio, "The budgetary cost of solidarity in the euro zone: getting things clear and into perspective", *Policy Brief No. 35, Notre Europe*, May 2012.

reforms and budgetary adjustments and, in looking to the Greece situation today, one can even wonder whether the level of "responsibility" required to this country has been proportional to its capacity to initiate such adjustments that rapidly.

In this context, the "TSCG" should then be interpreted as opening the way towards a deepening of the dialectic solidarity-responsibility. A step towards more European solidarity could indeed be needed, and could be adopted alongside the "Two-Pack", which aims to provide and *ex ante* control of national budgetary policies: this step should consist into the pooling of risks related to national debts. In the short run, the issuing of Eurobonds would be decisive to calm the markets, because it would symbolize the Eurozone countries' will to assert their community of destiny and the cohesion of the Eurozone, even though its concrete results would need time to be fully produced. But there is a persistent fear that the move towards Eurobonds results into a relaxation of the efforts of fiscal discipline at the national level, as long as some mid-term results have not been achieved on this field. A lot can be done in the design of Eurobonds in order to prevent potential moral hazard. Issuing Eurobonds will then rather be a goal than a starting point.

Another more realistic starting point could be the "redemption bonds" scheme proposed by the "5 German wise men", because it would be a temporary albeit massive scheme, legally and political more feasible, including from a German point of view. The fact that the EP has recently linked the adoption of the "Two-Pack" and the promotion of a "redemption pact" opens a very promising perspective on this regard – which shows that the "TSCG" is not a goal in itself.

2. The economic contribution of the "TSCG" needs to be completed on at least three points

Whereas the political contribution of the "TSCG" makes no doubt, its economic impact has been more debated, both in the short and medium run: in this regard, I will stress that this Treaty should be only a starting point. Its adoption should be part of a much wider European economic strategy to get out of the current crisis as well as to put the basis of a more solid Economic and Monetary Union. I see at least three main complements to be added to the TSCG in the perspective of the European Council of the end of June: one leading to adopt an additional protocol on growth, the two others promoting an "Economic union" and a "Banking union".

2.1. Beyond austerity: the inclusion of an additional protocol on growth

The TSCG is clearly unbalanced from an economic point of view, because it focuses too much on the "solidarity-responsibility" dialectic, for the political reasons I have just mentioned. Stability and austerity are necessary but not sufficient, in both the short and medium term, in an EU which urgently needs growth, for both economic and political reasons.

The bleak forecasts for European growth show the negative consequences of applying too much austerity. At the same time, a strong European commitment in favour of growth is also essential to render the TSCG acceptable to public opinions and, beyond that, to maintain citizens' support to the European project. It is then twice necessary to complement the TSCG by a form of European commitment in favour of growth-enhancing measures[3], which should take the form of an additional protocol. The adoption of such protocol is preferable to the adoption of an *ad hoc* political statement or to the approval of various measures already under discussion, one after the other. This protocol will help formalize the vision of a more balanced "Stability and Growth Treaty", a treaty more in line with the needs of the present situation, economically and socially.

What should be included in this "growth" protocol? While all EU countries now accept the need to develop an EU growth strategy, the latest informal meeting of the European Council seems to have

[3] Jacques Delors, António Vitorino and *Notre Europe*'s Board of Directors, "Stability and growth: perfecting the new European pact", Declaration on 16 May 2012.

revealed the existence of an important divide between two groups of countries: those calling for stepping up EU efforts on investment and financing (through the use of EU project bonds, an increase of the loaning capacity of the European Investment Bank, a better use of the current Structural funds to support growth and jobs or the creation of a European financial transaction tax); and those emphasizing the need to deepen the single market (in particular the services internal market), support the mobility of workers and improve EU access to third markets.

Let me say that a growth protocol to the TSCG should include both types of measures. Increasing EU investment and EU financing is essential at the moment when national governments are cutting spending; at the same time, deepening the single market would report important benefits in terms of growth, and measures to support the mobility of workers could help reduce the alarmingly high levels of unemployment in those countries most hit by the crisis.

But let me also underline that an additional growth protocol should not be seen as "manna from heaven", which would eliminate the need for structural reforms at the national level. While the EU has undeniable an added value in promoting growth, it is at the national and regional levels that the key challenges of strengthening the economic momentum, competition and social cohesion of European countries must be raised. From a political point of view, the ratification of the "TSCG" and an additional growth protocol should then encourage each country's determination to carry out the needed structural reforms to overcome the crisis and promote its living standards in a globalized economic order.

2.2. Beyond surveillance: the need for a more positive "Economic Union"

The TSCG is a useful "ordo-liberal" instrument but its impact will be structurally limited, given the fact that having all the "national houses" in order won't make the European village work perfectly. The crisis has shown just how interconnected the economies, the banking systems and even elections can be within the Eurozone, thus prompting the need for additional integration. What is needed is not only the monitoring of national economic policies, even if it is useful: it is more assertive coordination, on the basis of comprehensive vision of the interdependences between the Eurozone countries. In this respect, the German Minister of Finance, Wolfgang Schäuble, should be applauded for his recent statement highlighting the benefits of increased coordination of national economic policies, far beyond what is foreseen by the provisions of the "TSCG".

The adoption of the "Six-Pack" now allows the EU to monitor the economic imbalances more globally, for example as regards the evolution of unit labour costs, including wages evolution. But we will need a real political will, expressed by a sufficient number of member states, to adopt more proactive measures, so as to pave the way for a better coordination of wage policies, integrating all stakeholders and decision-makers, including the social partners.

Equally, while respecting the national sovereignty on tax matters, further coordinating tax policy decisions could be advantageous for the whole Eurozone, so as to prevent a "race to the bottom" which is not in the global interest of the European countries, especially in a period of huge public debts and deficit. The fiscal differences between member states are natural: the bigger their markets are, the higher their corporate tax can be; but the establishment of a bigger and bigger European "internal market" has been accompanied by an important decrease of the average level of the corporate tax: such contradictory and counterproductive evolution is only linked to the uncoordinated fiscal competition which has taken place on the EU during the last decades. Here again it would be helpful to try and promote more coordination, on the basis of a more comprehensive and aggregated vision of the European economy.

2.3. Beyond the sovereign debt crisis: fixing the banking crisis through a "Banking union"

Finally, the Spanish situation helps us not to forget that the current crisis is not only a sovereign debt crisis, but also a banking crisis, whose dimension is very acute. There is indeed a direct interaction between banking and sovereign debt crises: the banks hold government bonds issued by their sovereign and, at the same time, the states are the sole responsible for bailing out their national banks. In itself, the ratification of the "TSCG" will unfortunately not contribute to break the vicious circle between banking and sovereign debt crises…

It is essential to move up to the European level the competences for banking crisis resolution, so as to apply the "dialectic solidarity-control" to the banking sector. In the present context, this could be achieved enabling the EFSF/ESM to lend directly to distressed banks. This action should be complemented with the decision to create a European deposit insurance scheme. And, as banking crisis resolution and banking supervision are totally intertwined, assigning the EMU with the responsibility for rescuing national banks needs to go hand in hand with the reinforcement of the European control and supervision powers on EMU's systemic banks. These efforts to stabilize the banking sector are all the more essential if the central objective is to support growth, given the massive impact of the banking sector to meet such challenge.

I cannot conclude this address without underlining that, apart its political and economic dimension, the TSCG is also interesting from an institutional point of view. It's indeed an intergovernmental treaty signed by 25 States and which need to be ratified by only 12 of the "Eurozone" countries. Even if it will not necessarily open a new era for the European construction, the adoption of the TSCG has re-launched the debate on the institutional balances within the EU[4] and the possible creation of a "two tier Europe".

Let me just draw your attention on two of the issues at stake, beginning with the impact of the implementation of the "TSCG" on the functioning of the single market, which represents both the legal and political base of European integration. In spite of the guarantees that are in the text of the Treaty, it will then be necessary to put into place a formal and regular assessment in order to survey that the Treaty does not distort the functioning of the single market. It is all the more important as we are about to commemorate the 20th anniversary of the decisive impulsion given by Jacques Delors around the "1992" objective.

Similarly, it seems to me that the "democracy challenge" should also be treated more firmly. "TSCG" provisions as regards the involvement of national parliaments are promising, but they have to be more clearly specified. They should also be better articulated with that of the European Parliament, which needs to remain fully engaged in the EMU governance both within the national democracies-European democracy "continuum" and in the framework of its relations with the Commission. There is no doubt that the social partners have also a key role to play to feed a democratic debate which is of crucial importance, not only to ratify the "TSCG", but also and above all, to define and implement the more global political and economic strategy the EU needs to overcome the current crisis.

[4] Yves Bertoncini, Valentin Kreilinger, "Seminar on the Community method. Elements of synthesis", *Notre Europe/BEPA*, May 2012.