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Commentary

Economic policies in the EU at a turning point

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Culminating an almost unprecedented *tour de force* of Council meetings in various formations, the European Council reached agreement on a comprehensive economic policy package on March 24-25th that effectively completes the economic arm of economic and monetary union (EMU) and, if consistently applied, holds out the promise of ending stagnation and dismal employment performance throughout the European Union.

Significantly, **the opening shot in the Council Conclusions addresses economic policies**, rather than governance issues, with two paramount messages:

- The member states are expected to present their fiscal consolidation plans in April, with annual adjustments well above 0.5% of GDP for countries with high structural deficits or public debt levels, as part of the new integrated economic policy cycle; later this year these plans will become binding policy guidelines under the new European Semester decision-making.
- And the Single Market, notably in services, comes back to the top of the policy priority list – after much hesitation by Germany, as well as by the Commission – with an agreed timeline for the approval of the Single Market Act.

Even those governments, like Italy's, that have long refused to confront the structural roots of their dismal economic performance now must act or be shamed before their peers and the public at large.

The new economic governance of the Union. For those who followed the preparatory works from a distance and are now confused about what has actually been decided, the main result is that the treaty provisions whereby the member states "shall conduct their economic policies with a view to the achievement of the objectives of the Union" (Art. 120 TFEU) and "shall regard their economic policies as a matter of common concern and shall coordinate within the Council" (Art. 121 TFEU) have now become reality, almost 10 years after the

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introduction of the euro and 20 years after the Maastricht Treaty. This is true in substance, since from now on the Union has made explicit a common view of economic policies covering fiscal stability (the revamped Stability and Growth Pact, with new operational criteria for debt reduction), structural reform and market integration, including services. And it is true procedurally, since the surveillance procedures over the member states' economic policies have been given sufficient teeth to make the consequences of non-compliance quite unpleasant.

For **eurozone member states, a new 'euro plus pact'** – which may also be joined by non-eurozone countries – requires enhanced policy commitments that amount to the requirements for an efficiently functioning monetary union, long-recognized as necessary but nonetheless ignored by weak and opportunistic leaders. Euro area member states will be required not only to follow appropriate policies over a medium-term horizon but also to adapt national budgetary and broad policy frameworks in line with new policy requirements: including the introduction of legally binding budgetary rules, accounting frameworks and independent bodies for their effective surveillance.

With only some language concessions, **the ill-conceived attempts by France and Germany to set up a special surveillance procedure** under the 'collective responsibility' of national policy-makers – responsible for so much damage to the Growth and Stability Pact in the early 2000s – have been rejected in favour of normal procedures. The enhanced commitments will be incorporated into the national policy guidelines, monitored by the Commission and decided upon by the Council. Thanks to the European Parliament, the same will also apply to policy commitments under financial assistance programmes granted by the European Stability Mechanism (ESM).

Quite appropriately**, enforcement procedures** have been designed across the board to start at an early stage of emerging imbalances and apply sanctions already in the 'preventive' part of the policy cycle – both for fiscal imbalances and, more broadly, for macroeconomic imbalances covering the main determinants of productivity and competitiveness. At the same time, the Commission will be able to act autonomously to signal emerging deviations from agreed binding policy guidelines and open 'in-depth' policy reviews liable to rapidly lead to the application of sanctions by the Council. The Council will only be able to soften or reject the Commission recommendations with 'reverse majority voting'. The only open question is whether the Commission will be willing and ready to use these powers: President Barroso will have to overcome his legendary lack of courage when faced with hard decisions.

Where European Council decisions have been incomplete and also somewhat wanting is in **the set-up of the new system for crisis management and resolution**. To be sure, important agreements have been reached to establish a permanent ESM, endowed with adequate resources (€500 billion effectively available) and able to enforce appropriate conditionality – also taking due account of debt sustainability in adjustment programmes, following well established IMF practices, on a case-by-case basis.

However, **the procedure chosen for amending the treaty** – described in Annex II to the Conclusions – raises some questions. Under the simplified treaty revision procedure of Art. 48 TEU, a new paragraph will be added to Art. 136 TFEU (in Title VIII, Chapter 4, Provisions) providing that "the member states whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area

as a whole". The European Council has now agreed on the need for euro area member to establish the ESM; and the ESM will be established by a treaty among euro area members "as an intergovernmental organization under public international law".

This cumbersome arrangement has been adopted basically in order to circumvent possible objections by the German Constitutional Court to what could be seen as an increase in the competencies of the Union; while the simplified procedure has been chosen to send the same message to those member states that would otherwise need to call a referendum on the treaty amendment. The European Parliament has strongly objected to the former decision, and rightly so, for creating a new procedure out of the treaty for the achievement of goals that clearly belong to the treaty – although, as has been mentioned, they were able to contain the damage by bringing the decision of the adjustment programmes supported by the ESM under ordinary treaty surveillance procedures. While a few member states may not be able to avoid a referendum anyway, raising once again the prospect of a troubled ratification process. Although all may finally end up well, we nevertheless see in this the deep scars left on the European construction by a long period in which European leaders had lost the sense of a common purpose and repeatedly pandered to anti-European domestic sentiment.

As to the substance of ESM powers, the Council **could not agree to let the ESM purchase distressed sovereign paper on the secondary market**, for the time being leaving the ECB on the hook for such paper already in its books: but the Board of Governors of the ESM "may review the instruments at its disposal and may decide to make changes to the menu of instruments" (cf. Annex II), raising hopes that this serious shortcoming will be corrected later on.

Moreover, the **crisis resolution system remains incomplete** until the Council can agree (with Parliament) on a system for bank crisis resolution. On this, European leaders still hesitate, in the transparent hope that time, and generous hidden help by national governments, will help their cosseted national banks mend their books with no further need for public intervention. Of course, it is plainly absurd to boast about making private creditors take their share of sovereign debt losses that may soon emerge, while at the same time pretending that this will have no consequences for banks holding massive amounts of that sovereign paper.