PISM | POLSKI INSTYTUT SPRAW MIĘDZYNARODOWYCH
THE POLISH INSTITUTE OF INTERNATIONAL AFFAIRS

BULLETIN

No. 27 (244) • March 18, 2011 • © PISM

Editors: Marcin Zaborowski (Editor-in-Chief), Agnieszka Kopeć (Executive Editor),
Łukasz Adamski, Beata Górka-Winter, Artur Gradziuk, Leszek Jesień,
Beata Wojna, Ernest Wyciszkiewicz

Summit of Eurozone Heads of State and Government, 11 March, 2011: Fundamental Decisions It Faces and an Attempt at Assessment

Marcin Menkes, Paweł Tokarski

The summit adopted a "Pact for the Euro," introducing the closer coordination of economic policies. Also fiscal consolidation in Greece, Ireland and Portugal was assessed, while certain details concerning the European Stability Mechanism, which will be established to safeguard the financial liquidity of eurozone states, were agreed upon.

Introduction. Recent financial and the subsequently fiscal crises revealed the considerable difficulties of maintaining a common monetary policy across 17 eurozone states without the coordination of economic policies. Comprehensive austerity measures implemented in countries benefitting from financial assistance from other Economic and Monetary Union (EMU) members and the International Monetary Fund (IMF) requires a broader coordination of economic policies. "Pact for the Euro" contributes towards that goal while at the same time supplementing other similar actions adopted since Summer 2010. Their direct effect is an agreement concerning six legislative initiatives, including an accord strengthening macroprudential and fiscal supervision that was reached during the latest session of the EOFIN Council on 15 March.

Pact for the Euro. The document is largely based on the proposed pact for competitiveness, the Franco-German initiative presented on 4 February during the European Council summit that called on states participating in the EMU third stage to strengthen economic policy coordination. That proposal by Merkel and Sarkozy was broadly criticized. Both the adoption and presentation methods were perceived as being imposed by France and Germany, and some of its merits questioned. States that are not EMU members claimed the right to shape the pact and participate. Also, G. Verhofstadt, J. Delors and R. Prodi criticised the proposal, saying Europe didn't need another pact at the inefficient intergovernmental level, but needed instead a comprehensive reform program planned and realised by the European Commission. Also, the two principal European Parliament fractions clashed over the initiative. On 4 March, two summits were held in Athens and Helsinki to present their respective visions for fighting the crisis and further integration. European Socialist parties delivered an alternative pact for growth, calling for greater social solidarity. The European People's Party, in line with the logic behind the Franco-German concept, stressed that financial risk and responsibility for one's actions constitutes an inherent element of the free-market economy.

Although the core-concepts of the Franco-German initiative were preserved, the wording of the new document, influenced unofficially by J.M. Barroso and H. van Rompuy among others, is somewhat more vague. Most important, the new pact will take effect within the current institutional set-up and in accordance with the economic management model, including the "Europe 2020" strategy, the European semester, the Stability and Growth Pact and the macroprudential supervision framework. The "Pact for the Euro" will enable progress in boosting competitiveness, enhancing employment, improving public fiscal and financial stability. Parties to the pact must undertake a precisely-defined obligation, the effect of which will be assessed during the annual summit of eurozone heads of states and governments along with other parties to the pact. Through the introduction of a high-level political component, European supervision over economic governance was strengthened. The efficiency of this solution will depend, however, on the political willingness

to cooperate and on member states' readiness to accept the strong position of the European Commission.

As for the singular objectives of the pact, demands for measures to constrain employment costs, increase efficiency monitoring, remove internal market barriers and improve the SME business environment were reiterated. Also, calls to promote the *flexicurity* model, life-long learning and a lowering of employment taxation were issued. Greater public financial stability will be achieved through a revision of social security systems (including a modification of pension plans in accordance with the demographic situation, and the introduction of employment incentives for aged workers) and more rigorous budget discipline measures at the Member State level.

Other Issues. Irish and Greek progress in introducing IMF/EU recovery programs was welcomed during the summit. Greece announced a continuation of structural reforms, the introduction of a rigorous budgetary framework and declared a 50 billion-euro privatisation scheme. In response to the tense fiscal situation in Greece and in order to calm financial markets, the key interest rate on loans was lowered by 100 basis points and its maturity was increased from 4.5 to 7.5 years. Also, the Portuguese efforts, including announcements on the eve of the summit about budget cuts in the public health sector, state enterprises and social security, was positively received. No compromise was reached, however, in terms of lowering interest rates on the Irish assistance package or closer coordination in the field of tax policies. Further debate on corporate tax base harmonisation in the EU will be based upon a European Commission proposal, which will be presented in the upcoming weeks.

Also, it was declared that the European Stability Mechanism (ESM) that protects the eurozone during a crisis will have an effective lending capacity of 500 billion euros, and in particular circumstances it will be allowed to intervene directly in the primary debt market. The issue of ESM financing remains unsettled. It is assumed, however, that it shall include both capital paid on request and a system of guarantees, as opposed to the European Financial Stability Facility (EFSF) funded entirely through a guarantee mechanism. Before the ESM becomes operational, the EFSF will raise its lending capacity to 400 billion euros.

Assessment Attempt. Linking the "Pact for the Euro" with the existing macroeconomic governance model, as well as opening the pact to non-EMU states will be highly welcomed. Although the provisions are very general, the pact sets the right course. Yet, its success will depend on numerous factors, including the goodwill of Member States. Participants surprisingly agreed upon many issues, which will "lighten" the agenda for the European Council summit on 24-25 March.

Just before the EMU summit, Greek and Spanish credit ratings were lowered and the yield of their obligations grew accordingly. This exerted pressure on the heads of state and governments. In view of those events, an important function of the summit was to send a clear message that actions were taken to maintain the financial markets' stability and announce further details about financial assistance to states risking financial default. Perspectives for Greek public debt maintenance, though, appear grim. Furthermore, the adopted measures seem insufficient to address the current strenuous fiscal and banking sector situation in several EMU states. A sustainable resolution of the financial sector problem constitutes a prerequisite to overcome the current crisis.

As for Poland, further efforts to adopt the common currency appear highly necessary, as it would not only provide macroeconomic benefits but also tangible political gains. That would foremost allow Poland to influence the decision-making process at the heads of state and governments level of the eurozone, such as the "Pact for the Euro." Adoption of the pact could constitute an important step towards that end.