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EU Economic Governance Reform: Small Steps Towards Fixing Big Problems?

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On 4 October 2011, member states finance ministers approved compromise text shaping the EU economic governance reform package. The so-called "six-pack" is so far the most comprehensive change in the principles of the functioning of the Economic and Monetary Union since it was formed. The adopted provisions strengthen the position of the European Commission by introducing semi-automatic sanctions for breaches of the Stability and Growth Pact provisions. These changes depending on their consistent application in practice can help prevent problems of excessive indebtedness in the euro area in the future.

The Reform Background. The Economic and Monetary Union (EMU) has been asymmetrical since it was established. This was maintained in the Treaty of Lisbon. While the EU has exclusive competence for monetary policy in relation to the euro area, decisions about their economic policies are taken at the member state level. The EU holds competence in their coordination only. The economic and financial crisis, together with the subsequent debt crisis, revealed the weakness of the system.

Due to differences in the competitiveness of the economies in the euro area, macroeconomic imbalances have accumulated for which no appropriate action at the national or EU levels were taken. In conjunction with loose fiscal policy, structural problems and cases in which economic statistics were manipulated, these imbalances have become a major cause for an unprecedented debt crisis in the euro area.

As a response and in addition to supportive measures consisting of liquidity support, assistance for the financial sector and economic stimulus measures, other measures to prevent similar crises in the future also were adopted. These include, among others, the strengthened coordination of economic policies. At the end of September 2010, the European Commission (EC) presented a package of six proposals (the "six-pack"). These proposals also were the subject of difficult negotiations conducted by the Hungarian Presidency between the European Parliament (EP) and the Council. Although pressure from financial markets largely accelerated the pace of talks within the Council, the parties failed to reach compromise until September 2011.

Major Provisions. Four of the adopted pieces of legislation aim to strengthen budgetary discipline within the Stability and Growth Pact (SGP), which supplements the Treaty rules on fiscal discipline. The other two concern the surveillance of member states' economic policies, which is based on monitoring and control of major macroeconomic imbalances in the EU member states.

One of the key reform elements is a semi-automatic mechanism for sanctions under both the preventive and corrective arms of the pact. In response to a recommendation from the Commission, the EU could decide by a vote to impose sanctions on a member state of the euro area (a deposit or fine in the amount 0.2 % of GDP), unless an objection is voted on by a qualified majority of Council members, not including the state in question. Only the eurozone members may participate in voting. The sanctions are to ensure a more effective enforcement of budgetary discipline and are a big step forward compared to the previous procedure based on political decisions.

The reform envisages deepening the surveillance of macroeconomic imbalances, thus creating a new procedure to deal with excessive imbalances. The surveillance covers the analysis of the surpluses and deficits of a state's current accounts as well as a search for the reasons and solutions to any imbalances. Therefore, while monitoring the data, the possible influence of these imbalances on other member states will be taken into consideration. The Council will be able to impose sanctions on a member state that fails to comply with its recommendations (a deposit or an annual fine in the amount of 0.1% of GDP). The "six-pack" provisions envisage strengthening the national budgetary frameworks in part by obliging member states to ensure there are adequate accounting and statistical standards and to use multiannual budget planning.

A proposal to call the finance minister of a member state that is under the excessive deficit procedure to explain to the EP the reasons for the state's actions was one of the controversies that arose during the negotiations over the package. The achieved compromise anticipates a voluntary exchange of opinions with the EP, and as such empowers parliament with the tool of political pressure towards a member state that violates the rules of fiscal discipline.

Conclusions. Negotiations with the EP, which decided together with the Council on the four proposals and was consulted in the remaining two, revealed an institutional divergence in the approach to the future shape of EU economic governance. While the EC and EP advocated for more restrictive rules for public finance discipline, the Council tried to dilute the Commission's ambitious proposals. Activities undertaken by the EP during the negotiations can be ascribed to the frameworks of the strategic partnership with the EC. Amendments issued by the Parliament to the initial "six-pack" proposals aimed at strengthening the role of the Commission. Close cooperation between these institutions, which may accelerate further reform of economic governance, seems to constitute an alternative to the member states' tardiness in their efforts to implement reforms that aim to consolidate public finances.

The previous sanction mechanisms depended much on the political will of the member states, which longed to keep national sovereignty in budget policy. The application of reverse-qualified-majority voting enhances the Commission's position in the coordination process of economic policies. This majority is needed in order to reject proposals directed to the EU Council by the Commission, not in order to adopt the Council's decision.

Introducing a semi-automatic procedure to the Stability and Growth Pact in order to take decisions to impose sanctions on a euro area member may constitute an effective instrument of budgetary discipline. However, its efficiency will depend on its consistent implementation in practice and, therefore, also on the Commission's decisiveness in this matter.

In the "six-pack", the eurozone members waive some part of their sovereignty in terms of fiscal policy. However, it occurs as a natural step towards further economic integration, while the proper functioning of the Economic and Monetary Union will require a further deepening of cooperation on the sub-national level.

Recommendations. Adopting the "six-pack" should be considered a success for both the Hungarian and Polish presidencies, which were committed to the dialogue with the EP. However, the current reform is still only a small step on the way to a eurozone recovery for which a complex solution to excessive indebtedness is still missing. Additionally, the time-consuming ratification process regarding the arrangement to broaden the scope of the European Financial Stability Facility (EFSF), the still uncertain shape of the second bailout for Greece as well as a lack of pro-growth actions will have a negative impact on the situation in the eurozone.

The intensification of the debate about the further enhancement of economic governance in the EU and the eurozone itself should be expected in the near future. This probably will be discussed during the planned European Council meeting on 17 October 2011. Taking into account the German and French proposals issued in August concerning the strengthening of the Eurogroup institutional frameworks, the discussion may focus on the eurozone. Since Poland chairs the Council for Economic and Financial Affairs (ECOFIN), it should strive during the European Council meeting to involve in debate those member states that remain out of the euro area but which are obliged to adopt the common currency in the future.

An accurate forum for the talks seems to be the Euro-plus pact parties. The EC and the EP could be allies to the presidency because of their resistance to a twofold development of the Union. The presidency also could mitigate inter-institutional conflicts, which may arise after the European Council meeting, between the president of the European Commission and the permanent president of the European Council, who was pointed to by Germany and France as a potential candidate to chair the meeting of the heads of states and governments of the eurozone. The rivalry, if it arises, may hamper the pace of EU reforms, which are necessary to countervail crises in the future.