AICEI PROCEEDINGS

The Challenges of Implementation of the Fiscal Stability Treaty

Zoran Sapurik, Ninko Kostovski, Elena Klisarovska

Abstract

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, known also as the Fiscal Stability Treaty or EU Fiscal Pact, entered into force on 1 January 2013, following the successful ratification by twelve of the sixteen signatory states. The Treaty introduced new rules in the Euro Zone and into the EU as a whole. Establishing strict requirements for budget deficit, it calls for strong fiscal discipline and for real fiscal austerity in many EU member states. , which makes this Treaty one of the biggest challenges for the EU in its sixty-two years of history. From now on the budgets of the EU states will have to follow very specific fiscal objectives and criteria. The Treaty is a legally binding act that sets new pillars for building a new economic and political profile of the EU. Moreover, it will influence the countries, which have not signed the Treaty yet, such as the United Kingdom and the Czech Republic, as well as the candidate states. This paper tries to put more light on the prospects of the Fiscal Compact and the related measures and on their impact on the economic, legal and the political future of the Union. It focuses on the implementation challenges of the Treaty and the new measures that aim for stronger cohesion within the Euro zone and further afield.

Keywords: EU, budget, cohesion, common economic policy, member states, future challenges, EU institutions, reforms.

AICEI Proceedings, 2013, Volume 8, Issue 1
DOI: 10.5281/zenodo.4543795

Introduction

The situation in the major European economies and the magnitude of the financial crisis call for urgent reforms of the economical, monetary and fiscal domains of the EU. The changes will inevitably entail deep cuts within the fiscal systems of states in the Euro zone and those outside it. Even the candidate countries will have to introduce similar if not the same measures in the light of their prospective membership. Academics agree that “monetary union can be a source of substantial benefits for their member countries” (Bukowski, 2011). Although, not without some drawbacks. Since the members of the Euro zone no longer have their own currencies and their respective monetary policies, their macroeconomic stabilization depends on market adjustments and on their fiscal policies. This should not present a significant problem for the developed EU states, as soon as their markets are open. Their fiscal and budgetary discipline served as benchmarks for many countries outside the EU, not to mention that one of the major objections to the faster introduction of the countries of the Western Balkans into the EU was precisely the lack of a proven record of their monetary and budgetary discipline. If this should be the case, then what happened in the meantime and why the existence of the pervasive financial crisis that threatens the very basis of the EU? Many argue that the crisis is a result of “the failure of market adjustment mechanisms and that, in fact, the EU market was never entirely opened up. The proclaimed high mobility of labour and capital, the openness of economies, production diversification and the flexibility of markets, prices and wages never happened” (Bukowski, 2011). In addition to this, without the virtues of a central bank, the governments of the states within the Euro zone had to maintain the macro-economic stability only by the means of the fiscal policy.

Pursuing the (over) ambitious Brussels programs, like that of making “Europe the most competitive and knowledge driven economy” and under the pressure of the never-ending series of election terms at all levels of government, they overextended employment in the sectors that they controlled, namely: the administration, education and social services. Consequently, the majority of the Euro Zone countries started to make huge budget deficits, financed by foreign debt. It was not a difficult task; the euro had a better image than the dollar so investors were eager to by their bonds. The Pandora's Box of the sovereign debt crisis was opened when the investors become suspicious that the less developed countries of the EU would not be able to repay the overdue portions of their huge debts due to the prolonged worldwide recession. The capital markets all of a sudden were very rigorous in assessing the risks related to their future debt, so they were not able to borrow at "normal" interest rates any more. Some economists argue that this was quite predictable since the only way for a monetary union to hold together long term is to have a strict and centralized fiscal policy at some supranational level. They claim that "a simple coordination of national policies is not enough" (Raluca at al. 2011). "While any good fiscal policy is expected to stimulate stable and sustainable economic growth, the crises in the second decade, in the case of the EU imposed an urgent need for consolidation of the public finances. In the case of some countries, there was also the need for slowing down their public debt and restoration of the elementary budgetary discipline and macroeconomic sustainability" (Postula, 2012).

One of the most important achievements towards the strengthening of fiscal cohesion of the EU was the adoption of The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, now known as Treaty on Stability, or Fiscal Compact. The Treaty entered into force on 1 January 2013 after ratification by twelve of the sixteen signatory states. It was good news for the euro-optimists and bad news for the euro-sceptics.

The Treaty introduced new rules and called for entirely new fiscal behaviour. Despite scepticism from the camp of the euro-sceptics, the European Council managed to pass the early measures necessary for the implementation of the Treaty. Consequently, the expectations that the Treaty will bring much stronger financial discipline seem realistic. However, the strict budgetary discipline of all actors, the private sector, the banks, the unions and the governments started to backfire in practically all EU countries. That is why this document can easily become the major source of future challenges for the entire EU. Academics and politicians, both for and against the Treaty are already entrenching their positions. They either claim the Treaty as a brave, new and modern document that will positively impact on the EU future, or see it as just another futile step in a row that could even dangerously threaten to change the original idea of the European integration of *sovereign* constituencies. The former interpretation stresses the need for a stronger and more centralized fiscal policy and discipline and wide cost cuts in order to re-establish the competitiveness and the agility of the EU economy, without the need to create some supra-financial power. Some of them said that it is simply legally impossible and next to treason! The latter approach also stresses the need for greater flexibility in the member countries in the budget setting as the major prerequisite for the very same objective: competitiveness and the agility of their respective national economies.

The Challenges Arising from the Implementation of the Treaty

The EU 2014 – 2020 Framework Budget provided the first occasion in which the numerous challenges related to the Treaty began to emerge. The first draft of the budget proposed by the European Commission was above a trillion euro and after a fierce debate in the European Parliament and with strong opposition from some states, especially from the UK, the budget was reduced to 960 billion. This was unprecedented. Moreover, in the future, the EU and its member states will have to take various additional long-term measures in response to the prolonged economic and financial crisis, mostly unpleasant cost cuts of various kinds. The future budgets will have to be orientated towards the creation of agile economies, economic growth, private investments and the creation of new jobs. However, the opponents of the budget cut, stressed that the unemployment rate among the young is already 25%, while investment in education and in other "youth related issues" is already at a meagre 0.8% of the current EU budget. They claim that the dissatisfaction of young people is already a major obstacle for further radical spending cuts by any government at any level in the entire EU. The tasks of creating new jobs to mitigate the negative social consequences arising from the crisis, together with the wide budget cuts and the better use of funds, are for many unsustainable. It can only be achieved by leaving others with a smaller piece of the budget cake.

Indeed, many electorates have rejected the statement “more quality than quantity”–which means that proponents of this idea are left with the choice of either having to abandon such a policy or to step down from power. Moreover, any serious effort towards the improvement of budget spending calls for mighty, but precise financial instruments, both monetary and fiscal, together with the free movement of labour and private capital on the open market. The protagonists have been found lacking in all these instruments. The Treaty introduced some instruments for “automatic” corrections in the case of the breaching of its provisions, but the major problems that caused the crisis: the lack of monetary instruments and locked markets have remained and have even increased. The labour market was further restricted due to the pervasive negative sentiments towards immigrants who were accused of “stealing scarce jobs”. This was an approach employed by the conservative parties in practically all of the EU countries not just in the crippled Mediterranean group. Their governments were unable to cut wages by a simple devaluation of their national currency thereby re-establishing their competitiveness and improving their damaged reputation as reliable debtors. Without their currencies, these countries were hopelessly dependent on the euro. The proposal put forward by George Soros, namely common EU bonds was rejected. Instead, Brussels and Frankfurt administered a “homeopathic” therapy based on even more sovereign debt. Moreover, Brussels and Frankfurt claimed that stepping out from the Euro zone, an option that some countries were contemplating at least as a last resort, is not an option and will only be understood as a departure from the EU. The government of Cyprus decided to undertake an unprecedented move in order to escape the bankruptcy of its banking sector by nationalizing a considerable portion of the savings deposited in the Cypriot banks. This move, masterminded and supported by the major EU players Germany and France, threatens to leave the EU out of the international capital routes for decades in the future. A number of private investors and rich celebrities started to leave the EU zone. The most notable example was that of Gerard Depardieu, the famous French actor, who left for Russia even giving up his “precious” EU citizenship when faced with a 75% personal tax rate in Belgium. Private capital has no ear for the Brussels, Paris or Berlin pro EU tirades, and many warned that radical fiscal operations could cost the EU a lot.

Meanwhile, the proponents of the Treaty have taken entirely different positions. For them it would be a "one-time-only measure" and that the EU now introduces a variety of tools for the correction of deviations in the budgets that will bring sustainable harmonization of the fiscal policies of the various EU institutions and the member states. They stress that despite some opposition, the member states all agree to build a new budgetary policy, particularly having in mind that they will preserve some sort of freedom in "determining the level of budget reductions and the dynamics of the implementation". They believe that the statement by the Euro Area heads of countries of December 2011 about the "reinforced architecture for new economic and monetary union" reaffirms the determination for redefinition of many aspects of the common economic activities and that the Treaty is an outcome of this determination that opens new possibilities for a new common coherence in the monetary and the economic domains. They even claim that it shows a road map for solving the numerous future problems arising from the economic crises and opens possibilities for the practical implementation of the principle of solidarity in the EU.

The Future of the Treaty

Recently, in February 2013, the European Council adopted *Conclusions* that express the determination of the Council to build a new governance model that will allow structural reforms aimed at consolidating and strengthening fiscal discipline across the Union. In the *Conclusions*, the heads of the states stipulate that the meticulous and on-going observation of the fiscal, financial and economic activities in the member states and effective coordination of all stakeholders will have a crucial impact on the future macroeconomic stability of the EU and its countries. However, how realistic is the requirement that the budgets of the member states should be balanced or in a surplus? The Treaty stipulates the obligation for the total deficit to be not more than 3% of GDP and the level of structural deficit not more than 1% of GDP and that the public debt should not exceed 60% of GDP of the countries. Moreover, the one year time window given to the states to adjust their respective legislations after the Treaty enters into force is simply not achievable, claim the sceptics. This dangerous step can throw the whole of Europe into an endless vicious recession. The pauperized electorates will then start seeing the EU idea as an obsolete and naïve daydream that threatens their personal destiny and, disappointed, will start looking for quick fixes. It is not difficult to predict what political forces will offer them. If that happens, there will be many ”Golden Dawns” and red nights of fire such as those in the 2011 riots all around the Europe. Last, but not the least argument in their favour, came from the scientists who found that the main Harvard paper “Growth in a Time of Debt” that the EU used to fabricate its one-size-fits-all austerity package was based on erroneous formulae (Austerity after Reinhart and Rogoff, 2013).

Strengthening the Functions of EU Institutions

It is a very unrealistic and pessimistic scenario, the World is not the same, the EU idea has already changed the people in a positive manner, argue the EU supporters. Since 1951, the cohesion of the EU has been strengthened continuously. The network of EU institutions is subject to continuous improvement and upgrading to serve as a reliable pillar of cohesion within the EU and that “institutions of the EU directly reflect its most fundamental goals” (Peterson & Shackleton, 2005). The Fiscal Treaty only continued that process, further empowering these institutions in order to better manage all common policies including those dealing with the economic and fiscal governance. This is even more important in a period of crisis. “There is almost a consensus in the EU that fundamental institutional reforms are needed to ensure that the enlarged EU could also function effectively” (Odenaren, 2005).

The Treaty promotes a further strengthening of the role of the common institutions, in the first place, the European Commission and the Court of Justice. The Commission, according to the Treaty observes the enforcement of the Treaty and plays a proactive role in the enforcement of measures and activities towards the implementation of the Treaty. The Court of Justice is entitled to impose sanctions for those member states which breach the Treaty. Despite the fact that some opposing attitudes believe that the Fiscal Stability Treaty, is not consistent with the core EU legal framework (The Treaty on the European Union and the Treaty on the Function of the European Union), most of the EU member states generally support the new role of common institutions. However, for a better performance of the new rolls of the European Union's institutions, it would be better to make some changes to the current secondary EU legislation that would create the legal framework for a stronger position for the Commission, together with that of the European Central Bank, the Council of Europe and the European Court of Justice. The European Parliament should also get more power in the economic, monetary and financial areas. It would only improve the "transparency" and the democratic capacity of the EU in these sensitive domains. The recent debate on the budgetary framework for the period 2014–2020, clearly demonstrated that need. Many argue that these new powers of the EU central institutions could be derived from the current "constitutional" acts, mainly by interventions at the level of directives and other secondary legislation. Others think that there is a need for a radical change of the EU principals, a rather painful and unpredictable process that many would try to avoid if at all possible. No matter who is right or wrong on this legal issue, for the successful implementation of the new economic governance, the coordination between the EU institutions, especially between the EU Commission, the Council of Europe, the European Parliament and the European Central Bank is critical. The new system should not be dependent on the goodwill of the political leaders but be self-sustainable over a longer period.

Conclusion

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union aims towards solving more effectively the numerous problems imposed by the economic crisis in the EU area. However, the number of issues and problems that arise from its implementation (such as the new EU economic governance, or the strengthening of the position of EU institutions) is sometimes overwhelming. One of the most critical issues is whether or not the new roles can be introduced based on a simple transfer of the competencies between the various players at an EU level and those at the regional and the national level in order to quickly redefine the new roles of the EU in the monetary and fiscal domains. The current EU leaders think that the EU institutions already have enough power to undertake various urgent measures towards the re-establishment of a sustainable economic and monetary stability. The approaching federal parliamentary elections in Germany will send a clear message and will show whether or not people share the same opinions of their EU leaders. If a resounding ‘yes’ is registered, then the EU sceptics’ camp will at least be silenced for a little while. If not, then the EU will have to deal with even harsher challenges. The management of the crisis in Cyprus confirmed that the coordination between the EU institutions could be (relatively) easy, together with the desired level of cooperation between the EU and the International Monetary Fund. On 16 March 2013, the European Commission, the European Central Bank and the International Monetary Fund agreed a ten billion Euro support package for Cyprus, making this country the latest member of the club of receivers of EU and IMF support, alongside Greece, Ireland, Portugal and Spain. The Parliament of Cyprus approved the Arrangement with the EU as a last resort to escaping from bankruptcy. However, some claim entirely different outcomes from this “Saving Private Cyprus” operation. Only time will tell who is right and who is wrong. No matter how much “freedom” is given to EU member states in the implementation of the Treaty, Germany and France will play the main roles in the implementation of the Treaty. These two countries will ultimately decide the destiny of the Treaty as well.

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