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« European economic governance: Current status and future prospects »

Conference Report

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On 6 February 2012, Egmont – Royal Institute for International Relations organised a conference on European economic governance. On this occasion, Egmont's Studia Diplomatica on the matter was presented to the public. Most speakers at the conference agreed that the EU's decisions will result in a strengthening of its Economic and Monetary Union, although more will still be needed. The conference made clear that economic governance still has to mature considerably if it is to support the common currency in a durable manner. This development is bound to lead to a different kind of Union.

Keynote Speech by Mr Didier Reynders, Belgian Minister of Foreign Affairs

The Belgian Minister of Foreign Affairs opened his keynote speech by discussing the evolutions that marked 2011 in terms of economic governance. These evolutions include the application of the European Semester, the increasing focus on structural reforms, as well as the strengthening of the European economic governance provisions. These evolutions have an important impact on the Member States, including Belgium. This impact will continue in future.

Building on these evolutions, the Minister outlined a three-pillar strategy to guide the EU through the current crisis. The first pillar of his strategy consists of attaining lasting fiscal discipline in the Member States. He argued that the European Commission should be responsible for overseeing adherence to fiscal rules. The Minister emphasized that rules on fiscal discipline are a prerequisite for the other pillars of his strategy.

The second pillar of the Minister's strategy concerned solidarity among Member States. To this extent, the Minister pleaded for a strong firewall, i.e. one that it is able to provide financial assistance even to the larger Member States. Such a strong firewall should be accompanied by market interventions by the European Central Bank, the Minister argued.

The third and final pillar of the Minister's strategy is focussed on jobs and growth. More jobs and growth should be achieved by shifting EU resources to research and development. In addition, the Minister argued, EU project bonds can be used to finance large infrastructure projects. Measures in this field need to provide hope for EU citizens. Hope will indeed be a crucial part of any recovery from the crisis, according to the Minister.

The Minister noted that his three-pillar strategy would provide a major move towards EU federalism. In his eyes, such a step-up in federalism is essential. It will determine both the success of the monetary union and the EU's future clout in the world. With Paul-Henri Spaak in mind, he concluded his keynote speech by stating that "*there are only two kinds of small European countries: those who know they are, and those who are yet to realise this*".

The Minister's full speech is available on [our website].

Presentation by Philippe de Schoutheete, former permanent representative of Belgium to the EU

Philippe de Schoutheete began his presentation by discussing Egmont's latest Studia Diplomatica, a publication that is entirely dedicated to the economic governance issue. He briefly outlined the content of the different chapters. He added that the publication was not likely to become outdated any time soon. In his view, the authors do not only discuss recent developments, but also make an effort to consider the fundamentals of economic governance, including the distinction between normative and incentive governance.

After this presentation, Mr de Schoutheete shared some of his personal views on European economic governance. He noted that policymakers have long been aware that the Economic and Monetary Union remains an incomplete project. Yet, as no major crisis had occurred up until the sovereign debt crisis, the governance of the common currency was neglected. The EU is now paying the price for this neglect.

It is too easy to state that the EU has just been kicking the can down the road ever since the crisis occurred. Many measures that were deemed unfeasible before the sovereign debt crisis have now been adopted, Mr de Schoutheete argued. Therefore, while the response to the crisis has not yet been sufficient, it was not insignificant either.

Mr de Schoutheete furthermore questioned the alleged intergovernmental nature of the new Treaty[1], as well as the negative connotation it entails. By definition, he stated, a treaty among governments constitutes an intergovernmental agreement. Yet, the new treaty's content is not that intergovernmental, as it contains both normative and incentive governance measures that are quite intrusive.

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1 The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

In this respect, the speaker stressed the important role of the European Council throughout the crisis. The European Council is a more intergovernmental institution than Parliament or the Commission. Yet, when the European Council does what the Treaty asks it to do, this should not be labelled intergovernmental, Mr de Schoutheete concluded.

Panel discussion

Following the presentation of the Studia Diplomatica, a panel discussion between three prominent European experts took place. The panel was moderated by Peter Ludlow (European Strategy Forum and founding director of CEPS).

Frans van Daele, Head of Cabinet of the President of the European Council

In his opening remarks, Frans van Daele acknowledged that the EU had been more vulnerable to a sovereign debt crisis than other parts of the world, such as the US and Japan. The main reasons for this weakness are well-known: the EU's political structure is far from complete. The coordination of national economic policies in the euro area proved insufficient, Mr van Daele stated.

In its response to the crisis, the EU has shifted the perceived limits of solidarity among Member States. The crisis has raised questions about the limits to sovereignty, but Mr Van Daele underscored that the response to the crisis is not about losing sovereignty, but about pooling it.

Mr van Daele went on to stress the added value of the new intergovernmental Treaty. The Treaty notably introduces an obligation for participating countries to adopt a so-called Golden Rule. This rule implies that national budgets have to be structurally in balance, i.e. in balance when considering the effects of the business cycle. Besides the Golden Rule, the Treaty also results in a change of voting rules in the Excessive Deficit Procedure. These new voting rules strengthen the role of the Commission. While the Treaty might be intergovernmental in nature, it nonetheless increases the powers of the EU institutions. Those who plead for a stronger Europe should thus regard the Treaty as a positive evolution, Mr van Daele remarked.

Commentators and academics often warn of a split between the countries of the eurozone and the other Member States. Mr van Daele downplayed this danger by pointing out that the tensions between the eurozone countries are often much stronger than those between the 27 Member States. According to the new Treaty, summits among eurozone leaders will be held in future. Yet, when the European *acquis* is at stake, all Member States are to be invited. In his view, these rules strike a balance between the interests of the eurozone countries and the other Member States. It should, however, be clear that handling the current crisis is predominantly a matter for the eurozone.

Ending on an optimistic note, Mr van Daele reminded participants that every crisis in the EU has led to more Europe. The current crisis is therefore bound to have the same outcome.

Yves Bertoncini, Secretary General of Notre Europe

Legitimacy was at the heart of Yves Bertoncini's intervention. Any increase in European economic governance needs to be perceived as legitimate in the different Member States. The EU is currently indeed exploring what it can legitimately do. In this regard, we see a large discrepancy between the EU's actions deemed legitimate in terms of fiscal policy and the EU's legitimacy in other policy fields.

As far as fiscal policy is concerned, the EU can now act in an IMF-style fashion, by providing conditional financial assistance in three eurozone countries, which had *de-facto* lost their sovereignty: Greece, Ireland and Portugal. In terms of policy fields other than fiscal policy, the EU often acts more as a sort of OECD, i.e. providing peer review and non-binding recommendations. In those fields, the EU does not have the power to coerce Member States.

Mr Bertoncini wondered whether such soft cooperation is sufficient to have a sustainable Economic and Monetary Union, and said that additional steps should be taken. These steps include effective macro-economic governance, financial supervision and a positive agenda that focuses on growth. The Delors Packages to re-launch growth can serve as an example in this respect. Eurobonds might also be introduced in the near future. Nonetheless, additional integration in these fields will need to be accompanied by fiscal discipline. The new Treaty plays an important role in ensuring such discipline.

Besides the question of what the EU can legitimately do, Mr Bertoncini also discussed who should act at the European level. He agreed with Mr de Schoutheete that the European Council has played an increasingly important role since the crisis' onset. Within that institution, two countries, France and Germany, clearly took the lead. This is not fully legitimate, Mr Bertoncini stated. In the future, the President of the European Commission will play an important role in economic governance. The new Treaty will even increase his powers. Mr Bertoncini argued that direct election by the European Parliament would increase the Commission President's legitimacy.

Involvement of the national parliaments will also be of crucial importance in the future of the EU. Parliaments should exercise control over EU policies, also in an *ex-ante* manner. Legitimacy begins in the Member States, Mr Bertoncini concluded.

European Policy Brief 7 by Mr Bertoncini builds on his intervention. It can be found on our website.

Guntram Wolff, Deputy Director of Bruegel

Mr Guntram Wolff began his intervention by discussing the major shortcomings of the Treaty of Maastricht. In the first place, structural policies were not sufficiently incorporated in the Treaty, as it focussed mostly on fiscal policies. Secondly, the Treaty did not provide for a crisis management framework to deal with sovereign credit risk. The no-bailout clause has even hampered effective crisis management. Lastly, the Treaty did not foresee financial sector supervision and resolution at EU-level. Such scattered financial supervision has proved problematic during the financial crisis.

The measures that have been taken since the onset of the sovereign debt crisis have not sufficiently addressed these shortcomings, Mr Wolff believed. The system remains fragile as sovereign risk and banking risk are still closely intertwined. Moreover, the financial assistance facility provides no solution for the credit risk of larger Member States, such as Spain and Italy.

In Mr Wolf's view, the core problem of the Economic and Monetary Union is that it lacks a central Fiscal Authority. Such an Authority needs to have several powers. First of all, the Authority needs federal taxation powers. This would allow for a European deposit guarantee scheme, and could provide a backstop to the failing of cross-border financial institutions. The Authority also ought to be able to carry out countercyclical fiscal policies in the Union as a whole. This would result in automatic assistance to those countries and regions that are hit particularly hard by an economic downturn. Finally, supervision of the financial sector should be brought to the EU level.

A eurozone Fiscal Authority would provide a crucial building block in the EU's future governance. Other ideas could be beneficial as well. The Golden Rule can be useful if the conceptual issues are resolved (see infra). Mr Wolff referred to the US, where balanced budget rules on state level have had a stabilising effect. Others ideas that are floated around can, however be counterproductive for economic governance, Mr Wolff argued. This is, for example, the case for the idea of putting in place a *European Kommissar* tasked to enforce austerity decisions in an individual Member State.

In contrast to Mr van Daele, the speaker believed that simply pooling sovereignty will not be enough. Some sovereignty will inevitably have to be sacrificed by the Member States. But this loss of sovereignty must not lead to sacrificing democracy, Mr Wolff argued. Increasing the legitimacy of the EU level will therefore be pivotal in order to establish a well-functioning Economic and Monetary Union.

Question and Answer Session

During the Q&A-session, a debate took place among the panellists, authors of the Studia Diplomatica and the audience. This report focuses on a few of the issues that were discussed.

The national **Golden Rules** proved one of the main topics of the discussion. Hon. Professor Jean-Victor Louis (ULB and the European University Institute, Florence) wondered whether the new Treaty is fully compatible with existing EU legislation. In his view, EU legislation should be used to clarify the new Treaty where needed. Mr van Daele replied that the structural budget is indeed a complex concept, which will need to be made operational. Yet, the Golden Rule is not to be applied in a mechanical fashion. The Commission will play an important role in ensuring the correct application of the rule, Mr van Daele believed. Mr Wolff was more sceptical about the Golden Rule's effectiveness. He added that, if the Rule nonetheless proves practicable, it would require a reduction in social expenditure in the Member States. That reduction will not be replaced by EU expenditure, which may harm the acceptance of the rule among EU citizens.

In a similar vein, Mr Pierre Defraigne (Madariaga - College of Europe Foundation) stated that **the new Treaty** provided no solution, as it did not deal with the debt overhang problem. In his view only a pooling of national debt can resolve this. He went on to describe the new Treaty as an *usine à gaz a-démocratique*. Mr van Daele rebutted this statement by arguing that the Treaty cannot be an *usine à gaz* and *a-démocratique* at the same time, as one excludes the other.

The issue of **European integration à la carte** was also debated. Professor Louis argued that the response to the crisis is increasingly leading to diverging levels of integration among the Member States. The new Treaty exacerbates this evolution. In his response, Mr van Daele underlined that 25 EU leaders agreed to the new Treaty. Once ratified, Member States cannot walk back. Furthermore, all participating eurozone countries make the same commitments under the Treaty. The new Treaty will therefore not necessarily add to a Europe à la carte. Mr Bertoncini remarked that Europe is currently building the needed mechanisms at its core and that other Member States should be added to this core in future. As such integration will need to be in line with national legitimacy, he applauded the fact that the German Chancellor addresses her national parliament before attending European Summits. In his eyes, such steps are useful to reduce the perceived "democracy deficit".

Professor Maria João Rodrigues (ULB and the Lisbon University Institute) focused on **the issue of convergence**. She argued that there is no consensus on its meaning, despite the fact that many EU texts refer to the concept. Mr Bertoncini indicated that in terms of fiscal policy, convergence could occur through eurozone-wide discipline and that, for the other policies, the main objective should rather be to reduce excessive divergences. In terms of economic growth the convergence can't be put in place easily as not all countries can put in place a growth model based on exports. Therefore, mere discipline in macro-economic policies will not be enough.

Professor Rodrigues added that a focus on macro-economic convergence was still missing. Mr Wolff remarked that macro-economic convergence would be more difficult than fiscal discipline. In his view, convergence between the different eurozone economies will take a very long time - as reversing the existing trends is most difficult. This constitutes a major stumbling block for the Economic and Monetary Union success. An increase in local demand in Germany would be a most helpful evolution. However, Mr Wolff did not see this happening without a strong impulse from the EU level.

Conclusions

Peter Ludlow, European Strategy Forum and founding director of CEPS

By way of concluding the panel, Peter Ludlow discussed the ways in which the EU has changed over the last two years. He underlined that these changes have mainly been due to the management of the crisis, rather than to long-term governance reforms. First of all, he noted that the crisis has strengthened the role of EU leaders, who have stated on several occasions that they would do whatever is necessary to save the euro. Member States have also begun to alter their unsustainable policies, although there is still a long way ahead to achieve sustainable policies. *On paper*, the crisis has not been at the expense of the Commission. This is remarkable, Mr Ludlow stated, although he added the institution currently has difficulties in letting its voice be heard.

The transformation of the role of the European Central Bank constitutes another major evolution. Despite its conservative image, the ECB has become a major player in the crisis response. Another positive evolution is the increasing mobilisation of national parliaments. This development was long overdue and should continue. Finally, some clarification of the ins and outs of European integration has been provided. Mr Ludlow saw a three-speed Europe emerging: the eurozone at its core, the UK and the Czech Republic at the outer limits and the other Member States somewhere in between.

Etienne Davignon, President of Egmont

In his concluding remarks, Etienne Davignon provided, *inter alia*, a roundup of the legitimacy discussion that had taken place during the conference. He considered that it was only normal that the public has become more sceptical towards the EU. Many feel that they are suffering from a crisis for which they have no responsibility. European leaders need to step up to the challenge and address these concerns.

Mr Davignon also reminded the participants that almost all European treaties had been drafted during periods of difficulties or crisis. The Maastricht Treaty is the sole exception to this rule. It was based on a conviction about European integration, rather than on a necessity. Nonetheless, the Maastricht Treaty constituted a compromise between different views. Consequently, not all issues were dealt with in a satisfactory manner. As subsequent governance reforms were often modest in nature, many of the outstanding issues were not sufficiently resolved.

In contrast, the sovereign debt crisis has led to some fundamental reforms. The new Treaty that was discussed during the conference provides an additional step. The significance of the EU's response to the crisis is not to be overlooked - although additional measures are still required. Importantly, the financial markets start to believe that the EU's commitments will be carried out. This could lead to an important turning point in the crisis. In the end, the success of the monetary union is in the interest of all European countries. The perspective of hope after the pain is absolutely necessary, Mr Davignon concluded.

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