The Fiscal Treaty Needs a Protocol

Extension to Include Economic Growth, Employment and Social Cohesion

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The »Treaty on Stability, Coordination and Governance in the Economic and Monetary Union«, generally known as the Fiscal Pact or the Fiscal Treaty, is supposed to tighten up the budgetary regulation of the signatory states in comparison to the current provisions of the Stability and Growth Pact (SGP). At its core is the introduction of national debt brakes, subject to sanctions. Accordingly, the annual structural budget deficit may in future not exceed 0.5 per cent of nominal gross domestic product (GDP). After ratification by at least 12 of the 25 parties the treaty, signed at the beginning of March, is supposed to come into force by 1 January 2013 at the latest. However, the firm stance taken by newly elected French President François Hollande against the predominant European approach to crisis management and his demand, made during his election campaign, for the renegotiation of the Fiscal Pact offer an opportunity to correct key defects and omissions.

No Relevance to Coping with the Crisis

The crisis has put the inadequacy of the Maastricht architecture into stark relief. The one-sided emphasis on public debt has led to the neglect of the enormous problem of private debt levels. The hopes invested in self-adjusting economic structures have not been realised by the unified monetary area. Instead, economic heterogeneity in Europe has increased, as the macroeconomic imbalances plainly show. This is due primarily to the lack of a common economic and fiscal policy, which would have a balancing effect and promote cohesion. Contrary to a European approach, the Member States, on surrendering the exchange rate instrument, were abandoned to a downward competitive spiral of low wages, low taxes and low social spending.

The Fiscal Pact entirely overlooks these blatant defects of the Eurozone. Instead, it concentrates exclusively on the regulation of state budget deficits and debt levels. No one denies that Greek financial policy has been fundamentally unsound for years and that the country should never have been admitted to the monetary union. This description does not apply to the other crisis states, however. Ireland and Spain, for example, complied with the Stability and Growth Pact in exemplary fashion right up until the outbreak of the global financial and economic crisis. Thus the stricter budget policy rules that are now to be implemented with the Fiscal Pact would not have prevented the current crisis. On the contrary, the potentially fatal effects on labour markets and growth of the putative remedy, austerity, are all too evident in southern Europe, and the states concerned are being driven into a vicious circle of ever increasing debt.

Political and Economic Dynamite

Spain's deviation from the planned deficit target for 2012; the foundering of the Dutch government on its austerity programmes; and the self-evident results of the last two elections in Greece constitute the first indications of the dysfunctionality of an even stricter austerity policy. In the current crisis situation the Eurozone does not need intensified consolidation, but rather to break out of the cycle of crises using unorthodox measures to generate growth and employment. The procyclical consequences of the debt brakes to be established in all countries would have quite the opposite effect.

There can be no question, either, of simply »exporting« Germany's debt brake, anchored in the Constitution, to other European countries. For example, the German debt brake applies explicitly to the federal and state govern-

ments, while the Fiscal Pact refers to the »annual structural general government balance«. This could mean that in future the budgets of municipalities and social security schemes could also be affected. Furthermore, the German debt brake will apply to the *Länder* only from 2020; the Fiscal Pact, however, would require the prioritising of spending cuts from as early as 2014. It can be anticipated that a large number of Euro-states will find themselves constantly embroiled in deficit procedures. Under the Fiscal Pact such procedures are supposed to kick-in automatically. But if a majority of States is constantly under supervision, the expected short-term gains from budget-policy rigour on the markets will be rapidly exhausted and renewed scepticism concerning the viability of European policy in the face of difficulties will spread. The linking of ratification of the Fiscal Treaty to authorisation of the use of the European Stability Mechanism (ESM) could even result in the highly touted »firewalls« against the crisis, in the form of stand-by emergency financial aid, not being deployed. The insistence on the principles of the neoclassical economic dogma that find expression in the Fiscal Pact could thus thwart the ingenious safety mechanism and exacerbate the crisis.

Lack of Political and Democratic Legitimacy

The Fiscal Pact was negotiated intergovernmentally on the basis of a German-French proposal. The European Parliament and national parliaments have not been allowed to play even a minor role in concocting this intergovernmental treaty. The European Parliament is graciously granted a report on the planned new Euro-summit meetings. Otherwise, the parliaments are referred to a protocol regulating their cooperation that enables them to discuss the budget policies mentioned in the Fiscal Pact.

At the European level, there are signs of procedural problems if, for example, the EU institutions were to be enlisted to implement components of this independent international treaty, although two Member States have not signed it. At the national level, it must be asked whether the European participation and control rights of national parliaments, reinforced by the Lisbon Treaty, will have any application within the framework of the Fiscal Pact. The possible transfer of sovereignty with regard to central budgetary policy to the supranational level has in Germany already led to a slew of actions before the Constitutional Court. Even if they are questionable from a legal point of view, from a political perspective it is an open question what an individual state has to gain from relinquishing sovereignty concerning the establishment of a debt brake. A change – possibly constitutional – in the debt rule and a fiscal treaty that can only be revised jointly by all signatories and contains automatic mechanisms constitute a double obstacle that points towards a curtailment of governments' scope for policy action.

Transforming the Sham Fiscal Pact into a Real One

The Fiscal Pact is not what it pretends to be, even linguistically. It is not aimed at a »fiscal union« because the abovementioned defects of the Maastricht Treaty remain. In fact, the highly problematic asymmetry of a monetary union without political union has been exacerbated, tacitly condoning fragmentation of the EU. This fragmentation will in future be distinguished less by the »debt brake« than by the existence of a group of economically and socially disconnected states. In order to prevent this, despite the precarious circumstances in the crisis states – recession, high unemployment, rising poverty, increasing political radicalisation – the present Fiscal Treaty must be expanded. This must not be merely symbolic, as in 1997 when the *Stability Pact* of the emerging monetary union was expanded into the *Stability and Growth Pact,* although it did not differ one jot from the monetary principles of the German government and the Bundesbank. What is now needed, therefore, is more than a *fiscal and growth pact* that does not even live up to its name. Supply-side structural reforms must be complemented by demand-side measures.

The Treaty has been signed and some of the parties have already ratified it. Complete renegotiation is therefore unlikely. Even a newly elected French President will not repudiate an international treaty signed by his predecessor and risk undermining the credibility of future transnational agreements. However, it would be quite easy to attach a *protocol* to the Fiscal Treaty. According to Art. 2 (1a) of the Vienna Convention on the Law of Treaties all documents of an international agreement count as elements of the treaty; a protocol thus has the same legal validity as the text of the treaty to which it belongs. A protocol to the Fiscal Treaty could, on one

hand, reassure those who do not want its budgetary policy provisions to be diluted or thrown overboard, while on the other hand such a supplementary document could take account of all those aspects that are not adequately regulated in the Fiscal Pact.

A Commitment to Growth Is Not Enough

In terms of content, a mere commitment to economic growth is not enough, given the urgent crisis in the Eurozone. Rather the Fiscal Pact must be expanded into an instrument for creating a genuine fiscal union. The goal must be to link budgetary solidarity with a protocol for economic growth, employment and social cohesion, supplementing the Fiscal Treaty. This would include the following elements:

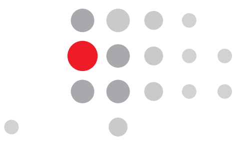
1. Implementation of an **EU debt repayment fund** into which all public debts of the parties exceeding 60 per cent of GDP are transferred on a one-off basis. Repayment would work by means of a joint bond. For this purpose the participating countries would assume payment obligations in relation to the fund. In contrast to the proposal of the German Council of Economic Experts the annuities and, accordingly, debt reduction paths should be closely tied to the economic development of the relevant states by means of a prosperity index (to be revised every year), oriented towards the Scoreboard for monitoring macroeconomic imbalances. The period of 20–25 years envisaged by the economic experts and the rigid 1/20 rule could therefore be under- or overshot.

2. For all states whose overall debt lies below 60 per cent of GDP a second kind of joint bond would be introduced on a permanent basis in the form of **eurobonds,** along the lines of the Blue Bonds proposed by Jacques Delpla and Jakob von Weizsäcker. Since highly indebted countries could not participate a high creditworthiness is guaranteed and it is much more likely to have the effect of lowering interest rates than a debt repayment bond. All countries with access to the debt repayment fund would therefore have an incentive to reduce their debts rapidly in order to benefit from favourable refinancing interest rates on a long-term basis. In contrast to the debt repayment bond the states in question would not have to earmark the capital made available on favourable terms through the eurobonds to service existing debt.

3. A **European New Deal** would be implemented in order to create economic growth and employment. Essential for this purpose is the introduction of a European financial transaction tax, the proceeds from which could be diverted towards strengthening small and medium-sized enterprises, big European infrastructure projects (for example, in the areas of energy or transport) and job-creation initiatives. Financial need, to be determined on the basis of an allocation formula, must be related to the economic situation of participating countries in accordance with the abovementioned prosperity index. Countries affected by an economic shock and mired in recession have, in the interest of all signatory states, a greater need for investment promotion and action to counter unemployment than countries at the top of the economic cycle.

4. Europe's economic and social cohesion would be accelerated by means of a **social stability pact**. Its aims would be to reduce socioeconomic heterogeneities in the Eurozone caused by the crisis and to prevent cross-national dumping strategies. For this purpose the signatory countries would commit themselves to the following: first, minimum wages in the amount of 60 per cent of the respective national average wage; second, a common consolidated corporate tax base and minimum tax rates; and third, the binding of individual states' level of social spending to economic development in terms of margins of fluctuation within a corridor arrangement, based on Klaus Busch's model.

5. In order to optimise European governance structures, in parallel with the biannual (at least) Euro-summits of heads of state or government envisaged in the Fiscal Treaty a new body would be established: based on the population of the respective signatory states national parliaments and the European Parliament would mandate a certain number of representatives to a joint **European economic and financial committee**. All regulatory matters concerning the Fiscal Pact and its protocol with binding force for the heads of state or government would be negotiated here or passed on to the European and national institutions for implementation. All Member States would be allowed to repudiate the Fiscal Pact at any time of their own free will.



Factoring-in Economic Performance

The individual elements of a protocol to the Fiscal Treaty proposed here are new in respect of their repudiation of the one-size-fits-all approach taken so far in the European integration process, in favour of a thoroughgoing orientation towards economic capabilities of individual states. All too often it has been the case that Community regulations have expected too much of some states, while letting others off the hook. What we are proposing is to bring debt repayment paths and entitlements to benefit from the eurobond system, the cash flows to be expected from a financial transaction tax earmarked for combating the recession and the regulation of internal European competition with regard to wages, taxes and social spending into line with the individual socioeconomic situation of the participating countries.

In order to put an end to the muddling-through characteristic of intergovernmental crisis arrangements, which have eroded democracy at national level without providing a democratically legitimate substitute at European level we propose to break new ground in institutional terms. The establishment of a European economic and financial committee indicates the direction in which things must develop if, on one hand, we wish to avoid the dismantling of economic integration and, on the other hand, we retain the distant goal of a federal Europe.

The advantages of a supplementary protocol to the Fiscal Treaty on economic growth, employment and social cohesion are self-evident: the laboriously negotiated treaty would not have to be unravelled, but instead complemented by elements urgently needed to cope pragmatically with the deepening crisis in the Eurozone. A balance could thus be struck between austerity and investment in the future. For all those progressive forces who have not written off Europe as a common idea with a promising future, despite continuous crisis, the election of François Hollande as President of France provides an opportunity to instigate a new era of European policy-making.

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