CEPS COMMENTARY
CE PS
Thinking ahead for Europe

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (aka Fiscal Compact)

Daniel Gros

8 March 2012

Signed on March 2nd by all member states of the EU (except the UK and the Czech Republic), this new Treaty may be long on good intentions but, on closer examination, it appears rather short on substance.

The only really substantive binding provision is that the member states undertake to adopt at the national level rules that limit their structural deficit to 0.5% of GDP. This should be done "preferably at the constitutional level". The European Court of Justice (of the EU) can be asked to pass judgment on these national rules, but the maximum fine that could be assessed is capped at 0.1% of GDP – hardly a strong deterrent by itself. The real enforcement will come through a little-noticed addition to the Treaty establishing the permanent bail-out fund, the European Stability Mechanism (EMS), which says that only countries that follow the fiscal compact will be eligible to receive ESM support.

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union is only concerned with the framework for fiscal policy, i.e. the rules setting up national 'debt brakes', not their implementation. Accordingly, it does not give any new powers to the Court of Justice (nor to the European Commission) to interfere with the actual conduct of national fiscal policy. Even if this Treaty had been in force today, it would not have given the European institutions any new powers to force Spain to reduce its deficit as quickly as member states are obliged to do under the more stringent rules of the Growth and Stability Pact.

None of the provisions on economic policy coordination in this new intergovernmental treaty is binding. They essentially reiterate oft-repeated statements of good intentions on structural reforms.

The provisions on governance institute regular meetings of the heads of state of the euro area (at least twice a year). But since these meetings will remain informal, there was no need for an international treaty to convoke them.

The treaty implies no obligations for non-eurozone countries. The signature of the eight non-euro area countries thus constitutes a mere political statement, which entitles them to a partial 'seat at the table', in the sense that they can participate in most of the euro area summits.

From a purely legal point of view, the treaty contains an inherent contradiction because it implies that its signatory countries agree to accept binding constraints on their constitutional order via an ordinary international treaty. In most countries, however, the (national) constitution is of a higher legal order than an international treaty, which implies that even

Daniel Gros is Director of the Centre for European Policy Studies.

the provisions on the 'fiscal compact' constitute essentially a political statement (unless this treaty is ratified with a constitutional majority, as will be done in Germany).

The main value of this political statement is of course that it provides political cover for the German government in its efforts to sell the euro rescue operations to a skeptical domestic audience. It is doubtful, however, that the 'fiscal compact' was ever really needed for this purpose, given that German public opinion remains much more constructive on the euro than widely assumed (see Gros & Roth, 2011) and given that even before the fiscal compact existed, all votes in the Bundestag showed very large majorities in favour of all euro area rescue operations, even when they implied substantial fiscal risks for Germany.

In judging the value of this Treaty, one should also keep in mind that of the four large euro area countries, three already have national debt brakes effectively in place at the constitutional level (at the operational stage in Germany, adopted in Spain and in the course of adoption in Italy). In the fourth country, France, it is already clear that the Treaty will only be implemented (if at all, given the negative attitude of the opposition) via a so-called *'loi organique'* and that the French Constitution will not be changed.

All in all, the Fiscal Compact is probably useful. It forces member states to adopt stronger national fiscal frameworks at home. Some, perhaps most, would have done so anyway under the pressure of the markets, but the new Treaty will probably still make a marginal difference.

The main danger is that that it has been oversold. It does not constitute a first step towards fiscal or political union.

It is likely that the ratification process (e.g. the referendum in Ireland) and then the implementation process in some difficult countries (e.g. France) will receive a lot of attention and create a distorted impression of the importance of the Fiscal Compact. However, once the initial excitement is over, when the national fiscal rules have been put in place, this Treaty will quietly be forgotten. Its only remaining impact will consist of the convening of euro area summits, which are likely to regularly produce Conclusions that "Member States commit" to everything desirable (structural reforms, etc.). And, as a matter of course, these Conclusions will become irrelevant once the heads of state and government return to their capitals and become immersed in their respective domestic political realities.

Reference

Daniel Gros and Felix Roth, "Do the Germans support the euro?", CEPS Working Document No. 359, CEPS, Brussels, December 2011