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MANAGING PUBLIC FINANCES
LESSONS AND PERSPECTIVES FOR THE EU AND THE EURO AREA

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- ES GILT DAS GESPROCHENE WORT -

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The public financial crisis exploded in Greece at the end of 2009 where the situation, in the words of Loukas Tsoukalis, was characterised by "a large budget deficit, added to an already huge public debt, an unsustainable current account deficit, coupled with a credibility deficit when previous governments were found to have been economical with the truth."
After hesitating for a few weeks, on 11 February 2010 the euro zone heads of state and government expressed their will to preserve, "the stability of the euro area as a whole". On 7 May, they amplified the formula and expressed their will to assure "the stability, unity and integrity of the euro area". We will find this and similar affirmations in a number of declarations, resolutions, press conferences and ultimately in a draft decision of the revision of the TFEU adopted by the European Council at its meeting on 16-17 December. It provides the main basis for assistance of the countries in need.
The rescue packages adopted in the first semester were not only necessary in order to achieve the right balance between avoiding moral hazard and the risks of contagion, between solidarity and responsibility. It was not only a correct answer to the challenges of an awkward situation but it was also an action compatible with the requirements of the Treaty, be it the general principles of Union Law or the provisions of the Economic Union chapter itself, taking into account the circumstances and the lessons learnt from over ten years of monetary union.

In the first part, we will consider how the euro area arrived in such a perilous situation and briefly recall the measures, which were taken.
Thereafter, in the second part, we will look at the legal support provided by the rescue packages.
And in the third part, we will draw some lessons before concluding with more general considerations aimed at the future.

It is often underlined that EMU is based on a solid "M" branch and a weak "E". It has been said that the "E" arm is a kind of accessory to the "M" arm. There is no economic union for its own sake. On the one hand, concerning the currency, there is an allocation of exclusive competence to the EU and in particular to its central banking system. On the other hand, procedures of coordination and surveillance, a code of conduct and a specific discipline to prevent excessive deficits are features of the economic arm but the ultimate responsibility for economic and budgetary policies remains in the hands of the Member States.
The emphasis is on the definitive role of the markets to limit the profligacy of the states, for the sake of price stability, an objective that has been inserted into the Lisbon Treaty in article 3 TEU. The States, like private entrepreneurs, have to ensure their finances on the market.
This system was based on a combination of market freedom and regulation. The crisis has, however, challenged this balance.

The philosophy of the economic union has been said to rely on a number of "key assumptions" that have been revealed to be wrong. Lorenzo Bini-Smaghi, one of the ECB's executive directors, explains this very well in a speech to the Group of Thirty:

"The first was that markets would exert strong pressure on euro area fiscal policies. The second assumption was that if the first assumption were insufficient to discipline public finances, then the Stability and Growth Pact, based on monitoring, peer pressure and sanctions, would do the job. The third assumption, reinforcing the previous ones, is that if a member of the euro area were unable to implement sound fiscal policies, it would be left to its own devices. The final assumption was that national economic policies would be geared to ensure convergence among euro area economies, within a strengthened single market."[1]

The assumptions have not materialised as this author observes.

"Markets have not exerted a strong pressure". They were late to react and when they did, their pressure was exaggerated, something that the Delors report had predicted and it was the reason why he pleaded for stronger discipline measures than adopted in the Maastricht Treaty.

"The Stability and Growth Pact (SGP) did not work as expected". This assessment of the situation, which is true must nevertheless be qualified: Aggregate figures demonstrate the positive effect of the SGP. In 2008, before the fall of Lehman Brothers when the 10th anniversary of the euro was celebrated, the medium deficit for the Member States of the euro area was of GDP 0,6 % in comparison with 4 % in the eighties and nineties. Thus it is justified to speak of significant progress. But these are medium figures. There were free riders. Asymmetries have developed among Member States. In 2007, only ten of the 27 EU Member States had reached their "Medium Term Objective" (close to balance or in surplus) under the revised Pact of 2005, an objective that except for the UK, with its exceptional status, was applicable to all Member States. Due to the crisis, the situation worsened.

From 66.5 % for the euro area in 2007, the medium sovereign debt increased to 69.8 % in 2008 and 79.2 % in 2009[2], due to the provision of stimuli to economy and the assistance to banks.

"The idea that countries could be left on their own and, finally, be defeated without contamination proved wrong". It is precisely the contagion risk that made the "no help policy" unrealistic which many found justified with reference to the no-bail-out clause[3].

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[1] See his speech: « Challenges for the Euro Area and the World Economy », Group of the Thirty, Rabat, 28 May 2010, www.ecb.int.press/key/date/2010/htlm/sp100528.en.htlm All the speeches of the President and the Executive Directors of the ECB are reproduced at the web site of the Bank, www.ecb.int.press .

[2] The figures for the EU 27 are respectively for the debt, 58.8 % in 2007, 61.8 % en 2008 and 74 % in 2009. See Eurostat. Newsrelease.Euroindicators, 170/2010, 15 November 2010.

[3] Peter Bofinger and Stefan Ried, *Intereconomics*, 2010/4. On contagion, see the reflections of Jacob Funk Kirkegard, "Will It Be Brussels, Berlin or Financial Markets that Check Moral Hazard in Europe's bailout Union? Most Likely the Latter!" Peterson Institute for International Economics, Washington D.C., PB10-25, October 2010, p. 3.

This led to the development of a divergence in nominal costs and in prices. Rapid economic growth, low income levels and easy money available through debts dissimulated a decline in competitiveness and caused great payment imbalance, according to Bini-Smaghi.
As observed by Commissioner Rehn, "...low financial costs fuelled a misallocation of resources, feeding unsustainable levels of consumption, housing bubbles and the accumulation of excessive debt. Such imbalances proved highly damaging when the crisis struck."4 The procedure against excessive deficits was strictly focussed on these deficits and ignored the macroeconomic imbalances.
In an evocative summing up, the Commission itself in its Communication on 30 June 20105, wrote that
"Rules and procedures for economic policy coordination, which are sound, have not been sufficiently respected. Peer pressure lacked teeth; good times were not used to reduce public debt sufficiently. Moreover, the building-up of macroeconomic imbalances was not addressed appropriately, even though the Commission has been warning about it for some time...the financial situation of the Euro area as a whole has been put of risk."

The situation turned tragic after the Greek drama exploded. The alarm could be stopped for a while as the euro area Member States and the EU reacted forcefully. But this situation still needs to be dealt with and we are in the middle of a new alarming situation.
In autumn 2009, after new elections had brought back the Pasok to the Government of the country, it appeared that the preceding one had given incorrect figures on the budget. In lieu of 5.96 % GDP, the foreseen deficit for 2009 was 12.6 % and revealed to be at 15.4 % after Eurostat investigations. The partners in the euro area reacted at an informal summit chaired by President Van Rompuy, announcing that the Member States of the euro area "will take determined and coordinated action, if needed, to safeguard financial stability in the euro area as a whole." Each word counts in this sentence that would command what the rescue could be and would not be.
Firstly, it would presumably be a coordinated action by the Member States and not a priori assistance by the EU itself.
Secondly, it was not clear for everybody whether pressure would duly be exercised on Greece to take the necessary measures;
Thirdly, future action, if any, would not per se be aimed at saving Greece but at providing the required assistance to safeguard the stability of the euro area as a whole. No bailout was intended. The aim was to prevent a disruption of the euro area threatened by contagion.
It is well known that three months or more were needed for concretising the intentions that have been expressed in February. No doubt that at the beginning the heads of state and government had thought that the joint expression of their resolution would succeed in

[4] European Commission. DG Ecfin, Annual research Conference 2010, Keynote address, 22 Nov. 2010.
[5] « A toolbox for stronger economic governance in Europe », MEMO/10/288.

somewhat calming the markets. Their firmness was substituted to their benevolence or complicity of past years, which had preserved for years countries that didn't respect the common discipline from a punishment by the markets. But the new step was not enough for calming the markets. The situation became worst.

The following meetings in March and April have contributed to designing the details of the future mechanism while at the same time an official request from Greece was anticipated, which eventually came on 23 April. The evolution changed the perspective and two schemes have finally been drawn, we should say - at least for the second one - improvised: one specific for Greece and another one much more ambitious in order to avert a possible contagion to other peripheral countries; at the same time, the ECB which played an important role in animating the heads of state and government to take ambitious decisions, engaged in so-called non-standard operations – a programme of buying public and private securities – that contributed to relax the situation but divided the ECB.

Everybody at the meetings between 7 and 10 May realised that much was at stake. The future of the euro seemed compromised and Bundeskanzlerin Merkel expressed that in dramatic terms, perhaps too dramatic, before the Bundestag in spring 2010: "Scheitert der Euro, scheitert Europa".[6]

We will not examine the mechanisms that were created by the decisions of last May/June in a detailed way, but we have to sketch them out for the sake of our developments.

The packages comprise, in a first stage, which was finalised on 7 May 2010, a finance plan for Greece consisting of bilateral loans by the euro area Member States (Slovakia refused to ratify the plan for Greece) with a total amount of 80 billion euro over three years, supplemented by 30 billion euro provided by the IMF, i.e. 110 billion euro in total, within the framework of a programme, which includes amounts and conditions negotiated with the Commission, the Greek Government and the IMF. Loans are allocated at a rate deemed to be non-concessional.

In May-June, after the crisis had become more dramatic and the after the beginning of contagion, a double-faceted mechanism was put into place, which could intervene for any euro area Member State that had run into difficulties.

A Council Regulation based on article 122(2) TFEU (the former article 100(2) ECT) established a "European Financial Stabilisation Mechanism" which could mobilise 60 billion euro for any Member State of the Union in need, in the context of a joint EU/IMF support and subject to strict conditions. Under article 122(2), this mechanism served to implement the medium-term support provided to non-euro area members for balance of payments needs under article 143 TFEU, which was activated for Hungary and Latvia.

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[6] Five months later, the *Financial Times* could write with a great self-assurance that "Europe must distance itself from the hysterical notion that the euro skirted disintegration", FT.com 13 October 2010. Disintegration, perhaps no, but a terrible crisis, yes.

Parallel to this, through an international agreement, a "special purpose vehicle" was created in the form of a company incorporated under Luxembourg law: the "European Financial Stability Facility" which would collect funds and provide loans, with the euro area Member States plus Poland and Sweden, guaranteeing an amount up to € 440 billion, to which the IMF added an amount equal to 50 % of the parts of the EU and its Member States, i.e. a total amount of (60 + 440) + 250 = € 750 billion.
As it is well known, Greece was the first to benefit from the assistance measures that have progressively been delivered to it on the basis of reports, which were established periodically by the Commission, the ECB and the IMF in order to ensure delivery of the next part of the support, aimed at accomplishing the realisation of the programme imposed upon it.
On 28 November 2010, the Eurogroup and ECOFIN ministers awarded a similar package to Ireland upon the government's request on 22 November. "Ministers concur with the Commission and the ECB that providing a loan to Ireland is warranted to safeguard financial stability in the euro area and the EU as whole." The difficulties in this country were mainly due to the recapitalisation of a hypertrophied banking system that pushed the deficit of this country to unsustainable heights. The three-year joint EU/IMF financial assistance programme for Ireland rests on three pillars:
- An immediate strengthening and comprehensive overhaul of the banking system
- An ambitious fiscal adjustment to restore fiscal sustainability, including the correction of the excessive deficit by 2015
- Growth enhancing reforms, in particular on the labour market, to allow a return to robust and sustainable growth, safeguarding the economic and social position of its citizens.

The financial package will amount to € 85 billion including a contribution of Ireland for € 17.5 and an external support of € 67.5 billion. The external support breakdown will include € 22.5 (1/3) billion of the IMF and € 45 (2/3) billion of Europe. The EFSM will contribute for € 22.5 billion and the EFSF for € 22.5 less (UK € 3.8 + Sweden € 0.6 + Denmark € 0.4) billion = € 17.7 billion. The support for banks (recapitalisation and contingent support) will be of € 35 billion of which half will be financed by the Irish authorities. The remaining € 50 billion will cover budget financing needs.
The rate of interest was somewhat superior to the one agreed on with Greece.

At their sessions of 6 and 7 December, the Eurogroup and the Ecofin accepted the policy conditions negotiated with the Irish Government by the Commission, the ECB and the IMF.

The legal support of the assistance measures

Article 125 TFEU (ex article 103 ECT) concerning the no-bailout rule is often considered the key provision on which assistance measures provided to a Member State are judged regarding their conformity with the constitutional law of the Treaty. It is a schematic view that needs some qualification. We have to place this provision in the context of the chapter on economic policy.

Article 125 reads as follows:

"1. The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project.

2. The Council, on a proposal from the Commission and after consulting the European Parliament, may, as required, specify definitions for the application of the prohibitions referred to in Articles 123 and 124 and in this Article."

The important words there are "shall not be liable for or assume the commitments of." That means, firstly, that a Member State or the Union are not the guarantors of the budgetary obligations of the Member States. Secondly, more generally, if we look at the philosophy of the provision and at the logic of the chapter, it means that Member States are, in this sense, on their own, as it was also observed in the academic literature. It confirms the autonomy of Member States and EU finance. Autonomy goes hand in hand with responsibility. The provision was held to be one of the symbols of the stability of the currency, particularly in the Bundesverfassungsgericht's Maastricht-Beschluss. The question is if the spirit of the no-bail-out clause has to prevail in a context of an acute crisis where other values seem to be preferred and thus deprive the rule of part of its credibility.

In parts of the German academic literature, the respect of the complex system of rules provided by the Treaty (budgetary code and discipline, no-bail-out and fight against excessive deficits) is often thought close to the Soziale Marktwirtschaft doctrine, as "solidarity" in the true meaning.[8] Theo Waigel, the former German Finance Minister expressed this view in a memorandum of October 1995 elaborating the means by which the German Government introduced the draft Stability Pact (as it was originally designed) to its partners:

"The monetary union must be committed to stability from the beginning. All participants in the final stage have the same interest in this. They form a community of solidarity

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[8] See Otmar Issing, « Why are a common eurozone bond isn't such a good idea", Summer 2009, http://www/europesworld.org , der Selbe, "*Finanzielle Solidarität*" means that "*der Gedanke der Solidarität wird dabei auf den Kopf gestellt.*" in "Gefahr für die Stabilität", FAZ 11 November 2010.

("Solidargemeinschaft") in the sense that the stability of the European currency will be reliably and permanently secured through strict budgetary discipline in all the participating countries."10

This concept of solidarity was consciously distinguished from the usual concept of solidarity in the common language, the one used by the dictionary that defines solidarity as the "agreement between and support for the members of a group".11 It is this latter meaning that the Court of Justice used in a case some forty years ago.

It concerned the adoption of preferential export credit rates by France contrary to the treaty.12 This judgment is interesting because it relates to the chapter of economic policy in an earlier stage when it was in a way more basic but it already refered to the « common concern » of the Member States13: « la solidarité, qui est à la base de ces obligations comme de l'ensemble du système communautaire conformément à l'engagement stipulé par l'article 5 du traité, trouve d'ailleurs son prolongement, à l'avantage des États, dans la procédure de concours mutuel (mutual assistance) prévue à l'article 108 (133 TFEU) en cas de menace grave de difficultés dans la balance des paiements des États membres. » As observed by Pierre Pescatore, « le passage cité …est particulièrement intéressant en raison du lien qu'il établit entre la notion de « solidarité », base de l'ensemble du système communautaire, l'engagement général de l'article 5 et la procédure de concours mutuel. »14

As is well known, under article 3 TEU, « [The Union] promotes the economic, social and territorial cohesion, and the solidarity among its Member States. 15»

In the chapter on economic policy, this solidarity, in the common understanding of the term, is embedded since the Maastricht Treaty, in article 122 (ex article 100 ECT) and, especially for financial assistance, in its paragraph 2:

"1. Without prejudice to any other procedures provided for in the Treaties, the Council, on a proposal from the Commission, may decide, in a spirit of solidarity between Member States, upon the measures appropriate to the economic situation, in particular if severe difficulties arise in the supply of certain products, notably in the area of energy.16

2. Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on a

[10] Reproduced in the English version that was distributed among the delegations, in www.ena.lu of the *Centre virtuel de la connaissance sur l'Europe* (CVCE). Italics are ours.

[11] For ex., *Cambridge International Dictionary of English*, CUP, 1995, p. 1373.

[12] Judgment of 10 December 1969, joint cases 6 and 11/69, *Commission/French République*, *Rec.* XVI, 1969, p.540. It was in the original article 107 EEC relating to the exchange rate policy.

[13] See now article 121 (1) TFEU: « Member States consider their economic policy as a matter of common interest ».

[14] « Les objectifs de la Communauté européenne comme principes d'interprétation dans la jurisprudence de la Cour de justice. Contribution à la doctrine de l'interprétation téléologique des traités internationaux. » in *Mélanges Ganshof van der Meersch*, vol. 2, Bruylant, Paris-Brussels, 1972, p. 325-363, ad 350-351.

[15] TEU, article 3 (3). Italics ours.

[16] The Treaty of Lisbon has introduced the words in italics. Article 100 of the EC Treaty in its Maastricht version took the place of article 103 of the EEC Treaty on conjonctural policy.

proposal from the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned. The President of the Council shall inform the European Parliament of the decision taken."

Due to successive reforms, the use of a qualified majority within the Council has become generally applicable through this provision. Although the reference to the "spirit of solidarity" has only been inserted in the first paragraph, it is difficult to draw conclusions of the absence of the term in the second paragraph. It is clear, especially in the second paragraph, that this provision is linked with times of crisis.

The requirement of "exceptional occurrences beyond its control" is the main limit imposed on the recourse to this provision. This could appear to be an obstacle for assistance by the Union in the present circumstances. If we look at the current crisis in peripheral countries, it is difficult to pretend that the authorities of the country are not, at least partially, responsible for the eruption and the development of the crisis. Greece is responsible for the state of its public finances; Spain for allowing the housing bubble to prosper, Ireland for mismanaging the bank crisis.

Nevertheless, it has been observed that a crisis, whatever its origin, can escape the control of the State concerned and become a risk for the Union or the euro area as a whole.17 In particular, there is the risk of contagion, in the euro area especially because of the unified capital market and the dissemination of creditors in the whole area.

The provision enables the Council to intervene. It doesn't compel it.

If the Council decides to provide support, on a proposal of the Commission, conditions are of the essence of the decision in order to avoid moral hazard. The circumstances must be exceptional.

Article 122 (2) doesn't offer a way to escape the disciplinary actions in the case of excessive deficits and it is not a genuine mode of "Finanzausgleich".18

The Council has great freedom to decide on the range of measures it intends to adopt for the financial assistance: They could be loans, guarantees, etc. and we do not see why an assistance outside the budget should necessarily require an act based on Article 352 TFEU, considering the interpretation of Article 119 TEC (now Article 143 TFEU) in the acts on mutual assistance in 1988 and 2002. The articles (143.2 and 122.2 TFEU) are comparable but not identical.

The existence of Article 125 has to be taken into account when interpreting the provision. Proportionality is of the essence on this matter. As we have already mentioned, a balance has

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[17] See Ulrich Häde, « Haushaltdisziplin und Solidarität im Zeichen der Finanzkrise", *EuZW*, 2009, p.399-403, 402-403; see by the same author, „Legal Evaluation of a European Monetary Fund", Challenges facing European Monetary Union, Intereconomics, 2010/2, p. 69-72, 71.

[18] See Jürgen Stark, "Wirtschaftspolitische Herausforderungen im Eurogebiet", speech, München, 27 October 2010, p. 4. *„Die Idee der Transferunion würde einer gänzlich anderen Logik folgen, handelte es sich doch dabei im Kern um einen europäischen Finanzausgleich, der unkonditionierte Transfers an Mitgliedsländer vorsehen würde. So sind die Ma□nahmen aber nicht konzipiert. Die EU ist kein Bundesstaat."*

to be found between the moral hazard inherent in the intervention and the risk of contagion in the case of inaction. The interest rate imposed on the debtor is to be determined with this in mind. That doesn't mean that the interest must be punitive with the risk of a pro-cyclical effect; it would normally not be concessional. It cannot be calculated on the latest rate available in a virtually inexistent market.

Considering the prolonged presence in the Treaty of articles 143 and 144 (ex 108 and 109 ECT) on mutual assistance, Article 122(2) TFEU (ex art. 100 ECT) appears as the result of a compromise during the Maastricht Treaty negotiations, a compromise between the positions of those stricter adepts of the exclusive responsibility of the State for its public finances and those who were, in line with the Commission, in favour of an effective assistance mechanism. In the beginning, for this kind of action was ruled by unanimity.19 Article 122(2), is a counter-weight, more than an exception to the no-bailout rule that, as the affirmation of the responsibility of the State for its public finances remains a fundamental principle.20

The action under article 122(2) TFEU is, generally, an action of the EU and not a collective action of its Member States. The Greek support scheme and the "Facility" were based on an international agreement, approved by national parliaments, contrary, at least to the "Facility", which was proposed by the Commission. But they were provided with the same conditions as the "Financial Stability Mechanism" adopted under article 122 (2) TFEU. In a way, this is what could be called an "application modalisée" in French.

The legality of an action of the Member States while article 122(2) enables the sole Council has been contested by Prof. Häde: "Article 125 TFEU excludes a bail-out by both the Union and the Member States while paragraph 2 of Art. 122 TFEU applies only to the Union; there is no provision for the Member States. Thus, one can assume that the Contracting Parties wish to give the right to a deviation from Art. 125 TFEU to the Union only."21

The reasons why the governments have discarded the adoption of the Union's acts to establish the Facility and preferred an intergovernmental agreement are various. Legal considerations were not pre-dominant during the weekend between 8 and 10 May last year. The facility is based on the same requirements as those prescribed by Article 122 (2) TFEU; the conditions are identical and they are overseen by the IMF; the rate of interest is non-concessional. Furthermore, the motivation was not one individual bailout but the aim was to create the conditions of progressively reintegrating a country into the "orthodoxy" of the monetary union in order to achieve the stability of the monetary union as a whole.

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[19] Jörn Pipkorn, "Legal Arrangements in the Treaty of Maastricht for the effectiveness of the EMU", *CMLRev* 1994, p. 263 et s., p.273.

[20] On the necessity to harmonise the interpretation of the two provisions, see Hade, "Legal Evaluation..."op. cit., p. 70; Francesco Martucci, "article 103 TCE", in I. Pingel (ed.), *Commentaire article par article des traités UE et CE*, 2e éd., Helbing & Lichtenhahn, Basel, Dalloz, Paris, Bruylant, Brussels, 2010, p. 883. For Jakob Funk Kirkegaard, op. cit., p. 3: "As it turned out in 2010, definitely the spirit, if not the letter of the "no bailout clause" was broken in the midst of the Greek sovereign debt crisis, as it threatened to spread to several other eurozone countries."

[21] See Hade, « Legal Evaluation… », op. cit., p. 71.

In our view, the facility should not be made permanent in its present temporary setting. A permanent structure should be included in the EU legal order, one that can be held accountable. Unifying the instruments would simplify things. As we will see, the Member States have preferred to keep the intergovernmental ties of the Facility in order to avoid particularly the necessity of recourse to the ordinary revision procedure including the risk of increasing the scope of revision to other subjects and, as a result, making the unanimity required impossible.

Lessons and Perspectives

Speaking in Berlin, a few weeks ago, President Van Rompuy told the Konrad-Adenauer-Stiftung: "One cannot maintain a monetary unity without an economic union."22 Referring to the decisions of the European Council of 29 October and in particular to the conclusions of the Task Force on economic governance he chaired, he exclaimed: "Taken together, these proposals are the biggest reform of the EMU since the euro was created."

This reform includes three "crucial points" that President Van Rompuy mentioned and that we will sum up:

The first one: "We will observe the economies of our countries, their competitiveness, the risks of housing bubbles and other vulnerabilities. We will act and correct if necessary." This observation of macroeconomic imbalances is an important addition to the action against excessive deficits under the Treaty and the Stability and Growth Pact. For sure, such an action was already possible before Lisbon, through the framework of coordinating economic policy but the proposals of the Commission and the Task Force report introduce a parallel excessive imbalances procedure alongside the excessive deficit procedure and they now provide for sanctions against Euro area members at least.

Second point: "We will strengthen the Stability and Growth Pact, to substantially increase fiscal responsibility and penalise irresponsibility..." Strengthening the procedure entails that Euro area Member States face sanctions in a progressive way.

Third point, quoting Mr. Van Rompuy again: "We will establish "a permanent crisis mechanism" to safeguard the financial stability of the euro area as a whole". A "robust and credible system" is "to be in place in 2013." This would need a limited revision of the Treaty, under the consensus reached in the European Council

After the European Council adopted the conclusions of the Task Force, the ball lays in the field of the Ecofin Council and the European Parliament's court, which have to decide on the Commission's proposals in September, before the end of the work of the Task Force next June. The ECB's President, who participated to the Task Force, has partially disagreed with the report. The ECB finds some aspects of the Commission's proposals and, a fortiori, of the

22 All the speeches of President Van Rompuy are to be found at his home page: http://www.european-council.europa.eu/the-president/speeches.aspx?lang=en The referred speech was pronounced on 9 Nov. 2010.

Task Force report too lenient. However, the European Council was to clarify its views on the European Stability Mechanism at its meeting on 16 and 17 December. This is the permanent crisis resolution mechanism that, as envisaged by the Eurogroup on 28 November, after a (limited) revision of the Treaty, has to substitute the EFSF from 2013. It also had to endorse the general features of the future mechanism prepared by the Eurogroup at the same meeting. This would allow the Finance Ministers of the Euro area and the Commission to finalise their work on the intergovernmental arrangement setting up the future mechanism by March 2011.
One can expect that the European Parliament will demonstrate the same voluntarism with regard to the proposals of economic governance regulations that it showed in the adoption of the regulations on the ESFS. But the debate will be more difficult considering the important political weight of the matter and the limits inherent to the Treaty as it is. The debate about "automaticity" of sanctions reflects this situation.
This question was central in the compromise, which was reached between President Sarkozy and Chancellor Merkel in Deauville. But automaticity is neither economically nor politically absolutely possible. President Trichet himself, a strong promoter of stricter economic governance, calls for a quasi-automaticity. Under Article 126.3 of the TFEU, the Commission, in preparing its report opening the EDP, shall always have to take into account "all relevant factors as indicated in this article" and, since the reform of 2005, also a number of other factors that any member State can raise. This leaves some room for interpretation. In the EIP, there is a limit in which scoreboards of indicators could reflect the reality in an adequate way.
Indicators will trigger dialogue, onsite missions and in-depth analysis that will allow formulating a judgment. The exercise of judgment is always needed.
The true question is, which role should and will be given to the supranational entity by excellence, the Commission and which one will be given to the intergovernmental one, the Council. The possibility to rely on a "reverse majority" procedure is preceded in the final compromise after Deauville[23] by a new stage that can prolong the procedure after the warning of the Commission, for a period not lasting more than six months in total before adopting sanctions.[24] For sure, as underlined by Minister Schäuble in his Sorbonne speech, on 2 November last, a reverse majority system will make the organisation of majorities against the sanctions within the Council more difficult.
Nevertheless, it is remarkable that in the final version of the Van Rompuy's Task Force report the decisions on sanctions that are adopted through reverse majority, - except for the

[23] Where the French president and the German chancellor agreed on a common position on economic governance two weeks before the European Council of 29 October 2010.

[24] In an interview, president Herman Van Rompuy who claims a role of go between before the Deauville meeting of the leaders of France and Germany observes that France had another view than the Commission on the question if a country should receive another chance before the imposition of sanctions. See Herman Van Rompuy, 'De euro heeft als slaappil gewerkt', *Knack*, 17 November 2010.

"increased fine" in case of a persistent lack of compliance -, would be made, not on a proposal of the Commission but on a recommendation.
The significance of this is well known by lawyers. The Council can amend the recommendation with a qualified majority, which can make an important difference in the case of disagreement. It requires, that is the rule, an unanimous vote for amending a proposal. It is to be expected that the European Parliament will defend the powers of the Commission in this procedure.
Although, thanks to an audacious interpretation of article 136 TFEU, based on the need to promote the effectiveness of this new provision,[25] the rules have undoubtedly been strengthened, at the end of the day we are always remain in a situation "in der potentielle Sünder über aktuelle urteilen"[26] .
As Paul De Grauwe, a Belgian economist, puts it: "As long as budgetary policies (spending and taxation) remain vested in the hands of national governments and parliaments, the political responsibility for the decisions about spending and taxation rests with these national governments and parliaments. The latter face the political sanctions by national electorates."[27] The report of the Task Force, which reflects the opinions of the Finance Ministers of the EU, expressly observes "the recommendations (...) address the high degree of economic inter-dependence, particularly in the euro area, while preserving national responsibilities on fiscal and economic policies" in its executive summary. Recently, Minister Schäuble, in a much debated interview underlined the same reality and drew the conclusion: "As long as we have a national competence for fiscal policy, we cannot give up the instruments for incentives and sanctions for members of the Eurozone, [to ensure] discipline in their national budget policies."[28]
In the preventive part of the procedures, peer support, peer control and peer pressure, i.e., soft law remains dominant and there will never be, not even after the reform, an absolute guarantee that, in the corrective part, fines will be duly applied.
In this situation that for many should not be remedied soon, it is essential, as it is included in the reform, that national rules reproduce if not all the elements of the budgetary discipline, at least, a minimum framework for the examination of the budget making a joint analysis possible. In the 2005 reform of the SGP, it was referred to "national ownership of the rules". But this call was not heard very much and national parliaments didn't draw great attention to

[25] We do not intend to elaborate here on the legal aspects, and in particular, on the legal basis of all the aspects of the proposals. We have made some first comments on Article III-194 of the Constitutional Treaty, the predecessor of Article 136 TFEU, in "The Legal Foundations of the SGP in Primary and Secondary EC Law", Fritz Breuss (ed.), *The Stability and Growth Pact. Experiences and Future Aspects*, Springer, Wien New York, 2007, p. 3-31, p. 18.
[26] See Otmar Issing, „Gefahr für die Stabilität", *FAZ*, 11 November 2010; Jürgen Stark, „Wirtschaftspolitische Herausforderungen im Eurogebiet", speech, Wiesbaden, 27 October 2010, p. 6.
[27] See « What kind of governance for the eurozone? », CEPS Policy Brief No 214, September 2010, p. 3.
[28] *Financial Times*, 6 December 2010: "Financial Markets 'do not understand the euro'.

the stability and convergence programmes, the MTO (Medium Term Objective of a budget close to balance or in surplus) or the BEPG.
The role of the European Systemic Risk Board (ESRB), created on 1 January 2011, could also be important in this context "in order to ensure that macro-financial stability issues are also considered alongside macro-economic, fiscal and structural policies" (Task Force report, point 43).
The adoption of national rules for the implementation of the (proposed) "directive on requirements for budgetary frameworks of the Member States" will allow for important steps in the collaboration between the national and the European processes. It is interesting to observe that the proposal of the directive includes, among many other provisions facilitating compliance with the budgetary discipline, "an effective and timely monitoring of compliance with the rules, such as by independent national budget offices or institutions acting in the field of budgetary policy". This is one of the multiple ways of soft law coordination of economic policies.29 The OECD also recommends the set-up of such an independent body. Tough "ein unabhängiges Gremium of Experten"30 couldn't dictate its law to political organs, either national or European, it would and should be a support mechanism for political decision.
As it is well-known, some countries have adopted stricter laws in this matter on a national leven.
Germany has implemented such a move through its constitutional reform of 2009, aiming at a balanced budget, with a small margin of 0,35% GDP at federal level, in 2016. France is also in the process of modifying its Constitution after the Camdessus Report. Other countries would probably follow suit but each will adopt rules that conform betst to its constitutional tradition. It is impossible, or at least difficult, to say the least, and perhaps inappropriate, to make such revision compulsory under EU law. It is also naïve to expect a result similar to the one adopted in Germany from constitutional changes. Such an "Entpolitisierung" of the fiscal rules is very difficult to anticipate in many countries, especially in France. But at least framework principles and procedural guarantees could be introduced.
Two important points are also to be underscored in the current debate: the extension of coordination and surveillance to fields other than fiscal policy and the extension of sanctions other than financial ones, before we will return to the question of the permanent crisis resolution mechanism.
The recent crisis has demonstrated that a State could be in significant difficulties, even in cases where it formally respects the SGP. This was the case in Ireland and Spain. The incompleteness of the Pact is generally underlined.31 Hence, the idea to submit macro-

[29] See Ekehard Rosenbaum, « Lisbon, Europe 2020, and the Case for Soft Coordination in EU Policymaking", Intereconomics 2010/5.
[30] Stark, op. cit.
[31] Gros and Alcidi, op. cit., p. 3 doubt about the need of a « tighter permanent coordination of economic policy (...) during normal times". Anyway, the situation of public finances in various countries requires for some years specific measures.

economic imbalances to analysis and to propose remedies to eliminate them was born. In this context, I mentioned the private indebtedness, the developments in assets prices (housing bubbles, in particular), the lack of competitiveness and the unsustainable level of salaries, the deficit (or excess) of the balance of current payments.32 The results of such action are not warranted. Authors have observed that there is little governments can do in a market economy to enforce lower wages in the private sector.33 A mix of regulation and negotiations with social partners would be advisable. The idea of a social pact has rightly been suggested. Social cohesion is indeed essential in the repair process. Sceptical reflections have also been made about actions against housing or other assets bubbles where monetary policy could perhaps be more efficient than political measures.34 It has been suggested that the ECB could adopt regulations that would focus not only on system-wide aggregates, but also on “local” situations, imposing differentiated minimum reserves requirements or anti-cyclical capital ratios.35 Practically, it appears anyway that governments have fewer powers to redress such imbalances than those they can exercise in the field of fiscal policy. The ECB has asked for a more stringent sanction power of the EU in this field. We will see if the European Parliament will follow this advice in such delicate matters, like, for example, income policy.

The next point concerns the possible suspension of voting rights in the Council for Member States, which have violated these rules. The ECB and Germany, with France’s agreement, have both advocated such a sanction, which would not have, unlike financial sanctions, a potential pro-cyclical effect and would endow an appreciable “reputational” effect.36 It would compensate the congenital lack of an automatic fine. There is no common standpoint among the Member States and the institutions with regard to the opportunity of this political sanction that would be required to establish a revision of the Treaty, as voting rights being fundamental rights of the Member States expressing their equality. The European Council has not given priority to the idea. As stated in the Presidency conclusions of the European Council of 28/29 October last, “The president of the European Council intends to subsequently examine in consultation with the Member States the issue of the right of euro area members to participate in decision making in EMU-related procedures in the case of a permanent threat to the stability of the euro area as a whole.” It would be a sanction of last resort for particularly disturbing conduct. Furthermore, on the one hand, the suspension would be valid only for EMU-related procedures and not for any kind of decision within the Council configuration

[32] Stark, op.cit., p. 7.

[33] Gros and Alcidi, op. cit., p. 5.

[34] See the cautious considerations of the ECB in “Asset Price Bubbles and Monetary Policy revisited”, *ECB Bull.*, Nov. 2010, p. 71-83. Also, “Volkswirte würden Änderung der EZB-Strategie begrüßen”, *Handelsblatt*, 25 Nov. 2010.

[35] Paul De Grauwe, « What kind of governance for the eurozone? », *CEPS Policy Brief*, n°214/September 201, p. 5.

[36] See Giuliano Amato, « Il savadanaio contro il debito ? Quattro idee per fare la Ue ? »*Il Sole 24 Ore*, 31 October 2010, p. 15.

37; on the other hand, Member States would be prevented not only from voting but also from "participating" in the decision-making, which could mean to be excluded from the process of deliberation as such. We presume that an appeal against such a far-reaching measure before the Court for procedural motives would be open to the State concerned, as it is the case for the suspension of the right to vote in the case of a violation of common values under article 7 TEU. It is far from certain that unanimity will ever be reached among the 27 Member States38 on this kind of sanction, notwithstanding its new limited field of application.39
The last but by no means the least point relates to the "robust and credible permanent crisis resolution mechanism".Concerning the questioning the necessity of such a mechanism one can state that in the case that rules are respected, it will not be necessary.40
President Van Rompuy has answered in advance "even if all the right budgetary and economic measures are taken by everybody, one may never exclude surprises. Politics is not a zero-risk business."41 Paul De Grauwe used a metaphor to express this reality in a more graphic manner, referring to "a fire code without a fire brigade" (...). This is like saying that if people follow the fire code regulations scrupulously there is no need for a fire brigade."42 As observed by a group of authors, "Even the most sophisticated and most effectively enforced set of fiscal rules will not eliminate the possibility of future debt crises in the euro area."43
At the meeting of the European Council on 29-30 October, heads of state and government have agreed that there is a need to establish such a "permanent crisis mechanism to safeguard the financial stability of the euro area as a whole" and invited "the President of the European Council to undertake consultations with the members of the European Council on a limited treaty change required to that effect, not modifying article 125 TFEU ('no bail-out clause')." As we have already mentioned, in its 16-17 December meeting, the European Council had to revert to this matter on the basis of preparatory work undertaken by the Commission, in close consultation with the President of the European Council, the Eurogroup and the Ecofin Council on the general features of a future new mechanism, i.e. "the role of the private sector, the role of the IMF and the very strong conditionality under which such programme should operate".

[37] The point was not clear when the idea was launched.
[38] The president of the Eurogroup and the president of the Commission have opposed this kind of sanction, as well as a number of Member States.
[39] The idea was also evoked of limiting or denying the access to structural funds (as it was the case for the Cohesion Fund) to States in serious breach of their obligations under the prohibition of excessive deficit. It was presented more as a reinforced conditionality than as a sanction, but the difference appears to be tenuous. The consequence of this distinction is that if it is not a "sanction", it could possibly affect non-Euro area Member States. And this is not favourably seen by the Member States concerned.
[40] Stark, *op. cit.*, p. 7.
[41] Press remarks 29 October 2010, PCE 249/10.
[42] Paul De Grauwe, « Fighting the wrong enemy », VOX, 19 May 2010 www.voxeu.org/index.php?=node/5062
[43] See the authors quoted in note (47).

The publication of the conclusions of the European Council of 28/29 October, at last announcing a political consensus on the private sector participation – under a form to be determined – with respect to the restructuring of future debts, has immediately triggered a fall of the euro on the exchange markets, a significant increase of the interest rates for the debt instruments of peripheral states and a tension of the spread for the CDS concerning in particular the Irish, Portuguese and Spanish debts, not to mention the Belgian debts with the German Bund. Within a few days, the EU has found itself in a situation comparable to the one in last May and great pressure was exerted on Ireland to accept European assistance.44

The participation of private creditors in the sovereign debt resolution has been the first suggestion of a number of economists and, on the political level, of the German Government.

This Government understands the participation of the private sector in the rescue as a way to lessen the burden for the taxpayer. In the views once voiced by Finance Minister Schäuble the duration of the loans would be prolonged in a first stage (reshuffling). It would be in a second stage, in the case that the situation became worse, that creditors would have to renounce part of their credits (a so-called haircut). The next step would be what is technically called a restructuring of the debt. A fund that would have become a permanent one would take onboard the financial assistance to the indebted state. The need for the participation of the private sector explains why, for the German Government, the "Facility" created in May/June could not be made a permanent one: For Mr Schäuble, it would create a social bomb if we let the risk linked to potential rescues weigh heavily on European taxpayers.

In his Sorbonne speech, Mr. Schäuble has expressed his views on the subject vigorously:

„Ein Kernelement des Mechanismus muss die Einbeziehung des Privaten Sektors sein. Halter von Staatsanleihen erhalten eine Risikoprämie, aber sie müssen dieses Risiko im Krisenfall auch tatsächlich tragen. Damit wird gleichzeitig der Steuerzahler geschont. Private Investoren und Märkte dürfen nicht länger auf einen bail out durch die europäischen Steuerzahler setzen können, denn dies verstärkt die Anreize für ein verantwortungsloses Verschuldungs- und Investitionsverhalten.

Diejenigen, die (noch) Probleme mit einem solchen Krisenbewältigungsmechanismus haben, möchte ich daran erinnern, dass die Währungsunion nie als Bereicherungsmodell für Finanzspekulanten gedacht war."

Financial markets would recuperate their disciplinary function towards indebted States by raising the interest rate of their loans in order to compensate the increased risk deriving from the perspective of restructuring. The lack of the automaticity of sanctions would not matter too much if markets would exercise their disciplinary function against the profligacy of

[44] See, on the criticisms of the German position, Charles Grant, "The price of German leadership", *Financial Times,* 17 November 2010 and Peter Spiegel, "Simmering anger at Germany boils over", *ibid*. The Finance Ministers of the five largest economies of the EU, meeting at Seoul G20 Summit, on November 11-12 have felt obliged to confirm that the participation of the private sector to the resolution mechanism could only concern future debts.

Governments. For its protagonists, restructuring the debts is a requirement of justice and equity and also of economic efficiency.45

At its meeting of 28 November, the Eurogroup adopted a Statement on the European Stability Mechanism (ESM) after intense consultations between various authorities of the Union.

The Statement of the Eurogroup briefly recalls the rules governing assistance that will be provided after an unanimous decision of the Eurogroup Ministers:

"Assistance provided to a euro area Member State will be based on a stringent programme of economic and fiscal adjustment and on a rigorous debt sustainability analysis conducted by the European Commission and the IMF, in liaison with the ECB."

Most of the Statement - which was endorsed by the European Council at its meeting of 16 and 17 December 2010 - bears on the participation of private sector creditors in the debt crisis resolution mechanism.

The German authorities were in favour of restructuring the debt systematically; the French were supporting a case-by-case approach; after the Deauville meeting, it was this latter orientation that was taken, as it results from the following sentence: "Rules will be adapted to provide for a case by case participation of private sector creditors, fully consistent with IMF policies." The next sentence is the explanation of the reference to these policies: "In all cases, in order to protect taxpayers' money, and send a clear signal to private creditors that their claims are subordinated to those of the official sector, an ESM loan will enjoy preferred creditor status, junior only to the IMF loan."

"For countries considered solvent, on the basis of the debt sustainability analysis conducted by the Commission and the IMF, in liaison with the ECB, the private sector creditors would be encouraged to maintain their exposure according to international rules and fully in line with the IMF practices. In the unexpected event that a country would appear to be insolvent, the Member State has to negotiate a comprehensive restructuring plan with its private sector creditors, in line with IMF practices with a view to restoring debt sustainability. If debt sustainability can be reached through these measures, the ESM may provide liquidity assistance.

In order to facilitate this process, standardized and identical collective action clauses (CACs) will be included, in such a way as to preserve market liquidity, in the terms and conditions of all new euro area government bonds starting in June 2013.46

[45] See recently among many others, Daniel Gros: "Il est urgent de restructurer les dettes en Europe", *Le Monde*, 23 Nov. 2010.

[46] The italics are ours. There has been an ambiguity on the start of the possibility of restructuring. In some German official circles, it should have started in 2011, already for present debts. A communiqué – to which we have alluded - adopted by Finance ministers present at the G20 meeting in Seoul had to specify that the new rules would be applied to future debts, but, obviously, the markets were not convinced. This distinction between "old" and "new" debts has been criticised. It has been suggested that any new issue containing such a provision would command a substantial discount to all then outstanding debt, aggravating considerably the cost of the future debt (re)financing or even inhibiting it altogether." See Paul N. Goldschmidt,

A majority vote decision of the creditors would be sufficient in order to "agreeing a legally binding change to the terms of payment (standstill, extension of the maturity, interest-rate cut and/or haircut) in the event the debtor is unable to pay."

Express reference is made to the need for the CAC's to be consistent with those common under UK and US law after the G10 report on CAC's,47 "including aggregation clauses allowing all debt securities issued by a Member State to be considered together in negotiations. This would enable the creditors to pass a qualified majority decision agreeing a legally binding change to the terms of payment (...) in the event the debtor is unable to pay."
The necessity of a pre-organised debt restructuring - for future debts because it couldn't be applied without risking a legal challenge to the Greek or other existing debts - has been applauded by many and heavily criticised by others.
Those, who like Gros and Mayer and Schäuble himself, proposed the creation of a European Monetary Fund ten months ago,48 have included in it the design of a scheme capable of dealing with the threat of sovereign default. The main objective of Gros in designing a Fund was indeed to provide a potential crisis resolution mechanism including state default. An extensive and deeply thought through project has been drafted in a Bruegel publication, a Brussels think tank, by a group of well-known economists associated to a renowned jurisconsult with the great experience of the IMF efforts regarding the establishment of a SDRM.49 Their aim is to create a European Crisis Resolution Mechanism (ECRM) consisting of two pillars: Negotiations between a sovereign debtor with an unsustainable debt and the creditors about debt reduction (so-called haircut) and the provision of financial assistance provided by an EFSF, as a permanent body and an "institution" of the EU. The Fund could also lend to euro area member states in need of liquidity. These authors propose to establish a court for this matter. It has been observed that a specialised court (and not only a chamber as they suggest) could be created within the European Court of Justice under article 257

"ECOFIN (sic for Eurogroup) Meeting: Rather more Questions than Answers!", http://www.paulngoldschmidt.eu/Economic%20Web/ECOFIN%20meeting.htm 29 Nov. 2010.

[47] http://www.bis.org/publ/gten08.pdf 26 Sept. 2002.

[48] See Daniel Gros and Thomas Mayer, « How to deal with sovereign default in Europe: Towards a Euro(pean) Monetary Fund" *CEPS Policy Brief*, N°202, February and *Intereconomics* 2010/2, p. 1-2; on Schäuble's original views, see "Schäuble droht Sparverweigerern mit Ausschlu der Eurozone", *Financial Times Deutschland*, 12 March 2010. On these projects, see Jean-Victor Louis, "Un Fonds monétaire européen? Réflexions sur un débat », Notre Europe, *Les Brefs*, N°15, April 2010.

[49] François Gianviti, Anne O. Krueger, Jean Pisani-Ferry, André Sapir and Jürgen von Hagen, « A European Mechanism for Sovereign Debt Resolution: A Proposal", 9 November 2009, bruegel, Brussels. One knows that both the G10 and the IMF have worked for establishing a Sovereign Debt Restructuring Mechanism (SDRM). The tentatives have not succeeded for various reasons, one being the reluctance of the States to relinquish their sovereignty and another the question of the opposability of collective clauses to all the creditors.

TFEU.50 It is likely that this operation would require a modification of the Treaty and therefore, the mechanism would only apply to debts issued in the future.
Jakob Funk Kirkegaard, of the Peterson Institute for International Economics in Washington, has supported the (Franco-) German standpoint vigorously.51 A group of politicians published a manifest that affirmed the following among other principles: "A decision to make the EFSF permanent should not exclude sovereign insolvencies in the eurozone. An orderly procedure for sovereign debt restructuring is needed and should be agreed in parallel."52
In contrast, a number of other voices have expressed serious doubts about the idea of a sovereign debt default mechanism.53 The first criticism came early on from the IMF staff in a paper which title included the dramatic words "Unnecessary, Undesirable and Unlikely".54 The standpoint of the authors was that, contrary to the situation of emerging countries in the past, the developed states don't have a problem servicing their debts – for the euro area member states, contracted in their currency - but structural problems of public (or private) finance that lead to deficits. Defaulting could not help in their situation. Lorenzo Bini-Smaghi, an ECB Executive Board member, denounced the idea of preconceived restructuring in various speeches and articles.55 To him, Schäuble's ideas were a recipe for disaster. Let us quote Bini-Smaghi: "There is no such thing as an orderly debt restructuring mechanism." A restructuring mechanism, "if made too simple, could lead to moral hazard. Furthermore, the very nature of the markets would mean contagion spreading immediately to the other countries, as participants would start guessing which other country might need to undergo restructuring." On 1 November, he returned to the argument stating that "there should be no automatic mechanism linking financial support to debt restructuring, because it would attract

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[50] See Paul Goldschmidt, "The EMU Sovereign Debt Crisis: Time for a Bold New Initiative", A complementary approach to the Bruegel Institute proposal, Institut Thomas More. Tribune, No29, November 2010.

[51] See PIEE Policy Brief 10-25, 2010: « Will It Be Brussels, Berlin or Financial Markets that Check Moral Hazard in Europe's Bailout Union? Most Likely the Latter" and *Realtime Economic Issues Watch*. Global Financial Crisis, "Why Germany Is Right – the Eurozone Needs a European Crisis Resolution Mechanism (ECRM)", http://www.piie.com/realtime/?p=1840

[52] Peter Bofinger, Henrik Enderlein, Tommaso Padoa-Schioppa and André Sapir, « Eurozone needs a permanent bail-our fund », FT.com 27 September 2010. Jacques Delors, Joschka Fischer, Romano Prodi and Guy Verhofstadt have endorsed the text.

[53] See Paul De Grauwe, « Duits 'moralisme' bedreigt muntunie. De autodestructie van de eurozone », *De Morgen*, 25 Nov. 2010 ; Daniel Cohen, « Crise de la dette: la zone euro n'est pas l'Amérique latine », *Le Monde*, 25 Nov. 2010.

[54] Cotarelli, Forni, Gottschalk and Mauro, « Default in Today's Advanced Economies: Unnecessary, Undesirable, and Unlikely », IMF Staff Position Note 10/12, 1 September 2010. The Press observes a ongoing reluctance of the IMF staff to restructuring the debt of a euro area country.

[55] Zeit Online, 10 November 2010; Intervention before the ECON Committee on « Improving the economic governance and stability framework of the Union, in particular in the euro area », 15 September 2010, p.4; "The Challenges Facing the Euro Area", speech, Abu Dhabi, 1 November 2010. Lorenzo Bini-Smaghi clearly expressed the standpoint of the ECB Governing Council. See J.C. Trichet, speech at ECON, 27 September 2010, p.2.

speculative pressure and precipitate a crisis, even for countries that are solvent."56 Bini-Smaghi affirms his reluctance to give the responsibility to evaluate the solvability of the States concerned to the markets, the same markets that one wants to prevent from speculating.57

Paul De Grauwe takes similar standpoint fighting against what he called no less than "a mechanism of self-destruction of the Eurozone".58 He compares the situation that would be created by the perspective of restructuring to the one observed in the functioning of the ERM 1, before the euro, when speculators were selling currencies hoping for the devaluation of the weak currency in the system.

What would our preliminary conclusion about these contrasting views be?

It is difficult for us to envisage the hypothesis of default/insolvency as a fact of life for a (developed) country, member of the euro area, not because it is a developed country but because of its impact on the reputation of the euro, increased by the risk of contagion. The euro is the second international currency. It accounts for 37,4 % (coming from 34 %) in the SDR basket, while the US dollar accounts for 41,9 % (coming from 44 %) and if it has a stake of 27 % in the World reserves. It is thus "received" on the international scene although it is still a young currency in the process of achieving international recognition. The participation in the single currency is not only an economic or financial reality but also a political concept. And it is of global concern.

The difference with the status of the dollar, which benefits from its general recognition, remains nevertheless clear. To our surprise, it is argued in the Bruegel document that in order to demonstrate that the default of a euro area Member State cannot handicap the exchange rate of the euro, as the bankruptcy of California has no effect on the external position of the dollar. As if such a comparison could hold up! This attitude neglects the various political aspects of the crisis.

The precedents referred to in this context are surprising.

In the Bruegel note, it is also observed that, among the Member States of the euro area, Austria, Greece, Germany (three times), Italy, Portugal and Spain, have all experienced at least one case of sovereign default since...1824. For most of these states, these were dramatic experiences associated with hectic times, mostly of wars or revolutions, or both. Bini-Smaghi notes for his part that the 19 (developing) countries that have defaulted, during the last twenty years, among the 113 which have been associated to an IMF support programme, none has the characteristics of a euro area country.59

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56 On this point, one will observe that the orientation taken by the Eurogroup on 28 November and endorsed by the European Council on 16/17 December, there is no such automatism.

57 Zeit Online, 10 November 2010. In the plan now discussed, it would be for the IMF and the Commission to judge on the insolvability.

58 CEPS Commentary, 9 November 2010.

59 Speech Abu Dhabi, op.cit., p. 3.

In favour of restructuring as a possibility of last resort, in conditions of transparency and under a due process of law, there is the legitimate caution about the intervention with taxpayers' money, which seems to primarily benefit the banking sector. Nevertheless, contrary to what is currently affirmed, it is far from sure that restructuring will lessen the burden of indebted states. This clearly appears from the fact that restructuring is seen as a means for increasing the discipline of the "sinners". The movement in the direction of a resolution mechanism implying the private sector seems almost inevitable anyway.
At its meeting of 16 and 17 December, the European Council adopted a draft decision amending Article 136 of the TFEU with regard to a stability mechanism for Member States whose currency is the euro, under the simplified revision procedure provided under Article 48, para. 6 of the TEU.
The proposed revision reads as follows:
"The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality."
It is regrettable that the debate about the permanent resolution mechanism has concentrated, not only in the media but also at the level of the authorities, on restructuring more than on the establishment of a regional fund,60 its working and the collaboration with the IMF. The reason advanced officially for justifying this emphasis is the lack of EU resources that are needed for creating such a fund. Broadening the debate with the perspective of the future programme of the G20 was obviously not to be expected.61
It is also to be regretted that the "new" permanent mechanism will remain intergovernmental, essentially because of Germany's attitude. In theory the European Parliament, which has only to be consulted under the simplified procedure (like the Commission)62 could take the initiative of a more ambitious revision.

Some final remarks

First of all, let us come back to the contrast made by Herman Van Rompuy in his Pergamon speech between "monetary unity" and "economic union". In this context, the author of this

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[60] More recently, plans for a European Stability and Growth Investment Fund (ESAGIF) appeared in the Press. See "Notfallfonds wäre gute Idee", *sueddeutsche.de* 23 Dec. 2010. This Fund would be an independent institution parallel to the ECB, giving assistance to euro area Member States but, at the same time, providing discipline. This plan was officially qualified as reflecting ideas developed at staff level, without any political endorsement but it was hold by the Press as a kind of "ballon d'essai"and the *Handelsblatt* of 30 Dec.2010 mentions that France and Germany are considering the creation of an EGASIF...

[61] See Stéphane Cossé, "Il faut tirer les leçons du sauvetage de l'Irlande. Un nouvel ordre monétaire est une nécessité », *Le Monde* ? 26 Nov. 2010.

[62] The European Council has also decided to consult the ECB.

distinction referred to the formula used by Bundeskanzlerin Merkel, in her College of Europe speech of 2 November 2010. She developed the concept of "Unionsmethode". Monetary Union would be the field of what was called the "Gemeinschaftsmethode" before; Economic union would be the result of the joint action of Union's institutions, Member States and their parliaments, a combination of "Gemeinschaftsmethode und koordinierendem Handeln der Mitgliedstaaten". Europe is all that, as the Bundeskanzellerin insisted, and not only the result of the collaboration of the classical triangle: Commission as the initiator, Parliament and Council as co-legislators, the Bundeskanzlerin stressed. In order to be able to adopt Union legislation, one needs an enabling clause, a legal basis in the Treaty. If this doesn't exist, "coordination" among states is the only alternative to doing nothing. Mrs. Merkel is right and what she said is not new but the so-called "Union method" should not replace what was called the "Community method" before Lisbon and when it is available, the "classical" method should be preferred for the sake of efficiency, transparency and accountability.

This is through the kind of coordination called for by Mrs. Merkel that the EU and its Member States have been able to react to an extraordinarily severe crisis of public finances that developed to the most important financial and economic crisis for over two generations. Nevertheless, a more enduring framework of action is needed.

The Monetary Union is prevented from benefiting from some institutions that would correspond to what it really needs. A fortnight ago, the president of the ECB told the ECON Committee of the European Parliament lucidly: "What exists doesn't correspond with the actual situation we are facing". He was referring to the need for what he called, conscious of the alignment, a "quasi-budget federation". This position can be put together with the declaration on the future collaboration in fiscal and taxation matters made by Mrs. Merkel and Mr. Sarkozy in Freiburg on 10 December. We would like to add that if conceding a significant budget to the EU is out of reach for a while, it should be necessary to provide for the policy and the financial resources for growth.63 Without growth, it is indeed impossible to repair the financial situation.

It would also be necessary, as recently suggested by Jacques Delors at the French Senate, to clarify which decisions would be for Member States whose currency is the euro and which decisions we are continuing to take at EU level.

The separation of the euro area also requires institutional reforms in the medium-term. In order to achieve a level playing field with the other international currencies, a Finance minister is required, who would combine the multiple roles of the High Representative for CFSP and CFDP, if and when this new experience would prove beneficial. One should also consider the need for a proper decision-making organ for the euro area (a Euro-Ecofin) substituting a Eurogroup without binding powers, a modification which will facilitate the development towards a Euro area speaking with one voice and a single representation on the international scene, as provided by article 138 TFEU.

[63] See Giuliano Amato, "L'impensabile di euro e deficit", *Il Sole 24 Ore*, 12 Dec. 2010.

From the preceding remarks, it is clear, that the present situation cannot be solved without a step forward towards more integration. It is the responsibility of the political leaders and the leaders of the civil society to convince the citizens of this indispensable move.

The ECB and the Eurosystem cannot be asked to do this job that pertains to political institutions. Of course, as underscored by Mario Draghi in an important recent interview, "when the ECB operates in [the] markets, it is not doing monetary financing – it is doing monetary policy". However, he underlines the limited role of central banks and emphasised the need for government action: "Would countries be willing to give up national sovereignty over their budgets? Would countries be ready to worry about other countries' problems, and tax their citizens to solve their problems?"64

We, like others, have been impressed by the words of Wolfgang Schäuble, in a recent interview with the Financial Times: "If the German parliament were asked for a vote today on giving up national budgetary authority, "you would not get a Yes vote" ... But "if you would give us some months to work on this, and if you give us the hope that other member states will agree as well, I would see a chance".65 In another interview, the Bundesfinanzminister answered a question: „Wir werden in zehn Jahren eine Struktur haben, die sehr viel stärker dem entspricht, was man als politische Union bezeichnet".66 Wishful thinking? An intention to make his mark against the more cautious chancellor? Or the lucidity and the courage of a confirmed true European?!

To come back to the central concern of my speech, I would like to stress that the euro area should strive for creating a financing instrument as liquid as the US Treasury bill. We all know how many opponents reject such a step that nonetheless is necessary. With the other measures mentioned previously, this is required if we want the euro as an international currency, to be on a level playing field with the present and future international currencies67 and if we want to put an end to the opposition between Northern and peripheral states, and avoid the speculation against the weaker ones. The objections, politically, economically and legally, against "eurobonds" are well-known and the German press is full of them these days.

64 *Financial Times*, 10 Dec. 2010: « Action on the addicts ». The day after this lecture, the ECB announced an increase of its subscribed capital by € 5 billion from € 5.76 billion to € 10.76 billion.

65 *Financial Times*, 6 Dec. 2010. The *Wall Street Journal* has reproduced these remarkable words that didn't have the repercussion one could have hoped.

66 http://www.bild.de/20/12/12/finanzminister-wolfgang-schaeuble/koeln

67 Comp. Paul Goldschmidt, „The EMU Sovereign Debt Crisis: Time for a Bold New Initiative". A complementary approach to the Bruegel Institute proposal", Institut Thomas More, Tribune, N°29, Nov. 2010, p. 6: "The absence of a Eurozone potential 'lender of last resort' benefiting from a joint and several guarantee of its Members or having by construction access to a credible amount of 'own resources', puts EMU members at a significant disadvantage compared with other Sovereign issuers." Paul Goldschmidt adds:" Designing such an entity seems out of reach if it is denied any direct or indirect access to the inflation/devaluation tools available to other Sovereigns."

Ministers Juncker and Tremonti and many economists68 have recently launched proposals, associating responsibility and solidarity, which would avoid the moral hazard that the opponents see in the issue of such bonds, if they are linked with common discipline.69 The question deserves to be looked at seriously.

Never were the European institutions so directly and persistently confronted with the world of global finance, which is referred to as "the markets" in a context where markets tend to physically disappear, most of the operations being channelled outside official markets. The recent events have shown the inadequacy of the usual accumulation of partial progresses based on political, often ambiguous, compromises with regard to the expectations of the markets. Any ambiguity in the resolutions, real or resented and propagated by not always European-minded media, is seen as a risk and causes the reactions to be diverse from what the authorities expected. Rapid, global, coherent and well-grounded decisions are needed. The time between 11 February and 9 May was short for the Union's standards. It was an eternity for "the markets". In this context, it is very true to say that "time is money". And no state heavily indebted can disregard the markets. The progress of regulation should impede markets from making the states their slaves.

Whatever the difficulties, we are confident that one of the most important achievements of European integration, the monetary union and its single currency will be preserved. The euro has and will be preserved not only due to the application of the famous TINA principle ("There is no alternative") which reflects a negative vision of the monetary union but because of the importance of a stable monetary union. It is, with the single market, one of the two pillars of the EU and the most advanced step of the European integration, which identifies the Union within the World. A return to national currencies would be like going back fifty years or more and it would mean an irremediable failure of the whole process of unification. We should be aware of the fact that in order to avoid moving backwards in such a way we need to stand with firm determination.

[68] Mario Monti has proposed the creation of a Debt Agency which could issue e-bonds, in his report on the single market presented to the president of the Commission at the beginning of 2010, see « Intervista a Mario Monti : « Gli Eurobond nell'interesse tedesco », *Il Sole 24 Ore*, 23 Dec. 2010.

[69] See Oliver Stock, « Ein neuer Wiener Kongress », *Handelsblatt*, 9 Dez. 2010.