Opinion of the European Economic and Social Committee on Strengthening economic governance — The reform of the Stability and Growth Pact

(2006/C 88/15)

On 10 February 2005 the European Economic and Social Committee decided to draw up an opinion, under Rule 29(2) of its Rules of Procedure, on *Strengthening economic governance — The reform of the Stability and Growth Pact*.

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 27 January 2006. The rapporteur was **Ms Florio** and the co-rapporteur was **Mr Burani**.

At its 424th plenary session, held on 14 and 15 February 2006 (meeting of 15 February), the European Economic and Social Committee adopted the following opinion by 88 votes to seven with five abstentions.

1. Summary

1.1 The EESC is greatly concerned at the current lack of momentum in European economic governance. It therefore believes that it would be appropriate to reflect once again on all the economic policy instruments that the European Union has adopted in recent years and to open another evaluation of the Stability and Growth Pact reform process.

1.2 This document aims to:

— outline the various viewpoints which have driven the political and economic debate over the six years in which the Stability and Growth Pact has been in existence

— provide an assessment of the process of reforming the Stability and Growth Pact which has got underway in recent months

— outline guidelines on strengthening European economic governance.

1.3 Since its inception, the Stability and Growth Pact has played a key role in ensuring continued European economic growth within a common framework of monetary stability.

1.4 Regrettably, along the way, there has been a lack of coordination of European economic governance and this at a time when international tensions have been — and are still — running high, both on the economic front and politically.

1.5 There has been repeated pressure on the Pact during its six years of existence from a number of Member States calling for its reform.

1.6 The reform process must be considered unfinished since it has not provided a guarantee that the process of coordinating European economic policy will genuinely be stepped up — a process which would enable us to make the most of the opportunities provided by Economic and Monetary Union for economic growth and job creation.

1.7 The changes proposed by members of the European Economic and Social Committee are focused on that very need to strengthen European economic governance. Their aim is the coordination of economic and fiscal policies, with due respect for Member States' budgetary consolidation and with a view to boosting investment pursuant to the Lisbon Strategy objectives.

2. From the Maastricht Treaty to the Stability and Growth Pact

2.1 The Stability and Growth Pact, adopted in 1997, was intended to secure ongoing *budgetary discipline* within Economic and Monetary Union as launched by the Maastricht Treaty ([1]). According to this principle, the concept of *safeguarding sound government finances* has represented — in the eyes of those who drafted it — the means to strengthening the conditions for price *stability* and for strong and sustainable *growth* conducive to employment creation.

2.2 Under this approach, '*Adherence to the objective of sound budgetary positions close to balance or in surplus will allow all Member States to deal with normal cyclical fluctuations while keeping the government deficit within the reference value of 3 % of GDP*' ([2]).

2.3 The Stability and Growth Pact is made up of the following basic elements:

— *a political commitment by the parties involved in the Pact* (Commission, Member States, European Council) to the timely strengthening of the surveillance of budget positions and coordination of Member States' economic policies;

— *preventive surveillance action* aimed at preventing budget deficits going above the reference value of 3 % of GDP. To this end, *Council Regulation 1466/97* reinforces the process of multilateral surveillance of budget positions and the coordination of economic policies. It provides for the submission by all Member States of *stability and convergence programmes*, which are examined by the European Council;

([1]) The Stability and Growth Pact was formally adopted in 1997 (with the aim of strengthening budgetary discipline within Economic and Monetary Union as provided for by Articles 99 and 104 of the Treaty establishing the European Community) and came into real effect with the launch of the euro on 1 January 1999.

([2]) Resolution of the European Council on the Stability and Growth Pact, Amsterdam, 17 June 1997.

— *dissuasive action:* an *early warning* is triggered for those countries which may be in danger of excessive deficit, inducing the country in question to adopt suitable correction measures;

— for countries with actual excessive deficits an *'excessive deficit procedure'* ([3]) is triggered, at the end of which, if the country does not take effective action to correct the excessive deficit, a sanction of up to 0.5 % of GDP may be applied.

3. **Review of the first six years of the Pact**

3.1 Before reviewing the first six years of the euro, it should be acknowledged that the implementation of European Economic and Monetary Union has been one of the most important, most surprising events in European history. The mere fact that some 300 million people in 12 European countries are now sharing the same currency — and have been since January 2002 — is an indication of how important this historic event is for Europe.

3.2 The successes and failures of the first six years of this experience can essentially be described in terms of the two words which typify the Pact: it has been an unequivocal success as regards monetary *stability* but just as clear a disappointment when it comes to the EU's economic *growth*, which has been inadequate. Over the past six years, inflation has been significantly contained in the euro area, at around 2 %. Persistent European Central Bank action controlling interest rates has successfully preserved monetary stability.

3.3 A second positive factor linked to the introduction of Economic and Monetary Union is the integration of European markets (particularly the financial markets), with the elimination of transaction costs and exchange risks. Combined with monetary stability, this integration has steadily brought down interest rates in the euro area.

3.4 The combined effect of price stability and lower interest rates meant that, after some initial uncertainty (1999-2001), confidence gradually increased in the European currency, as can be seen from figure 3, which shows how the euro rose in value.

3.5 Despite these clearly positive factors linked to the introduction of the euro, there are others — in the area of economic growth — which are cause for serious concern. It should be noted that the second half of the 1990s saw substantial GDP growth rates in the countries which had joined the European single currency. This raised considerable expectations in the run-up to EMU that the single currency would further boost economic growth. In actual fact, the expected increase in economic growth in the euro area did not materialise. Contrary to forecasts, it was those countries which had not joined the euro that benefited from an increase in economic growth, recording GDP growth rates which actually outstripped those recorded in the euro area.

3.6 Another unexpected effect of the introduction of EMU was asymmetric shocks within the euro area. Indeed, growth performance varied widely between the EMU States, with much greater disparities than might have been expected: some countries were in recession while others were enjoying periods of economic growth.

3.7 The expectations nurtured in the euro-area Member States included the hope that a single currency would lead to greater price transparency and that greater competition in the consumer goods market would result in lower prices and clear benefits for consumers (thanks to an increase in their real income); unfortunately, this did not always prove to be the case. Failure — on the part of some Member States — to carry out controls, particularly in the changeover phase, led to unjustified price increases. This was the case as regards the prices of some foodstuffs in Italy, in particular, but also in Germany and Greece. Because of the distortions (in transfer pricing mechanisms) in these countries, the euro was not seen by the public as being able to increase the prosperity of consumers in general.

3.8 There is no doubt that these initial six years of EMU have been a success mainly in monetary and financial terms. The euro has become more widely-used by financial markets and banks. In just six years, it has become the second most widely-held currency in the world ([4]). This was facilitated by a rigorous monetary policy whose principal goal was to encourage price stability, in line with the primary objective of the European Central Bank, and thereby to increase confidence in the new currency on the financial markets ([5]).

4. **EMU: stability versus growth**

4.1 Sadly, the success achieved in monetary and financial terms was not matched by similar success in the real economy, in terms of increasing production or employment. Hence, despite the fact that it is a development of considerable importance, the euro is not yet perceived — by a large part of the public in the euro area — to be the success story that it is.

([3]) The excessive deficit procedure is not applied in the following exceptional cases: i) where the deficit is the result of an unusual event outside the control of the Member State concerned; ii) if the country is in economic recession (if there is a fall in real GDP of at least 2 %). It should be pointed out that the excessive deficit procedure has been applied at least 26 times to date and that, on at least 10 of these occasions, it concerned euro-area countries. The countries in question were: Germany and Portugal (2002); France (2003); Greece, Hungary, Czech Republic, Cyprus, Malta, Poland, Slovakia, the Netherlands, France, Germany and the United Kingdom (2004); Hungary, Greece, the Netherlands and Italy (2005).

([4]) The internationalisation of a currency is essentially driven by market forces and, therefore, by the degree of confidence that economic operators have in that currency's stability.

([5]) *'The primary objective of the ESCB (European System of Central Banks) shall be to maintain price stability'*. And: *'without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2'* (Treaty Article 105(1)). The objectives of the Union (Article 2 of the Treaty on European Union) are a high level of employment and sustainable and non-inflationary growth.

4.2 There are a number of interpretations regarding the causes of this 'stalling' of Economic and Monetary Union, with two main schools of thought: those (whom we can call *structuralists*) who feel that the economic growth shortfall is due essentially to structural rigidities which have nothing to do with the rules laid down by EMU, and those (*macroeconomists*) who hold the diametrically opposed view that first the Maastricht Treaty and then the Stability and Growth Pact introduced rules which generated an ineffective macroeconomic policy which 'blocked' the potential for European economic growth.

4.3 The existence of substantial structural disparities between the EMU Member States is indisputable, although this interpretation alone does not suffice to explain the sluggish growth of the euro-area economy from 2001 onwards. The European countries which were not part of the euro area came out of a situation of stagnation more definitively and quickly than the euro-area countries. As of 2001, the difference in economic growth rates between euro-area and non-euro-area countries averaged at 1.1 %, with the latter in the lead. A comparison of economic trends in the euro-area countries and the United States reveals that although the downturn was less intense in the euro area, it lasted longer than in the United States.

4.4 These disparities cannot be wholly explained by structural factors. There are additional contributing factors and, as will become clear, the second interpretation — which deems the current European macroeconomic policy inadequate in both monetary and fiscal terms — supports this theory.

4.5 As far as monetary policy is concerned, the European Central Bank, in line with its sole objective of 'guaranteeing monetary stability' in the euro area, adopted a particularly rigid monetary policy, setting a target inflation rate of 2 %, which was seen as excessively constraining during the period of stagnation in 2001-2002. It should, however, be pointed out that the widely differing situations within the euro area did not encourage the ECB to react quickly to the difficult economic situation by cutting interest rates more drastically.

4.6 In the area of fiscal policy, too, the behaviour of the euro-area countries was not such as to enable them to find a timely way out of the difficult economic situation in 2001. During the period of stagnation, these countries' debt ratio remained almost unchanged (between 2001 and 2003 it rose from 69.6 % to 70.8 %), while the United States reacted more quickly during that period (its debt ratio rose from 57.9 % to 62.5 %), pursuing a Keynesian policy of using deficit spending to bring the economy out of a period of stagnation.

4.7 The inability of the euro-area countries to adopt anti-cyclical fiscal policies is in part a legacy of the past (due to the public debts of national governments and the failure to get them down during the upturn of 1996 to 2000) and in part the result of the constraints imposed by the Stability and Growth Pact. Both in the case of countries which have a government debt/GDP ratio under the 60 % limit (Spain 48.9 %, Ireland 29.9 %, Netherlands 55.7 %, Finland 45.1 %) and of those which give no cause for serious concern, because they are slightly above the limit set (Germany 66 %, France 65.6 %, Austria 65.2 %, and Portugal 61.9 %), the pact lays down budgetary constraints which many see as unjustified ([6]). One of the main criticisms of the Pact focused essentially on the 3 % government deficit rule, which was viewed as completely arbitrary and ineffective in both downturns and upturns. During downturns, it did not allow individual governments to employ an expansionary fiscal policy to bring their economies out of the downturn within a reasonable period of time. During upturns, it did not guarantee that they would behave appropriately and strengthen budgetary discipline. The Pact was thus accused of being one of the main causes of EU institutional inertia in the area of macroeconomics. Focusing solely on intermediate goals (budget equilibrium and financial stability), the Pact neglected or even hampered achievement of the final objectives of economic growth and full employment, i.e. macroeconomic stability ([7]).

4.8 Many proposals for reform involve concentrating not so much on the deficit/GDP ratio, but rather on that of government debt/GDP. Seen in these terms, the Pact should address the *debt sustainability* of euro-area countries and introduce greater flexibility for those countries whose debt level is below or around 60 %.

4.9 In September 2003, the economist Paul De Grauwe put forward an interesting proposal for reform under which every euro-area government should define its own objective regarding debt/GDP (based on its own economic and financial circumstances) and take a series of economic policy measures over time to achieve it. Although De Grauwe's proposal allowed any country to deviate briefly from this objective (when justified by cyclical factors), it did guarantee that the target debt/GDP ratio would be met in the medium to long term.

4.10 Another proposed reform to the Pact was to introduce a *'golden rule of public finances'*, under which investment expenditure supporting the Lisbon Strategy goals (introduction and dissemination of technological innovation, R&D and education expenditure, etc.) would not be counted as expenditure affecting the government deficit.

4.11 The *'golden rule'* gives further ammunition to criticism that the definition of public investment is too vague and could end up covering all forms of expenditure. To confound such criticism, there are those who propose — among them, the French economist J.P. Fitoussi — that the European Council, after consulting the European Parliament, should settle on what public investments the *'golden rule'* covers. This would use the

([6]) Paul de Grauwe, 2003.

([7]) J.P Fitoussi, 2004.

vague definition of public investment as an opportunity to develop a coordination policy by first establishing a system of incentives to encourage individual countries to invest in particular areas of common interest ([8]). Commission President Barroso's recent proposal to set up a Community fund for investments of European interest, which are necessary for growth and economic development, is therefore interesting and should be further developed.

4.12 By this time, there was widespread discussion on the measures needed to implement the Pact properly. The debate centred on two opposing viewpoints: one which advocated retaining a fixed regulatory framework, and one which asserted that the Pact should be open to political decisions — taken by governments — underpinned by economic principles. Thus emerged the need to reform the Pact on the basis of a system of rules capable of underlining its technical, economic and political legitimacy ([9]).

5. Reform of the Pact: from the European Commission proposal ([10]) to that of the European Council ([11])

5.1 Criticism of the Pact was compounded when repeated pressure on it in the difficult downturn of 2002-2003 showed it was in need of reform. We all remember Germany and France's refusal to submit to the 3 % rule and the diatribe that ensued between the Commission and the European Council. By any measure, this was a real institutional sea-change, moving from a Community method of open coordination set by the rules of the Pact to a method of intergovernmental control that was entirely self-referential. Many of the proposals for reform required attention to be focused not so much on the deficit/GDP ratio, but on that of debt/GDP.

5.2 The institutional conflict within the European Union mirrored that between the two pillars of the Union's fiscal and economic policy: ensuring economic growth and at the same time fiscal discipline on the part of the Member States. There was thus a need for urgent reform of the Pact which would strengthen it by making the two pillars more compatible. In autumn 2004, the Commission drafted a reform proposal for the European Council which set out five guidelines:

5.2.1 The important thing in surveillance of budgetary positions is to concentrate on debt and sustaining equilibrium, while continuing to monitor the deficit.

5.2.2 Medium-term budgetary objectives would be set for each Member State, so as to allow for specific circumstances. This would on the one hand prevent infringements of the 3 % deficit/GDP rule if there is a downturn, and on the other reduce the debt/GDP ratio, not least to stave off the impact that population ageing would otherwise have on the budgets of some countries.

5.2.3 It is proposed that excessive deficit procedures (EDP) take greater account of economic circumstances. The Pact's definition of 'exceptional circumstances', which allows a country to escape the excessive deficit procedure, could be changed to cover longer periods of recession. The path for deficit correction could be reviewed to take into account both cyclical conditions and risks to sustainability. This would make the adjustment procedure more responsive to the particular circumstances of the country in question, guaranteeing more time to correct the deficit than the year following that in which the excessive deficit was identified.

5.2.4 Preventive actions to correct budget deficits should be made more effective. Prompt preventive action would guarantee that budgets were re-balanced during upturns.

5.2.5 Implementation of surveillance rules should be improved. The proposal gives the Commission ex ante powers without any prior approval by the Council. Both the Commission's surveillance powers and that of the national monitoring authorities would be strengthened.

5.3 The Commission saw the proposal to reform the Pact not as a revolution, but as an evolution that would allow the Pact to deal with those critical situations which could lead, as in the past, to institutional deadlock. By bringing the Pact into line with reality, moreover, the Commission sought to improve its credibility and encourage the Member States to take greater ownership of its rules.

([8]) Fitoussi, 2004.
([9]) It is worth quoting the conclusions of a recent article by Jean Pisani-Ferry to stress the importance of the debate that began in 2004 on reform of the Pact: '*The significance of the debate that will take place in the coming months should not be underestimated. The key issue that clearly emerges is whether economic governance in the Eurozone should be based on legally binding fixed rules or on collective decisions underpinned by economic principles. The first model has been tried – until politics reclaimed its rights. The second has not yet been tried – but the evidence is that it cannot be made successful in the absence of technical, economic and political legitimacy. If no agreement is reached, or if the second model fails, the Eurozone is likely to adopt some kind of revamped version of Sinatra doctrine – which is certainly not the best way to manage a currency union. The Sinatra doctrine, named after the Frank Sinatra song "My Way", was the name that Mikhail Gorbachev used to describe the policy of allowing neighbouring Warsaw Pact nations to determine their own internal affairs. What followed is know.*' Pisani-Ferry, J. (2005).
([10]) COM(2004) 581 final.
([11]) COM(2005) 154 and 155 final.

5.4 The response issued by the European Council in the spring of 2005 was not quite what the Commission was expecting. At its spring meeting (22-23 March 2005), the European Council adopted 'Improving the implementation of the Stability and Growth Pact', a document submitted by the ECOFIN Council and putting forward significant changes to the Pact. These are aimed at *speeding up and clarifying the implementation of the excessive deficit procedure* (Council Regulation (EC) No. 1056/2005 of 27 June 2005) and the *strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies* (Council Regulation (EC) No 1055/2005 of 27 June 2005). These changes introduced greater flexibility in providing specific forms of relief for countries which had excessive deficits and in extending the time allowed for their correction. It is worth focusing on the principal changes made to the Pact by the European Council.

5.4.1 One major change concerns the definition of *medium-term objectives (MTOs)*. In the previous version of the Pact, these were defined as positions close to balance or in surplus. Deficits up to 0.5 % of GDP were accepted in special cases where measurement of some budget headings was unreliable. There was no provision for deviation from MTOs.

5.4.1.1 The measures introduced by the Council embrace EMU and ERM II Member States with a government deficit ranging anywhere from parity or surplus (for countries with high debt and low growth potential) to a deficit of 1.0 % of GDP (for countries with low debt and high growth potential). Failure to meet the medium-term objective is accepted where the government of the country concerned has carried out structural reforms.

5.4.2 *Adjustment path to the medium-term budgetary objective*. In the previous version, this was not set by the Pact, but by decisions of the European Council.

5.4.2.1 The new version allows a country to deviate from the medium-term objective, and provides for this deviation to be corrected by **an annual adjustment of 0.5 %**. The adjustment path can be *'modest'* in downturns and *'vigorous'* in upturns, so that the *'windfalls'* of the latter can be used to reduce deficit and debt levels. Deviations are permissible in the case of structural reforms, and there are no sanctions for failure to meet the annual adjustment of 0.5 %.

5.4.3 *Factors justifying breach of the 3 % GDP reference value*. The previous Pact took account of the following temporary and one-off factors: natural disasters, a 2.0 % fall in GDP and, at the discretion of the Council, a fall in GDP of between 0.75 % and 2.0 %. No other factors were taken into account.

5.4.3.1 The reform of the Pact identifies, but does not quantify, the following **exceptional factors**: a negative annual GDP growth rate; a cumulative fall in *output* together with GDP growth rates below potential growth. These justifications are accompanied by **other important factors** which the Commission should take into due account 'in order to comprehensively assess in qualitative terms the excess over the reference value'.

i) potential growth,

ii) prevailing economic downturn conditions,

iii) implementing the Lisbon Strategy,

iv) expenditure on research, development and innovation,

v) fiscal consolidation efforts in 'good times',

vi) debt sustainability,

vii) public investment,

viii) overall quality of public finances,

ix) size of financial contribution to support international solidarity,

x) size of financial contribution incurred in meeting European policy goals in the unification process ([12]),

xi) pension reform.

5.4.4 *Deficit-correction deadline*. In the previous Pact, this coincided with the year following identification of the deficit, unless special circumstances emerged. These circumstances were not specified, however, and the Council was therefore free to set a new deadline.

5.4.4.1 Generally speaking, the new Pact retains the deadline of the year after the deficit is identified, but, in view of the 'special circumstances' included in the *other factors* referred to above, it can end up being two years after the identification of the deficit. There is a whole series of EDP deadlines stretching over a period of time.

5.5 The reform undertaken by the European Council follows a very different course from the Commission proposal, and can hardly be seen as a compromise between that proposal and the Council's demands. By distorting the distribution of competences between EU bodies, the reform introduces a number of elements which weaken the Pact. Thus there is an imbalance in competences between the Commission (as guardian of the Treaty), which emerges considerably weakened, the Council, which comes out unduly powerful and the European Parliament, which is completely ignored in the process.

([12]) This factor was inserted at the insistence of the German government to take account of German re-unification costs. It is possible, however, that the exception may also be claimed in future by governments of countries that call for greater indulgence for their budget deficit as they are net contributors to the EU budget (Bouzaon and Durand, 2005).

6. Initial evaluations of the Stability and Growth Pact reform process

6.1 The reform chosen by the European Council substantially weakens the principle of fiscal discipline introduced by the Maastricht Treaty (1991) and subsequently affirmed by the Pact at the Amsterdam summit in 1997. As Bouzon and Durand (2005) have pointed out, the schizophrenia of the reform process adopted by the Council was already discernible in the ECOFIN Council document of 12 March, which said that: '[I]t is essential to secure ***a proper balance*** *between* ***the higher degree of economic judgment and policy discretion*** *in the surveillance and coordination of budgetary policies and* ***the need for keeping the rules-based framework simple, transparent and enforceable***.' This amounts to real conflict between the need to achieve political and economic discretion and the maintenance of a regulatory framework that is simple, transparent and reinforced: the economic and political elements appear to have prevailed in the current reform process at the expense of the simple and transparent regulatory framework.

6.2 The reform substantially weakens the Pact in two ways: firstly, by extending the deadlines, and secondly, by introducing a system of exemptions and exceptions whose criteria are so open to interpretation that they could cover everything. The combination of these two elements tends to make budget surveillance weaker and less transparent. This makes the goal of balanced public finances — as pointed out by the Deutsche Bundesbank — *'a moving target'* ([13]). With a Pact now less well equipped to guarantee the fiscal discipline of the Member States, this could lead the European Central Bank to take on the role of sole guardian of the Pact and the sole guarantor of the European Union's monetary stability. This will then create, in macroeconomic terms, a typical *zero-sum game* situation in which the *'gains'* from relaxing fiscal policy would be offset by the *'losses'* of a more rigid monetary policy ([14]).

6.3 Leaving aside what has emerged as a clear — and rather successful — attempt by national governments to claw back an economic policy instrument which the Pact had wholly or partially taken from them, it is worth making a few general observations.

6.4 It is absolutely clear that the way to increase the debt/GDP ratio is to achieve a steady rise in the deficit/GDP ratio. But it is equally true that when it comes to sustainability of public finances, deficit is a mid-term goal and debt a final goal ([15]).

6.4.1 One of EMU's key problems relates to the long-term sustainability of Member States' public finances. The adoption of Community instruments which can bring consolidation of public finances for countries with high levels of government debt would be useful because, in addition to ensuring monetary stability, sustainable public finances are a sound basis for a development and growth process.

6.4.2 Sustainable public finances are not to be achieved by automatically reducing social expenditure but by optimising it and making it more efficient and effective, in line with the principle repeatedly upheld by the European Commission: *'Social protection is seen as having the potential to play an important role as a productive factor, ensuring that efficient, dynamic, modern economies are built on solid foundations and on social justice'* ([16]).

6.5 Another feature of the ECOFIN Council's proposal document and the ensuing reform of the Pact itself, by means of Regulations 1055/2005 and 1056/2005, is its focus on pension reform. It devotes far greater space to the need to reform Europe's pension systems (favouring the introduction of a *multi-pillar* public and private system) than to the role the public debt level should play in assessing Member States' fiscal sustainability. One consequence of this is that countries which have carried out such reforms are allowed to deviate from the MTO or to overshoot the 3 % deficit threshold.

6.5.1 The document introduces the concept of *'implicit liabilities'* or liabilities incurred by the increased spending that awaits the various countries in the near future because of their ageing populations. This concept thus becomes part of the system of criteria used by the Commission and the Council to assess the sustainability of Member States' public finances. The problem with this kind of approach is — as highlighted by Bouzon and Durand — that there is no consensus on how these are defined or what the definition could include ([17]).

7. The EESC's proposals for re-establishing European economic governance

7.1 Regrettably, in the course of the reform process launched by the Commission in the autumn of 2004 and concluding with the reform of the Pact decreed by the European Council in the spring of 2005, the courage was lacking to

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([13]) Deutsche Bundesbank's monthly report, April 2005.

([14]) In a press release, the European Central Bank said it was 'seriously concerned about the proposed changes to the SGP [...] it is essential that all parties concerned fulfil their respective responsibilities', ECB, 2005.

([15]) As was quite rightly suggested in Paul de Grauwe's 2003 proposal, quoted earlier.

([16]) Commission of the European Communities: 1995, 1997, 2003.

([17]) 'Potentially, the boundaries of these liabilities could extend far beyond the simple pensions. According to an OECD document, in some member countries, only the liabilities associated with the pension system of public employees (for which there is a contractual relation), are included in the definition of public debt. This seems to be the approach supported by the Ecofin report.' (Bouzon and Durand, 2005).

review and redefine the theory and ideology underpinning the Pact. This timidity ruled out from the start any chance of radically transforming and of implementing the Pact ([18]). Such a transformation is necessary in order to try to resolve *once and for all* the sovereignty paradox that pervades the Pact (though which also features in many other fields of European policy).

7.2 The paradox consists in having, on one side, nation states and the European Parliament (representative bodies which have democratic legitimacy but no adequate economic policy powers) and, on the other, bodies such as the Commission and the European Central Bank, which, though not having direct legitimacy, nevertheless have sufficient economic policy powers. Legitimacy without power is thus set against power without legitimacy: a power which rests its legitimacy not on a clear democratic process, but on a *'doctrinal system'* on the basis of which the role of governments is rendered ineffective. Overcoming the sovereignty paradox involves moving away from the stark division between legitimacy without power, on the one hand, and power without legitimacy, on the other.

7.2.1 The criteria to be adopted for assessing sound economic performance by the Member States are derived from this doctrinal system and include a balanced budget, flexibility of markets, structural reforms, and so on. These are the principal goals of sustainable public finance which, unfortunately, gain ascendancy over the final objectives of macroeconomic stability, growth and full employment (as per the Lisbon Strategy) ([19]).

7.3 In this particular respect, the reform of the Pact has sought to resolve the sovereignty paradox. The European Council has in essence annulled the Commission's power of surveillance and given it to a Council composed of the potential subjects of that surveillance. If one poses the question *'who supervises the supervisors?'*, the rather embarrassed answer would have to be *'the supervised!'* The reform of the Stability and Growth Pact seems not to have eliminated the democratic deficit in the original Pact, but has compounded this shortcoming with another: lack of transparency and simplicity. It is well worth asking here, what role the European Parliament could play to strengthen the Pact's democratic legitimacy. Also, along the same lines, we must consider what steps could be taken to enhance the powers of and redress the balance between the European Commission, Council and Parliament.

7.4 The reform of the Pact has been followed by a string of events which have seriously undermined the EU integration process, namely the *'no'* votes in the French and Dutch referendums on the European Constitution, the decision to suspend the referendum process in the other countries, and the embarrassing failure to agree on the EU budget for 2007-2013. It is as if the slow but inexorable process of putting together the European jigsaw has been interrupted because each of the Member States has decided to reshape the pieces to fit its own national interests. Now the pieces will no longer fit together and can only be placed side by side or even on top of one another, leaving the picture largely incomplete and liable to be destroyed the first time it is accidentally — or perhaps not so accidentally — nudged by one of the parties to its con(de)struction.

7.5 It is at delicate moments such as that currently being experienced by the EU, that choices need to be taken which can move the debate on. For this reason, we should consider whether it would be worth following the advice of Habermas, as set out in his recent article ([20]). The German philosopher shows how the EU today finds itself *paralysed by the unresolved conflict between diverse and irreconcilable conceptions of its objectives* and how *the European institutions must both internalise this conflict and bring it into the open, in order to find productive solutions*. The EESC welcomes the proposal to launch a political reflection involving the EU's Member States on a voluntary and not necessarily unanimous basis. This reflection should help overcome the current stalled situation resulting from the need to reach unanimous inter-governmental agreements in a European Union of 25 Member States.

7.6 This reflection should be carried out using the instrument of *enhanced cooperation* — as laid down in Articles 43 and 44 of the Nice Treaty — involving at least eight Member States. While such cooperation allows joint decisions to be reached by means of less restrictive procedures, it also remains *open* since Member States may join the group at any time, in accordance with Article 43b of the Nice Treaty.

7.6.1 One initial area where enhanced cooperation could be applied is indeed Economic and Monetary Union. What necessitates recourse to enhanced cooperation in the context of EMU is the fact that the countries which are currently involved in the single currency have an undoubted need to bring their own economic policies into line with each other, unlike other countries which are not currently involved. Moreover, fiscal policy is an integral part of economic policy, and so, as has already been stated in other EESC opinions ([21]), measures adopted on these issues in the euro area could facilitate greater economic and social cohesion for the entire EU system.

([18]) Ibid.

([19]) J.P Fitoussi, 2004.

([20]) Habermas, J., 2005, *Only a dream can save Europe, la Repubblica* 9/06/2005.

([21]) 'Taxation in the European Union: common principles, convergence of tax laws and the possibility of qualified majority voting' (OJ C 80 of 30.03.2004, page 139).

7.6.2 EMU countries could appoint a coordinator or spokesperson for EU Member States' economic policy who would be tasked with coordinating European economic policies and who would be given real power to do so. The coordinator would work in collaboration with both the president of the European Central Bank and the European Commission president.

7.6.3 Furthermore, members of the enhanced cooperation group could decide to set up periodic hearings involving the coordinator of the EMU enhanced cooperation group, the Commission, the Council, the European Parliament and the European Central Bank. In this way, we could attempt to redress the balance of power, which is currently weighted too heavily towards the European Council.

7.6.4 The coordination of EMU Member States' economic policies must involve establishing a set of economic policy priorities as well as instruments for achieving those objectives. Provision should also be made for real-time monitoring to enable necessary adjustments to be made along the way. In this context, strengthening European economic governance must involve support for the macroeconomic dialogue and due regard for the European social dialogue.

7.7 In addition to the solution provided by enhanced cooperation, it would be worth taking the advice given by Jacques Delors in his 1993 White Paper ([22]), i.e., setting up a European fund for furthering economic growth and increasing competitiveness, by issuing long-term EU bonds, linked to strategic tangible and intangible infrastructure schemes. Moreover, the development fund proposed by President Barroso seems to be along these lines.

7.8 The process of strengthening European economic governance requires the involvement of all Member States, given that it represents an opportunity for EU growth.

7.9 The debate arising from the reform of the Stability and Growth Pact has brought to light contradictions at the heart of the EU's institutional framework.

7.10 Implementation of the Stability and Growth Pact must involve efforts to clarify how we see the future institutional framework of the EU. Only in this way can the Pact become an instrument for ensuring economic growth — and therefore job creation — preventing, at the same time, economic instability in its various manifestations.

7.11 The difficult situation facing Europe today calls for courageous decisions which would allow new impetus to be given to the European idea espoused by the EU's founding fathers and which today is entrusted to us.

7.12 For the Stability and Growth Pact to be applied successfully and achieve its original objectives, there needs to be broad consensus and support among the public, and not just among EU institutions and national governments. To this end, the EESC intends to organise a conference over the coming months, bringing together for a substantial and wide-ranging discussion all those involved in this process, including official decision-makers, civil society actors and the social partners.

Brussels, 15 February 2006.

The President
of the Economic and Social Committee
Anne-Marie SIGMUND

([22]) Commission of the European Communities, 1993, White Paper on growth, competitiveness, and employment: The challenges and ways forward into the 21st century, COM(93) 700 final, Brussels, 5 December 1993.