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DB Research

Research Briefing
European integration

Debt brakes for Euroland

A progress report

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On March 2, 2012, representatives of 25 EU member states signed what is known as the Fiscal Compact. In doing so, they agreed to introduce common fiscal correction mechanisms (debt brakes) in their respective jurisdictions – all 17 eurozone members were among the signatories. Eight eurozone countries have already fully ratified the Compact. In four other countries the ratification process has already advanced to the point that 12 of the 17 eurozone countries may realistically be expected to have ratified by year-end. This would enable the Fiscal Compact to take effect on January 1, 2013 as scheduled.

Debt brakes do not have to be established in the signatory countries until January 1, 2014. The overview below shows that to date the EMU countries have fulfilled the requirements of the Fiscal Compact to differing degrees.

Supranational objectives as set out in the Fiscal Compact or the European Commission's accompanying measures play an only modest role, however, as they are subject to the limitations set by the current EU framework. The member states are still politically and materially responsible for the implementation of national debt brakes – and thus they must also bear the burden of proof that they are serious about the institutional anchoring of sound fiscal policy.

Debt brakes in EMU: Current status of implementation 1

	Fiscal Compact ratified?	Debt brake law already passed?	Does debt brake have constitutional status?
BE	No	No. But in March 2013 at the latest.	No
DE	Sep 27, 2012	Yes	Yes
EE	No*	No	No
FI	No**	No	No
FR	No*	Yes	No
GR	May 10, 2012	No	Not yet decided
IE	No	No. But by end-2012 at the latest	No
IT	Sep 14, 2012	Yes	Yes
LU	No	No	No
MT	No	No	Yes
NL	No	No	No
AT	Jul 30, 2012	Yes	Not yet decided
PT	Jul 25, 2012	No. Still requires president's signature	No
SK	No*	Yes	Yes
SI	May 30, 2012	No	Not yet decided
ES	Sep 27, 2012	Yes	Yes
CY	Jul 26, 2012	No. By end-2012 at the latest	No

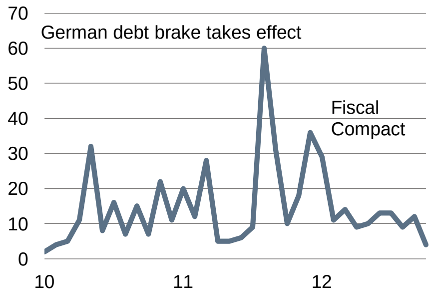
* Parliament has ratified, but instrument of ratification not yet deposited
** Ratification by December
See detailed overview on page 9

Source: DB Research

Debt brakes for Euroland: A progress report

Debt brake is seasonal issue 2

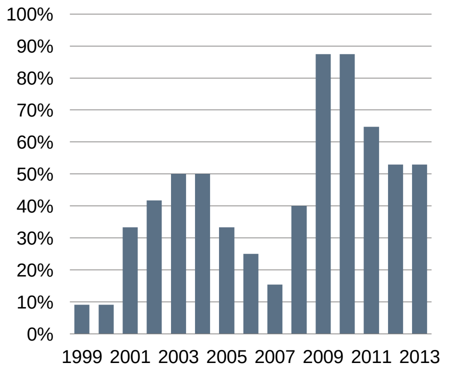
Appearances of "debt brake" in German headlines per month



Sources: DB Research, IKOM Pressedatenbank

Budget offenders in the majority 3

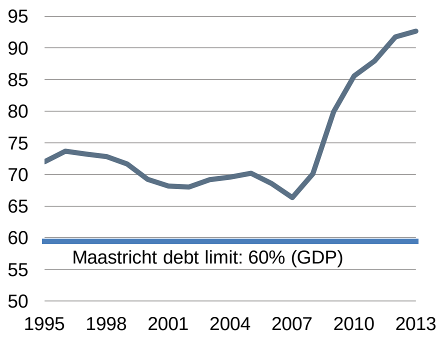
Share of euro countries beyond the deficit threshold (%)



Sources: European Commission, DB Research

Maastricht has never been reached 4

EU-27 government debt (% of GDP)



Source: European Commission

After three years of crisis, the situation in the European Economic and Monetary Union (EMU) has stabilised for the time being: the European Stability Mechanism (ESM) has been in service since mid-October. Combined with the unconventional monetary measures of the European Central Bank (ECB), it constitutes a "firewall" that is ready for deployment at short notice and designed to improve systemic stability. Government officials now want to complement this firewall with an effective "fire protection regulation". The rules for fiscal policy coordination developed over the past two years have been supplemented with a macroeconomic surveillance component. In addition, two intergovernmental agreements such as the Euro Plus Pact and the Fiscal Compact[1] are meant to prevent the eventuality of macroeconomic imbalances leading to renewed turmoil. Moreover: national debt brakes are to ensure that misguided budget developments are remedied already at the member state level by integrating the requirements of the Stability and Growth Pact into the national legal order and thus bringing them closer to the decision makers responsible for budget policy. Debt brakes for Euroland – an innovation Deutsche Bank Research called for in a report back in May 2010[2] – look set to become tangible reality in the foreseeable future. Or don't they?

Coordination of fiscal policy: What has happened to date

The method of coordinating budget policy in the EU has been radically overhauled in the past two years. The Stability and Growth Pact was reformed. Sanctions are now set to kick in at an earlier juncture of fiscal wrong-doing – i.e. both when the deficit target threshold (3% of GDP, corrective arm) is permanently exceeded and also when structural deficits are permanently excessive (preventive arm). However, sanctions remain unlikely, since they can still only be imposed at the finance ministers' discretion.

Many participants believe the overhaul fails to remedy the fiscal ills, since recommendations were long disregarded and there is little scope for sanctions: since the founding of the European Economic and Monetary Union, its members have already exceeded the 3% Maastricht threshold more than 77 times – not only during the crisis. Taking all the EU member states together, the number of deficit transgressions is well into the triple digits.

Therefore, the existing framework for budget policy coordination has been supplemented with new intergovernmental arrangements over the past few years. As political declarations or agreements under international law, these arrangements do not fall under EU law. They may also be adopted by fewer member states than the full EU-27 – an advantage as then individual countries are neither able to dilute content nor delay projects.

One such agreement, first of all, is the Euro Plus Pact – signed in March 2011 by the euro members and six other EU member states[3]. This political agreement is meant to operationalise the rather general objectives of the 10-year *Europe 2020 growth strategy* in the form of annual intermediate targets. The emphasis is on competitiveness, employment, public finances and financial stability. However, the agreement is not legally binding – rather, the measures were adopted via voluntary commitments. It is not mandatory to implement given measures.[4]

[1] See also Heinen, N. (2010). European economic policy: A profile of the coordination mechanisms. Research Briefing. Deutsche Bank Research. Frankfurt.
[2] Heinen, N. (2010). Debt brakes for Euroland. EU Monitor 74. Deutsche Bank Research. Frankfurt.
[3] These being: Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania.
[4] In response to the additional consolidation requirements arising from the Fiscal Compact, the Euro Plus Pact was fleshed out in July 2012 with a EUR 120 bn package of measures designed to encourage growth and employment via investment.

At present, particularly high hopes are being pinned on the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), referred to in short as the Fiscal Compact. 25 EU member states – including all 17 euro countries – signed the treaty on March 2, 2012. The United Kingdom and the Czech Republic opted out. The Fiscal Compact will enter into force as soon as 12 euro countries have ratified it.

Four of the Fiscal Compact's requirements are of key importance. They stipulate:

— that the structural budget deficit of the contracting parties may reach a maximum of 0.5% of GDP (the so-called "medium-term objective", not including the cyclical component). Signatories with a public-sector debt of less than 60% (of GDP) may even run a structural deficit of 1% (of GDP). The Commission sets out an adjustment path.

— that this arrangement has to be anchored in the national constitution – or on a comparable national legal basis.

— that correction mechanisms are to be triggered automatically if there are deviations from the medium-term objective or the adjustment path specified by the Commission.

— that countries which do not, or do not fully, implement correction mechanisms may – following a warning as recommended by the European Commission and issued by the three countries holding the EU triple presidency[5] – be taken to the European Court of Justice (ECJ).

One year after the Fiscal Compact has entered into force, such control mechanisms are to have been implemented in the signatory states. This gives rise to three questions that are to be addressed in this Research Briefing.

— How do the European Commission's latest implementation measures rate?

— To what extent have national correction mechanisms been implemented to date?

— What does the future hold?

Assessment of the European Commission's measures

In June, the European Commission[6] published seven common principles on national fiscal correction mechanisms. They specify minimum standards which correction mechanisms must fulfil with regard to, for instance, legal status, activation and operational instruments. The principles are assessed individually in a table at the end of this section.

Regardless of the individual appraisals, the Commission's approach merits an overarching assessment. Three criteria for effective budget rules, which we already mapped out in our report back in 2010, would appear appropriate as an assessment yardstick (see Box 5).

— Do the measures impact the expectations of participants in the budget-making process?

— Do they improve the quality of budget policy in the long run?

— Can the rule win over capital market investors and thus help to improve the countries' refinancing potential?

[5] The differing size and administrative capacities of the EU member states have resulted in the six-month rotating presidency of the EU being held since 2008 by a group of three countries at a time – as a rule, one large country supports two small ones in administrative matters.

[6] European Commission (2012). Common principles on national fiscal correction mechanisms. COM (2012). 342 final. June 20, 2012. Brussels.

Effective budget rules: Three criteria 5

— Does the rule impact participants' expectations in the budget process? Effective budget rules provide a framework for expectations. Transparent budget rules can show voters and policymakers ex ante that fiscal policy needs to be geared to the long term. This can boost public awareness that expansionary fiscal policy for reasons other than investment becomes a long-term burden on the budget. In turn, this reduces politicians' tendency to pile up deficits in the present.

— Does the rule produce a long-term improvement in budget policy? Budget rules prescribe a reduction of deficits and a stabilisation of debt levels – as a rule via quantitative targets and process specifications. In order to achieve this objective, however, the incentives provided by these rules must not conflict with other policy objectives. Potential conflicts between objectives can arise, for example, from general political preferences, the normative anchoring of a budget rule and the resulting binding force: how a budget rule's binding character is perceived certainly differs depending on whether the rule is anchored in the constitution or only normatively in a political arrangement.

— Can the rule convince capital market investors? Unfettered capital markets can intensify the impact of budget rules. A low debt level can convince investors that public-sector budgets are sustainable, for instance. The direct consequence is lower sovereign risk premia and lower interest rates. Budget rules thus relieve the pressure on the public purse not only directly but also indirectly. The decisive aspect, however, is to what degree economic policy communication is able to convey the message to the markets that such rules are a sign of sound budget policy.

A look at the Commission document leads one to fear that it will not have a major impact on the expectations of the participants in the budget process in respect of an improved, more transparent process.[7] Just like the Fiscal Compact, the Commission document does not prescribe mandatory constitutional status for the correction mechanism. The minimum requirement is merely that the legal status "be enshrined in national law through provisions of binding force and permanent character".[8] Nonetheless, many countries have provided for debt brakes that can only be changed with a two-thirds majority. This creates greater pressure on politicians to justify their action if the rules should be altered in the short term – even if strategic, cross-party voting arrangements ultimately cannot be avoided.

A further problem of a legal nature arises in respect of the Fiscal Compact per se. As a treaty under international law, it is subordinate to EU law if any conflict arises. This has two particular consequences.

— It is indeed possible to sanction the failure to implement debt brakes, or their flawed implementation, on the basis of the Fiscal Compact.

— However, there is no additional supranational potential for sanctions if national targets should fail to be met, for these are more narrowly defined than in the higher-ranking Stability and Growth Pact.

Despite this aspect, the right granted to member states to bring such matters to the European Court of Justice is problematic if national correction mechanisms are not implemented or not implemented to a sufficient degree. It is doubtful whether the triple presidency would really resolve to take action against member states in line with the Commission's opinion. A look at pending country combinations for the triple presidency (see table 6 and footnote 4) suggests that when countries consider their interests most of them will invariably be biased against legal action since, as a rule, countries with traditionally lax budget policy are in the majority in the groups of three and the decision to launch such action is a matter of discretion. The triple presidency will not be dominated by a traditionally more stability-conscious country again until 2016, under the Netherlands. And, even if such action were successful, repeated non-compliance would merely attract a penalty fee of 0.1% of GDP. This minor sanction could presumably be interpreted by some political forces as a fine for wrong-doing, but not as an incentive to remedy the situation.

Furthermore, it remains doubtful whether the Commission's measures can lead to a long-term improvement in budget policy outcomes. True, according to the Commission requirement the correction mechanism should ensure that (1) there is a rapid return to the prescribed adjustment path and (2) the medium-term objective is reached. However, a third point has been overlooked: the Commission has not made any stipulation whatsoever about rules-based repayment of debt incurred on the back of excessive deficits in the past. Since the preamble of the Fiscal Compact provides for such a case, a chance to nail down further specifications has been wasted. Countries could conceivably adopt the position that this is remedied in any event by the stipulation that one-twentieth of the debt overhang exceeding 60% of GDP will have to be amortised (every year) from 2014.[9] However, compared with the reformed Stability and Growth Pact and thus the status quo, this would not be a conceptual improvement.

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7 In the short term, the problem is compounded by the fact that the European Commission has still not set up any country-specific adjustment paths along which structural deficits have to be reduced. Their publication in the fourth quarter of 2012 is overdue – it is too late to have a major impact on budget planning for 2013.

8 At least the Fiscal Compact and the Commission paper rule out circumvention of the mechanism in the budget law framework.

9 See European Central Bank (2012). Monthly Bulletin May 2012. ECB, Frankfurt. p. 99.

ECJ action unlikely for the time being 6

Triple presidency by 6-month period

2011 II	PL
2012 I	DK
2012 II	CY
2013 I	IE
2013 II	LT
2014 I	GR
2014 II	IT
2015 I	LV
2015 II	LU
2016 I	NL
2016 II	SK
2017 I	MT
2017 II	GB
2018 I	EE
2018 II	BG

Source: European Council

Regardless of the above, the Commission's paper is missing numerous points of substance which could easily have been sorted out on the basis of the Fiscal Compact.

— The role of lower levels of government is defined in disappointingly vague terms (see overview table 7).

— No further fine-tuning was done on the so-called budgetary and economic partnership programmes, which according to the Fiscal Compact are to contain a detailed description of the structural reforms in order to effectively and permanently correct excessive deficits.

— It remains unclear which avenues should be taken to prevent government debt from increasing via off-budget items or by shifting new debt into public-private partnerships.

This raises the question as to whether the third assessment criterion – a positive capital market reaction – can be met. There is little likelihood that national debt brakes modelled on the Commission proposal can soon mitigate the interest rate pressure on crisis countries – for two reasons, in fact.

— The Commission proposals can achieve little on their own. Their abstractness leaves most of the specific details up to the member states.

— Debt brakes are a long-term project. The national correction mechanisms do not have to enter into force until one year after the Fiscal Compact. Their effect does not develop in real time but instead along lengthy adjustment paths which – if the mechanisms are not anchored in constitutional law – are exposed not only in election years to pronounced political risks.

Despite these circumstances the Commission paper itself does not deserve to be criticised, because at this point in time there is nothing more it can do: the national fiscal frameworks differ too much for European targets to be able to create minimum standards across the board. In addition, a fundamental restructuring via the Fiscal Compact is not feasible in the current framework of European Union law. Therefore, the Commission is treading a fine line between necessary national detail and sufficient supranational abstractness. Responsibility for budget policy remains mainly in the hands of the national authorities – and thus also the burden of proof that they are serious about the institutional safeguarding of sound fiscal policy.

That countries can make great progress even without targets from Brussels can be seen in Estonia and Finland – two countries with sound government finances but without a debt brake having constitutional status.

— Even though Estonia had never anchored a numerical debt brake in its constitution, it reached political consensus on low new debt. Fiscal discipline was seen primarily as a means to gain political autonomy and independence from foreign creditors. The target of joining the euro in 2011 was another factor.

— Since the 1990s, Finland has had central government expenditure rules and a medium-term financial plan that provides the framework for 80% of the central government budget during the four-year parliamentary term. Annual budgets set spending ceilings for individual ministries. An independent auditor checks the government's finances. Highly independent lower levels of government cover 80% of their expenditures (healthcare, education) via their own revenues.

Precisely these two examples show that especially the political will of the member states is a key factor for the successful implementation of correction mechanisms Nonetheless, supporters of the Fiscal Compact invariably emphasise the positive message that such a voluntary commitment could send to other countries. An external contractually binding force could additionally boost the sense of *ownership*. To be able to judge whether this assessment is borne out, the current status of the Fiscal Compact's implementation shall be appraised in the following section.

Debt brakes: Seven recommendations from the European Commission 7

Recommendation	Critique
Legal status: Binding, permanent rules, preferably with constitutional status. Full respect for prerogatives of national parliaments.	— Without constitutional status, the debt brake can be undermined at any time by the prerogatives of national parliaments.
Consistency with EU framework: Correction mechanisms (size, timeline) shall rely closely on the fiscal concepts of the Stability and growth Pact (SGP).	— Adoption of definitions is to be welcomed. — Commission document only says "*shall rely* […] *closely*". Room for interpretation.
Activation: Correction mechanism may be triggered by EU-driven or country-specific criteria.	— One problematic aspect is that European criteria are not mandatory. — National criteria could weaken European criteria.
Nature of the correction: Given deviations from the fiscal target, the size and timeline of the measures shall be framed by pre-determined rules.	— No stipulations requiring correction of those deficits that result from past slippage. Approach is geared strictly to the present and the future.
Operational instruments: Adjustment of public expenditure and tax measures. Measures for "*Coordination across some or all of the sub-sectors of general governments*" should be "*considered*".	— Imprecise wording in respect of the interplay between sub-sectors of government. Fiscal federal structures are, however, often the reason for a lack of fiscal sustainability.
Escape Clauses shall adhere to the requirements of the Stability and Growth Pact and be temporary in nature.	— Not fully in lockstep with the SGP ("shall adhere to"). — Definition of "temporary" not adequately specified – this leaves national governments scope for repeated extensions of deadlines.
Monitoring via independent bodies or bodies with functional autonomy.	— A government is not obliged to comply with the assessments of these bodies if it provides a reason for not doing so. This reason is not required to be fleshed out with details. — Requirements for institutional independence are poorly defined ("*high degree of functional autonomy*").

What is the current state of implementation?

Italy: Debt brake has constitutional status 8

In September, the Senate and the Chamber of Deputies amended the country's constitution. Legislation is now being hammered out for the implementation of the correction mechanism. However, the European Commission does not expect full implementation before 2015, since independent supervisory bodies and relations with the lower levels of government are problematic issues. As things stand today, the system is likely to be modelled closely on the German version. If there is a slight deviation from the medium-term deficit target the government has a year to return to the mapped-out course, and in case of a significant deviation, two years. A control account, in which deviations from the target value are registered, is meant to prevent overly optimistic new debt forecasts. Only in the case of extreme circumstances (natural disasters, serious economic crises) are deviations from the target allowed. These must be approved by parliament by qualified majority and accompanied by an amortisation plan. Lower levels of government are not permitted to borrow funds. Investment expenditure is an exception and is also subject to an amortisation plan.

Despite the ambitious targets often linked with the Fiscal Compact in political communications, its de facto success hinges on the implementation of the debt brake in the signatory countries – and thus on political commitment at the national level. Three aspects are of interest here in particular.

— Which euro countries have ratified the Fiscal Compact?

— Which countries have already established a debt brake?

— In which countries does this debt brake have constitutional status?

At least 12 euro countries have to ratify the treaty by the end of the year in order for it to come into force on January 1, 2013. This deadline could be met: as of November 23 only eight of the 17 euro members had fully ratified[10] the Fiscal Compact.[11] However, four countries are poised to complete the ratification process soon: in three of them – Estonia, France and Slovakia – parliament has already ratified the Compact; the only step left is official notification. Furthermore, Finland is also expected to ratify soon.

The measures prescribed by the Fiscal Compact are to be implemented within one year of when the Compact comes into force. If it is adopted as of January 1, 2013 this deadline would probably be January 1, 2014 – but later if there are further delays.

[10] To be more specific, the issue here is notification – that is, the communication to the Commission of the depositing of the instrument of ratification after its passage in parliament.
[11] Altogether, these are 12 of the 25 signatories.

The fact that the Fiscal Compact has been ratified does not mean that its targets have also been implemented and a debt brake established. This is illustrated by the case of Greece – the first country to ratify the Compact, on March 28, 2012. Ever since the formation of the new government the plans for anchoring the debt brake in the constitution have remained on hold: there is neither draft legislation nor is it clear whether Greece will anchor its debt brake with constitutional status or not.

In the crisis countries of Spain and Italy, by contrast, a fiscal correction mechanism has already been written into the constitution. This means that Italy is seeking to attain a structurally balanced budget next year, in fact independently of the accompanying law on the debt brake which is not likely to take effect until the end of 2014. Hungary and Poland, which are not euro members, have also established a correction mechanism in their national constitution. While there are no plans for a constitutional amendment in numerous other EU countries, there the debt brake is to be given the status of a special law that cannot be overturned by a simple majority vote. As a rule, a two-thirds majority is required in the national parliament.

— Portugal is a good example: both the Fiscal Compact and the debt brake have already been adopted there. While the debt brake is to be a simple-majority law and not anchored in the constitution, it is to be adopted in parliament by a two-thirds majority, so the opposition's approval is necessary in any event.

— Belgium and Luxembourg are also refraining from establishing a debt rule with constitutional status. However, the debt brake law also requires a two-thirds majority to be adopted and amended.

Ireland is a special case. Whenever a law is amended in Ireland and this amendment affects the constitution, it has to be put to a referendum. To rule out legal challenges the debt brake law was not presented to parliament until July 2012, i.e. after its approval in a referendum. However, it has not been passed yet.

In Slovenia, the government plans to anchor the debt brake in the constitution, but it has not yet achieved the two-thirds majority required to do so. The opposition does not think constitutional status is necessary, though.

The non-euro countries are also taking pains to launch the debt brake and have already adopted the Fiscal Compact. In Denmark, a majority of the parties have settled on an agreement that has constitutional status and cannot be dissolved by a new ruling party without the approval of all parties. In Poland, the debt brake has already been anchored in the constitution. As soon as Poland's government debt ratio exceeds 55% (of GDP), measures to improve the budget situation – such as increasing the value-added tax – are triggered automatically.

Germany was a first mover back in 2009 when it anchored a fiscal correction mechanism in its constitution. In the context of the legislation accompanying Germany's ratification of the Fiscal Compact, by year-end several accompanying laws for the debt brake will be amended in order to make them compatible with the Fiscal Compact. Observers' main criticism is that the changeover to a new method of calculating growth dynamics based on the European Commission standard enables freedom of choice for parameters and models – and this produces the risk that the cyclical component is not interpreted symmetrically, but instead more favourably in the sense of higher new debt (during a downswing) or lower consolidation requirements (in an upswing).[12] The Stability Council is also meant to provide independent supervision and control to this end – it is to be assisted for this purpose by an

Ireland: Progress without constitutional status 9

The introduction of a debt brake was authorised by the referendum on the Fiscal Compact in May 2012. Detailed legislative proposals (Fiscal Responsibility Bill) are being drawn up. The Irish Fiscal Advisory Council (IFAC) had commenced its work back in July 2011. Introduction of a correction mechanism to drive deficit back down to medium-term objectives. The IFAC prepares macroeconomic forecasts and monitors compliance with the budget rule. However, its members are nominated by the finance minister.

A profile of Germany's debt brake 10

The German debt brake differentiates between the structural and the cyclical components of the government deficit. According to an assessment factor embracing budget sensitivity and output gap, the cyclical component enables automatic stabilisers to kick in. While the federal government will only be allowed to run a structural deficit of 0.35% of GDP (plus cyclical component) from 2016, the Länder will no longer be allowed to post a deficit from 2020. A Stability Council comprising the Länder finance ministers, the federal economics minister and the federal finance minister checks the budget situation of the federal government and Länder governments on the basis of a fixed set of indicators. Following the federal rule, the Länder have already introduced their own debt brakes or intend to do so. There, too, exceptions are possible, such as for events of catastrophic proportions. Whether the federal state in question is facing a budgetary emergency is decided by the Stability Council. This Council can repeatedly admonish Länder that miss the budget ratios (deficit targets) to improve their performance. The representatives of the Länder affected are not allowed to participate in related voting. However, at the end of the day there are no sanctions to be feared.

[12] The Bundesbank is among the critics. On the cyclical adjustment procedure under the German central government's new debt rule. Monthly Bulletin. November 2011. p. 71.

independent advisory council. Critics[13] say that the Stability Council is no longer independent already because of its composition, especially since the decision makers represented there have a decisive impact on potential circumvention of the debt brake via their influence in the parliaments. The critics claim that representatives of institutions commonly regarded as more independent such as the Bundesrechnungshof (federal auditor), the Bundesbank and the Council of Economic Experts are not on board.

The discussions so far show that even with European stipulations the member states continue to bear political and material responsibility for the implementation of national debt brakes. This becomes relevant particularly with regard to actual compliance with the rules. Especially since there may be a stretch of poor growth ahead it remains to be seen to what extent the countries will comply with these correction mechanisms they set themselves. Considering the Commission's stipulations it will no longer be possible to consistently derail the system via easily constructed exemption clauses, as used to be the case regularly in Germany under the old investment-oriented debt ceiling set out in Article 115 of the Basic Law. However, room for interpretation, right up to an amendment of the law at short notice with corresponding majorities, cannot be ruled out.

Regardless of the above, further projects lie ahead in the context of overarching economic and fiscal coordination between the euro countries.

[13] See, for example, Schweisfurth, T. (2012). Fiskalpakt: Glaubwürdigkeitsfrage. Wirtschaftsdienst. September 2012. p. 582.

Debt brakes in the signatory countries of the Fiscal Compact: Current status of implementation 11

	Fiscal Compact ratified?	Draft legislation tabled for debt brake?	Law already passed?	Does debt brake have constitutional status?
EMU				
BE	No	No	No. But in March 2013 at the latest	No. Amendment with ⅔ majority
DE	Sep 27, 2012	yes	Yes	Yes
EE	No*	No	No	No
FI	No**	No	No	No
FR	No*	Yes	Yes	No
GR	May 10, 2012	No	No	Not yet decided
IE	No	Yes	No. But by end-2012 at the latest	No
IT	Sep 14, 2012	Yes	Yes	Yes
LU	No	No	No	No. Amendment with ⅔ majority
MT	No	No	No	Yes
NL	No	Yes	No	No
AT	Jul 30, 2012	Yes	Yes	Not yet decided
PT	Jul 25, 2012	Yes	No. Still requires president's signature	No. Amendment with ⅔ majority
SK	No*	Yes	Yes	Yes. Planned
SI	May 30, 2012	No	No	Not yet decided
ES	Sep 27, 2012	Yes	Yes	Yes
CY	Jul 26, 2012	Yes	No. By end-2012 at the latest	No
Non-EMU				
BG	No*	Yes	No	No
DK	Jul 19, 2012	Yes	Yes	No
HU	No	Yes	Yes	Yes
LT	Sep 6, 2012	Yes	Yes	No
LV	Jun 22, 2012	No	No. By end-2012 at the latest	No
PL	No	Yes	Yes	Yes
RO	Nov 6, 2012	No	No	No
SE	No	Yes	Yes	No

*Parliament has ratified − instrument of ratification not yet deposited **Ratification by December

Source: DB Research Country overview researched and compiled by Yannick Timmer

European Commission forecast 12

Deficit targets out of reach

	Budget deficit (% GDP)			Target: deficit below 3%(GDP) until
	2012	2013	2014	
BE	-3.0	-3.4	-3.5	2012
DE	-0.2	-0.2	0.0*	
EE	-1.1	-0.5	0.3*	
IE	-8.4	-7.5	-5.0	2015
GR	-6.8	-5.5	-4.6	2014
ES	-8.0	-6.0	-6.4	2014
FR	-4.5	-3.5	-3.5	2013
IT	-2.9	-2.1	-2.1	2013
CY	-5.3	-5.7	-6.0	2012
LU	-1.9	-1.7	-1.8*	
MT	-2.6	-2.9	-2.6	2011
NL	-3.7	-2.9	-3.2	2013
AT	-3.2	-2.7	-1.9	2013
PT	-5.0	-4.5	-2.5	2014
SI	-4.4	-3.9	-4.1	2013
SK	-4.9	-3.2	-3.1	2013
FI	-1.8	-1.2	-1.0*	

* Country not in deficit procedure.
Source: European Commission, DB Research

A profile of the Economic "two-pack" 13

The *Economic two-pack* consists of two draft regulations:

Regulation on monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficits in euro-area member states.

— Requires member states to draw up independent debt projections.
— By October 15, each euro country has to submit to the Commission its draft budget for the following year for appraisal.
— Further provisions concerning the powers of the Commission (it may request amendments) and of the member states (they may request recommendations).
— The budget powers of the parliaments are not to be restricted.

Regulation on enhanced surveillance of euro-area member states experiencing or threatened with financial difficulties.

— Increased monitoring for countries in difficulties, e.g. via quarterly reports.
— Regular economic and fiscal surveillance required under the European Semester is suspended for programme countries.
— Post-programme surveillance until 75% of the debt loans have been repaid.
— Requires member states to commission independent debt projections.

How will the story continue?

On November 7 the European Commission released its autumn forecast and new data on the budget deficits of the 27 EU member states in respect of their future economic performance. The forecasts comprised major downward revisions regarding budget deficits and growth perspectives. In particular, the position of the countries stricken by the euro crisis has deteriorated versus the spring forecast. All these readings are a long way away from the Maastricht target (3% of GDP). The country-specific adjustment paths to correct the deficits, which the Commission is to publish for all the member states in the weeks following, are to be geared to them. Countries that have already set up correction mechanisms automatically incorporate these targets in their national legislation. However, these consolidation paths are most likely to be prolonged if moves are made to upgrade the weighting of economic growth vis-à-vis austerity efforts. This scenario is not all that far-fetched, considering:

— that Commissioner Rehn stated at the press conference on the autumn forecasts that the Commission would, for now, refrain from recommending sanctions for those countries that do not comply with their fiscal adjustment paths;
— that there is a political consensus to allow euro bail-out countries such as Greece or Portugal more time to achieve their austerity targets; and
— that the Commission has been reticent this year about criticising the national reform and consolidation efforts of crisis countries – even though this would have been appropriate in one or two cases.

Following the reform of the Stability and Growth Pact in the so-called *Economic six-pack* last year, the follow-up package of laws in the *Economic two-pack* will be hammered out in Brussels over the next few months. These two draft regulations are meant firstly to turn the stipulations of the Fiscal Compact and secondly the stipulations on enhanced surveillance provided for by the ESM for programme countries into secondary European law. The European Parliament debated the drafts in the Economic and Monetary Affairs Committee in mid-May and agreed a common negotiating position on July 13. It is now at the stage of *trilogue* (tripartite) meetings between Parliament, European Commission and the Council. These are likely to be tough negotiations for two reasons, and drag on until well into 2013.

— The European Parliament has adopted a partly contradictory position[14] and would first like to await the final version of the report being drafted by the working group under Herman van Rompuy in December.
— Individual euro countries have an interest in playing for time, since the situation in the capital markets has calmed down since summer and they would again like to refrain from relinquishing any sovereignty: unlike under the current intergovernmental ad hoc coordination, the loss of sovereignty under secondary EU law cannot be renegotiated, but is instead permanently binding.

One potential long-term course may be inferred from the recent conclusions of the October European Council and the interim report submitted by Council President van Rompuy's working group. Both documents contain abstract recommendations:

[14] For example, the European Parliament's Ferreira report, which in addition to the Gauzès report is a foundation stone for the Parliament's negotiating position, calls for a combination of a cross-border debt redemption fund based on the German Council of Economic Experts' model along with a simultaneous roadmap for eurobonds. Implemented rigorously, the two objectives are mutually exclusive conceptually in the long run.

— that member states agree reform targets with EU institutions in individual contractual arrangements.[15] As a supplement to the stipulations of general economic and fiscal policy coordination this should additionally create a sense of *ownership* for reforms.

— that an integrated budgetary framework be created as part of an economic and monetary union – in this case the visions go beyond the economic governance of the *Economic two-pack*.

— that in the long run the eurozone should obtain its own *fiscal capacity* which could both create incentives for structural reforms and have a stabilising effect in the event of asymmetric shocks.

These points will have to be elaborated further for the final report to be submitted to the European Council by the van Rompuy group in December before they can be subjected to a more stringent (politico-)economic assessment.

In this context, the ideas expounded in this report could certainly be of benefit as an assessment yardstick – after all, they show once again that a key factor for overcoming the European debt crisis is that fiscal responsibility be assumed at the member state level. This is the only way that the Fiscal Compact and upcoming mechanisms of European economic policy will be able to contribute towards the long-term stabilisation of the eurozone, stabilise expectations and ultimately generate new confidence in European fiscal policy.

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[15] The extent to which these match the budgetary and economic partnership programmes of the Fiscal Compact has not been properly clarified.

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