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Introductory Remarks

From the early beginnings of the idea for European Monetary Union (EMU), it was clear that a common currency needs to be accompanied by adequate mechanisms for fiscal policies. While for the proponents of the *coronation theory*, a common currency should only follow after achieving political union with a centralised fiscal policy. The road actually chosen was the opposite: forming a monetary union, with rather limited transfer of political sovereignty in other areas of economic policy.

For fiscal policy, a three-pronged approach was chosen according to the Maastricht Treaty to ensure sound fiscal policies in individual EMU countries, and thus ensure fiscal flexibility to absorb asymmetric shocks and to avoid negative spillovers to euro area Member States:

– First, market forces were supposed to sanction governments who violated fiscal virtue and to reward those who adhered to it. To this end, monetary financing of governments by central banks, bailouts of governments by other governments and by the EU as a whole as well as privileged access of governments to financial institutions were prohibited by the Maastricht Treaty.
– Second, peer pressure among EU finance ministers, heads of state and government and high-ranking officials represented in the Economic and Financial Committee were expected to ensure fiscal rectitude.
– And third, fiscal rules with rather precise quantitative ceilings for fiscal deficit and debt ratios as well as elaborate procedures in the event of violations were introduced.

To true believers, each of these three mechanisms theoretically should by itself have ensured fiscal discipline. From the beginning, skeptics held against this framework the very fact that employing all three channels bore witness to a lack of trust in the reliability of any of them.

It seems the critics unfortunately were right: Market forces, including their guideposts such as rating agencies, were late in detecting and appropriately pricing in risks to fiscal unsustainability. Once they did, they acted very abruptly and, as some argue, also excessively. Peer pressure worked incompletely or towards soft implementation of the rules. The rules themselves were relaxed once a sufficiently influential group of countries found difficulties in adhering to them in 2005, and the regulations became de facto not executable in the course of the crisis from 2009 onwards.

Where do we stand now? Belief in the ability of market forces to ensure fiscal discipline early on has vanished because of markets' failure to deliver early warning and because the respective EU rules have been compromised by various emergency measures, since market forces, once hitting, were felt to be overwhelming and damaging. Peer pressure towards fiscal soundness now seems to have been replaced by peer pressure to support fiscal rescue packages for crisis countries, conditional on consolidation and reform packages. So, what about the remaining device: fiscal rules?

A comprehensive package of reform has been presented several months ago. It provides some tightening in the area of fiscal policy as well as some broadening to include macroeconomic imbalances. The European Central Bank has officially and very clearly signaled that reform of the rules is called for but that the reforms envisaged by the European Council fall short of what is required. Currently, the new framework is being discussed by the European Parliament, and also the European Parliament is pushing for extending reversed qualified majority voting to more areas of the legislation, to facilitate decision-making and give the rules more bite. On the whole, it seems the lessons from the current crisis have only been learnt to some extent.

The two panelists, Daniela Schwarzer from the Stiftung Wissenschaft und Politik, Berlin, as well as Professor Wolfgang Franz, ZEW, Mannheim and German Council of Economic Experts, will provide a more detailed analysis and assessment of the reformed Stability and Growth Pact, the European Crisis Mechanisms and of the EU's economic governance framework at large. Both contributions make clear that the current reforms, while falling short of some expectations, are in principle useful, but that further and far more fundamental reforms of EU economic governance will likely (have to) follow in the future.