Fiscal Union
The Solution of The Euro-Zone Crisis and The Future of The Economic Governance of Europe?

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Abstract—The crisis in the euro-zone has indicated the weakness of economic governance both on the national and on the supranational level. On one side of the coin, countries such as Greece, Italy and Portugal have accumulated such a huge amount of debts because they did not follow the fiscal rules laid down in the Maastricht Treaty and the Stability and Growth Pact; nevertheless, on the other side of the coin, the provisions did not provide the EU a power to strictly supervise national matters.

This paper discusses why a large number of proposals were insufficient to solve the Greece’s dept crisis, represents a possible solution to the economic crisis in the euro-zone, called the fiscal union and examines how the negotiations during the Hungarian Presidency contributed to the realization of a stronger political and economic integration.

Index Terms—fiscal union, Euro-zone crisis, economic governance, Hungarian Presidency

I. Introducing Fiscal Union

During the last sixty years, the European Union was considered to be one of the most developing supranational organizations in the world. It was created after the Second World War in order to maintain peace, deliver prosperity and raise the living standards of its citizens. Recently, the EU faces several deep financial crises, from which the most significant is the euro-zone crisis, which started in 2010.

Larch, Noord, and Jonung claim that the causes of the debt crises are the weak institutional structures of the European Union, the insufficient implementation of the euro, and last, but not least, the economic mismanagement of some of the seventeen member states within the euro area [1]. Countries such as Greece, Italy and Portugal have accumulated excessive debts, confidence from creditors was lost hence some of these countries are on the brink of bankruptcy.

This paper describes several initiatives which tried to mitigate the Greece’s debt crisis, discusses which proposals of the Hungarian Presidency can contribute to the economic growth of the EU, provides a potential solution to the crisis in the euro-zone and represents the possible future of the economic governance of Europe as a whole. A potential solution, advocated by the German Chancellor and the President of the French Republic, would be a greater integration. They assume that European countries should proceed towards a much stronger integration than it was before. This integration would not only be political but also an economic one. An economic integration which guarantees the fiscal surveillance and policy coordination of the member states is called the fiscal union.

This union could have positive achievements. It could bring complete change to the political and economic system of the European Union and could also provide an effective provision for the less prosperous economic times with its crisis-resolution mechanism. This mechanism would be the novelty of the fiscal union as it did not exist before. There was a rescue fund, called the European Financial Stability Facility (EFSF) which provided loans to countries in crisis, but it was not as effective as it was expected to be. As its scope was limited it could not provide the necessary financial assistance to countries in difficulties like Greece.

II. The Euro-Zone Crisis: Greece

As of 2010, increasing attention has been paid to the euro-zone member country Greece and its economical situation. The rising level of debts due to irresponsible governance put the country into financial troubles. Experts suggest different solutions to avoid complete economic downfall. While Papazoglou claims that the privatization of some weak state-owned companies could serve as a financial source for the government to decrease its debts [2], Economides and Smith suggest that Greece should reduce its expense by curtailing the number of employees working in the public sector so then Greece would be able to reach certain economic stability [3]. Although the dismissals of public sector employees seem to be a convenient idea, it would lead to the rising rate of unemployment and an economic downfall.

Exiting from the euro-zone is considered to be another answer but not a solution to the crisis. This would not help to avoid an economic downfall but would increase the risk of bankruptcy. Eichengreen argues that members of the euro-zone do not plan to withdraw because they could not carry the political and economic costs of it [4]. A country that leaves the euro would be expected to devalue its newly-introduced national currency and could not actively participate in EU-related decision-makings.

Greece is fortunate in the sense that it does not have to tackle the financial crisis on its own. The country can count on the assistance of its European partners. On the one hand, it is undeniable that finding solutions to the Greek problem is in the mutual interest of the euro-zone’s seventeen member states because their economies are interdependent,
on the other hand, it is also clear that Greece’s European partners and creditors gradually lose their confidence in the country. Rohan says that the International Monetary Fund (IMF) is losing its confidence in Greece because the country does not carry out any of its instructions [5]. For instance, Greece is not willing to develop its own taxation system, provides insufficient structural readjustment plans and does not enact the necessary austerity measures.

Darvas suggests that Greece could regain its credibility and avoid either bank runs or bankruptcy if it allowed significant foreign ownership (investors and bankers from other countries place their capital in Greece) in its national banking system [6]. The execution of this idea would not only ensure the continuous flow of support from IMF and EU institutions but can retain a large number of Greek citizens to take their money out of the banks suddenly and could pave the way towards debt restructuring. Debt restructuring aims to reduce a huge amount of debts and extend the payment terms. While it helps lessen the expenditures of the government, the process of restructuring requires financial assistance from the EU.

Greek citizens are aware that the financial crisis deepens in their country. Therefore, they want to be sure that the national bank, where they place their deposits, cannot become insolvent and they can get their money back when they wish. As mentioned above, Darvas stresses that foreign ownership in the national bank system could reassure bank customers that their deposits are safe, they can get their money back any time they want and they do not have to withdraw their deposits.

While Darvas emphasizes the importance of foreign ownership in the Greek national bank system and that the reform in the euro area does require a new attitude from the governments of the countries in crisis [6], Schuknecht et al. claim that the reform cannot be effective without fiscal policy coordination and new institutional structure for the EU as a whole [7]. They assert that the fiscal governance in the euro-zone has to be strengthened and more measures need to be taken [7]. By stating that national level deficits should be approved on the European level, Schuknecht et al. undoubtedly talk about a much closer integration than it was beforehand. Beforehand the EU did not strictly supervise the economic matters of its member states.

Schuknecht et al. claim that the EU should exercise its power over the national matters of its member states and introduce sanctions against euro area countries where the deficit exceeds 3% of their GDP after 2013. It is also discussed that a powerful fiscal union requires a new institutional structure. Schuknecht et al. assert that at the national level, member states should introduce an independent budget office that can provide forecasts about the economic matters of each member states and at the euro area level, provisions would be assessed and implemented if they cannot lead to economic failure [7].

The introduction of sanctions and the new institutional system could help prevent a country from bankruptcy and protect all member states of the EU from economic mismanagement in the future. Schuknecht et al. describe a stronger economic and political union [7]. They are convinced that this union could bring complete change to the political and economic system of the European Union, foster a better integration and help member states to tackle the crisis.

National governments of the member states have also recognized that joining a fiscal union does not only have negative consequences: losing some of their sovereignty. If the EU ordains austerities or sanctions a national government due to its economic mismanagement, the government can blame the EU for its decision. The national governments can secure their political position in their country by claiming that austerities directly come from European institutions and these austerities are not part of their political program.

III. Economic Mismanagement

In 1990, the basic fiscal rules were laid down in the Maastricht Treaty and the Stability and Growth Pact [8]. The Maastricht Treaty fostered the realization of the Economic and Monetary Union (EMU) and laid down strict criteria to get a membership. The EMU promoted economic progress, social cohesion and tried to prevent member states from economic mismanagements by supervising their national spending.

The objective of the other provision, the Stability and Growth Pact, was to ensure the effective coordination of national fiscal policies in the EMU. The provisions of the pact encouraged member states to submit convergence and stability plans. These plans were assessed by the Commission and the Council. These institutions provided early warnings to prevent member states from economic downfall and they also offered policy advice in order to avoid a huge deficit in the national budgets.

Although the provisions of the treaty and the pact were apparent, the member states of the EMU did not always accommodate their economic governance plans to the agreements and did not consider the recommendations of the Commission. Therefore, they accumulated huge debts.

Gianviti et al. claim that the problem was not only that the members of the EMU did not follow the provisions of the treaties and had undisciplined budgetary policies, but also that the EMU did not work out any European Crisis-Resolution Mechanism (ECRM) to solve an unexpected crisis [9]. In the last few years there were a few unexpected debt crises, among which the Greek crisis is the best-known.

It is obvious that the first responses to the Greek crisis were poor and temporary because the EU did not have a crisis-resolution mechanism. In the future, an ECRM should be established. This mechanism could foster negotiations between debtors and creditors and could provide sufficient financial assistance to the member states of the euro-zone.

On the one hand, the EU has to work out a formal crisis-resolution mechanism to tackle possible future crises; on the
IV. Hungarian Proposals

The idea that the EU has to closely watch the development of its member states in order to reach a tighter economic integration has already been raised during the negotiations in Hungary between January and June 2011. The Hungarian Presidency had a great chance to extensively discuss the possible restructuring of the European Union, the causes and the solutions of the debt crisis within and outside of the euro-zone.

Although it was also recognized by the Hungarian politicians that the European Union should stiffen the conditions to join the euro-zone and deepen its policies, Hungary did not play a significant role in decision-makings for the stabilization of the euro-zone [10]. As Hungary was one of the four EU member states that decided not to join the Euro Plus Act, it was excluded from the negotiations. The Euro Pact Act creates an alliance between the Eurozone and some of the non-Euro-zone countries, and provides the basis of joint economic governance in the European Union.

Apart from the fact that Hungary did not pay a central role in decision-makings, experts, such as Vida [11] and Gostyńska [12], claim that the Hungarian Presidency had two significant achievements regarding economic matters. One is that it fostered the implementation of the Europe 2020 Strategy and the other is that it proposed a groundbreaking economic governance package, called the Package of six legislative proposals assisting the harmonization of the economic policies of the member states.

While the Europe 2020 Strategy offers a support mechanism for the members of the euro-zone and fosters closer EU surveillance of fiscal policies, the Package of six legislative proposals could even sanction member states having excessive deficits. The Package of six legislative was adopted on 4th October 2011 by the Council of the European Union. The Council appreciated that the proposal could enhance fiscal discipline and help to avoid macroeconomic imbalances [13].

The Hungarian initiatives aim to develop actions to safeguard the euro area against a new crisis and introduce new mechanism with which the EU can easily monitor the economies of the member states. If a member state refuses to follow the instructions laid down, the EU could impose sanctions against the country. This would develop greater fiscal discipline within the union.

V. Two Types of Fiscal Union

While acknowledging the positive effects of the Hungarian initiatives in the economic governance, Marzinotto proposes a different idea which, she thinks, could result in an even higher integration between the members of the euro-zone. She says that a limited fiscal union would be the best solution to avoid future problems. In this union, the budget policies of the national governments would be regulated regularly by a euro-area finance minister who can have veto rights over national budgets that could threaten the growth of the euro-area [14].

One could argue that it would be practically impossible to introduce a finance minister in the euro-area. The member states would not promote an idea which could lead to the loss of all of their sovereignty. To avoid future crisis, a fiscal union without a finance minister but with the stronger integration of the policies of the member states would sound better. The fiscal union would be also a solution to the Greek debt crisis. As a member of a union which supervises the national budgets of each of its member states, Greece could regain its credibility and receive more funds from its creditors. The creditors would rely on a strong union which provides more transparency in the economic matters of its members.

Willsher and Chu claim that both the French President, Nicolas Sarkozy and the German Chancellor, Angela Merkel are convinced that a closer economic union with strict rules on government spending and sanctions against rule breakers could be enough to curb budget deficits and regain control over the debt crisis that threatens the eurozone [15].

VI. Conclusion

The crisis in the euro-zone represents that without transparency of the financial affairs of each of the member states, an interdependent economy cannot work sufficiently. Leading political figures, like Ms. Merkel and Mr. Sarkozy think that a stronger integration is a must to avoid further crises. Therefore, the European governance should proceed towards a much higher integration than it is today and its member states will have less sovereignty (because the national level deficits will be approved on the European level as well) but more economic security.

This higher integration will possibly be a fiscal union. This union could have positive effects. It could bring complete change to the political and economic system of the European Union, could encourage the member states to discipline their national budget and could also help avoid future crises or solve them by using a crisis-resolution mechanism. The Council of the European Union has already fostered the realization of the fiscal union by implementing a Hungarian proposal: the Package of six legislative. The Council recognized that the new structure of the EU could help Greece to solve its economic difficulties and could provide a better ground for economic growth.
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