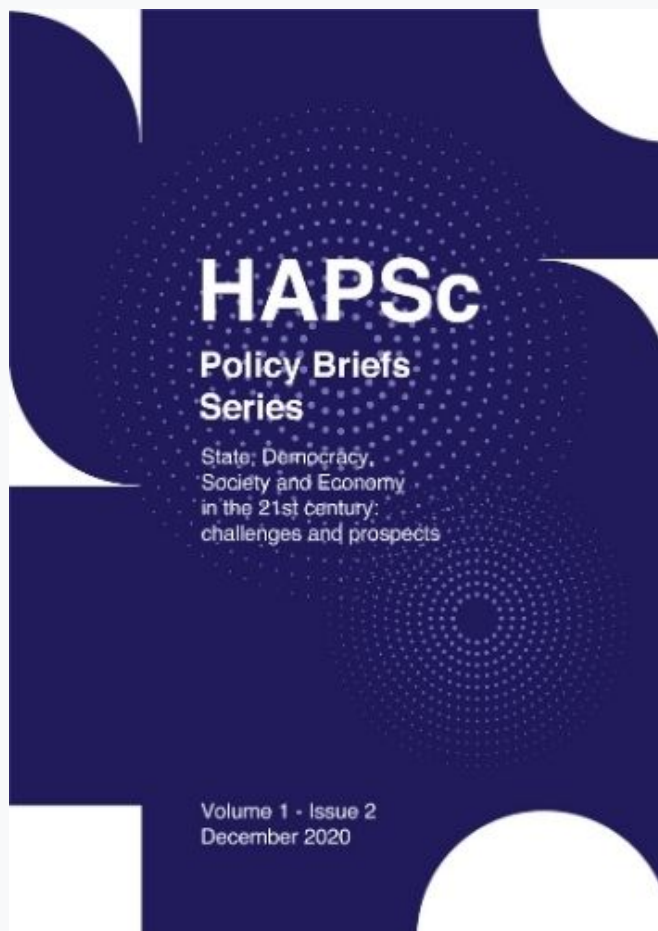


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### The Differentiated EU Policy on Facing Economic Crises: Prospects for EU to Anticipate the Financial and Fiscal Crises of its Member States

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## The Differentiated EU Policy on Facing Economic Crises: Prospects for EU to Anticipate the Financial and Fiscal Crises of its Member States<sup>1</sup>

Maria S. Katsigianni<sup>2</sup>

### Abstract

The present policy brief shed light to the recent developments, in EU level, as regards the economy of the European member states threatened by financial and fiscal crises. In particular, it evaluates the prospects for a top down – driven recovery, in the framework of the EU Economic Governance. The estimates emerged from this survey show that the speed of a recovery based alone on the efforts of the individual member states would be insufficient to address the urgent problems of economic crises and under-development. Therefore, are evaluated the alternative policy options of the EU aimed at stimulating any economic dysfunctions without endangering its existence. This policy note concludes that the EU's response to the Eurozone crises will depend on its ability and determination to deal with and prevent any future challenges that may arise.

**Keywords:** Eurozone crisis; EU funding mechanisms; precautionary measures; reforms.

### Introduction

The need for this survey arises as a consequence of the continuous and rapid evolution of the EU's role in the field of member states' finances. Particular attention is given to the – until recently – EU's inability to detect economic malfunctions and prevent them before they become a threat to the Union. In specific, the present policy brief aims to arise an interdisciplinary dialogue as regards the EU's interventionist role in the economic policy of its member states and provides some recommendations on the best policy options in the following axes: a) Re-elaboration of the Commission's role, b) Further strengthening of ESM, c) EU independence from international funding organizations, d) Enhancement of controlling and supervisory measures. Before proceeding to the analysis of the recommended mechanisms, it is provided a concise summary of what has the EU done so far to anticipate and face economic crises. The present policy brief is targeting government policymakers who are interested in formulating or influencing EU policy.

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## **The emergence of significant EU weaknesses to maintain financial stability**

Historically, despite the fact that according to the EU's founding treaties, fiscal policies were left up to each Member State (MS), some countries in the EU, particularly those that share euro currency, decided to coordinate their economic policies throughout the year to ensure their alignment with common objectives and responsibilities (Economic and fiscal policy coordination, n.d.). In accordance to the EU's "economic and fiscal policy coordination", several priorities for action have been developed, including financial assistance for the MS and the EU economic governance. In specific, the EU financial assistance mechanisms that apply on MS threatened by financial difficulties, act correctively and provide loans on condition that the MS would implement policies designed to address their structural problems (How is financial assistance provided to EU countries?, n.d.). On the other hand, the EU's economic governance framework monitors, prevents and corrects problematic economic situations that could hit national economies, affecting all EU countries (EU Economic governance: monitoring, prevention, correction, n.d.). In particular, European Commission monitors the MS for potential problems, such as risky or unsustainable policies or declining competitiveness. As regards the prevention of economic imbalances, EU governments have agreed on a wide range of rules (How the EU monitors national economic policies, n.d.), including the Stability and Growth Pact established in 1997 for the Commission and the Council of the EU to monitor their budgets and to ensure that fiscal discipline is maintained (Safeguarding the euro in times of crisis, 2019). In the corrective field of EU's economic governance, was established the Excessive Deficit Procedure to ensure that governments take effective action to correct economic problems (How the EU monitors national economic policies, n.d.).

The corrective and supervisory mechanisms mentioned above have not proved to be effective in times of economic crises (Safeguarding the euro in times of crisis, 2019). The first weaknesses of the EU system to anticipate and deal effectively with fiscal crises were evident as early as 2003 when Germany and France tried to avoid sanctions for their high fiscal deficits. The situation worsened when the global financial crisis broke out in 2007 in the United States and brought to light more of EU's institutional weaknesses (Explanatory Memorandum on the Proposal for a Council Regulation establishing the European Monetary Fund, 2017). As early as 2009, it was revealed that the EU lacked sufficiently solid instruments to act decisively in response to challenges to its financial stability and became obvious that there was a great need for a more effective governance framework for EU (Proposal for a COUNCIL REGULATION on the establishment of the EMF, 2017). The period between 2010 – when the first rescue fund was established for Greece – and 2018 – when Greece became the last country to successfully exit its financial programme – was a defining phase in the

history of European integration (Safeguarding the euro in times of crisis, 2019). The Greek experience of 2010 led the euro area to consider a different approach to lending terms. In response to the immediate emergency challenges, many acts were adopted, creating new financial security mechanisms that helped the most affected countries to overcome their difficulties, preventing the crisis from escalating further (Explanatory Memorandum on the Proposal for a Council Regulation establishing the EMF, 2017).

### **The main Funding mechanisms and facilities emerged**

In May 2010 was established the European Financial Stabilization Mechanism (EFSM) for the Commission to provide financial assistance to EU countries threatened by severe financial difficulties. EFSM allowed the Union to respond in a coordinated and rapid manner to acute difficulties on a purely temporary basis; so far has provided financial assistance to Ireland and Portugal and a short-term bridge loan to Greece, on condition of reforms' implementation. Subsequently, in June 2010 was created the European Financial Stability Facility (EFSF), as a temporary crisis resolution mechanism for euro area countries and till now has provided financial assistance to Ireland and Portugal between 2011 and 2014, and short-term bridge loans to Greece in July 2015, conditional on the implementation of reforms (Proposal for a COUNCIL REGULATION on the establishment of the EMF, 2017). EFSF no longer provides new financing but continues to manage activities linked to its outstanding loans and bonds (How is financial assistance provided to EU countries?, n.d.). As early as December 2010, the European Council agreed on the need for the euro countries to establish a permanent stability mechanism replacing the EFSF for granting possible new financial support (Explanatory Memorandum on the Proposal for a Council Regulation establishing the EMF, 2017). Thus, in February 2012, the European Stability Mechanism (ESM) was created as a permanent intergovernmental institution, by and for euro area countries, to safeguard financial stability in EU. The ESM's arrival is emblematic of the euro area's advances in these areas, and of its commitment to combat future crises and sustain its single currency (Safeguarding the euro in times of crisis, 2019).

### **Policy recommendations**

The recent euro crisis made clear that the EU lacked a comprehensive funding assistance mechanism, which would face but also prevent any economic malfunctions that may occur. Despite the immediate measures taken in order to prevent the crisis from escalating further, there are still much to be

achieved (Explanatory Memorandum on the Proposal for a Council Regulation establishing the EMF, 2017). With that in mind, the following policy recommendations are in order:

**a) Re-elaboration of the Commission's role in monitoring, preventing and correcting financial imbalances**

The European Commission, being the Institution that promotes the general interest of the EU, plays a prominent role not only in the economy of the MS individually, but also in the EU as a whole. Therefore, measures should be taken in order to strengthen its role to monitoring, preventing and correcting economic imbalances. First and foremost, it is recommended for the Commission to tighten its budgetary assessment, reconsidering the rules on the Excessive Deficit Procedure, which is a central aspect of the assessment. The Commission's opinion on the MS's draft budgetary plan should acquire a more clear orientation, as well as an obligatory compliance. In terms of the assessment of Stability Programmes and Convergence Programmes that take place each spring, Commission should focus on medium-term fiscal plans, rather than on providing concrete ex ante guidance for the budget of the year ahead (Annual draft budgetary plans (DBPs) of euro area countries, n.d.).

Another factor under consideration is redefining the role of the "Directorate - General for Economic and Financial Affairs", keeping closer cooperation with finance ministries for its national economies and taking more responsibilities in order for the Union to promote and achieve economic growth, higher employment and stable public finances. The Commission, on behalf of the EU should also strengthen its offer of technical assistance and expertise, mobilizing expertise from the Commission services, national administrations and international organizations to design and monitor reforms, bearing in mind the former "Structural Reform Support Service", established in July 2015 (Financial assistance to Greece, n.d.).

**b) Further strengthening of ESM and the activation of the EMF**

Although ESM has constituted a valuable tool in facing economic crises, given the short time of its establishment, it is highly recommended to evolve further and acquire a more effective role. What ESM could do is to impose simpler and improved procedures and to acquire a more formal position in the legal firmament of the Union. Except for the EFSM, most of the funding mechanisms created to face the euro crisis were established outside the legal framework of the Union, thus, emphasis should be placed on the legitimacy of these financial aid institutions (Strategic plan 2016-2020, 2016).

ESM shall be integrated into the EU's framework and this could be accomplished through the activation of the European Monetary Fund (EMF), contributing to increasing transparency and

accountability in the EMU. This will further strengthen ESM's institutional anchoring and create new synergies within the EU framework, in terms of transparency, efficiency of the EU financial resources and legal review. In order for the EMF to enhance the democratic control should be accountable to the European Parliament and to the Council, reporting annually on the execution of its tasks (Proposal for a COUNCIL REGULATION on the establishment of the EMF, 2017). Taking into consideration that only two of ESM's six available aid tools have been used so far – long term loans for Greece, Ireland, Cyprus, and Portugal and indirect aid to help Spain recapitalize its banking sector – it should be considered the idea these tools to be enhanced, expanded in new areas of cooperation or even become a blended toolkit ready to face any discrepancies.

### **c) The EU independence from international funding organizations**

As early as 2010, it was obvious that the euro system had to proceed to reform. At that time, the euro area countries facing financial imbalances sought assistance from the International Monetary Fund (IMF), in order to finance their deficits and return to recovery. Actually, it was a forced solution under time pressure, but in fact the euro countries never depended upon IMF entirely. As Klaus Regling mentioned 'We needed to create our own European funds (Safeguarding the euro in times of crisis, 2019). In line with this statement, it had become apparent that concrete measures should be taken, in order for the Union to become economically independent of IMF and other international mechanisms, utilizing its own forces.

Due to the big concern as regards the acceptance and legitimacy of Troika, which has often been the target of intense criticism in European countries, it is highly recommended the establishment of a supervisory body that will be widely accepted by the MS. Another aspect that should be taken into consideration is the fact that during the last euro crisis, IMF specialized in rehabilitating less developed economies, which means that the new mechanism should focus especially on the economy of the weaker members of the Union (Safeguarding the euro in times of crisis, 2019). Further, the role of the European Central Bank (ECB) could also be enforced both in allocating funds and cooperating with potential funding bodies within the EU. As the monetary policy action of the ECB has proved crucial during the euro area crisis (Explanatory Memorandum on the Proposal for a Council Regulation establishing the EMF, 2017), the euro area leaders shall take advantage of its previous experience in order to build a more efficient and independent funding mechanism.

#### **d) Enhancement of controlling and supervisory measures towards the Member States**

One of the major lessons to be learned from the euro's crisis, according to Christine Lagarde, is that the EU needs "to have the right data – the case of Greece in particular shows that, when economic statistics aren't accurate, the fallout can be devastating" (Safeguarding the euro in times of crisis, 2019). To this statement is based the last recommendation of this policy brief. Keeping in mind that several states have been observed to report false information it is highly suggested, a part of the EU's budget is suggested to be allocated towards the establishment of an empowered safety valve that would impose severe sanctions in cases of false data or non-compliance with data analysis specifications. Should any discrepancies regarding the economic development of each MS to be observed, an immediate response must be in order, in case the partner would not comply within a given timeframe.

This would constitute as a legal ground for any possible derogation from the legal reference procedures, encouraging European countries to comply in fear of a penalty. In this framework, new improved auditing tools and alternative schemes of monitoring are vital in re-defining the EU's policy with further attention on trust and further cooperation within the euro area. As regards the Economic monitoring, the European Commission conduct regular analysis of a broad range of national and international economic data and forecasts for a wide-range of economic indicators such as GDP growth, inflation, and unemployment (How the EU monitors national economic policies, n.d.), tasks that should be enhanced through an advanced supervisory mechanism.

#### **Conclusions**

Passing to the results of this research, it could be pointed out that the recent euro area crisis brought to light some of its institutional weaknesses, whilst it made apparent that any economic malfunctions were not possible to be handled by the euro area countries on a country-by-country basis (Safeguarding the euro in times of crisis, 2019). In response to the immediate emergency challenges, many acts were adopted in EU level, creating new financial security mechanisms that helped the most affected countries to overcome their difficulties. Nevertheless, several improvements need to be planned and executed, but the forecasts are encouraging, as the European leaders have understood the importance of structural measures to ensure European prosperity. The present policy brief concludes that the EU's response to the Eurozone crises will depend on its ability and determination to deal with and prevent any future challenges that may arise. In the years to come, EU shall take advantage of the lessons learned along the way and try to figure out how will handle possible crises in the future.

What remains to be done is for the EU Institutions to play an even stronger role in the process and try to predict and prevent potential crises in all sectors of the economy and the society as a whole.

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