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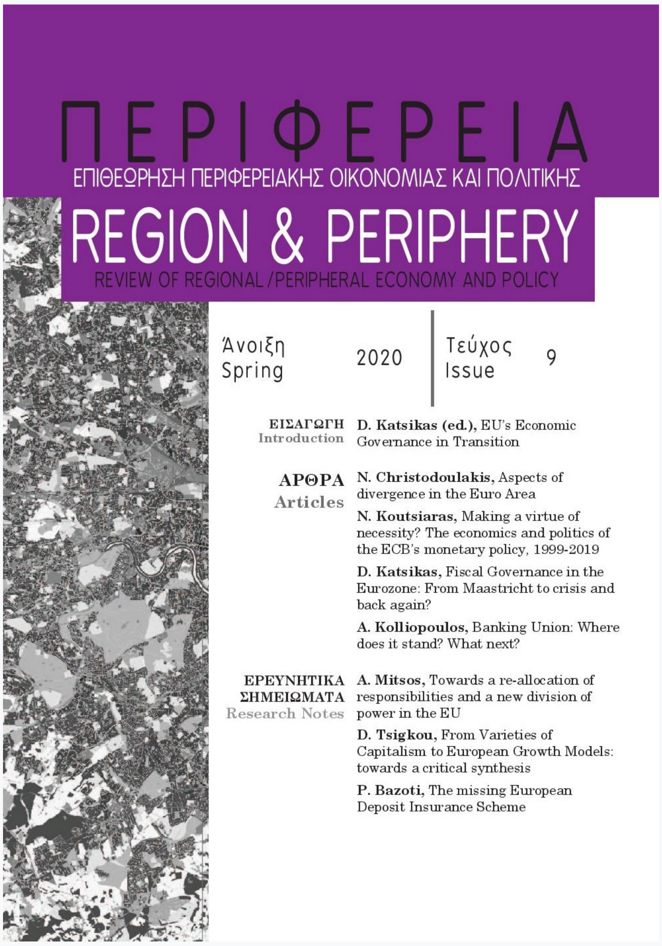

Δημοσιονομική Διακυβέρνηση στην Ευρωζώνη: Από το Μάαστριχτ στην κρίση και πάλι πίσω;

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Fiscal Governance in the Eurozone: From Maastricht to crisis and back again?*

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Abstract

Determining the optimal level and instruments of fiscal governance in a monetary union of sovereign states is not an easy task. A monetary union needs to have in place a comprehensive framework of fiscal governance, which allows enough flexibility to deal with asymmetric shocks in different member states; discourage fiscal mismanagement, and minimize spillover effects when it happens; provide the means for effective fiscal management over the business cycle; and build the necessary mechanisms to deal with a common external shock. The fiscal governance designed at Maastricht was imbalanced and incomplete. It instituted a decentralized 'individual responsibility' approach, with no effective compliance mechanism and no support facilities for times of economic turbulence. Its weaknesses, revealed by the global financial crisis, contributed to Eurozone's deterioration into a second, debt crisis and a double dip recession. The lack of institutional provisions for dealing with the crisis, turned its handling into a de facto political, and therefore, intergovernmental process where creditor countries, enjoying a highly asymmetrical negotiating advantage, dictated both the terms of the bailout agreements and the provisions of the new fiscal governance. Being essentially a reinforced version of the pre-crisis framework, the 'reformed' fiscal governance has tried to balance conflicting objectives with little success; it is simultaneously more constraining and more prone to political maneuvering, increasingly complex while leaving more room for variable interpretations, and ultimately it is not more effective than its predecessor. As a result, a short few years after its implementation, the calls for a new reform are multiplying.

KEY-WORDS: Fiscal governance, fiscal rules, moral hazard, risk reduction, risk sharing.

Δημοσιονομική Διακυβέρνηση στην Ευρωζώνη: Από το Μάαστριχτ στην κρίση και πάλι πίσω;

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Περίληψη

Ο καθορισμός του βέλτιστου επιπέδου και των μέσων δημοσιονομικής διακυβέρνησης σε μια νομισματική ένωση κυρίαρχων κρατών δεν είναι εύκολο έργο. Μια νομισματική ένωση πρέπει να διαθέτει ένα ολοκληρωμένο πλαίσιο δημοσιονομικής διακυβέρνησης, το οποίο θα επιτρέπει ευελιξία για την αντιμετώπιση ασύμμετρων σοκ στα διάφορα κράτη μέλη· θα αποθαρρύνει τη δημοσιονομική κακοδιαχείριση και θα ελαχιστοποιεί τις δευτερογενείς επιπτώσεις όταν αυτή συμβαίνει· θα παρέχει τα μέσα για αποτελεσματική δημοσιονομική διαχείριση κατά τη διάρκεια του οικονομικού κύκλου και θα δημιουργεί τους απαραίτητους μηχανισμούς για την αντιμετώπιση ενός κοινού εξωτερικού σοκ. Η δημοσιονομική διακυβέρνηση που σχεδιάστηκε στο Μάαστριχτ ήταν ασύμμετρη και ελλιπής. Καθιέρωσε μια αποκεντρωμένη προσέγγιση «ατομικής ευθύνης», χωρίς αποτελεσματικό μηχανισμό συμμόρφωσης και χωρίς μηχανισμούς στήριξης για περιόδους οικονομικών αναταράξεων. Οι αδυναμίες της, αποκαλύφθηκαν από την παγκόσμια χρηματοπιστωτική κρίση και συνέβαλαν στην επιδείνωση της κρίσης στην Ευρωζώνη οδηγώντας σε μια δεύτερη κρίση χρέους και σε διπλή ύφεση. Η έλλειψη θεσμικών δικλείδων για την αντιμετώπιση της κρίσης μετέτρεψε τον χειρισμό της σε μια de facto πολιτική, και ως εκ τούτου, διακυβερνητική διαδικασία όπου οι πιστώτριες χώρες, βρισκόμενες σε μια εξαιρετικά πλεονεκτική διαπραγματευτική θέση, υπαγόρευσαν τόσο τους όρους των συμφωνιών διάσωσης όσο και αυτούς της μεταρρύθμισης της δημοσιονομικής διακυβέρνησης. Όντας ουσιαστικά μια ενισχυμένη έκδοση του πλαισίου που προϋπήρχε της κρίσης, η νέα δημοσιονομική διακυβέρνηση στέφθηκε με περιορισμένη επιτυχία στην προσπάθειά της να εξισορροπήσει αντικρουόμενους στόχους· είναι ταυτόχρονα πιο περιοριστική και πιο επιρρεπής σε πολιτικούς ελιγμούς· ολοένα και πιο πολύπλοκη, αφήνοντας παράλληλα περισσότερο περιθώριο για διαφορετικές ερμηνείες, χωρίς να είναι τελικά πιο αποτελεσματική. Ως αποτέλεσμα, λίγα μόλις χρόνια μετά την εφαρμογή της, οι εκκλήσεις για μια νέα μεταρρύθμιση πολλαπλασιάζονται.

ΛΕΞΕΙΣ-ΚΛΕΙΔΙΑ: Δημοσιονομική διακυβέρνηση, δημοσιονομικοί κανόνες, ηθικός κίνδυνος, μείωση του κινδύνου, επιμερισμός του κινδύνου.

1. Introduction

Determining the optimal level and instruments of fiscal governance in a monetary union of sovereign states is not an easy task. A monetary union needs to have in place a comprehensive framework of fiscal governance, which allows enough flexibility to deal with asymmetric shocks in different member states; discourage fiscal mismanagement, and minimize spillover effects when it happens; provide the means for effective fiscal management over the business cycle; and build the necessary mechanisms to deal with a common external shock.

The fiscal governance of the European Economic and Monetary Union (EMU) was the result of a political compromise. This led to an imbalanced and unsustainable fiscal framework, which along with other shortcomings of EMU's broader economic governance contributed to the outbreak of the eurozone debt crisis. Eurozone's lack of institutional preparedness forced European leaders and policy makers to embark on a reform effort at the same time that they were trying to bring the crisis under control. The adverse economic and political environment put pressure for prompt decisions, often based on last minute compromises and more often than not, on the imposition of the will of member states enjoying an asymmetrical power advantage in an increasingly intergovernmental negotiation setting. The resulting governance framework raises significant political economy concerns, and it is doubtful whether it is effective and indeed, whether it signifies a substantial departure from the previous governance's failed philosophy.

The aim of this chapter is to explore these questions by reviewing the fiscal governance of the Eurozone and its evolution after the crisis, against lessons derived from the theoretical and empirical literature on fiscal governance in a monetary union. The first part of the article engages with the theoretical and empirical literature on fiscal governance in a monetary union, employing insights from the Fiscal Federalism and Optimum Currency Area (OCA) theories, as well as from the literature on fiscal rules and coordination. The second part, focuses on the design and evolution of Eurozone's fiscal governance, particularly following the crisis. The aim is to provide a critical examination of the reforms under the analytical lens of political economy, in order to evaluate their contribution to a more effective economic and monetary union.

2. Fiscal policy in a monetary union

According to classic public finance theory, a government can use the state budget to perform three basic functions: (a) the efficient allocation of the resources of an economy (for example by providing public goods in case of market failure), (b) the redistribution of income and (c) the stabilization of economic activity in fluctuations of the economic cycle or in case of an exogenous shock (Musgrave 1959). Although the justification of these functions is based on economic criteria, their adoption as objectives of government policy depends to a large extent also on non-economic factors, such as political and social institutions and traditions, which shape the prevailing perception of the role of the state in a society, and thus affect the priority given to different functions, as well as the intensity with which these are pursued.

In the case of member states of the EMU, achieving a desirable but also fiscally sustainable balance between these objectives, should also take into account the budgetary constraints and opportunities arising from their participation in such a union. In this context, a key question to be answered concerns the level of governance (national/supranational) on which the different budgetary functions should be exercised.

One way to answer this question is by recourse to the literature on 'fiscal federalism'. The theory of fiscal federalism refers to the operation of a central fiscal system, which includes all members of a federal state, both the federal administration, as well as the Länder or states (Whyman and Baimbridge 2004, 1). In its classical form, the theory puts forward arguments about the appropriate level (local/federal) of exercise of the different fiscal functions and what financial tools should be used in each case (Oates 2004). More specifically, restrictions on the operation of the fiscal multiplier and the risk of external debt growth make stabilization operations less effective at the local level (Oates 1968). The effectiveness of the redistributive function is also hampered at the local level, due to the mobility of individuals and other productive factors, while finally, the effective production of public goods can be implemented at both local and central level, depending on the nature of these goods (Oates 1968).

The above analysis shows that despite the normative predilection of fiscal federalism for fiscal decentralization,[1] the centralization of fiscal functions is often necessary. This conclusion is of interest in the study of fiscal policy in the EMU, which has several of the characteristics of a federation, such as a multi-level governance structure, freedom of movement of goods, services and people and a common monetary policy. On the other hand, however, several of the assumptions of the theory of fiscal federalism are not met in the case of the EMU. Thus, for example, the hypothesis of high labour mobility, which is central to the theory of federalism (Ribstein and Kobayashi 2006), does not apply in the EMU, as the existence of different institutions, languages and cultural traditions restrict the mobility of individuals. Also, an important hypothesis for the stabilization function, that cycle fluctuations or exogenous economic shocks occur primarily at the national (central) rather than at the local level, does not apply in the EMU, where different member states often face asymmetric economic shocks. Finally, unlike a federation, in the EMU there is no fiscal union where a budgetary authority can pursue fiscal policy at a central level.

It is clear therefore, that the EMU's sui generis nature, where increased levels of economic integration and multi-level governance structures co-exist with sovereign nation-states, complicates the determination of its optimal fiscal governance. The absence of basic characteristics of a typical federation, such as the high degree of human mobility and economic symmetry, is a problem for the functioning of the EMU, as according to the OCA theory (Mundell 1961, McKinnon 1963, Kenen 1969), these conditions are considered to be particularly important for the successful operation and stability of a monetary union.[2]

Economic symmetry ensures that the macroeconomic fluctuations experienced by members of a monetary union are closely correlated with each other. Otherwise, asymmetric economic shocks lead to very different macroeconomic developments in each country, which cannot be effectively addressed by the union's single monetary policy (De Grauwe 2009). In these circumstances, flexibility in the member states' labour markets can be an important stabilizing mechanism. Labour market flexibility refers both to the mobility of the labour force within the monetary union and the flexibility of wages according to economic conditions (Mundell 1961). Labour factor mobility allows workers to leave member states in the downside of the economic cycle, which experience high unemployment rates, and move to member states on a high growth trajectory, where there is strong demand for labour. Wage elasticity, respectively, allows wages to be adjusted downwards (upwards) in member states facing high (low) unemployment, thereby reducing (increasing) production costs and making their products more (less) competitive. This simultaneous adjustment helps to restore the balance between the member states of the union.

From the preceding analysis, it follows that when economic symmetry and labour mobility among member states of a monetary union are low, and wages in their labour markets do not adjust easily downwards, dealing with asymmetric economic shocks is a major challenge. In these circumstances, and since the single monetary policy is not capable of effectively addressing the different asymmetric shocks, fiscal policy becomes necessary for stabilizing the economy. The budgetary stabilization function can be exercised both at the supranational and the national level.

The OCA theory supports the creation, at supranational level, of a central, common budget, which can automatically use the (increased) revenues from the countries on the upward phase of the economic cycle, in order to support the countries in recession, thus facilitating the adaptation of member states to asymmetric economic shocks (Kenen 1969). The creation of a common budget also has the advantage of removing pressure from national governments to use their national budgets to stimulate the economy in the event of a recession, avoiding the risk of running high budget deficits, which, as experience has shown, are not easy to reduce, at least in the short-term.

However, the creation of a common budget has its own risks, and more specifically, the so-called 'moral hazard'. Moral hazard arises from the alteration of the incentives of the governments of the countries receiving the cash flows from the central budget. Access to centralized funding relaxes incentives to promote and implement reforms, which may be necessary, particularly when the economic shock proves to be long-term, suggesting structural problems. For this reason, centralized budgetary transfers should have a limited duration and be used in short-term fluctuations of the economic cycle and not in crises having structural causes, by substituting for necessary reforms (De Grauwe 2009).

3. The limitations of national fiscal policy in a monetary union

At the national level, the functioning of automatic fiscal stabilizers can contribute to the smoothing of consumption and limit the negative effects of an economic shock. On the other hand, the use of discretionary fiscal policy to stabilize the economy is a much more complex issue, which presents significant technical difficulties (Tanzi 2005), poses the risk of further destabilization (Kamps et al. 2017) and could lead to high fiscal deficits and the accumulation of public debt. If this happens, the cost of adjustment will be transferred to future generations, who will have to repay it through a restrictive fiscal policy, thereby limiting the degrees of freedom of future policy makers (De Grauwe 2009). This problem is magnified when public debt reaches a level where its viability is questioned; in this case, the use of fiscal policy for stabilization purposes in the event of an economic shock will not available, worsening the potential effects of the shock.

On a second level, high budget deficits and increased levels of government debt may create indirect negative effects in other member states of the monetary union (cross-border spill-over effects). According to the literature, these effects may stem either from the possible bankruptcy of a member state with increased levels of debt, or from the existence of high budget deficits in a member state, even if there is no danger of bankruptcy (Buiter 2006).

In the first case, the bankruptcy of one member state may lead to significant problems in the financial sector of other member states, in so far as part of the first state's debt is held by investors in the other states (which is expected in a monetary union with increased levels of financial integration). The possibility of a bankruptcy is increased in a monetary union, as in the event of a liquidity crisis, the inability to devalue the currency and exercise an autonomous national monetary policy create conditions for its conversion into a solvency crisis (De Grauwe 2011).

This creates an incentive for the other member states, to rescue the state facing a debt crisis, either directly or through a central (supranational) mechanism, even when there are explicit rules (no-bailout clauses) that prohibit such action. Although historical experience from federal states has shown that no-bailout rules have contributed to a more prudent financial management on the part of local governments (Bordo et al. 2011), the case of a monetary union of sovereign states is different; the presence of no-bailout rules is not credible, as a possible bankruptcy would not only damage the economy and thus burden the budget of the other member states, but would also call into question the continued participation of the member state in crisis in the monetary union, risking an irreparable damage to the latter's credibility.[3]

In the second case, the policy of increased budget deficits by one member state may lead to an increase in inflation and interest rates at the union level, thereby affecting both the economic policy of the other member states (e.g. through the adoption of restrictive budgetary measures to curb inflation), and the exercise of monetary policy by the single monetary authority (Beetsma and Giuliodori 2010).

4. Fiscal Governance in a monetary union

The mechanisms typically chosen to overcome the limits of supranational fiscal governance and address the risks of discretionary national fiscal policy within a monetary union are two: (a) fiscal rules and (b) coordination of national fiscal policies. The aim of fiscal rules is to place restrictions on the exercise of national fiscal policy to avoid excessive budget deficits and the accumulation of public debt. The debate on fiscal rules in a monetary union revolves mainly around two issues: (a) their necessity and (b) their effectiveness.

On the first issue, arguments have been made challenging the necessity of fiscal rules, particularly at the central (supranational) level. The inherent weakness of fiscal rules emanates from their very nature, as they set predefined targets without taking into account the prevailing conditions, which creates a problem of time inconsistency for fiscal policy (Wyplosz 2012). The problem lies in the fact that the 'rigidity' of fiscal rules restricts the ability to exercise the stabilization function at a time when it is most needed. The imposition of supranational rules restricting the ability of national governments to react to adverse economic conditions inevitably leads to a clash between member states and monetary union institutions with negative results for the credibility of the rules and therefore for the functioning and reliability of the monetary union itself (De Grauwe 2009).[4] Furthermore, it is argued that the participation in a monetary union tends to improve the budgetary discipline of the member states, as they lose the ability to 'print' money to finance their budget deficits, thus making fiscal rules unnecessary (De Grauwe 2009).[5] Finally, in so far as the spill-over effects of an expansive fiscal policy in other member states are not significant, the need to establish budgetary rules at the supranational level is called into question (Buiter 2006).

As regards the effectiveness of fiscal rules, recent empirical research seems to suggest a positive impact on the fiscal deficit (e.g. Debrun et al. 2008, Holm-Hadulla et al. 2012, Badiger and Reuter 2017). On the other hand, other studies report lack of impact when all available instruments of debt (Von Hagen 1991), or levels of government (Kiewiet and Szakalay 1996, Von Hagen and Eichengreen 1996) are taken into account, or mixed results, depending on the effectiveness of the rules' design (Kennedy and Robbins 2003, Tapp 2013, Caselli and Reynaud 2019). A recent meta-regression analysis of 30 studies performed by Heinemann et al. 2018, points to overall positive results, which however are significantly reduced when methodological approaches become more sophisticated to account for factors of endogeneity. The experience of EMU, as described in more detail in the next section, also gives a mixed picture, as the budgetary rules introduced by the Maastricht Treaty for entry into the EMU appear to have had a positive effect on the restriction of budget deficits, while the Stability and Growth Pact (SGP) does not appear to have had an equally effective impact on the fiscal management of the member states once they were inside the Eurozone (Ioannou and Stracca 2011). This provides support for the view that fiscal rules are effective when they are compatible with the preferences of governments, i.e. when they act as mechanisms for signaling their incentives (Debrun and Kumar 2007), and not when they are used as 'suppression' mechanisms, since in this case policy-makers find ways to bypass the rules (Koen and Van Den Noord 2005).

The ambiguity about fiscal rules' effectiveness, has led in recent years to a debate on the role of fiscal institutions and more specifically, the usefulness of independent fiscal councils (Calmfors and Wren-Lewis 2011, Wyplosz 2012, Debrun et al. 2013, OECD 2014, Calmfors 2015, Beetsma et al. 2018). Although fiscal councils had initially been considered as an alternative to fiscal rules (e.g. Wyplosz 2005), in recent years it seems that the use of fiscal councils is increasingly considered as a complementary institution in an existing framework of fiscal rules (Calmfors and Wren-Lewis 2011, Wyplosz 2019). In particular, it is considered that a fiscal council independent of political influence and increased technical competence can help both in designing and monitoring the implementation of more complex (non-rigid and counter-cyclical) fiscal rules.

On the other hand, fiscal councils should not be considered a panacea. Although they can potentially play an important role in reducing the trend towards excessive budget deficits, their effectiveness depends to a large extent on the root causes of deficits and on their own institutional characteristics, which are shaped by the preferences of the political system, making them therefore subject to some of the same restrictions facing fiscal rules (Calmfors 2015). Although initial empirical studies show positive results from the functioning of the fiscal councils on budgetary discipline (Debrun and Kinda 2017), as well as on the quality of forecasts and the application of fiscal rules (Beetsma et al. 2018), it is probably still too early to draw definitive conclusions, particularly as there is a wide variety of institutional designs in place across countries.

A second mechanism to address the potential negative consequences of unilateral fiscal policies by the member states of a monetary union refers to the coordination of national fiscal policies. Although the adoption of common fiscal rules at the supranational level can be seen as a kind of coordination mechanism, it is not the same. In the case of common fiscal rules, member states act independently and without taking into account the fiscal policies of the other member states; on the other hand, coordination requires cooperation between member states with a view to formulating a common fiscal stance at the union level.

Fiscal coordination has the potential to overcome the relative rigidity of fiscal rules, and its benefits are magnified during a crisis when the potential negative effects of unilateral discretionary fiscal policy increase (Frankel 2014, Alcidi and Gros 2014). Having said that, fiscal coordination is not easy to achieve given the different cyclical positions of different member states in a monetary union; in this context, the stabilization needs of individual states and the union as a whole may be different (Kamps et al. 2017), which could lead to a clash between the sustainability and stabilization objectives between different states. Implementation difficulties aside, there is also some uncertainty about the desirability of fiscal coordination, given the possibility of member states in a monetary union working in a coordinated manner to pressure the single monetary authority to ease monetary policy (Beetsma and Giuliodori 2010).

The latter possibility also highlights a second dimension of fiscal policy coordination in a monetary union, that between national fiscal policies and the single monetary policy. The coexistence of a single monetary and multiple fiscal authorities creates a conflict of policy priorities and objectives resulting in an inefficient overall policy mix for the union. This inefficiency is likely to be magnified in the event of a crisis, when interest rates fall to very low levels and the monetary authority is forced to enlist non-conventional monetary policy tools, as has been the case in recent years in the EMU; in this case, the coordinated use of monetary and fiscal policy is necessary in order to restore macroeconomic balance (Corsetti et al. 2016).

The previous analysis shows that fiscal policy at both the national and supranational levels faces significant constraints. A common, and perhaps most important, limitation for both levels of governance is the duration of its use. Although the definition of a predetermined period of time is not desirable, as the duration of its use for stabilization purposes should be judged individually according to the type and intensity of the economic disorder that is called upon to address, it is obvious that its use for a long time can cause significant problems.

This assumption highlights the importance of structural reforms in a monetary union. More specifically, the preceding discussion of the OCA theory shows that reforms which increase the flexibility of member states' labour markets, so that the latter can act as a mechanism for restoring imbalances in the wake of asymmetric economic shocks, can improve the stability of the monetary union. The need to increase economic symmetry between member states of a monetary union also suggests the need to coordinate a range of national macroeconomic and other policies, often linked to broader political, social and institutional characteristics of an economy. Different traditions, institutional characteristics of the labour and product markets, but also political and social preferences on the level of wages, inflation and unemployment can create economic divergences with significant consequences (Calmfors and Driffill 1988, Maclennan, Muellbauer and Stephens 1999).

In conclusion, the theoretical debate, the findings of empirical research and historical experience seem to imply that the use of fiscal policy for stabilization purposes is necessary in a monetary union consisting of sovereign nation-states. However, given the political incentives for its abuse and the risks it entails both for the states exercising it and for the other members of the monetary union, it is equally necessary to create institutions to monitor and control its use. The views on the design and the level (national/ supranational) of fiscal governance are divided, as some analysts consider it necessary to exercise centralized fiscal stabilization, while others consider that a more flexible central framework of fiscal rules, combined with the creation of national institutions such as fiscal councils, could be a satisfactory solution. In any case, promoting reforms for the convergence of economies and increasing flexibility in the labour market should be considered necessary both to prevent the asymmetric economic shocks affecting the member states of a monetary union, and their more effective management when they arise.

5. The development of fiscal governance in the EU

From EMU to the crisis

The idea of creating a supranational governance framework for fiscal policy in the EU is inextricably linked to the prospect of a European economic and monetary union. Although its implementation had to wait for the signature of the Maastricht Treaty in 1992, the idea was first suggested a long time before that. In particular, in 1970 the Werner Report argued for the need to coordinate the fiscal policies of the member states of an economic and monetary union,[6] while the Marjolin Interim Report (1975), which examined progress towards economic and monetary integration, went much further, stating that all fiscal functions should also be exercised at the supranational level and proposed the creation of a Community unemployment fund as a kind of supranational stabilization mechanism. The MacDougall report (1977), which followed, was the first attempt to systematically study the fiscal dimension of European economic integration; the report adopted the previous proposals, which it analyzed more systematically, and proposed the possibility of grants and lending at the Community level for the stabilization of the economy and the management of the economic cycle both in different member states and for the European Economic Community as a whole. On the last point, the report refers to the need to coordinate fiscal and single monetary policy in the context of a monetary union.

The first attempt to create a European economic and monetary union failed. The adverse economic conditions of the 1970s and the sharp exchange rate fluctuations following the collapse of Bretton Woods led member states to adopt independent and often divergent economic policies, which did not allow further progress. The EMU would have to wait for the revival of the European project in the mid-1980s, as the common currency was presented as a logical but also necessary complement to the single market.

The Maastricht Treaty provided for three stages on the road to the EMU. Fiscal policy was at the heart of this process from the second stage, which began on the 1st of January 1994 and introduced, inter alia, the fiscal rules (convergence criteria) laid down in the Maastricht Treaty. These appeared to work effectively, at least in part, since all the countries wishing to enter the EMU satisfied the criterion for a budget deficit of less than 3% by the end of the decade. On the other hand, the criterion for public debt (less than 60% of GDP) was clearly not met by three countries, Italy, Belgium and Greece.[7] These countries were burdened with high levels of public debt (more than 100% of GDP) which could not be reduced to levels that met the sovereign debt criterion in the foreseeable future. To overcome this problem, the criterion included an ‘override clause’, which allowed higher levels of public debt, provided that the latter was on a downward trend.

The decision to override the debt criterion, illustrates the political nature of the EMU, which was clear from the outset (see Sadeh and Verdun 2009 for a review of the relevant literature); when the decision to create the EMU was taken, it was obvious that the conditions for an optimal currency area were not met (e.g. Eichengreen 1990, De Grauwe and Heens 1993). Against this background, the design of EMU's governance framework was bound to be shaped by political factors. EMU's governance reflected more the preferences of certain member states and the balance of power in the EU at the time, rather than the dictates of economic theory. In particular, the pillar of monetary policy was, from the start, institutionally strong. The European Central Bank (ECB) had a clear mandate to maintain price stability, was equipped with all the necessary policy instruments and authority and was protected from political interference. The strong institutional guarantee of ECB's independence, but also its strict commitment to the objective of price stability, were modelled after the German central bank and reflected Germany's preferences in this field.

On the other hand, the fiscal governance of the EMU was based on the Stability and Growth Pact (SGP), which set a balanced or surplus budget as a medium-term target for the member states of the euro area, establishing also a threshold (3% of GDP) for the start of an excessive deficit procedure. This procedure could lead, on a proposal from the European Commission to be adopted by the Council of Ministers, to recommendations to the member states violating the deficit threshold; if these were not adhered to within a specified timetable, sanctions could be triggered. The objective of the SGP was to ensure that member states adhered to budgetary discipline after entering the EMU (Pisani-Ferry 2006).

This institutional set-up soon proved to be ineffective; ironically, in 2003 it was Germany, which had pushed for the SGP framework, but also France, that refused to implement the Commission's recommendations on budgetary discipline in the midst of a recession, and led a coalition of states in the Council which blocked the continuation of the excessive deficit process against them. In the wake of this conflict, the renegotiation of the SGP in 2005 introduced more flexibility, which was interpreted in many quarters as a weakening of the fiscal rules' framework (Buiter 2006). In any case, the significance of the reform is questionable, since data on member states' fiscal management reveals that the SGP was equally ineffective both before and after the reform. For the EU-15, there were 14 cases of excessive deficit (over 3% of GDP) between 1999-2003 and another 16 cases between 2004-2007 (Begg 2011). In addition to these violations, there were another 50 cases of deficit in the 0-3% range (Ibid), which while below the excessive deficit threshold, were obviously not in compliance with the SGP's target of balanced or surplus budget. It appears then that, after entering the EMU, governments relaxed their fiscal efforts and the fiscal rules did not provide a credible external constraint, particularly since the political nature of the procedure ensured the impunity of the offenders.

Given this data, it is evident that there was no EMU-wide fiscal stance and accordingly no coordination between fiscal and monetary policy before the crisis. Against a background of differential growth rates, driven by different institutional and economic dynamics (e.g. non-tradables in the periphery vs exports in the core) and divergent fiscal policies, the one-size-fits-all monetary policy, became a one-size-fits-none policy (Schmidt 2015), which ended up magnifying macroeconomic imbalances between the member states. Thus, for example, the combination of substantial inflation differentials and common official rates, led to widely divergent levels of real interest rates. In countries like Ireland and Spain real interest rates were on average below one percent for the period 2000-2007, which in turn contributed to the creation of asset bubbles; during the period 2002-2007, dwellings' prices increased by 70% in Ireland and doubled in Spain (Financial Crisis Inquiry Commission 2011). The development of significant fiscal and macroeconomic imbalances in several countries,[8] resulted in increased divergence among euro area economies instead of the much-anticipated convergence.

Once the bubbles collapsed, these countries were forced into an abrupt adjustment, as access to funding was quickly restricted. Things were even worse for countries like Greece, which had entered the global financial crisis with little fiscal space and a high public debt. There was no central instrument which could deal with the shock and ensure funding for the governments dealing with a meltdown of their financial systems, the slowdown of their economies and/or the sustainability of their public debt. The EU's budget, close to one percent of GDP was clearly insufficient to deal with the crisis -not that employing funds from the common budget for stabilization purposes was ever seriously considered- while the ECB was unable, due to its mandate, to act as a traditional lender of last resort, although it did employ various instruments designed to enhance access to credit and liquidity to the European banking system.

In hindsight, it could be argued that the rationale of the pre-crisis fiscal (and more generally economic) governance in the EMU, rested on a political deal, which at the same time, employed and defied economic rationale. Against a background of low labour mobility and highly asymmetrical and diverse national economies, EU's political leaders based the monetary union on institutionally weak fiscal and macroeconomic pillars and resisted the creation of supranational fiscal capacity, which could perform a stabilization function and coordinate an EMU-wide fiscal stance. By completely defying the tenets of OCA theory they effectively made sure that the growth of macroeconomic imbalances could not be monitored and controlled, allowing thus the development of conditions that would lead to a crisis, and that once a crisis erupted, there would be no procedure or mechanism to address it effectively. In combination with the monetary authority's institutional constraints to act as lender of last resort, the institutional outcome 'ensured' that the consequences would be magnified in the event of a crisis.

Why did they opt for such an obviously imbalanced and ineffective framework? The answer lies in a combination of national preferences, selective economic argumentation and political short-sightedness. The stronger EU members acknowledged the differences in the institutional organization and potential of different economies, but they opted to ignore them -a decision necessary to achieve the political agreement of weaker members- resting their hopes on a much anticipated 'catching-up' process, while also limiting their liability in case things did not develop as planned. This political compromise, was justified by a selective use of economic theory, whereby OCA theory's dismal predictions were replaced by the more optimistic projections of the so-called endogenous theory of optimal currency areas, which stipulated that economic integration and symmetry could follow monetary unification (Frankel and Rose 1998, 2002), and by the belief that 'market discipline' would prohibit the emergence of large imbalances, particularly when a no-bailout clause, was in place.

Unfortunately, markets dismissed the no-bailout clause alleging instead the existence of an implicit bailout clause. On this assumption, increased financial integration instead of disciplining member states, relaxed the funding constraints of weaker states, allowing the emergence of large fiscal deviations (e.g. Greece), or hiding weak fiscal foundations (as was the case with the fiscal windfalls related to real estate bubbles in countries like Spain, Ireland and Cyprus).[9] When the crisis hit, the decentralized 'individual responsibility' governance of the EMU, had no institutional tools to handle it, forcing member states to engage in a major reform effort, amid economic difficulties and political recriminations.

Crisis and the first wave of fiscal reforms

The global financial crisis unfolded gradually from 2007 in the US housing market, and then expanded to the rest of the world and Europe at a rapid pace, particularly since the collapse of Lehman Brothers in September 2008. In this context, the outbreak of the Greek crisis in autumn 2009 exacerbated an already negative European and international economic environment and served as a catalyst for the wider eurozone debt crisis that followed. The crisis revealed the limitations of the Maastricht compromise -dealing with fiscal spillover effects became a necessity when sovereign default turned into a likely scenario. The danger of default in the periphery threatened the solvency of European financial institutions at the core, while the scenario of a default-induced exit of a member state from the Eurozone threatened the credibility and therefore survival of the entire monetary union. In this context, 'bailing out' countries under distress became necessary. The reluctant acknowledgement of this necessity did not alter creditor countries' previous attitude on fiscal transfers and common fiscal capacity; on the contrary, it incentivized them to reduce their fiscal exposure as much as possible. The approach was justified by invoking the moral hazard that would result from the creation of stabilization or other 'fiscal solidarity' mechanisms at the supranational level; countries in trouble needed to have the proper incentives to reform.

The handling of the crisis through national adjustment programmes with a view to ensure fiscal sustainability at the national level with the minimum pooling of fiscal resources at the supranational level, led to a prioritization of austerity over all other policies, including structural reforms (Pisani-Ferry et.al. 2013, Petralias et al. 2018). The policy recipe was based on a diagnosis of fiscal mismanagement and irresponsibility, obviously not true for most cases aside Greece. The coincidence of the Greek crisis' outbreak being the first, erroneously shaped the view of policy-makers' response to the other countries, whose problems did not originate from fiscal mismanagement (Buti 2020); the most likely explanation for this misdiagnosis is that the Greek case served as an excuse to promote a policy which satisfied creditor countries' aversion to fiscal risk sharing. Irrespective of one's interpretation of decision makers' motives, the result was an unnecessary and prolonged economic and social suffering in crisis-hit countries, which undermined further the economic and political cohesion of the euro area, and ultimately threatened its very survival.[10] What is more, the endorsement of austerity policies, even in countries like Germany, which did not face fiscal constraints, led to a de facto EMU-wide deflationary fiscal stance, which led the euro area in a double deep recession in 2012/13. The asymmetry of the response was evident at both national and euro area levels; fiscal sustainability took precedence over stabilization in the midst of a recession.

At the same time the EU was forced to reform its economic governance (see Appendix I for a brief review of the most significant reforms). A cursory review of the reforms is enough to acknowledge that a significant reform effort was made; existing rules and procedures were updated and entirely new institutions and mechanisms were introduced, making this the most comprehensive institutional reform initiative since Maastricht. Such progress notwithstanding, the design of the new economic governance echoed the approach that dominated the handling of the crisis. Given the narrative of fiscal irresponsibility, the emphasis of the reforms lay in the fiscal dimension of economic policy (Pisani-Ferry

2015). Their aim was to ensure fiscal sustainability in member states, in order to minimize negative fiscal spillovers and therefore the need for the pooling of fiscal resources at the supranational level. The creditor countries, which enjoyed a highly asymmetrical negotiating advantage, came to dictate the terms of the new fiscal governance according to their national preferences (Schimmelfenning 2015). In order to ensure the desired outcome, reforms were often negotiated outside the EU's legal framework; both of EU's new funding mechanisms, the emergency European Financial Stability Facility (EFSF) and the ESM, and one of the most important fiscal reforms, the Fiscal Compact, were negotiated as international agreements.

Accordingly, the main reforms in the area of fiscal governance comprised mechanisms of enhanced national fiscal discipline and surveillance, while EMU-wide fiscal coordination and/or supranational fiscal instruments and funding mechanisms were absent. The requirement of the Fiscal Compact for the incorporation of budgetary rules into national law, 'two-pack's' requirement for the screening of national budgets by the European Commission before submission to national parliaments, the principle of a negative majority for the obstruction of sanctions on member states which do not apply the Commission's directives within the framework of the excessive deficit procedure, the obligation to create independent fiscal councils to supervise national fiscal policy and the enhanced surveillance procedures of the European Semester, have created a strong fiscal framework, which limits the budgetary discretion of national governments.

At the same time, the stabilization function remained at the national level, with the main changes relating to the recognition of the need for greater flexibility in order to cope with fluctuations in the economic cycle. There was no move to create a stabilization mechanism at the supranational level, nor was the use of the EU budget discussed for macroeconomic stabilization purposes. Moreover, proposals for the creation of a European safe asset did not progress, despite the fact that it could provide an effective mechanism for restoring access to funding for countries undergoing a crisis and prevent uncertainty-induced contagion to other member states (Gilbert et.al. 2013).[11] Furthermore, the coordination of fiscal policies remained an institutionally unrealized objective; nonetheless coordination as previously noted, did take place, by member states' voluntary or imposed adherence to austerity. The creation of the European Fiscal Council, which could assist in formulating a common fiscal stance, took place in 2017, several years after the first wave of reforms; in any case its role is advisory, and its proposals do not have binding force.

On the other hand, there were two important reforms with implications for fiscal policy. The first was the establishment of last resort funding mechanisms like the European Stability Mechanism (ESM).[12] The ESM provides funding to countries which lose access to the international markets and thus functions as a lender of last resort. The problem however, is that it operates on the basis of strict policy conditionality, aimed at restoring imbalances at the national level. Conditionality tends to work in a procyclical manner, intensifying in the short-term the negative effects of the economic shock. Beyond economic inefficiency, these features reduce the bailout programmes' political appeal for member states in difficulty and can produce frictions between national governments and EU institutions, undermining the credibility of the union. As already noted, these problems were observed during the crisis. A second significant development relates to the promotion of an EU Banking Union, intended to limit the close links between sovereigns and banks, which can prove detrimental in times of crisis for both sides. Although progress has been satisfactory regarding the establishment of a common supervisory mechanism and restructuring procedures in case of a banking crisis,[13] agreement on the common deposit guarantee system has proved elusive thus far, which is hardly surprising, in view of the shared liability it entails.

6. Completing the EMU's fiscal governance

Trying to balance conflicting priorities and objectives, has unsurprisingly led to unsatisfactory outcomes; the framework of fiscal governance has proven complex, technically difficult to implement and ineffective (Alcidi and Gros 2014, Pisani-Ferry 2015). Trying to ensure adequate flexibility to deal with asymmetric shocks, without committing supranational resources has led to an ever-increasing number of overlapping rules and exceptions, which undermine both their operability, and their credibility, by allowing room for political maneuvering, not only by national governments, but increasingly by the European Commission as well (Claeys et al. 2016, Beetsma and Larch 2019). Indeed, the experience from the first few years of the new fiscal framework's operation casts doubt on its credibility as the application of fiscal rules has been characterized by discontinuity and inconsistency (Begg 2017).[14] Paradoxically, the result is a fiscal governance framework, which while relying more than ever before on rules, at the same time allows more discretion in their interpretation and implementation (Begg 2017). In the end, and in spite of all the reforms efforts, it seems that once again, as was shown before the crisis, fiscal performance responds more to domestic political preferences and constraints, rather that adjust to externally imposed fiscal rules. This is nowhere demonstrated as vividly as in the system's inability to enforce fiscal targets symmetrically, that is, not only for the deficit but also for the surplus countries, like Germany, which in recent years as noted above, tightened its fiscal policy well above its SGP medium-term objective (Claeys et al. 2016). Beyond the economic inefficiency that such an asymmetry entails, it also undermines the ability to coordinate an EMU-wide fiscal stance, and has significant distributional implications for the other euro area member states.

Given these problems, there seems to be wide agreement that, so soon after its reform, the EMU's fiscal governance needs to be reformed again (Beetsma and Larch 2019). In this context, the European Commission proposed new measures and a roadmap for the completion of EU's economic governance (European Commission 2017). In addition, to amendments in order to streamline existing institutions, the Commission proposed new and ambitious initiatives, including among other things, turning the ESM into a European Monetary Fund and founding the position of a European finance minister. The European Commission's proposals and the proposals of the French President Emmanuel Macron in September 2017, for a broader EU reform, triggered a public debate on the issue of EU's economic governance.[15]

Although the terminology has slightly changed, the stakes in the discussion have remained the same; the distribution of costs to restore balance in the European economy. The debate is now taking place in terms of actions necessary to reduce or share the risk, that is, the cost for dealing with the crisis' legacy problems. The position on risk reduction essentially represents the position of the creditor countries, that restoring the balance should be the result of an adjustment process undertaken by the member states that face problems, which, of course, would alone bear the cost of this adjustment. Only when the imbalances faced by these states are addressed and therefore the risk of fiscal and other economic spillovers has been reduced, can the discussion on more ambitious risk-sharing initiatives proceed. This sequence of political choices illustrates the basic argument on which this view is based, which is none other than moral hazard. The concern is that the introduction of risk-sharing mechanisms prior to the completion of the adjustment process will create distorted incentives for the political elites of countries in trouble, thereby loosening their reform efforts. This will lead to a perpetuation of problems in these economies, which will be able to survive thanks to transfers and guarantees of solidarity mechanisms at the supranational level. The permanent nature of these transfers essentially entails the establishment of a transfer union.

On the other hand, those who argue that emphasis should be placed on risk-sharing mechanisms are essentially calling for greater solidarity. The economic rationale behind the immediate creation of risk-sharing mechanisms lies in the belief that the creation of such mechanisms will contribute to reducing risk, thus facilitating and accelerating the adjustment process. A particularly important element of this argument has to do with the fact that many problems that seem to be theoretically manageable can develop into uncontrolled situations due to the behaviour of financial markets (De Grauwe 2011). To the extent that part of the problem is the way financial markets operate, insisting on the adoption of tough national adjustment policies at significant economic and social cost is not only unfair but also unlikely to be economically effective. So, for example, without the completion of the banking union (in particular the common deposit guarantee system), the credibility of banks, particularly in countries whose banking sector still experiences difficulties, will continue to be low. This in turn will have a negative impact on banks' ability to fulfil their intermediary role, thereby delaying the consolidation of a sustainable recovery. In other words, the lack of supranational risk-sharing mechanisms prolongs market uncertainty, making their adjustment more difficult and painful than necessary.

For this reason, a number of voices have been arguing that the two options should be treated not as alternatives but as complementary: supranational solidarity mechanisms facilitate adjustment at national level, which makes it less likely that they will actually be used. This interpretation is evident in the Commission's 2017 proposals and has also been adopted by officials of all EU institutions, like the ECB (Draghi 2018), the European Fiscal Council (Beetsma and Larch 2019) and the European Commission (Buti 2020). In addition, in order to address the concern about the moral hazard of the creditor countries, many of the proposals include a series of measures to discourage their possible abuse.

Alas, progress is not probable in the foreseeable future as the two sides in the political economy contest seem immovable; the negative attitude maintained by both Germany and a number of other countries in Northern Europe has already been recorded on many of the Commission's proposals. The resistance of these countries is not only a matter of definition of their national interests, on the basis of the question of moral hazard described earlier, but also stem from internal politics, as the crisis has shaped trends of Euroscepticism not only in the countries that have implemented hard adjustment programmes, but also in the creditor countries.

The Joint Communication between France and Germany in Mesenberg on 19 June 2018, largely confirmed the political difficulties of the project. The most ambitious and rather unexpected proposal in the joint declaration was to create a budget for the euro area. Despite the initial surprise, the proposal, was actually not what many people thought; the proposed budget was linked to EU's multiannual financial framework, which diminished expectations regarding its size, particularly in a post-Brexit context. Moreover, the proposed budget was meant to promote competitiveness and convergence and not function as a stabilization mechanism. On the other hand, the declaration also contained a proposal for part of the budget to finance a European Unemployment Fund, on the basis of budgetary neutrality between the countries. With regard to the Banking Union, it was proposed that the fiscal backstop should be in the competence of the ESM, but start operating only if significant progress is made in reducing risks to member states' banking systems, in particular those arising from the issue of non-performing loans.

The Eurozone Summit of 14 December 2018 fully adopted the priorities and proposals of the French-German cooperation. In addition to decisions taken about the fiscal backstop of the Banking Union's resolution fund, and other technical modifications of ESM's institutional features, in the direction of the proposals of the French-German declaration, the Summit also approved the integration into the Multiannual Financial Framework of a fiscal tool specifically for the Eurozone. This tool will be used to promote the competitiveness and convergence of European economies, while no reference is made to the possibility of financing a European Unemployment Fund. The June and December 2019 Euro Summits recognized the technical progress made in implementing the above decisions without deciding on any major new reforms.

7. Conclusions

National preferences and economic idiosyncrasies dictate different fiscal policy priorities and attitudes towards deficit spending in different countries. Such differences affect the frequency, intensity and duration of discretionary fiscal policy, leading to different fiscal stances. This is problem in a monetary union is necessary because uncoordinated fiscal policies do not allow the adoption of a union-wide fiscal stance, and consequently the coordination between fiscal and monetary policy. In addition, discretionary fiscal policy faces serious technical difficulties and holds an irresistible political appeal for incumbent governments leading to a deficit bias in public finances. This is also a problem in a monetary union, because the fiscal derailment of a member state can have adverse spillover effects for the other members of the union. On the other hand, economic theory argues in favor of central, 'federal' mechanisms for the exercise of fiscal functions, particularly for stabilization purposes. As a result, in a monetary union of sovereign states, there is a need to monitor and control national fiscal policy, but also to support it in times of need.

The fiscal governance decided at Maastricht was imbalanced and inadequate in both respects. Being the result of a political compromise, it instituted a decentralized 'individual responsibility' approach, with no effective compliance mechanism and no support facilities for times of economic turbulence. Its weaknesses, revealed by the global financial crisis, contributed to Eurozone's deterioration into a second, debt crisis and a double dip recession. The lack of institutional provisions for dealing with the crisis, turned its handling into a de facto political and therefore intergovernmental process where creditor countries, enjoying a highly asymmetrical negotiating advantage, dictated both the terms of the bailout agreements and the provisions of the new fiscal governance. Being essentially a reinforced version of the pre-crisis framework, the 'reformed' fiscal governance has tried to balance conflicting objectives with little success; it is simultaneously more constraining and more prone to political maneuvering, increasingly complex while leaving more room for variable interpretations, and ultimately it is not more effective than its predecessor.

As a result, a short few years after the new fiscal governance has been implemented, the calls for a new reform are multiplying. Unfortunately, substantial progress does not seem likely in the near future; the central issue, which is the management of the problems inherited by the crisis in a number of countries and banking institutions, continues to divide the member states. The question is whether countries should be left to manage them on their own, taking on the costs involved and then going ahead with the most ambitious reforms, or whether risk-sharing mechanisms should be created now, facilitating the adjustment and reducing its cost. This question has obvious distributional and therefore political implications. Given the rise of Eurosceptic parties in both crisis-hit and creditor countries, the political resolution of EMU's fiscal predicament any time soon seems very difficult.

Notes

* The article is based on work done for a research project on EU's fiscal policy, assigned by the Bank of Greece to ELIAMEP.

1. According to the theory, each fiscal function should be exercised at the lowest possible level of governance where it is most effective (Oates 1972).
2. The coincidence of these criteria in the two theories should not come as a surprise given that typically federal states are also monetary unions.
3. Empirically, this argument is supported by the extremely low level of interest rate spreads for the public debt of different member states of the Eurozone in the early years of its operation. This has been attributed to the markets' conviction of the existence of an implicit bail-out clause, despite the Treaty no-bailout provision.
4. Again, this was seen in the EMU already from the first years of its operation with the refusal of Germany and France to abide by the rules, in conditions of economic recession (see next section).

5. On the other hand, as already noted, the markets' conviction about an implicit bailout clause in a monetary union of sovereign states, may relax their discipline and allow governments to borrow more than it is economically justified.
6. In 1969, the Heads of State of the European Economic Community (EEC) instructed a committee under Pierre Werner, Prime Minister of Luxembourg, to formulate a plan for the implementation, in stages, of the economic and monetary union of their countries.
7. There were other countries that did not meet the debt criterion but were close to it, which allowed the Commission to declare that provided fiscal consolidation efforts continued, these countries' debt would soon fall below the 60% threshold (European Commission 1998).
8. If fiscal governance proved ineffective, macroeconomic coordination was almost entirely absent; it was based on the Broad Economic Policy Guidelines, which were rather generic and essentially non-binding. In this context, the development of significant imbalances in productivity, wage policies and the current account were not surprising.
9. The adverse effects of large capital inflows were not exhausted on the fiscal front but led to broader macroeconomic imbalances, which weakened further the position of the periphery economies once the crisis hit.
10. There is a large literature on the design of the bailout programmes and their consequences, which is outside the scope of this paper.
11. The debate on a European safe asset continues. In recent years, experts (e.g. Brunnermeier et al. 2016) have suggested European Safe Bonds (ESBies), which are now referred to as Sovereign Bond-Backed Securities (SBBS), i.e. securities backed by a diversified portfolio of euro area government bonds. The European Commission has endorsed this proposal and on May 2018 released a proposal for a Regulation on SBBS.
12. The ESM was preceded by the European Financial Stability Facility (EFSF) and the European Financial Stability Mechanism (EFSM) established in 2010.
13. Despite the establishment of a new resolution process, the link between sovereigns and banks is not as easy to break as thought, as demonstrated by the banking crisis in Italy in 2017.
14. A similar picture emerges in the field of macroeconomic coordination, where stipulations produced by both the European Semester and the macroeconomic imbalance process do not appear to be taken seriously by the Member States (Alcidi and Gros 2014, Begg 2017).
15. A particularly influential paper in this context was the so-called policy paper 'No 91' of the prestigious Centre for Economic Policy Research (CEPR), in which 14 prominent economists from Germany and France put forward a

series of proposals for reform (Bénassy-Quéré et al. 2018). These proposals received praise but also critique, from many quarters, primarily for their lack of ambition and their affinity to the official German position. See for example the *Blueprint for a democratic renewal of the eurozone*, Politico, 28.2.2018 (the counter-proposals of another 14 economists and politicians), *Merler (2018) and Messori and Micossi (2018*).

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Appendix I

Fiscal Reforms

European Semester

Framework for the coordination of budgetary and economic policies to achieve the objectives of the Europe 2020 strategy. It takes place in the first half of each year before the preparation of national budgets. It was first implemented in November 2010.

'Six-Pack'

A package of six legislative measures that revised the Stability and Growth Pact. It was adopted in December 2011 by all EU Member States and aims to strengthen member states' fiscal compliance by reforming provisions for the imposition of financial fines in the event of a fiscal derailment and of excessive macroeconomic imbalances. In the revised Stability and Growth Pact, the Commission's proposals for sanctions against Member States which do not take satisfactory measures to correct their budgetary imbalances are taken on the basis of the negative majority rule, i.e. the Commission's proposals are adopted automatically, unless a qualified majority of Member States disagree.

Fiscal Compact

International agreement of EU Member States. The aim of the pact is to strengthen budgetary discipline. The most important provision of the Pact is that Member States should incorporate into national law the rule of the balanced budget. This rule provides for a structural deficit of up to 1% of GDP if public debt is less than 60% of GDP and 0.5% of GDP if debt is more than 60% of GDP, in which case it should be reduced (by a rate of 1/20th of the above-threshold debt). An automatic correction mechanism should be put in place if deviation from the objectives is observed. It entered into force on 1 January 2013.

'Two-Pack'

Package of two European Regulations to strengthen the supervision and control of the budgetary policy of the Member States. Increased supervisory and accountability obligations are provided for by states facing or likely to face financial stability problems. The screening of the draft national budgets by the Commission before their adoption by the national parliaments is also established. The Commission can examine the draft plans and submit recommendations in the event that they lead to budgetary and macroeconomic derogations; the Commission does not have veto power, in the event of non-compliance with its instructions. It is also envisaged to set up independent financial councils in each Member State with a view to monitor more effectively the implementation of fiscal planning and the compliance with the rules set out in both the Stability and Growth Pact and the Fiscal Compact. The Regulations are in place since May 2013.

European Fiscal Board

In the wake of the proposals of the Five Presidents' Report, the European Commission set up the European Fiscal Board. The Board's objective is to ensure transparency and coordination of fiscal policy at the European level. In this context, the Board supervises the implementation of fiscal planning at both national and European levels, formulates proposals for the overall fiscal position of the EU, as well as for the Member States, and proposals for the reform of the EU's fiscal governance, and cooperates with the independent national fiscal councils. The Council began its work in October 2016 and in November 2017 published its first report.