

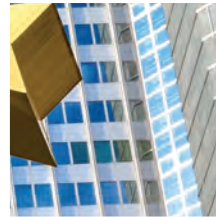
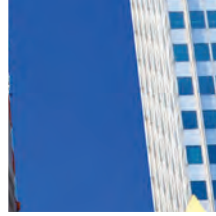


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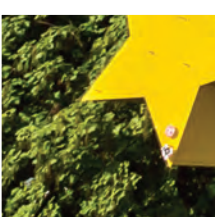
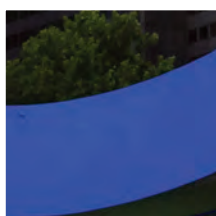
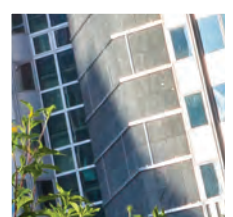
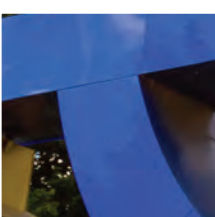


FLORENCE SCHOOL  
OF BANKING & FINANCE



# RESEARCH REPORT

## The rise of a fiscal Europe? Negotiating Europe's new economic governance



FLORENCE SCHOOL OF BANKING & FINANCE

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## **Introduction**

The Eurozone crisis brought the question of public finance oversight sharply into focus. In February 2010, as the global financial crisis morphed into a deep crisis of the single currency, the attendant problems were framed as fiscal profligacy in the Eurozone state of Greece. Over the next four years, as the Union struggled to bring the acute phase of the crisis to an end, the question of Eurozone economic governance came to the fore. Agreement was reached on a host of new regulations – Six-Pack, Fiscal Compact and Two-Pack – designed to oversee the public finances and macro-economy of the member states, particularly members of the Eurozone. Without the crisis there would have been no pressure to reform the economic governance regime or to agree on the Fiscal Compact, which was negotiated outside the formal treaty framework. An important feature of the EU's crisis response was the parallel negotiations on crisis management (bail-outs and other rescue instruments) and crisis prevention, ushering in a new regulatory framework for economic governance. It was politically necessary to address both the immediate crisis and the future economic governance of the Eurozone simultaneously. The negotiations on economic governance involved intense negotiations among the member states and EU institutions in the heat of the crisis. The negotiations required the deployment of different legal instruments and the relative weights of different EU institutions varied depending on the negotiations in question.

This article goes to the heart of the puzzles addressed in this special issue. First, it is central to the first question posed, namely, the problem-solving capacity of the Union in the eye of the crisis. The negotiations analysed here were crucial to the Union's crisis response, particularly to the ability of political actors to take highly controversial decisions to give financial assistance to a number of programme countries. Governments in the creditor countries needed to tell their parliaments and publics that the design faults in the Eurozone's economic governance were being addressed. Thus the functional pressures were both major and urgent in this policy area. Second, the negotiations provide an important lens into the power and strategies of various institutional actors which allows us to probe the decision-making style in this period, the traditional 'Community method' or a 'new intergovernmentalism' (Puetter et al, 2014). Third, the analysis of the policy outputs of these three negotiations enables us to address the question of the importance of the reforms in terms of Hall's categorization of different orders of change (Hall, 1993).

## **Europe's economic governance reform**

The euro crisis has resulted in a significant reform ('a decisive change') of Europe's fiscal surveillance regime. Among the number of policy initiatives undertaken at the height of the crisis, i.e. over the period 2010-2013, to reform EMU's incomplete economic governance, three key developments are particularly noteworthy: (1) the Stability and Growth Pact (SGP), the fiscal cornerstone of Europe's Economic and Monetary Union (EMU) which was strengthened and expanded by the so-called "Six Pack"; (2) a new international agreement branded 'Fiscal Compact' was adopted to enshrine the rule of balanced budgets into national law and (3) the so-called 'Two Pack' came into being to further institutionalise the European Semester and to lay down a community framework for the provision of financial assistance. The common thread of these substantial initiatives is that they aimed at strengthening the credibility and enforceability of the EMU's rules-based economic coordination regime through further formal competence transfer and an improvement of the EU's problem-solving capacity. Although all three sets of negotiations were designed to enhance economic governance, the legal nature and basis of the policy instruments differed as did the constellation of actors (and hence veto players) involved in the negotiations - see Table 1 which provides an overview of the legal nature and decision rule that governed the adoption of the new instruments. There is an important distinction between the 'Six Pack' and the 'Two Pack' on the one hand which are secondary EU legislation and the Fiscal Compact on the other hand which is an international treaty.

The Eurozone crisis did not fundamentally affect the EU's decision-making process, notwithstanding the significance of the reform agenda. Instead, it provided an important testing ground for the newly adopted Lisbon provisions which, when implemented under the pressures of the crisis, fundamentally changed the institutional landscape of EMU. Overall, major innovations in terms of actors involved, policy processes and policy content have occurred. This goes against the expectations of an **institutional paralysis** or **gridlock** driven by a joint decision trap. Ways out have always been found to reach common solutions, and with the exception of the Fiscal Compact, reforms have enhanced the problem-solving capacity of the Union (see table 2 which classifies the degree of change as major). The article proceeds as follows: the negotiations on the 'Six Pack' and 'Two Pack' are analysed sequentially as they were both negotiated on the basis of treaty provisions, followed by the analysis of the outlier, the Fiscal Compact, which was negotiated as an international treaty. The analysis encompasses the negotiations of each new instrument and the outcome.

## The 'Six Pack'

### Agreeing on the 'Six Pack' in the shadow of Lisbon

The context of the 'Six Pack' reform was the urgent crisis induced pressure to act to 'restore the credibility of the EU vis-à-vis the markets'<sup>1</sup>. The historic resistance to reform that was long considered the central economic policy coordination in EMU (the SGP) abated: 'this new framework had to be created in a rush', as a Commission official puts it<sup>2</sup>. One often forgets that due to the density of the euro crisis, that the SGP reform was the first policy action undertaken by European leaders to counteract the volatility of the bond markets and to ensure that bail-outs would pass muster in the creditor states. Far from anticipating the systemic effects that the large-scale Greek fiscal data falsification would have on Europe's financial stability, the first reaction of European leaders in 2010 was to address the design failures of the SGP and restore its credibility. As an EP official highlighted<sup>3</sup>, 'non compliance with rules was identified as the cause of the crisis, not the good or bad performance of economies'. Consensus to act emerged quickly. Although the Six Pack was adopted in first reading, it proved to be a lengthy first reading process: 14 months passed between the issuing of the Commission proposals (September 2010) and the adoption of the legal acts (November 2011). Two crucial elements may explain this lengthy and novel process: (a) a power game between the Commission and the European Council in agenda-setting, and (b) a struggle between the European Council, the EP and the Commission in law-making.

Agenda-setting on the "Six Pack" was novel as consensus-building on the key provisions occurred upstream of the Commission proposal, as part of the so-called Task Force Van Rompuy (TFVR), named after the President of the European Council. In March 2010, European Council President Van Rompuy and the Commission were requested by the European Council, in its conclusions<sup>4</sup>, to draw up a new programmatic agenda to reform the fiscal governance of EMU with a view to ensuring 'better budgetary discipline, exploring all options to reinforce the legal framework' (European Council, 2010). The presence of the new office of President of the European Council provided the EU's leadership with an alternative actor to the Commission in agenda-setting. This marked the start of an agenda-setting contest between the Commission, which traditionally cherished its policy shaping power, including on the EMU (the Delors Committee is a telling precedent), and the European Council. An interviewee involved in the early work of the Task Force witnessed 'French-German pressure to take the lead and to not leave the initiative to the Commission'<sup>5</sup>. This view

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<sup>1</sup> Interviewee 3 – 1 December 2014, Brussels.

<sup>2</sup> Interviewee 2 – 3 November 2014, Brussels

<sup>3</sup> Interviewee 4 – 10 December 2014, Brussels

<sup>4</sup> 26-27 March 2010 European Council conclusions.

<sup>5</sup> Interviewee 5 – 22 October 2014, Brussels.

supports the characterisation of the Task Force Van Rompuy as acting as the European Council's 'policy patrol' (Chang, 2013) by constraining the Commission's autonomous agenda-setting power. The latter, on the other hand, showed no willingness to surrender, with EU Commissioner Olli Rehn allegedly declaring at the first TFVR meeting: 'I take note of this Task Force but I will make proposals in independence'<sup>6</sup>. In line with this statement, the Commission published a communication to set the agenda of the SGP reform on 12 May 2010, just 10 days before the first and most strategic meeting of the TFVR due to convene on 21 May 2010. Another Commission Communication followed a few weeks later on 30 June 2010. The substantive content revealed the Commission was keen to seize the momentum of the Eurozone crisis to fix some of the EMU's fiscal governance flaws and to challenge the institutional status quo, a strategy that was apparent in the Commission's discourse. The Commission repeatedly referred to functional arguments, highlighting the clear 'interdependence' (Commission, 2010a: 1) or the 'deep economic and financial linkages within the euro area' (Commission, 2010a: 5) to justify its task expansion in the EMU's surveillance (Commission, 2010a, 2010b). The institutional rivalry with the European Council continued until the end of the Task Force proceedings. One Council official recalled: 'in September [2010], there was the feeling that the TF would adopt conclusions not conform to the Commission's views, and which were not going in the direction of the Community method'<sup>7</sup>. When the Commission unveiled its comprehensive package on 29 September 2010, i.e. one month before the final adoption of the Van Rompuy report, the same interviewee remembered that 'Schaüble was very angry'<sup>8</sup>.

The second institutional novelty which contributed to slowing down the legislative process of the co-decision procedure to revise the SGP was the co-decision power of the EP. This implied both the involvement of the European Parliament (EP) as a co-legislator but also entailed the development of a cooperative relationship between the EP and the incumbent EMU actors (the Council and the Commission) who previously had no need to interact with the Parliament on EMU matters. As a first time participant in the definition of the new economic governance regime, the EP had an active role during the negotiations of the Six Pack but it took some time for the establishment of a constructive relationship with the Commission. Although formally not all of the legislative proposals required co-decision (4 out of 6 texts), the EP used the package deal nature of the negotiations to influence all provisions of the Six Pack and always worked with one team of negotiators. One trilogue participant recalled that 'the trilogues were enormous in size in the Six Pack'<sup>9</sup> since all aspects were negotiated as a package. Another EP interviewee confirmed there was 'much discussion in the EP before the ECON vote' and to illustrate this, added 'making a rough calculation of meeting hours, an MEP reached the figure of 200 hours'<sup>10</sup>. In the account of EP officials, the Commission was rather passive and immune to suggestions coming from the Parliament, an attitude that can be partly explained by the fact that 'DG ECFIN was not used to co-decision procedure, they were in Beaulieu<sup>11</sup>, far away, doing forecasts'<sup>12</sup>. For example, although the European Semester was an old Commission idea, it was the 'EP which codified the European Semester into the Six Pack'...'ECFIN said it wouldn't happen'<sup>13</sup>. Overall, the degree of centralisation agreed in the Six Pack owed a lot to the crucial contribution made by the EP who strongly advocated further sovereignty transfers to the EU level to enforce fiscal discipline. In the words of one of the most active EP *rapporteurs* on the package, the EP clearly

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<sup>6</sup> Ibid

<sup>7</sup> Interviewee 5 - 22 October 2014, Brussels.

<sup>8</sup> Ibid.

<sup>9</sup> Interviewee 6 - 5 December 2014, Brussels.

<sup>10</sup> Interviewee 3 - 1 December 2014, Brussels.

<sup>11</sup> Beaulieu refers to the Commission building in which DG ECFIN used to have its offices until they got moved to the Charlemagne building in 2013. It is located outside of the Brussels 'quartier européen'. To get an idea, it is located six metro stops away from Schuman, the centre of the 'quartier européen'. For more: <http://blogs.wsj.com/brussels/2013/02/20/ecfin-sits-next-to-the-king/>

<sup>12</sup> Interviewee 6 - 5 December 2014, Brussels.

<sup>13</sup> Interviewee 7, 29 October 2014, Brussels.

favoured a reduction of 'horse-trading'<sup>14</sup> (Goulard, 2011:3) in Council deliberations about sanctions and was a key problem-solving actor when it promoted the Reversed Qualified Majority Voting in the Council over sanctions, thereby undoing the outcome of the grand French-German bargain previously made in Deauville<sup>15</sup>.

### **The "Six Pack": a familiar flavour but a new game**

While the Stability and Growth Pact (SGP) remained broadly in line with the minimal requirements of the Maastricht Treaty in its first (1997) and second (2005) versions, the 2011 reform – the so-called 'Six Pack' – was a critical juncture in competence distribution, despite representing a continuation of rules-based coordination. Through regulatory means, it broadened and deepened centralised control over domestic economic policies and in particular over fiscal policies and saw the novel involvement of the European Council and of the European Parliament. The Six Pack reform process evolved under the shadow of the Lisbon Treaty which foresaw the creation of two new actors who became a central part of the EMU scene: the permanent President of the European Council (art. 15 TFEU) and the European Parliament (art. 121-6), which had a role in relation to the multilateral surveillance procedure (i.e. most aspects of the SGP) as part of the wider extension of co-decision foreseen by the Lisbon Treaty.

The SGP's 2011 reform subjected member states to a higher and more intrusive scrutiny; it strengthened sanctions while specifying and extending the circumstances under which the Commission may request member states to adjust their fiscal position. Reform of the SGP's preventive arm focussed on further incentivizing member states to achieve their Medium-Term budgetary Objectives (MTOs). To ensure this, a benchmark was set up that anticipated the matching of new expenditures with adequate resources, 'placing a cap on the annual growth of public expenditure according to a medium-term rate of growth' (EC, 2011:1). Moreover, a financial sanction in the form of an interest-bearing deposit of 0.2 per cent of GDP (and even of a non-interest bearing deposit if no action is taken), can now be applied also under the preventive arm in case of a 'continuous non-correction' (EC, 2011:1). The reform of the corrective arm traditionally centred on its key instrument, the Excessive Deficit Procedure, which can lead to fines, was also substantial. The key novelty was the adoption of a system of Reverse Qualified Majority Voting in the Council upon the proposal of sanctions falling on member states, thus limiting the decision-making power of the Council on sanctions. Other elements included the operationalisation of the debt criterion (previously, surveillance was solely focussed on deficit developments) and the definition of a new benchmark of debt reduction of 1/20<sup>th</sup> of the excess debt (i.e. the debt left over the 60% debt/GDP ceiling). Taken as a whole, the Commission can now deploy a stronger enforcement toolkit - it disposes of tougher, more diversified and more progressive financial sanctions which can be initiated earlier. The pattern of policy change can be summarised as 'more of the same': more rules, more sanctions, and more regulatory control. Previous policies and earlier institutional designs (the Maastricht Treaty and the SGP) pre-determined the final outcome to a large extent, which underlines a path-dependence mechanism: 'the euro-zone is not breaking-free of the Maastricht legacy' (Featherstone, 2012: 24). This view has been confirmed by a policy-maker who stated 'you foster the system in which you have been operating'; 'we tried to defend the system and improve it'.

Other key policy transformations agreed upon also grew out of the SGP's traditional scope. The first novelty was the Macroeconomic Imbalance Procedure (MIP) which replicates the concept of the SGP on current account/competitiveness imbalances and where non-compliance can also lead to fines. The second breakthrough was the so-called European Semester, a policy process tool whose aim is to integrate and centralise all surveillance procedures into a single calendar cycle that precedes the

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<sup>14</sup> i.e. an exchange of favours.

<sup>15</sup> <http://www.economist.com/blogs/charlemagne/2011/12/germany-france-and-euro>



development of national fiscal plan for the year t+1. This inversion of the budgetary calendar ensures that the logic of budget-making in the EMU becomes more top-down and vertically institutionalised. The third development was to ensure that fines on the manipulation of statistics (an obvious follow-up to the Greek crisis) could be applied to a 'Member State that intentionally or by serious negligence misrepresents deficit and debt data' (Regulation (EU) 1173/2011, art. 8). The last key contribution of the Six Pack was to set up minimum requirements for national budgetary frameworks with an insistence that member states move towards 'multi annual budgetary planning' (EC, 2010b: 2).

### **The Two-Pack: strengthening the arsenal**

In May 2013, a package of two EU regulations, known as the "Two Pack" entered into force, following a year and a half of negotiation between the European Commission, the European Parliament and the EU Council as part of the ordinary legislative procedure. The Two-Pack's primary goal was to strengthen the central control over the fiscal and macro-economic policies, but only for Eurozone members. Overall, the 2 Pack affected both the vertical distribution of powers, creating a clearer budgetary hierarchy between the centre and member states as enshrined in the budgetary timeline, and the horizontal distribution of powers – the Commission gained autonomy vis a vis the Council. The process was marked by a year-long blockade of the texts by the Parliament.

### **Under the radar screen**

The power game surrounding the Two Pack evolved parallel to and in the shadow of two more salient policy discussions: the elaboration and ratification of the Fiscal Compact and the European Stability Mechanism Treaty. These two Treaties captured headlines: a basic search in the archives of the FT.com for example provided 408 results for the Fiscal Compact, 750 results for the ESM and only 15 results for the Two Pack<sup>16</sup>. Interviews held in Brussels confirm that the Two Pack was more technical and more specific than the Six Pack and had been negotiated in a different climate: 'everyone in the EP had an opinion on the Six Pack, it wasn't the case for the 2 Pack.' Yet, as we can see, the Two Pack is probably the legislation that goes the farthest in terms of the centralisation of fiscal powers, in particular for Eurozone member states receiving financial assistance.

In a context marked by a the de-escalation of market pressure and decreasing interest within the Council and Parliament compared to the Six Pack, the Two Pack gave additional centralised powers to the European Commission. Such an EMU-focused legislative package was made possible by a new article of the Lisbon Treaty that allowed for those member states who share the euro and are exposed to higher externalities/interdependence to 'strengthen the coordination and surveillance of their budgetary discipline' (art. 136-1), i.e. further pooling their sovereignty. This new legal basis enabled a relaxation of the consensus requirements among the EU28 countries and provided EU leaders with an escape route from the joint decision trap. Proposed in November 2011 and adopted in May 2013, the Two Pack occurred in a policy context made up of escalating and then, after July 2012, de-escalating crisis induced pressure. Perhaps for this reason, the Commission found space to act as a core actor. Interviews conducted point towards the crucial role played by the Commission in conceptualising and bringing forward the Two Pack: 'The Two Pack? It was the Commission'. The same EP official recalled 'a top-down push from the cabinet [Olli Rehn's cabinet] to do more and to do more Community method and a bottom up attention in DG ECFIN services where the staff became more aware of what happens in the corrective arm of the SGP, after the Six Pack

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<sup>16</sup> The research was conducted on the 17 April 2015 using the search tool of the Financial Times web portal (ft.com).

implementation’ . In a context where there was an ‘outside pressure to do a bit more, the European Commission took the chance’<sup>17</sup> .

Interviewees also pointed to the swift consensus-building on the Two Pack within the Council with no major opposition to be noted. The Commission texts, proposed on 23 November 2011, did not raise key controversies. In fact, the EU Council reached political agreement on the Two Pack on 21 February 2012, just three months after the Commission made the proposal which implied a broad alignment with the Commission. This suggests that the crisis may have had lasting effects on the awareness among EU governments of the need to act together on fiscal coordination because of the deep interdependence of Eurozone countries, illustrated during the course of the crisis and more than two years after the outset of the Greek fiscal crisis.

The ease of translating the Council consensus into law was considerably slowed down by another innovation provided by the Lisbon Treaty - the extension of co-decision to multilateral surveillance which implied the involvement of the European Parliament. The final agreement with the EP was reached one year later in May 2013, since the EP was determined to withhold its vote until the Commission tabled more ambitious proposals on the mutualisation of debt: ‘the whole process of negotiation of the 2 Pack was a fight’<sup>18</sup> . Ultimately, the parliament’s negotiation tactics managed to secure (1) the integration of some Fiscal Compact provisions in EU secondary law (De La Parra, 2013), (2) regular information on the surveillance measures taken and (3) the ability to organize a hearing to be informed on the assessment of budgetary plans as part of an economic dialogue as well as on the results of the enhanced and post programme surveillance processes. In addition, in a side-deal with the Commission, the EP secured a high level report on a redemption fund and euro-bills in exchange for its support of the Two Pack.

### **Crowning the Commission’s executive powers?**

The term ‘Two Pack’ gives the misleading impression of a unifying logic in its objectives. At a minimum, some unity resides in its scope (a strict focus on the Eurozone) and in its broad aim to reinforce the EMU surveillance mechanisms to prevent contagion/spill-over in the EMU. Its true rationale was, however, to deal with institutional left-overs and complete the unaccomplished work which had not been performed by the previous reforms of the EMU’s economic governance (e.g. mainly the Six Pack legislations). Apart from this, the two regulations pursued two different goals: Regulation 472/2013 aimed at clarifying the procedure and competences to address member states experiencing financial difficulties under so-called ‘enhanced surveillance’. Among others, the Commission may autonomously decide on the basis of objective criteria to subject a Member State to enhanced surveillance and can prolong it if it deems it necessary. From a legal perspective, this regulation also strove to ensure consistency between intergovernmental agreements and EU law, notably on conditionality. As such it largely elaborated on the so-called operational guidelines of both the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM) and lays down the legal frame of ‘macroeconomic adjustment programmes’ for euro area countries requesting financial assistance (European Commission, 2013).

Regulation 473/2013, on the other hand, sought to lay down a procedure for the assessment of draft budgetary plans in the euro area. Driven by the need to further reinforce the central control over fiscal policies, it set out both the conditions and procedures for the assessment of draft budgets in the Eurozone and specified the corrective provisions in the case of excessive deficits in euro area member states. Its purpose was to further institutionalise a crucial novelty of the Six Pack – the European Semester. The Two Pack pushed the intrusiveness of the European Commission into

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<sup>17</sup> Interviewee 8 – 13 November 2014, Brussels.

<sup>18</sup> Interviewee 4 – 10 December 2014, Brussels.



domestic politics and policy-making to a higher level. The Two Pack foresaw a clear and binding timetable for the elaboration and discussion of national draft budgetary plans. It required Eurozone member states to submit medium-term fiscal plans by 30 April each year followed by the blueprint of national budgets by 15 October. In case of serious non-compliance with the rules of the SGP, the Commission may request a revised draft budgetary plan. Several interviewees pointed to the fact that with the Two Pack, Treaty provisions were stretched to their maximum: 'we are using the existing coordination provision to their full potential'<sup>19</sup>. The Two Pack impinges on core state powers, which carries longer term implications for legitimacy. As a Commission official summarised it, 'with some historical distance, it is a folly. Never on earth could we have imagined this a few years ago'<sup>20</sup>.

### **The Fiscal Compact: an intergovernmental subterfuge?**

In its initial (German) conception, the adoption of the Fiscal Compact's debt brake rule was meant to be implemented through a Treaty revision, not through an international treaty negotiated outside the EU framework. The Compact's innovative shape should thus be considered as a second best outcome for the EU and its main proposer, Germany. Its peculiar design resulted from the UK's strong reluctance and ultimate veto of an EU Treaty revision at the European Council in December 2011. The Compact's rationale was part of a conditionality compromise made to Germany for the injection of liquidity through the ESM and the ECB in a context marked by continuously rising Italian and Spanish bond spreads. Its adoption did not alter the EU's distribution of powers either horizontally or vertically, nor did it result in the transfer of significant formal powers to the EU. Its key contribution was rather symbolic: it sent a signal of commitment to sound finances at a time when financial assistance was deployed throughout Europe.

### **A straightjacket, but only on paper**

The main purpose of the Fiscal Compact was to enshrine a 'balanced budget' rule into national primary law, thus departing from the Maastricht requirement which focussed only on avoiding 'excessive deficits'. The Compact provided that the 'budgetary position of the general government of a contracting party shall be balanced or in surplus' (TSCG, 2012: art. 2), thereby limiting member states' budgetary discretion further. The structural budgetary position was operationalised as the 'lower limit of a structural deficit (is) of 0.5% of the gross domestic product at market prices' (TSCG, 2012: art. 2). The Compact also foresaw that 'in the event of significant observed deviations from the medium term objective or the adjustment path towards it, a correction mechanism shall be triggered automatically' (TSCG, 2012: art. 3). Lastly, it stipulated that these rules should be transposed into national law 'through provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes' (TSCG, 2012: art. 3).

The Fiscal Compact was a highly salient political issue at the time of its adoption. Yet, from the beginning, policy-makers questioned its added-value compared to the previously adopted Six Pack. A diplomat called it 'an important distraction' while Mario Monti, then Italy's Premier, described it as a 'decorative songbird' (The Economist, 2012); despite its entry into force, the Compact is by and large un-enforced (Alcidi & Gros, 2014). Interviewees, both from the EP and from the EU Council, confirmed this interpretation: 'you do something on rules but then it is not followed'<sup>21</sup>; 'the Fiscal Compact is dead'<sup>22</sup>; 'no one cares about it'<sup>23</sup>. In spite of its higher ranking in the hierarchy of norms,

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<sup>19</sup> Interviewee 2 – 3 November 2014, Brussels.

<sup>20</sup> Interviewee 9 – 8 December 2014, Brussels

<sup>21</sup> Interviewee 8 – 13 November 2014, Brussels.

<sup>22</sup> Interviewee 7 – 29 October 2014, Brussels.

the Compact is no different than the ambitious EU declarations, such as Council conclusions, which remain empty agreements. It can be characterised as largely symbolic and a suboptimal political outcome in contrast to the problem-solving nature of the Six Pack and of the Two Pack: ‘it’s about legal symbolism and the Germans are always caught in this’<sup>24</sup>. Analysing similar outcomes, Héri-tier (1999; 18-19), following on Brunsson (1989), documented how the hypocritical creation of symbolic political outcomes by separating talk from action could be used as an escape route to the EU’s tendency towards deadlock. In bargaining theory this is referred to as ‘framework solutions’ (Héri-tier, 1999: 19), i.e. political compromises which have been adopted despite a high diversity of interests among actors and which are ‘not meant to be implemented because their realisation would bring irreconcilable conflicts to the fore’ (Héri-tier 1999:19). The Fiscal Compact seems to illustrate this phenomenon very well.

In contrast to the Six Pack’s reliance on the Community method, the Fiscal Compact was an intergovernmental and in particular a German project from the beginning. Concerned by the moral hazard implications of the new financial firewalls (European Financial Stability Mechanism and European Financial Stability Facility/European Stability Mechanism) and sceptical that the Six Pack reform, a secondary law package, would send sufficiently reassuring signals to the markets and to its (powerful) domestic institutions and electorate, Germany started pushing for the widespread adoption, by all EU member states, of a constitutional debt brake to ensure fiscal discipline in the EU. It was supported later by France and, decisively, by the newly appointed ECB President Mario Draghi who called for a ‘Fiscal Compact’ during his first hearing at the European Parliament’s plenary on 1 December 2011<sup>25</sup>.

On 9 December 2011, a first outline of the Fiscal Compact was discussed by heads of state and government at a European Council meeting. To the surprise of many, UK Prime Minister David Cameron vetoed the text and attempted to obtain concessions and exemptions on financial markets regulation. In other words, the UK framed its opt-out (i.e. its regular way to exit the EU’s joint decision trap) as an ambitious shopping list of exemption measures impacting the City of London. However, these requests were side-payments that all other EU member states were not prepared to grant to the UK: ‘he arrived with an unrealistic and unacceptable list of opt-outs’<sup>26</sup>. As the same official from the EU Council concluded: ‘Cameron is someone who is blinkered...he underestimated the consensus for an intergovernmental treaty’<sup>27</sup>. Faced with a UK veto, agreement to proceed without the UK outside the formal treaty framework was reached quickly<sup>28</sup>. Working discussions on the text carried on and within one month, on 30 January 2012, ‘heads’ endorsed the text. The treaty was signed a month later, on 2 March 2012, by 25 European member states (all EU member states at the time excluding the UK and the Czech Republic). The ECB greeted the Pact as ‘strengthening confidence in the euro area’ while German Chancellor Merkel welcomed it for being ‘a small but fine step on the path to restoring confidence’<sup>29</sup>. Over the following weeks, the ESM Treaty was modified to make a financial assistance request conditional on the ratification of the Fiscal Compact while, on 21 December 2011, the ECB extended its Long-Term-Refinancing Operations from 12 months to 36 months to support bank lending further.

The ultimate legal form of the agreement was not the only policy innovation of the Fiscal Compact. The process through which the treaty was elaborated was completely novel too. The Commission’s

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<sup>23</sup> Interviewee 7 – 29 October 2014, Brussels.

<sup>24</sup> Interviewee 5 – 22 October 2014, Brussels.

<sup>25</sup> <http://www.ecb.europa.eu/press/key/date/2011/html/sp111201.en.html>

<sup>26</sup> Interviewee 5 – 22 October 2014, Brussels.

<sup>27</sup> Interviewee 5 – 22 October 2014, Brussels.

<sup>28</sup> <http://www.theguardian.com/world/2011/dec/09/david-cameron-blocks-eu-treaty>

<sup>29</sup> <http://www.reuters.com/article/2012/01/31/us-eu-summit-idUSTRE80S0SR20120131>

traditional monopoly of initiative was sidelined and the same occurred on the Council side: ‘we bypassed everything, the COREPER and the General Affairs Council’<sup>30</sup>. In addition, new delegation patterns emerged. The Economic and Financial Committee, an economic policy forum made up of Treasury directors, was assigned the task of chairing the intergovernmental conference leading to the elaboration of the new international treaty. In the background, the political preparation was delegated to the Sherpas, the diplomatic advisors of EU leaders, located in the PM’s or Presidential ministries. The European Parliament was granted the right to send three representatives and one observer to the Sherpa group. MEPs began by snubbing the Sherpa Meetings ‘but they quickly understood that it was there that the power was’<sup>31</sup>. Despite these new delegation patterns, it would be an exaggeration to conclude that the elaboration of the Compact sidelined all formal EU actors at all times. Both the Commission and the Parliament did influence the process; significantly, they obtained a provision under article 16 which specified that within five years following the entry into force of the Treaty, ‘necessary steps shall be taken...with the aim of incorporating the substance of this Treaty into the legal framework of the EU’ (TSCG, 2012: art. 16).

Overall, the Fiscal Compact came to symbolise what was later regarded as an intergovernmental twist in EU decision-making. It is probably too early to tell whether the liberties taken with the standard *modus operandi* of the EU were only a result of the UK veto and the time pressure of the moment and therefore *ad hoc* in nature, or whether they were illustrative of a lasting and ‘new intergovernmentalism’ cooperation pattern (Puetter, 2014)<sup>32</sup>. Due to the current lack of enforcement of the Fiscal Compact, one can be sceptical about the extent to which the working method that led to the Fiscal Compact provides any guide for action in the future. Interviews conducted with participants in the process revealed the inner tension of policy-makers on this issue: ‘this mode of governance, it’s not perfect but at the same time it is realistic’<sup>33</sup>; ‘it is more realistic politically but less efficient’<sup>34</sup>; ‘this informal process is useful but one should not forget that there is a COREPER’<sup>35</sup>.

### Significance of Reforms: Orders of Change?

Policies are complex constructs involving various institutional settings, instruments, techniques, and, most importantly, policy paradigms (Hall, 1993; Daigneault, 2014). Hall identified three orders of change which was later refined by Daigneault who distinguished between policy output and change at the level of ideas. See Table 3 for an overview in relation to the three negotiations analysed here. All three negotiations resulted from urgent and major changes in the setting of the existing instruments given the nature and depth of the systemic crisis that unfolded within the Eurozone. Second order change, defined as change in the instruments and techniques deployed within the policy was also evident across all the three instruments. Both the ‘Six Pack’ and ‘Two Pack’ represented major changes in the processes and instruments of economic governance-enhanced rules, timeframes and sanctions. Taken together they represent a major shift in the balance between the member states and the EU in relation to domestic budgets and public finances. The Fiscal Compact represented a significant domestic change for most of the member states. Third order change – change at the level of goals and priorities – requires a nuanced interpretation of the degree of change. The Stability and Growth Pact was already committed to prudent budgeting and sound public finances and these goals and priorities remain at the core of the new system of economic governance. However, the salience of these priorities was greatly enhanced by the tumult of the

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<sup>30</sup> Interviewee 5 – 22 October 2014, Brussels.

<sup>31</sup> Interviewee 5 – 22 October 2014, Brussels.

<sup>32</sup> For example, the Sherpas represent a continuity with the Task Force Van Rompuy in which they were involved, as alternates.

<sup>33</sup> Interviewee 5 – 22 October 2014, Brussels.

<sup>34</sup> Interviewee 8 – 13 November 2014, Brussels.

<sup>35</sup> Interviewee 5 – 22 October 2014, Brussels.

crisis and the fragilities exposed in the currency union. In addition to sound public finances, a new priority was added - the importance of macro-economic imbalances as a source of concern within the Eurozone. All programme countries suffered from a deteriorating macro-economic profile in the lead-up to the crisis. Fourth order change – change at the level of overarching ideas – has not occurred. Paradigm breakers such as the mutualisation of debt have not occurred. Rather there has been a reinforcement of the pre-existing ideas about sound public finances. However, this article had not analysed the role of the ECB which has broken the paradigm by becoming a lender of last resort in practice if not de jure.

### **Resilience and Robustness in EU Negotiations and Policies**

The Eurozone crisis acted as an exogenous shock to an ill-prepared system that lacked the policy instruments and toolkit to deal with the challenges it faced. Given the degree of market pressure and the clear evidence of contagion, doing nothing was not an option for Europe's leaders. Thus, notwithstanding the length and depth of the acute phase of the Eurozone crisis, the Union's decision-making process did not face gridlock. Rather, its capacity proved resilient<sup>36</sup> as the member states found sufficient consensus to pass a complex range of legislative acts and an international treaty in the area of economic governance and a new financial perspective that runs to the end of the decade. Path dependency was apparent in the key provisions on economic governance as the Six Pack and Two Pack represented a hardening and layering of the original Stability and Growth Pact, not an entirely new invention. The Fiscal Compact was largely symbolic and responded to the demands of the dominant member state, Germany, for legal assurances on debt and deficits. It formed part of the domestic political management of the development of new policy instruments, notably the EFSF and the ESM. The decision to adopt a treaty outside the formal treaty framework was taken to overcome the veto power of the UK.

The Treaty of Lisbon had an important impact on the negotiations of many of the new measures because it pre-structured the negotiating process. The horizontal balance of power among EU institutions changed and process innovation was evident. The presence of a Commission President, in this case Herman Van Rompuy, had an important effect on agenda-setting on economic governance. Because there was a Council President in March 2010, the European Council could call on him rather than the Commission President to chair the Task Force on Economic Governance. This ensured there was a contest in agenda-setting on the new economic governance provisions although the Commission retained the responsibility of making the formal legislative proposals on both the Six and Two Pack. The European Council President also played an important role in the end game of the MFF negotiations, brokering a deal in February following a failed European Council in November 2012. The President's role in the MFF negotiations came at the expense of the rotating Presidencies because once an issue is on the European Council agenda, it is taken over by the Council President. The second major impact of the Lisbon treaty was the opportunity it gave the European Parliament in the legislative process. Although only four of the six legislative acts that made up the Six Pack required co-decision, the EP was in a position to influence all the acts by treating them as a package deal and engaging intensively in the trilogues. During the MFF negotiations, the EP also had enhanced influence since its consent was necessary for the conclusion of the agreement. The influence of the Commission varied across the different negotiations. It retained its role in proposing the initial draft of the MFF and drafted all of the EU legislative acts. Agenda-setting on the Six Pack was a complex process given the role of the Task Force and the Commission. It had a freer hand in relation to the Two Pack because of the de-escalation of the crisis and the activism of the Rehn

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<sup>36</sup> Following the framework provided for the analysis of euro crisis response by Joachim Schild in his introductory remarks to the conference 'Five Years of Crisis – Lessons Learned and Paths Towards a Resilient European Monetary Union' University of Trier, October 9th-10th, 2014.

cabinet and Commission services. The Commission's role in the implementation of the new economic governance regime was immensely strengthened as it was given enhanced powers of surveillance, monitoring, review and sanctioning.

The crisis had a major impact on the content of the new economic governance regime as it was crafted as a direct response to pressure from the markets and from the creditor countries in the Eurozone. Given market volatility and the constant threat of contagion, there was a need to reassure markets that the Eurozone could solve its problems and survive. The creditor countries were also determined that in addressing the problems of the programme countries, they would also address the design faults of the single currency. Thus crisis management and crisis prevention were intertwined from the outset. The ECB also demanded reassurance from the member states that if it engaged in non-standard measures, the Governments would also address the problem of economic governance. Cumulatively, this led to a step change in economic governance characterised by a hardening of the rules both on the preventive and corrective arms of the regime, a ratcheting up of monitoring and surveillance, and a strengthening of the sanctions regime. Both in terms of process and content, domestic budgets were encased in a set of procedures captured by the European Semester.

The crisis triggered a major policy response from the European Union, particularly within the Eurozone. It induced agreement on far reaching changes in economic governance which will play out in the next phase of economic and monetary integration. The new system involves horizontal policy-making at the EU level and EU member state engagement on the annual recommendations that flow from the European Semester. How the member states respond to the changes and the policy prescriptions of the Commission and the Council will be a major test of the new regime. Will the member states display a high level of compliance with the new regime or will it trigger a domestic backlash given that many of the fields addressed in the economic governance regime are national competencies? Just how much flexibility the Commission will display in interpreting the rules is difficult to predict although it appears to recognise that the economic governance regime cannot become a straitjacket for the member states. The EU and Eurozone are still faced with the challenge of creating an environment which is conducive to structural change of many sensitive areas of policy. Moreover, because the acute phase of the crisis has abated, the member states may not feel the need to continue to address the design faults of the single currency and go much beyond what has been agreed so far. In line with earlier predictions of the 'rise of regulatory state in Europe' (Majone, 1994), the EU is following a process of 'regulatory state building' in fiscal matters (Schelkle, 2009:1). As a result, the EU finds itself trapped in an unprecedented situation (Hallerberg, 2014): while there is no substantial EU fiscal capacity, the EU has a strong central regulatory power to control national budgets. The crisis did not induce agreement on fiscal federalism or on debt mutualisation, instruments that would be profoundly transformative for the EU and European integration. Agreement on the centralisation of banking supervision, the Banking Union, was the high watermark of federalism and centralisation as a result of the crisis.

It remains far from clear that the crisis is over. The member states and EU institutions brought the acute phase of the crisis under control but did not address many of the underlying causes and legacies. Public and private debt remains very high, particularly in the troubled countries. Europe continues to face the prospect of low growth and low inflation which exacerbates the debt problems. Unemployment remains high in many countries, particularly youth unemployment. A cleavage has opened up between the core and periphery within the Eurozone and the overall macro-economic stance of the single currency area is far from optimal. To date, the resilience and robustness of the policy-making system has averted disaster and the implosion of the Euro but has not created a stable policy environment for the longer term. The member states remain deeply divided concerning core questions of fiscal and economic policy and capacity at the EU level.

The resilience of the Union's policy-making system in the face of the crisis was accompanied by a fracture between policy-making and politics in the member states. The world of the Brussels beltway appeared immune to the political fall-out within the member states. Across Europe incumbent governments lost power and volatility characterised electoral outcomes and party systems. Heads of government represented in the European Council were caught in the crosswinds of demands for collective responsibility, particularly in the Eurozone, and the demands of their electorates. Responsibility to the collective came at the cost of responsiveness to electorates. EU constraints on domestic economic policies have been increased at perhaps a longer term cost of legitimacy of both EU and domestic governance and governments. Electoral instability at the domestic level and the growing weight of Eurosceptic parties in the EP and the member states may not undermine the robustness of the Union's policy-making system in the short-term but may do so in the longer term. The legacy of the crisis will play out over a very long time in the Union.

**Table 1: The varying decision rules in economic governance reform**

Reform Initiative	Legal Nature	Decision Rule	Member State Involvement
Six Pack	Secondary EU Law	QMV among the member states (Art 121)	All
Fiscal Compact	International Treaty	Unanimity among signatures	All except UK and Czech Republic
Two Pack	Secondary EU Law	QMV among Eurozone states Art 136	Eurozone member states

**Table 2: Grid of Economic Governance Negotiations**

Concept	Sub-Categories	Value
Importance of Change	Major or Minor Change	Major Change
Direction of Change	Path breaking or path-dependent	Path Dependent
Form of Process	Drift, conversion, layering, displacement	Layering
Timing of Change	Short-long term	Short and long term

**Table 3: Orders of Change**

	'Six Pack'	'Two Pack'	Fiscal Compact
<b>1<sup>st</sup>: Change in setting of existing policy</b>	Major change due to market turbulence and political management of bail-outs	Major change due to crisis and designed only for Eurozone	Major change due to crisis and political management in Germany
<b>2<sup>nd</sup>: Change in instruments and Techniques</b>	Major change in both the prevention and corrective arms- enhanced sanctions. New decision rule- Reverse Qualified Majority Voting in relation to the Excessive Deficit Procedure	Institutional leftovers from the 'Six Pack' which together with the 'Two Pack' greatly strengthen the surveillance capacity of the Commission	'Domestic debt break was an innovation in many member states
<b>3<sup>rd</sup>: New goals or altered priorities</b>	Major change: Introduction of the Macroeconomic Imbalance Procedure (MIP)/Fines concerning the manipulation of statistical data and the European Semester	Designed to address means rather than ends- process and procedure	Enhancement of the priority accorded to sound public finances
<b>4<sup>th</sup>: Paradigmatic change</b>	No paradigmatic shift in terms of goals and priorities but a paradigmatic shift in terms of surveillance of the domestic by the Commission and the EU	Contributes to the paradigmatic shift of enhanced surveillance	No paradigmatic shift

List of interviews



Semi-structured interviews were conducted in Brussels from 20 October 2014 to 12 December 2014. To maximize the collection of observations on such a sensible subject, Chatham House rules were applied and confidentiality was guaranteed to the interview partners. As a result, interviews are anonymized and only the primary affiliation of the interview partners is apparent.

- Interviewee 1, EU Council official, 19 November 2014, Brussels.
- Interviewee 2, European Commission official, 3 November 2014, Brussels
- Interviewee 3, European Parliament official, 1 December 2014, Brussels.
- Interviewee 4, European Parliament official, 10 December 2014, Brussels
- Interviewee 5, EU Council official, 22 October 2014, Brussels.
- Interviewee 6, European Commission official, 5 December 2014, Brussels.
- Interviewee 7, European Parliament official, 29 October 2014, Brussels.
- Interviewee 8, European Parliament official, 13 November 2014, Brussels.
- Interviewee 9, European Commission official, 8 December 2014, Brussels.

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