Box 6

THE "TWO-PACK" REGULATIONS TO STRENGTHEN ECONOMIC GOVERNANCE IN THE EURO AREA

On 20 February 2013 the Council of the European Union (EU Council), the European Parliament and the European Commission reached an agreement on two EU regulations (the "two-pack"), which aim to strengthen further the existing economic governance framework for euro area countries by complementing the "six-pack" and the fiscal compact[1], in accordance with the Euro summit statement of 26 October 2011. The two EU regulations, which are based on two proposals published by the Commission in November 2011, consist in: (i) "monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area"[2]; and (ii) strengthening the "economic and budgetary surveillance of Member States experiencing or threatened with serious difficulties with respect to their financial stability in the euro area"[3]. Following formal approval by the EU Council and the European Parliament, the regulations are expected to enter into force at the end of May 2013, in order to be applied to the 2014 draft budgets. This box summarises, and briefly assesses, the main elements of the "two-pack".

Regulation on draft budgetary plans and the correction of excessive deficits

The first regulation foresees a common budgetary timeline, according to which euro area Member States will be required to publish their medium-term fiscal plans by 30 April each year, and their draft annual budget for the central government and the parameters of the budget for the general government sub-sectors by 15 October. The draft annual budget should be adopted by 31 December at the latest. The European Commission will assess the countries' draft budgetary plans. In case of "particularly serious non-compliance" with the budgetary policy obligations, as laid down in the Stability and Growth Pact (SGP), the Commission would be asked – after consultation with the Member State concerned – to adopt an opinion on the draft budgetary plans within two weeks of their submission and to publicly request revised draft budgetary plans (which are then to be submitted to the Commission no later than three weeks after the issuance of the opinion). Compliance with such a request, however, is not enforceable (although the Commission will take it into account when deciding whether an excessive deficit exists). Subsequently, the Commission will adopt a new opinion on the revised draft budgetary plans.

The regulation also requires that countries have independent bodies in place to monitor compliance with numerical fiscal rules, and that they report ex ante on their national debt issuance plans.[4] Furthermore, the regulation enhances the monitoring requirements for countries subject to an excessive deficit procedure (EDP), by obliging them to report to the Commission on a

1 For further details on the "six-pack" and the fiscal compact see, for example, the article entitled "The reform of economic governance in the euro area – essential elements", *Monthly Bulletin*, ECB, March 2011; the box entitled "Stronger EU economic governance framework comes into force", *Monthly Bulletin*, ECB, December 2011; and the article entitled "A fiscal compact for a stronger economic and monetary union", *Monthly Bulletin*, ECB, May 2012.
2 Proposal for a regulation of the European Parliament and of the Council on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (COM(2011) 821 final), European Commission, Brussels, 23 November 2011.
3 Proposal for a regulation of the European Parliament and of the Council on the strengthening of economic and budgetary surveillance of Member States experiencing or threatened with serious difficulties with respect to their financial stability in the euro area (COM(2011) 819 final), European Commission, Brussels, 23 November 2011.
4 Besides the debt issuance plans, the "two-pack" also integrates other elements of the fiscal compact, such as the requirement to prepare economic partnership programmes, which describe the policy measures and structural reforms that are needed to ensure an effective and lasting correction of the excessive deficit.

six-monthly basis on their in-year budgetary execution, the budgetary impact of discretionary measures and the government's expenditure and revenue targets. This should help to prevent, or correct in the early stages, any non-compliance with the deadline for correcting an excessive deficit. The Commission can also request that a Member State carry out a comprehensive independent audit of the general government accounts. In case of a risk of non-compliance with the deadline for correcting an excessive deficit, the Commission can publicly recommend that the Member State concerned fully implement the measures provided for in the initial country-specific EU Council recommendation, and that it adopt other measures within a time frame consistent with the EDP deadline.

Regulation on the enhanced surveillance of countries under financial stress

Under the second regulation, the European Commission may publicly decide to subject a euro area Member State to enhanced surveillance, if the country is experiencing or is threatened with serious difficulties with respect to its financial stability which are likely to have adverse spillover effects on other countries in the euro area. Furthermore, when a Member State receives financial assistance on a precautionary basis, for instance from the European Financial Stability Facility/European Stability Mechanism or the IMF, the Commission must subject that Member State to enhanced surveillance. In such cases, the country concerned must adopt measures in consultation with the Commission (in liaison with, inter alia, the ECB and, where appropriate, the IMF), aimed at addressing the (potential) sources of difficulty. It must also provide information as to the resilience of its financial system (including the results of stress tests) to the respective European authorities. The Commission, in liaison with the ECB and, where appropriate, the IMF, must then conduct regular review missions to ascertain the progress made in implementing the agreed measures. When the Commission concludes that further measures are needed and that the financial and economic situation indeed has significant adverse effects on the financial stability of the euro area or of its Member States, the EU Council may recommend that the country concerned adopt precautionary corrective measures or prepare a macroeconomic adjustment programme. The latter should include annual budgetary targets (replacing EDP targets) and should be based on an assessment of government debt sustainability. For the duration of the macroeconomic adjustment programme, the country concerned is not subject to a macroeconomic imbalance procedure. Compliance with the programme is monitored by the Commission, in liaison with the ECB and, where appropriate, the IMF. A country will remain under post-programme surveillance until a minimum of 75% of the financial assistance received has been repaid.

Assessment

The "two-pack" is a welcome addition to the reinforced EU economic governance framework for euro area Member States and a further step towards a genuine economic union, as outlined in the "Four Presidents' Report"[5] on the future of EMU. It is expected to help prevent the build-up of significant fiscal and economic imbalances, ensuring their early correction and maintaining confidence of the financial markets. The success of the "two-pack", however, will depend very much on the extent to which the Commission makes use of its new powers. In particular, it remains to be seen how strictly the Commission will interpret "particularly serious non-compliance"

5 Van Rompuy, Herman, *Towards a genuine Economic and Monetary Union*, European Council, Brussels, 5 December 2012. (Written in close collaboration with José Manuel Barroso, President of the European Commission; Jean-Claude Juncker, President of the Eurogroup; and Mario Draghi, President of the ECB.)

with the SGP, in which case the Commission would need to ask the country concerned for a revised draft budget. It is essential that the Commission make use of its new authority to issue a recommendation, ensuring that any EDP corrections remain on track, or to subject a country to enhanced surveillance.

Some aspects of the "two-pack" could have been stronger, as stated in the related legal opinion of the ECB.[6] In particular, the regulation on draft budgetary plans could have better captured the substance of the fiscal compact, notably by referring to a mandatory balanced budget rule with an automatically triggered correction mechanism. Regarding the regulation on enhanced surveillance of countries under financial stress, it would have been beneficial to strengthen some of the provisions, for example by giving the EU Council at least the possibility to make an explicit recommendation for a euro area Member State to seek financial assistance where there are significant adverse spillover effects on the financial stability of the euro area or of its Member States.

It should also be noted that reaching an agreement among the three European institutions (EU Council, European Commission and European Parliament) on the "two-pack" legislation was only possible after the Commission issued a statement committing itself to set up a high-level expert group to examine the feasibility of the common issuance of euro bills and the establishment of a redemption fund.[7] While the conclusions of the expert group will not be binding, it is crucial to keep in mind that issuance of any common debt instrument can only be considered as the end point of a comprehensive economic governance reform process which entails an adequate transfer of fiscal sovereignty to the euro area level.

6 Opinion of the European Central Bank of 7 March 2012 on strengthened economic governance of the euro area (CON/2012/18). The legal opinion is based on the European Commission's initial proposals published on 23 November 2011 (see footnotes 2 and 3).
7 See the joint statement of 20 February 2013 by José Manuel Barroso and Olli Rehn, President and Vice-President of the European Commission respectively, on the occasion of the trilogue agreement on the "two-pack" legislation on the economic governance in the euro area.