'Fiscal compact not very stringent and no go-ahead for Greek bailout yet' from BBVA – Research (5 March 2012)

Caption: This article, published on the BBVA (Banco Bilbao Vizcaya Argentaria) site on 5 March 2012, comments on the agreement signed on 2 March 2012 by the Heads of State or Government of 25 European Union Member States to strengthen common discipline following the debt crisis.

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Europe Flash

Euro summit: Fiscal compact not very stringent and no go-ahead for Greek bailout yet

Bottom line: The EU summit that took place on March 1 and 2 developed mostly as expected. It advanced in the solution of the Greek programme, but did not provide the full go-ahead for the new funds. The new fiscal agreement was signed among 25 countries, but it does not sound particularly stringent. There was no reference to an eventual relaxation of deficit rules, while all growth-related remarks were insubstantial. The key pending issue is now the reinforcement of the liquidity firewall for Europe, which has been delayed until late March.

Evaluation: Most of the important content of the fiscal compact (the structural fiscal rule, reversal of majority rule for the excessive deficit procedure and involvement of the Court of Justice) was expected. However, there are details in the treaty which suggest some lack of stringency in the application of the rules. In particular, despite the automatic mechanism to sanction countries and the role of the Court of Justice, the maximum sanction of 0.1% of GDP may not be a large enough incentive for countries to comply with the rule. This is per se not very important to solve the current crisis, but it might be perceived in Germany and by the ECB as not enough for ensuring fiscal discipline, which in turn could make it difficult for them to apply key measures to solve the eurozone crisis, like increasing the liquidity firewall or approving eurobonds. On the later, the new treaty and the statement continue to be mute. On deficits, any reference to relaxing the targets was absent from the statement. On Greece, the Eurogroup advanced in the solution of the problem, but the second bailout is not yet approved. We continue to think that it will arrive in time for avoiding a major accident.

- **On Greece**
  - The Eurogroup recognizes that Greece has taken most of what was asked to do before the summit, but that they will wait to give them the money until the troika makes a detailed report next week. This delay was not expected. The Eurogroup authorized, however, the EFSF to raise the money to support the PSI agreement, the recapitalization of the Greek banking sector, and allowed the EFSF to set up a collateral anhancement facility presumably to back Greek debt such that it can be used as a discount at the ECB. This follows the earlier than expected declaration of default by raing agencies this week, which implies that Greek debt could to be discounted at the ECB.
  - The actual payment of the contribution to PSI will be made once participation in the scheme is closed, while the final decision on the second bailout will be presumably taken at a finance ministers meeting on March 12th.
- **On the fiscal compact**
  - The pact obliges signatory countries to implement a **structural deficit rule** to limit the structural deficit to 0.5% of GDP in their national legislation, preferably in their constitution, within one year after ratification. Transitory deviations can be accepted under exceptional circumstances. However, the definition of what is transitory is not provided, while the concept of “exceptional” is loosely defined (“unusual event outside the control of the country” or “severe economic downturn”, not even a recession is needed)
  - If countries deviate from this rule, an **automatic correction mechanism** will be triggered, with a correction plan to be defined by the country in line with principles provided by the European Commision. If the country does not comply with the correction plan, the **Court of Justice will be involved**, with an eventual final sanction of 0.1% of GDP, which does not seem very high (the Stability Pact has potential sanctions of up to 0.5% of GDP). The novelty of this procedure is the involvement of the Court of Justice, with no participation of peer countries.
  - Countries **whose debt is above 60%** of GDP will have to reduce 1/20th of the excess debt per year. This was already expected. However, no sanctions or special procedures are defined against countries who breach this rule.
  - The procedure against countries that breach the old Stability Pact is reinforced. Now, the **excessive deficit procedure** (when a country exceeds a deficit of 3%) will be subject to reverse qualified majority (it will be launched and sanctions applied unless 66% of weighted votes are opposed to it) instead of a direct qualified majority (launched only if 66% are in favour).
  - The compact was signed by 25 countries (except the UK and Czech Republic). The Treaty will **enter into force in January 2013** provided 12 eurozone countries have ratified it, or earlier if 12 countries do so. Implicitly, it will not enter into force if by January not enough countries have ratified it.

- ## On the ESM
  - The statement says that the eurogroup will revise “the adequacy of the overall ceiling” of the EFSF and ESM by the end of March. They have also agreed to accelerate the payment of the paid-in capital for the ESM, with at least two tranches in 2012, and the rest to be defined by the end of March.

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