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Appendix 1: The Stability and Growth Pact (SGP)\textsuperscript{151}: Surveillance of Budgetary Policies

\begin{itemize}
\item Overview:
Agreed in 1997, the SGP contains two arms: “[t]he preventive arm seeks to ensure that fiscal policy is conducted in a sustainable manner over the cycle, preventing recourse to the corrective arm” while “[t]he corrective arm – also known as the Excessive Deficit Procedure (EDP) – sets out the framework for countries to take corrective action in the case their government deficit is above 3\% of GDP or when their debt is over 60\% of GDP and not falling quickly enough towards the Treaty reference value” (SGP FAQs, European Commission).

“The cornerstone of the preventive arm is the country-specific medium-term budgetary objective (MTO), defined in structural terms (i.e. in cyclically adjusted terms and net of one-off and other temporary measures). Member States outline their medium-term budgetary plans in stability and convergence programmes (SCPs), which are submitted and assessed annually in the context of multilateral fiscal surveillance under the European Semester.

[...]

Non-compliance with either the preventive or corrective arms of the Pact can lead to the imposition of sanctions for euro area countries. In the case of the corrective arm, this can involve annual fines for euro area Member States and, for all countries, possible suspension of Cohesion Fund financing until the excessive deficit is corrected.” (“Stability and Growth Pact”, European Commission)

In short, “3\%” and “60\%” are the two key convergence criteria for the EU member states to join EMU as well as the rules in place to ensure sound public finances of the euro countries. The evolution of the SGP reflects the demands and necessity of strengthening the fiscal discipline for the eurozone states. In comparison, “[t]he Macroeconomic Imbalances Procedure (MIP) operates alongside the SGP to identify and correct macroeconomic

\textsuperscript{151} If not otherwise indicated, this appendix is adapted from “Stability and Growth Pact” (European Commission).

These two crucial ‘convergence criteria’ were maintained later, while other elements were introduced during the evolution of the SGP between 1997 and the SGP reforms of 2005, in 2011 with the “six-pack” and in 2013 by the “two-pack”. Moreover, the intergovernmental TSCG, also known as the “Fiscal Compact”, concluded by the eurozone countries plus eight non-eurozone members (but without the participation of the UK and the Czech Republic), has entered into force on 1 January 2013. An emphasis was notably put on the country-specific MTO, aimed at meeting the two fiscal criteria defined in the original SGP, which actually is the core of the “balanced budget rule” as introduced by the TSCG (Hosli and Pan 2014).

- **Legal basis of the SGP:**
  Treaty on the Functioning of the European Union (TFEU): Articles 121 and 126 provide the legal basis for the SGP preventive arm and the corrective arm and the EDP; Protocol 12 defines public deficit and debt reference values: 3% and 60% of GDP.

- **The evolution of the SGP’s preventive arm:**

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<td>Significant SGP reforms in 2005 and 2011 via the six-pack:</td>
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| March 2010: *The European semester* was agreed, and at the beginning it was framed as a new code of conduct on the implementation of the SGP, which only needed approval from the Ecofin Council of 7 September 2010 to initiate the first cycle of the Semester.*④*, p.12)
September 2010: The Commission proposed the “six-pack”, which consists of five Regulations and one Directive to strengthen EU economic governance.

12 January 2011: The adoption of the first AGS by the Commission marked the start of the first European semester in line with the *Europe 2020 strategy* (which was launched in 2010, concerning the EU’s ten-year growth and jobs strategy).

March 2011: *The Euro+ Pact (i.e. the Euro Plus Pact)* concluded by the 17 euro states with another six non-euro member states (Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania) aims at “improving the fiscal strength and competitiveness of Member States” via “present(ing) their commitments in time to be included in their SCPs and NRPs”①, and thus the Euro Plus Pact falls directly into the European Semester mechanism. It is not a secondary legislation, and rather a political commitment of the euro area states and other interested EU member states to enhance policy coordination.

13 December 2011: The “six-pack” entered into force, legislatively bringing the coordination, surveillance and policy advice given on the budgetary and economic policies under the same umbrella of the European Semester. Among other things, “[t]he Economic Dialogue codified by the six-pack gives the European Parliament the right to intervene in the Semester at almost any point in time”, thus redefining the EP’s role in as well as giving legitimacy and credibility to the Semester process (④, p.14); meanwhile, the new MIP is also introduced by the six-pack, “which imposes compulsory adjustment on euro area Member States that suffer from significant macroeconomic imbalances” (④, p.15). Furthermore, the six-pack strengthens financial sanctions for euro area states by introducing reverse qualified majority voting (RQMV) for most sanctions.

- Further SGP reforms after the six-pack:

1 January 2013: *The Fiscal Compact*, contained in the intergovernmental TSCG, entered into force, further strengthening SGP key provisions by enshrining a balanced budget rule with a lower limit of a structural deficit of 0.5% GDP and a country-specific automatic correction mechanism “in case of deviation from the MTO (as defined in the SGP) or the adjustment path towards it (also included in the ‘two-pack’)” into national law, preferably of constitutional nature②, and the failure to do so may lead to a financial sanction of 0.1% GDP imposed by the ECJ⑤. The TSCG without the participation of the UK and the Czech Republic, is binding on all euro states which shall ratify it, “while other contracting parties will be bound only once they adopt the euro or earlier if they signal it”②. Other provisions in the TSCG aiming at reinforcing the SGP include: re-stating the debt rules introduced by the six-pack, particularly deficit behavioural commitment reproducing RQMV for the euro states and reinforcing economic policy coordination and surveillance via “ex-ante coordination of debt issuance plans among Contracting Parties and economic partnership programmes for Member States in EDP, which detail the structural reforms needed for an effective and durable correction of their excessive deficit”⑤. Though the TSCG is an intergovernmental Treaty and not an EU Treaty, it does prescribe the incorporation of its substance into the EU legal framework within five years. Currently, the TSCG runs in parallel with the six-pack. In fact, the TSCG further strengthens SGP rules and continues SGP reforms after the six-pack via an intergovernmental approach: it imposes more stringent sanction rules than the six-pack does. For instance, Article 7 of the TSCG suggests that the RQMV applies to all stages of the EDP, as the eurozone states breaching the deficit criterion have to support the Commission’s proposals or recommendations unless a qualified majority opposes the Commission’s decisions. This means RQMV “applies to all stages of the EDP, even if not foreseen in the six-pack”⑤.

30 May 2013: *The “two-pack”*, built on the six-pack and complementing the SGP reforms, “the
European framework for fiscal surveillance, and the European Semester for economic policy coordination” while only applicable to the euro area states, entered into force, with the purpose of specifically introducing additional surveillance and monitoring procedures and thus stronger budgetary discipline mechanisms for the euro area countries due to “the higher potential for spillover effects of budgetary policies in a common currency area”; it paves the way for further reinforcing EMU with the steps outlined in the Commission’s “Blueprint for a Deep and Genuine EMU”\(^3\). The six-pack reforms the SGP mainly by adding new requirements to budgetary policy, notably new fiscal rules to the EU member states, while the “two-pack” focuses on euro states’ budgetary coordination and surveillance by introducing and integrating a common budgetary timeline and common budgetary rules into the European Semester: “national draft budgets (of the euro states) need to be submitted to the Commission by 15 October every year so that the Commission can check adherence to commitments taken in their Stability Programmes” (\(^4\), p.46). The relation between the two-pack with other EU economic governance measures are as follows: (1) regarding the TSCG, it integrates some elements of the Fiscal Compact into EU law; “including the requirements for Member States in EDP to prepare economic partnership programmes and the requirement for ex-ante coordination of Member States’ debt issuance plans”; (2) as for the reformed SGP and the European Semester, it adds an autumn counterpart to the spring semester exercise, focusing on the eurozone countries’ budgetary plans for the coming year so as to check whether national budgetary policy is in line with the SGP and CSRs and thus give opinions before national budgets get adopted; in addition, due to the enhanced surveillance process (i.e. the new reporting procedures of the measures taken by member states in the EDP), it strengthens the Commission’s “toolbox” for making timely on a breach of EDP recommendations, which may lead to decisions of imposing gradual financial sanctions introduced by the six-pack; (3) concerning the operative financial backstops, it is consistent with ESM/EFSF guidelines, and moreover, it “embeds in the EU legal framework the working practices established under these intergovernmental instruments”\(^3\).

Further SGP reforms and content expansions of the European Semester may continue in the future.

Sources: \(^1\) European Parliament-2012/0002(NTT); \(^2\) “Stability and Growth Pact” (European Commission); \(^3\) European Commission-MEMO/13/457 (27 May 2013); \(^4\) Hallerberg et al. (September 2012); \(^5\)“Six-Pack? Two-Pack? Fiscal Compact? A Short Guide to the New EU Fiscal Governance” (European Commission). The Table of “The evolution of the SGP” above is adapted from \(^1\),\(^2\),\(^3\),\(^4\),\(^5\) and “Surveillance of Budgetary Policies” (European Union).
Appendix 2: The ECB’s Responses and Actions in the Post-2008 Crisis Era

In the entry of “EU Response to the Economic and Financial Crisis” on the official website of the Economic and Financial Affairs of the European Commission, it is clearly stated that

“The economic crisis has prompted intense and sustained action by the EU’s national governments, the European Central Bank and the Commission. All have been working closely together to support growth and employment, ensure financial stability, and put in place a better governance system for the future.” (“EU Response to the Economic and Financial Crisis — April 2014”, European Commission)

Therefore, in order to obtain a rounded picture of the EU’s efforts to address the eurozone sovereign debt crisis, which is the main theme for the EU after the 2008 crisis, it is essentially necessary to know the ECB’s responses and measures to counter the economic and financial crisis as well as the euro crisis. Apart from its procedural involvement in adopting new EU regulation and rules to address the crisis (e.g. the codification of the European Semester, the establishment of the ESRB, the six-pack, and the two-pack) and the new concrete tasks conferred upon the ECB along with the implementation of the EU’s new measures to combat the crisis, the ECB has its own eye-catching initiatives: it purchases member states’ sovereign debts on secondary markets, contributing to the building up of a financial stability safety-net alongside the EFSM, the EFSF, the permanent ESM and the IMF. Two events demonstrate such initiatives.

The first one is that, from 6 July 2009 to the end of June 2010, the ECB directly purchased a nominal amount of 60 billion euro-denominated covered bonds issued in the euro area, which is called the “covered bond purchase programme” (CBPP) (Beirne et al. 2011, 5). This initiative aims at “(a) promoting the ongoing decline in money market term rates; (b) easing funding conditions for credit institutions and enterprises; (c) encouraging credit institutions to maintain and expand their lending to clients; and

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152 Also see ECB Press Release (4 June 2009, Purchase Programme for Covered Bonds); ECB/2009/16 (Decision of the European Central Bank of 2 July 2009 on the Implementation of the Covered Bond Purchase Programme). Trichet (13 July 2009) explained that “[c]overed bonds are debt securities issued by banks, which give them access to funding of a longer-term nature than the ECB’s refinancing operations. Covered bonds thus allow banks to manage the maturity mismatch between their assets and liabilities”, which are believed to complement the ECB’s other liquidity management measures.
(d) improving market liquidity in important segments of the private debt securities market” (ECB/2009/16), and it is evaluated that “the CBPP has been effective in meeting its objectives” (Beirne et al. 2011, 5). As this CBPP expired on 30 June 2010, the ECB, after “taking into account market conditions and the Eurosystem’s monetary policy needs”, decided to start a second CBPP (CBPP2) of a nominal value of EUR 40 billion from 4 November 2011 onwards till 31 October 2012 with the objectives to “(a) easing funding conditions for credit institutions and enterprises, and (b) encouraging credit institutions to maintain and expand lending to their clients” (ECB/2011/17), and being available for lending is the salient feature of the CBPP2 portfolio (ECB Press Release, 3 November 2011). Such new policies, however, are against the statutory rules for the ECB as being a fully independent institution (Hosli 2005, 51), so when the two CBPPs were legalized, the ECB clearly stated that the Guideline ECB/2000/7 of 31 August 2000 (ECB/2000/7) is NOT applicable to both programmes. \(^{153}\) This new policy instrument of covered bond purchasing is defended by former ECB President Trichet (1 November 2003 — 31 October 2011) as one of the “non-standard measures” — compared with the traditional standard measure: the interest rate management — taken by the ECB to tackle the new problems arising from the new situations (Trichet 13 July 2009).

The second initiative taken by the ECB is that on 6 September 2012, “aim(ing) at safeguarding an appropriate monetary policy transmission and the singleness of the monetary policy”, the Governing Council of the ECB, following the terminated Securities Market Programme (SMP), decided to implement outright purchases of sovereign bonds on secondary markets in the euro area — a new framework called Outright Monetary Transactions (OMTs), which is conducted with strict and effective conditions to the countries attached to an appropriate programme under the EFSF and the ESM (e.g. Cœuré 23 September 2012; Draghi 9 October 2012). \(^{154}\) New ECB President Draghi (9 October 2012) said it is an important initiative for the ECB to address the distortion and the asymmetry of financing costs for banks across the euro area, which “hinder[...] the smooth functioning of credit markets and the transmission of monetary policy”, but the conditionality means that the countries concerned have to request a bailout via the EFSF or the ESM before the OMTs can be activated. The

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\(^{154}\) See also ECB Governing Council Decisions (September 2012).
OMT is a bold method put forward by the ECB to drive down the sovereign debt yield levels in Spain, Italy and other troubled euro countries, and the market did give positive reactions to the ECB’s this decision as the Spanish government’s costs of borrowing over two years fell from 4.71% to 2.80%, three years from 5.09% to 3.68%, and four years from 5.97% to 4.60% (“ECB’s Mario Draghi Unveils Bond-Buying Euro Debt Plan”, BBC News, 6 September 2012). The OMTs are valued to be able to “address severe distortions in government bond markets which originate from, in particular, fears on the part of investors of the reversibility of the euro” and thus is taken as an instrument of the ECB to support confidence in the European financial market as well as to keep price stability in the euro area (Cœuré 23 September 2012). Again, the OMT framework does not comply with the original ECB rules, which forbid the ECB to monetize national debts or directly buy government bonds, and the OMT tool, “cut(ting) the borrowing costs of debt-burdened eurozone members by buying their bonds”, is a new invention by the ECB against the new harsh financial and economic situation to save the single currency (“ECB’s Mario Draghi Unveils Bond-Buying Euro Debt Plan”, BBC News, 6 September 2012). Draghi, the President of the ECB, defends this new device in the following way:

“The Governing Council remains firmly committed to preserving the singleness of its monetary policy and to ensuring the proper transmission of the policy stance to the real economy throughout the euro area. OMTs will enable us to provide, under appropriate conditions, a fully effective backstop to avoid destructive scenarios with potentially severe challenges for price stability in the euro area. Let me repeat again what I have said in past months: we act strictly within our mandate to maintain price stability over the medium term; we act independently in determining monetary policy; and the euro is irreversible”. (Draghi et al. 4 October 2012).

Moreover, the ECB has adopted other measures such as admitting certain assets denominated in pounds sterling, yen or US dollars as eligible collateral (ECB/2012/23) and lowering key interest rates155 to improve euro countries’ capital liquidity. Altogether, as Trichet (13 July 2009) once summarized, the ECB approaches the financial crisis and then the euro crisis from four dimensions: interest rates, enhanced

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155 Starting from 11 July 2012, the ECB decided that the interest rates on the main refinancing operations, on the marginal lending facility and on the deposit facility are at 0.75%, 1.50% and 0.00%, respectively. Since 2008 till October 2012, it has lowered its policy rate from 4.25% to 0.75%. See “Key ECB Interest Rates” (European Central Bank).
credit support, liquidity management measures, covered bond purchases. All in all, the most significant and eye-catching policies adopted by the ECB during the post-2008 crisis era are the newly implemented non-standard measures, such as the modification of the allotment procedures and the collateral policy and the introduction of OMTs so as “to ensure the effective transmission of its monetary policy across the euro area” (Cœuré 23 September 2012). All the non-standard measures suggest the creativity, flexibility and changing positions of the ECB in front of the new severe challenges.

Finally, it is worth pointing out that an integrated “banking union” is forming. On 12 September 2012, the Commission made proposals on a single supervisory mechanism (SSM) for all banks in the euro area under the leadership of the ECB (COM(2012) 510 Final), which “includes further components such as a single rulebook, common deposit protection and a single bank resolution mechanisms”, marking the first step towards the establishment of a “banking union” (“Banking Union”, European Commission). Later, on 8 October 2012, Cœuré, a Member of the Executive Board of the ECB, said that the ECB was proceeding with a banking union and he elaborated the banking union as follows:

“It is an institutional framework which ultimately should have three legs: a single supervisory mechanism (SSM), a common resolution structure and a shared deposit insurance. The SSM would bring all supervisory decisions about euro area banks under one roof, at the ECB, allowing supervisors to take into account externalities and general exposures to systemic risk. The common resolution structure, with a unified resolution regime and single resolution fund, would manage efficiently the wind-down even of large cross-border banks. Shared deposit insurance would reassure depositors that their money is safe in any euro area bank, regardless of its country of operations or legal domicile.” (Cœuré 8 October 2012)

The SSM is finalized and created by two regulations: Council Regulation (EU) No 1024/2013 (in accordance with a special legislative procedure) and Regulation (EU) No 1022/2013 (in accordance with the OLP), and according to the latter, the SSM becomes effective as of 30 October 2013. The significance of the creation of the SSM, as Draghi (17 December 2012) once pointed out, lies in the fact that re-launching the

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156 For the detailed and updated information on the ECB’s responses to the post-2008 crisis situation, see the Annex of “Chronology of Monetary Policy Measures of the Eurosystem” in each ECB Monthly Bulletin from, for example, January 2009.
longer-term vision on EMU, the SSM shall complete the current EMU “towards a genuine EMU” with “a clear demonstration that euro area Member States are ready to agree to a substantial sharing of sovereignty when circumstances require”. Meanwhile, Cœuré (8 October 2012) emphasizes that the banking union should be jointly implemented with other measures, such as the Fiscal Compact and the functioning of the EBA. Besides, according to the Commission website, on 10 July 2013, the Commission tabled its proposal for a Single Resolution Mechanism (SRM) for the Banking Union (COM(2013) 0520 Final), which, as being designed “to centralize key competences and resources for managing the failure of any bank in the Euro Area and in other Member States participating in the Banking Union”, is believed to complement the SSM and the bank union; it is now in the legislative procedure, and on 15 April 2014, the EP gave its support to the Commission’s proposal (“Banking Union”, European Commission).

In a nutshell, each new policy and measure developed by the ECB is an integral component contributing to keeping the financial stability of EMU and enhancing the credibility of the euro. Taking a holistic point of view, each EU institution and member state shall pay their shares in solving the post-2008 crisis, and the mutual communication, coordination and cooperation among various actors and institutions at both the EU and the national level is a requirement for the successful and effective implementation of EU policies.
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