Handelsblatt

The Stability Pact

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One of the sweet pleasures of growing older is to witness the demise of poorly thoughtthrough undertakings such that the Stability and Growth Pact. In its short and hectic history, the pact already has already displayed many humorous twists and, if things evolve as it currently seems that they will, thinly concealed smiles will again illuminate our faces over the years to come. Our greatest debt for entertainment value goes to Theo Waigel. When he was running the Federal Ministry of Finance, he tried hard to keep Italy out of the monetary union, but Italy knew better how to doctor its numbers. Sensing his defeat, he then imagined a tough Stability Pact that would put Italy under tight control. Former French Prime Minister Lionel Jospin deserves our second highest gratitude for his negotiating savvy. Freshly elected, he was initially opposed to the pact and only accepted to support it after he very successfully achieved to put a mark on history by introducing the word "stability", keeping Waigel's construction otherwise intact. The smaller countries were then invited to follow the big countries' lead, and they did, as always. That was eight years ago.

Over the last two years, France and Germany only escaped facing the tough consequences of the pact by ignoring it. The smaller countries expressed outrage, what else can they express? All the powers that be in the European Union have explained that the pact is not dead, only in abeyance. Indeed, it is alive in the emergency room. It was good politics for everyone to pretend that the pact was not dead. Germany was not guilty of infanticide, France could keep the word "stability" on the cover page, the small countries' dignity was safe, and the Commission, the Guardian of the Treaty, was still in charge. Importantly, as the pact is a signed document, law-abiding citizens could not tolerate that it be summarily dismissed. The European Court of Justice was even called upon to clarify the status of the body and, in one of its famously balanced judgments, managed to please everyone.

Thus, we have now moved to the next chapter. Fortunately, it is of equal entertaining value. Last September, the Commission produced a reasonable document that could please everyone. Germany, France and other budget busters could relax; the proposal offered to deal with every country a la carte, which means that the Finance Ministers meet and talk and decide whatever is politically smart on that particular day. Of course, fiscal discipline is another issue, but who cares? Well, the smaller countries do. They know all too well that politics is about power and that the large countries will always escape unhurt while they, the smaller countries, should not expect much understanding. Are the large countries happy, then? Not even. They fear that small country militancy might grow as the EU expands and undermine old time cozy arrangements. This is why France and Germany, like all aging dictators, want a guarantee of immunity. They want the new pact to include a list of commendable public spending items that would be put off-budget. Problem is that their lists do not really overlap. Germany wants an exemption

for the enormous costs of its unification. Back in 1997, Waigel did not think that unification would be worth an exemption but now, more than15 years after the Berlin wall disappeared, his successor thinks differently. France wants an exemption for research-related spending, which is imprecisely defined. You could convincingly argue that training of researchers start in kindergarten, right? If both requests are accommodated, the list of exemptions will be so long that it will provide complete immunity. The small countries want no exemption. The Chairman of Eurogroup, Jean-Claude Juncker, who is also Luxembourg's Prime Minister and the current President of the EU, has talked tough but has circulated a draft agreement that allows for special treatment of "major events". The vagueness of the definition is smart diplomacy. Yet, a ten-hour meeting of the Eurogroup of Finance Ministers on March 7 failed to deliver any agreement.

So here we are. Our leaders spend an enormous amount of time disagreeing and will likely deliver an eleventh hour compromise that will make even less sense than the original pact. There are good reasons why apparently reasonable people behave so unreasonably: they are stuck with a flawed logic. This is really what the debate on whether the pact is dead or just sick is all about. If it were declared dead, they could start from scratch and go where sensible principles suggest they should go. If the pact only needs medication, changes can only be at the margin, leaving its sick heart in place. Why, then, are politicians clinging to the old pact? One reason is that there are too many jurists around the body. These people believe that a formal agreement must be upheld no matter what. Adjusted, maybe, but not thrown away. Another reason is that politicians are instinctively scared of a clean sheet. If they were to start from scratch, there would be too many options and, in their minds, too many sources of potential disagreement. But the deeper reason is that, beyond their disagreements, politicians all share the view that the pact should be kept in political hands. As long as they stick to this approach, they will do what politicians do, that is quarrel and strike deals.

And yet, there is another approach that would solve the problem. It starts by recognizing that governments all too often suffer from a deficit bias, much as they used to suffer from inflation bias. Inflation bias disappeared when central banks were made independent, the jewel at the heart of monetary union. Deficit bias can be cured in the same way, by giving a say to independent national committees of experts. Experts, including central bankers, are technocrats, they are not as funny as politicians, but when given a precise task, like bringing the public debt down, they deliver. Until this happens, and it is not on the radar screen right now, the show will keep entertaining us and public debts will continue swelling.