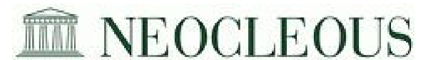
Perspectives of the Eurozone's Future



The presentation of a "Pact of Competitiveness" at the EU summit on 4 February by Germany and France was the plan for the Eurozone Member States to agree on a closer economic convergence in order to restore competitiveness to the euro area.

The proposed Franco-German Eurozone plan, which wanted to push reforms underpinning the strength of the single currency, came up against significant immediate resistance at the summit. Many smaller Member States resented that for the second time during the financial crisis, Germany and France had worked out a policy and then presented it to the rest of the EU leaders in order to achieve a deal. Apart from the concerns raised about the intergovernmental nature of the pact, it has to be mentioned that the involvement of EU institutions was also excluded.

The Pact includes six elements that Member States would have to implement within 6 months; automatic indexation of wages to prices, mutual recognition of diplomas and professional qualifications, as well as a common corporate tax base. Member States would also pledge to adjust pension schemes to take into account demographic developments, introduce debt-alert mechanisms into their constitutions and create a national crisis management regime for banks.

Doubts have also been expressed about the added value the pact will bring to existing EU economic governance rules, which are currently being reviewed by the European Parliament. The Commission also raised concerns as to whether the plan would be subject to existing EU treaty rules.

On 11 March 2011 Eurozone leaders gave in to fresh demands from Brussels and Germany to sign up to a competitiveness pact that will prompt countries to further coordinate their economic policies. The Pact for the euro, which establishes stronger economic policy coordination, will be presented to the European Council on 24 – 25 March 2011 with a view for non-euro area Member States to indicate whether they intend to participate in the Pact.

The implementation of the Pact is foreseen for next year followed by a number of measures to strengthen fiscal positions and growth prospects through fiscal, financial and structural reforms.

Regarding its financing capacity the European Stability Mechanism (ESM) will have an overall effective lending capacity of 500 billion euro, while 440 billion euro of the European Financial Stability Facility (EFSF) will be made fully effective during the transitional period and until the entry into force of the ESM.

Among the concrete policy commitments encountered in the Pact, the new Pact commits Euro area Member States to translate EU fiscal rules as set out in the Stability and Growth

Pact into national legislation. The choice of the specific national legal vehicle to be used will be left to the Member States, but it has to make sure that it has a sufficiently binding and durable nature.

Special attention will be paid to tax policy coordination. Certainly, direct taxation remains a national competence. However, the Pact commits Member States to engage in structured discussions on tax policy issues, notably on exchange of best practices, avoidance of harmful practices and proposals to fight against fraud and tax evasion.

Furthermore, the development of a common consolidated corporate tax base needs to be realised and the Commission will present its proposals in this regard in the coming weeks.

This commitment can be demonstrated by the fact that the Member States are required to achieve these objectives within 12 months as set out in the strict timetable.

The Republic of Cyprus is in line with common action of Eurozone members and the general goals that are included in the Pact. According to statements of the President of the Republic, it is especially important that the Pact ensures that the Member States will decide autonomously the particular measures to be implemented in order to achieve the general goals.

Moreover, the President stated his opposition to tax convergence and corporate tax harmonisation proposals. He specified that Cyprus's competitiveness would be severely hit, if such measures were adopted. He clarified that the tax system was already in place before the country's accession to the EU and was approved by the EU upon entering. He also stated the opposition of Cyprus to the suspension the Cost-of-Living-Allowance (COLA).

Apart from Cyprus, the Pact met a general resentment among European governments. Portugal, Luxemburg, Austria and Spain, which all have elements of automatic inflation adjustment, opposed the proposal, whereas Italy, which has the EU's second highest debt to GDP ratio after Greece, disliked the proposal to anchor binding debt reduction targets in its constitution. Ireland, which is counting on foreign investment to help it recover from its own bail out, rejected the idea of setting a minimum corporate tax level in the Eurozone and Belgium, whose government cannot afford a social crisis, objected to ending inflation and indexing of wages.

Interestingly China has offered its support. China's central bank governor, Zhon Xiaochnan stated: China has confidence in the Eurozone. Although some Eurozone nations have hardships, we will vigorously support them in surmounting their present fiscal difficulties and improving their economies.

The next step remains the formal adoption of the Pact on 24 March by the Eurozone leaders including those Member States not participating in the euro if they wish. In any case,

concrete commitments should be included in the National Reform documents and have to be presented to the European Council.

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