

**COMMUNITY ACT  
FOR ECONOMIC  
GOVERNANCE AND CONVERGENCE IN THE UNION**

## **Why we have written this paper**

Chancellor Merkel and President Sarkozy recently presented some ideas for a "Pact for Competitiveness". There is no doubt that besides the monetary union we also need as soon as possible a genuine economic union. The sovereign debt crisis in the eurozone has demonstrated that a monetary union without an economic union simply cannot work. The question is if the proposed "Pact for Competitiveness" is exactly what we need? We have serious doubts about that. First of all, the pact limits the areas for improved governance to just six specific measures. In so doing it narrows the scope of the much needed economic governance. Rather than integrating and building on existing instruments (EU2020, European Semester, Integrated guidelines, Stability and Growth Pact, macro economic surveillance framework) it adds yet another separate tier of economic policy to the Union. Finally, the pact is based on the intergovernmental method which has proved in the past to be a failure.

Therefore we urge the Commission to use its right of initiative and come forward with an alternative, a "Community Act for Economic Convergence and Governance". In this paper we provide key elements that should be included in such an act.

## **Why the "Pact for Competitiveness" will not succeed**

The first reason why the "Pact for Competitiveness" will not achieve its objectives is because the intergovernmental method simply does not work. The history of the European Union shows that intergovernmental initiatives have mostly failed, while the Community method has proved to be successful. Clear examples showing that the Community Method works are the efficient functioning of the internal market and competition policy. In these fields the European Commission is in charge and both policies are widely recognised to be success stories. Furthermore, this is a guarantee for equal treatment of all Member States.

If the Member States were to safeguard competition and internal market rules it would certainly not work. Member States would almost certainly protect their national industries if EU rules would not be enforced by the Commission. Moreover, it is clear that since the beginning of the crisis, economic protectionism has begun making a return and threatens to create a dangerous spiral, unravelling the work of fifty years of economic integration and solidarity.

The Lisbon Strategy and the Growth-and Stability Pact are other examples of policies that have failed due to the fact that no impartial referee enforces the rules. Both projects are mainly based on the intergovernmental method using open coordination, bench marking, best practice and political monitoring by the Heads of State and Government, as its main tool to discipline the Member States.

During the last decade, many countries did not respect the Growth and Stability Pact but were never confronted with a sanction. The Pact has proved inefficient in preventing high debt and deficit levels in the EU because Member States were not willing to sanction their peers. The same goes for the Lisbon Strategy that has not delivered on most of its initial promises.

We believe it would be very naive to think through the “Pact for Competitiveness” or the Barroso/Van Rompuy proposals, that Member States will improve their behaviour. We therefore strongly urge the Member States not to base the economic governance on intergovernmentalism, but on the Community method in which the Commission and Parliament, as well as the Court of Justice, have a proper role to play.

### **Limited approach of “Pact for Competitiveness” is not sufficient**

The second reason why the “Pact for Competitiveness” has limited chances to succeed is due to its narrow focus on six fixed measures or standards<sup>1</sup>. Economic governance is more complex than this. Let us give two examples. First, the sustainability of the pension system. This is not solely determined by the average age of retirement as proposed in the pact for competitiveness but also by the years and the amount of the contribution, life expectancy as well as the size of the so-called second pillar. A good example is the Dutch pension system which with a lower average age of retirement than in Germany guarantees more sustainable and higher pensions (see annex). Therefore, all elements that have an influence on the sustainability of the pension system should be taken into account.

A second example is the development of wages where the pact proposes to abolish wage/salary indexation systems. The method to determine wages and salaries is less essential than the result, namely that wages should be moderated and in line with productivity. So, it is that result that should be safeguarded.

### **Commission to draft a common economic policy based on a convergence code**

If the Heads of State and Government take economic governance and competitiveness seriously, they should entrust the Commission with providing proposals for more economic convergence and monitoring their compliance. Therefore we propose that the Commission comes forward with a "Community Act for Economic Convergence and Governance in the EU".

The Commission should propose a convergence code for Member States with minimum and maximum levels to be applied to the main pillars of their economies. Member states would have flexibility on how to apply these, but within a range fixed by the convergence code.

Convergence does not mean harmonisation but rather paving the way for further integration. Convergence involves establishing a range within which the economies of the various Member States must develop in order to collectively form a more integrated, financially robust and competitive European economy.

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<sup>1</sup>Abolition of wage/salary indexation systems

<sup>2</sup>Mutual Recognition Agreement on education diplomas and vocational qualifications for the promotion of mobility of workers in Europe

<sup>3</sup> The creation of a common assessment basis for the corporate income tax

<sup>4</sup> Adjustment of the pension systems to the demographic development (i.e. average age of retirement)

<sup>5</sup>Obligation for all Member states to inscribe the "debt alert mechanism" into their respective Constitutions

<sup>6</sup>Establishment of a national crisis management regime for banks

The range must be set in such a way that it actually encourages countries to adapt. Using ranges instead of fixed standards or vague goals takes into account more effectively than in the past the specific characteristics of each national economy. This flexible approach will allow one country to focus on industry while another concentrates more on services, and different countries have different forms of social protection. On the other hand, these ranges must be adequate, in other words the distance between the minimum and maximum levels should not be too wide.

By setting minimum and maximum levels for each of the key components that substantially affect the economic and social environment of our Member States and giving them sufficient flexibility on how to apply them, we can formulate a practical convergence code which could be applied throughout the European Union.

There is a wide range of areas for which the code of convergence should be applied.

- *Wages, productivity and unit labour costs*
- *Pensions*
- *Labour mobility and protection for workers*
- *Taxation such as a common consolidated corporate tax base, a tax band for corporate taxes and shifting taxes from labour to consumption*
- *R&D*
- *Investment in infrastructure*

### **Other key elements of the Community Act**

- The Commission shall come forward with bold proposals to accelerate the completion of the internal market based on the Monti report and an action plan for economic growth and jobs which includes, among others, binding targets for the EU2020 strategy.

- The Commission shall also propose a plan to recapitalise the European banking sector, including credible stress tests, and a European crisis management mechanism for cross-border operating financial institutions.

- The current economic governance package has to be further strengthened by introducing real automaticity and additional measures to reinforce compliance with the SGP such as a bond system that provides incentives for reducing debt, adds stability to the Euro zone and at the same time injects market confidence and frees resources for boosting EU growth.

### **Monitoring and Sanctioning**

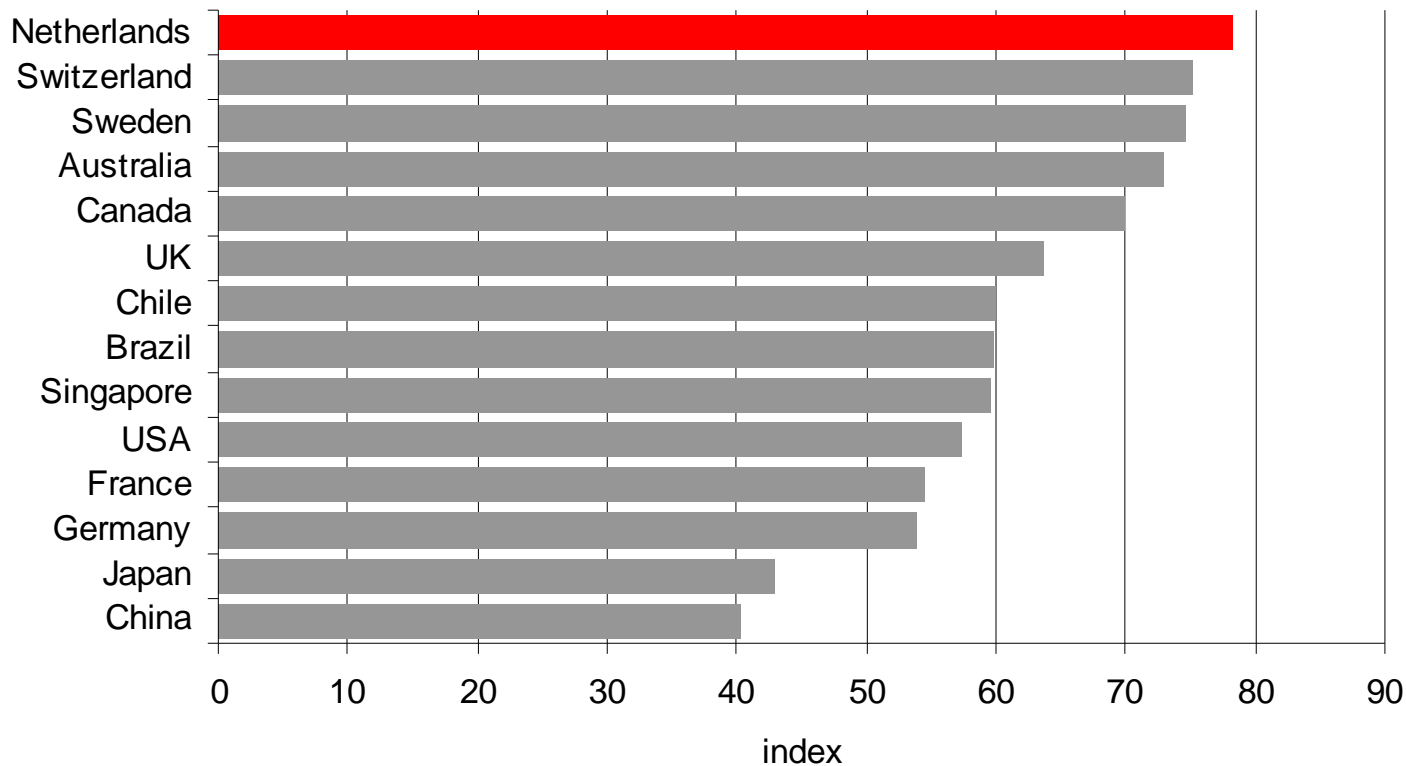
It should be the Commission and not the Member States that monitors compliance and decides on sanctions. The Commission shall examine every national measure or reform and decide if a national measure complies with the criteria and objectives as set out in the “Community Act for Economic Convergence and Governance”. In case of non-compliance the Commission shall request corrective action. If a Member State decides not to take the requested corrective action, the Commission may impose

sanctions. These should also include cuts to EU subsidies for regional funding and funds targeted at agriculture and fisheries

In order to make this way of working possible a clustering of competences in the European Commission is necessary. More specifically, we need a cluster of all economic competences and Commissioners under the lead of the Commissioner of Economic and Monetary Affairs. This cluster should have its own services able to act as independently as the services of the directorate for Competition.

## Most adequate and sustainable pension system in the world

Melbourne Mercer Global Pension Index 2010



Source: Australian Centre for Financial Studies / Mercer (October 2010)