

LEGAL AND ECONOMIC ASPECTS OF DEEPER EU INTEGRATION IN THE CZECH REPUBLIC

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Abstract

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The deeper economic integration in form of fiscal union, bank union, or increased macroeconomic surveillance is for the Czech Republic not only the question of whether and when to enter the euro zone, but also whether and when to join the other institutes. The aim of this paper is to analyse the legal background of these instruments and estimate their possible economic impact. These hypotheses would be a subject of author's further search. The future impact on enterprises in the Czech Republic is evident in some areas of the EU enhanced cooperation. Adoption of the euro is an example. Other aspects of deeper economic integration as for example the bank union do not impact the microsphere so obviously; however can significantly change the business environment in the country.

EU integration, euro adoption, impact on enterprises, EU law, European Stabilisation Mechanism, European financial stabilization mechanism, LTRO operations

The Czech Republic cannot adopt the euro at this moment because it does not fulfil the Maastricht convergence criteria. According to the Convergence report of the European Commission for the period 2009–2011 the Czech Republic does not fulfil the criterion on price stability, public finances, the exchange rate criterion and its legislation concerning the Czech National Bank is not fully compatible with the EU legislation. The criterion on long-term interest rates is under the reference value and thus does not prevent the CR from adopting the euro (European Commission. Directorate-General for Economic and Financial Affairs 2012)"source": "Open WorldCat", "event-place": "Luxembourg", "abstract": "Convergence Reports examine whether Member States satisfy the conditions for adopting the single currency. Convergence reports are issued by the European Commission and the European Central Bank every two years, or more often if a country intending to join the euro requests it. These reports form the basis for the decision on whether a Member State may join the euro area. The 2012 Convergence Report, adopted on 30 May 2012, is a regular biennial report and examines progress with convergence in eight Member States with a derogation – Bulgaria,

the Czech Republic, Latvia, Lithuania, Hungary, Poland, Romania and Sweden. It contains the Report from the Commission COM2012. Even though the fulfilment of those criteria does not pose a big challenge, the Czech government has not yet set the date for the eventual adoption of the Euro, preferring a "wait and see" policy, emphasising the continually increasing costs to current Eurozone states resulting from the deeper EU economic integration.

MATERIALS AND METHODS

This paper is based on the synthesis of the pieces of knowledge of various legal and economic texts. Other methodological instruments are scientific description and comparison. The scientific comparison is applied in case of the comparison of primary and secondary legislation of the European Union. Also other scientific disciplines as economic politics are used in the synthesis. The main materials are scientific publications, articles, documents of the Czech government and the EU institutions and legal order of the EU, i.e. the Treaty on European Union and the Treaty on the Functioning of the European Union.

RESULTS

Adoption of the euro

According to the Article 140 TFEU the Czech Republic is a Member State with a derogation from the economic and monetary union. As soon as it fulfils the convergence criteria the derogation is abrogated in accordance with the procedure described in paragraph 2 (2010 O.J. C 83/01).

The Council deciding by the qualified majority voting, abrogates the derogation, i.e. the Czech Republic can be over voted. Saying "NO" in the European Commission that makes the proposal, might not help either considering the fact, that this institution decides by the simply majority (i.e. 14 votes is enough to approve the proposal). And the third decision making body in the EU – the European Parliament – is only consulted on this matter. The relatively small role of the Member State in the decision making process changing its own currency has been one of the most used arguments of Czech eurosceptic groups for negotiating an opt-out like Great Britain and Denmark did. However even if hypothetically the EU authorities decide on the abrogation of the derogation against the Czech Republic's will they would not be able to over vote it in the next step because the binding conversion rate is fixed by the Council for Financial and Economic Affairs (ECOFIN) voting unanimously, i.e. the Czech Minister of Finance would have to agree on it.

In addition the European Council, as the highest EU political institution, also discuss the abrogation of the derogation and from the political point of view it is highly improbable that saying "NO" by the Czech prime minister would be followed by the real proposal of the European Commission even though the European Council is not the legislative but the political body in the EU.

Even though the abrogation of the derogation and final examination of whether the criteria have been met are made by the EU institutions, the decisions on the timing of the measures that will lead to euro adoption are the responsibility of the Member State (National Coordination Group for Euro Changeover in the Czech Republic 2007, page 7–8). The most obvious example is the non-fulfilment of the exchange rate criterion. The Czech koruna is not participating in Exchange Rate Mechanism II because the Czech Government has never agreed on entering in it.

The current position of the Czech government is evident from the joint document of the Ministry of Finance and the Czech National Bank Evaluation of fulfilment of the Maastricht convergence criteria and the degree of economic convergence with the euro area from December 2012. This document stipulates that due to the debt crisis in the euro area resulting in changes of economic and political arrangement the fulfilment of the Maastricht criteria, accompanied by adequate convergence of the Czech economy would be no longer sufficient

to enter the Eurozone. New Members will be also obliged to engage in new created institutions and mechanisms and that will significantly increase the costs of eventual membership of the Czech Republic in the euro area and the situation is unfavourable for the adoption of a common currency. *In light of these facts, the Ministry of Finance and the Czech National Bank ...recommend to the Czech government for now not to set a target date for entering the Eurozone* (Ministry of Finance, Czech National Bank, page 7).

Measures deepening the economic integration – legal aspects the rescue mechanisms

The Council Regulation No. 407/2010 approved the European financial stabilization mechanism (EFSM) that was necessary for helping the countries in trouble. This mechanism has been called as temporary rescue mechanism because of its non-compliance with the EU law. As required by the EU law each legal act of the secondary legislation has to be based on the primary legislation. That represented a real challenge in this case. The Article 125 TFEU often called the "no bail-out clause" says that *the Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State....* (2010 O.J. C 83/01) and should have originally been a stop sign for moral hazard of the Member States that would have relied on the fact that the EU would help them out of trouble no matter how bad their fiscal and other economic governance is (Syllová *et al.*, 2010, p. 517–518).

At the end of the day the Council Regulation was based on the Article 122 (2) TFEU saying *where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned...* (2010 O.J. C 83/01).

However Christine Lagard, a director of the IMF, made a comment for the Wall Street Journal *We violated all the rules because we wanted to close ranks and really rescue the euro zone. The Treaty of Lisbon, she says, was very straightforward. No bailing out.* And David Cameron, the prime minister of the Great Britain, enforced into the text of this Council Regulation: *The prime ministers and presidents agreed not using Article 122 for future bail-outs.*

That is why it was necessary to base the permanent rescue mechanism on the revision of the primary legislation. This change was performed by the simplified revision procedure in accordance with Article 48(6) TEU that could be used in case of proposals changing the „Internal Union policies and activities“ that are given in the Title III of the TFEU under the condition of no extension of powers. In case of the simplified revision procedure the proposals are submitted to the European Council. It adopts unanimously all or part of the changes after consulting the Commission and the EP (or with its

consent). Than all Member States have to agree on it in accordance with their respective constitutional requirements. In the Czech Republic it is set out in the Rules of Procedure of both chambers of Czech Parliament and the procedure is the same as by the ratification process used by each international agreement or its change.

The primary legislation namely the TFEU was changed by adding a paragraph 3 to the Article 136 stating: *The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality.*

The European Stabilization mechanism has been active since October 8, 2012 following the signature of German president Joachim Gauck who was waiting for the ruling of the German Constitutional Court. The Court ruled against a group of conservative politicians who requested a non-ratification of this amendment.

The stability and growth pact and pact for the euro

The EU institutions adopted some changes to existing rules and a number of new measures since the beginning of the debt crisis.

The Stability and Growth Pact (SGP) approved in 1987 has represented political commitment of Member States to stay even after the entering the euro zone in compliance with the fiscal reference values of 3% of public deficit to GDP and 60% of public debt to GDP set by the Maastricht convergence criteria. The revision of the SGP was proposed a long time before the crisis began. It started in November 2003 when the Council decided that the France and Germany (both breaking the three per cent limit for some time) should have just hold "the excessive deficit procedure in abeyance" despite the Commission recommendation to implement urgent measures to reduce the cyclically adjusted deficit. This Council decision was annulled by the European Court of Justice in 2004 ruling that the Council could hold the SGP in abeyance, but could not do so in violation of its own procedures and regulations. However it suspended the SGP so far that the ECOFIN proposed its first change in March 2005 (Subacchi, 2005, p. 749). The first fundamental change came much later, though. In December 2011 the reinforced Stability and Growth Pact in form of six pack and later on two pack measures was approved. The SIX PACK has contained five regulations and one directive that should among others provide a bigger impact on public debt criterion by decreasing it of 1/20 per year in case it is over the reference value of 60%. In addition the excessive imbalance procedure was introduced. This procedure should guarantee that also other factors as balance of payments, price unit work, private debt or real estate price have been under control in the Member States taking into account that some of these factors caused the start

of economic crisis in some countries in trouble. The TWO PACK regulations adopted in the summer 2012 enabled the budgetary surveillance over the Member States that receive a financial aid.

The Pact for the Euro was approved in March 2011. Its goal was to strengthen the competitiveness of European economies by fostering the employment, the sustainability of public finances and reinforcement of the financial stability.

The treaty on stability, coordination and governance (TSCG)

This Budgetary Pact was approved in February 2012 and has presented three groups of measures. Stricter rules regarding deficits and public debt that should be introduced into the national legislation, sanctions against the Member States which are lax in this area and the euro zone summit. As for the first group the structural deficit must not arise above 0.5% of the GDP except of exceptional circumstances. When a State's debt is below 60%, the structural deficit must not arise above 1% of the GDP except of exceptional circumstances. When a State's public debt is higher than 60%, the State in question must reduce it "at an average rate of" 1/20 per year. In case of excessive debt procedure, the MS establishes a budgetary and economic partnership with the EU. It is approved by the Council and supervised by the European Commission. Qualified majority of the Member States is required to stand against the implementation of recommendations and proposals made by the Commission. If the Commission believes that the rules have not been respected, a case is brought by it or by another Member State before the Court of Justice of the European Union. Even though the TSCG stands outside the EU law, this moment is very controversial, because the Court of Justice of the European Union has not been yet involved in cases of budgetary discipline in the primary legislation (Craig, 2012). The Heads of State of the euro zone that approved the TSCG would attend euro zone summit. Heads of States who do not belong to the euro zone (and ratified the TSCG) can take part in some euro zone summit discussions. It takes place when necessary but at least twice a year. The TSCG has come into force January 1, 2013 when 12 countries ratified it as required by it.

They are two main defects of the former approach of the Stability and Growth Pact. It did not allow for cyclical variation in budget positions and not provide much discipline for countries inside the limit. However the new approach represented in the TSCG faces on the other hand the measurement problems. It requires to distinguish between cyclical fluctuations and trend fluctuations in output almost in the real time. It means that governments have to enact a mechanism that requires adjustments in the forecast errors for structural budget balance cumulate over several years to a significant level (Lane, 2012).

Bank union

The bank union, which first stages are being implemented since January 1, 2013, is based on four pillars. The single supervisory mechanism for all EU bank is nothing especially questionable as well as the second pillar concerning common rules for bank functioning, which has been to some extent already applied. On the other hand the common system for deposit guarantees is very controversial and would definitely need a number of further negotiations within the EU. The fourth pillar, which is the common management of bank crisis, covers the financial aid to banks in trouble from the European Stabilisation Mechanism and risk of moral hazard that is closely connected to it.

DISCUSSION

Economic crisis as a ground for deeper economic integration and its impact on the rule of the EU law

It would be presumptuous and controversial to say that part of the "stakeholders" who are in favour of the deeper European integration were waiting for such an occasion as the European debt crisis. However it has been a great occasion to go ahead in this area and most interestingly the measures mentioned in this paper seemed to be prepared well in advance waiting for the right time to be implemented. It is apparent, for example, from papers prepared by the Robert Schuman Foundation explaining the European and global financial crisis and providing a quite detailed overview of the reform of the Economic and monetary union at the very beginning of the crisis.

It is also obvious from the results of this paper that the EU law was and has been often challenged if not broken. It has started with the temporary rescue mechanism where it was admitted publically, gone through the permanent rescue mechanism and extension of powers of the EU institutions and ending by the Budgetary Pact and the role of European Court of Justice.

Hypotheses of possible economic impacts

Among the economic indicators that in the long term speak for euro adoption in the Czech Republic are the high degree of openness of the Czech economy and its close trade and ownership links with the euro area (Ministry of Finance, Czech National Bank). It is therefore expected that, from a microeconomic point of view, the introduction of the euro has been beneficial. This is confirmed by the study of the impact of the euro in the Slovak Republic (Lalinský, 2010). The author will further survey the position of Czech SME/exporters/importers position in form of questionnaires and reviews.

As stated in the Article 136 the aid from the rescue mechanisms has been provided under the strict conditionality, which in this case means that the concerned Member States have to consolidate their national budgets. Thus, the rescue mechanism may play a positive role in the future. However both rescue mechanisms dispose of 750 billion EUR, which is not as much in comparison with the debts of the EU Member States. The financial markets seemed to understand this fact from the very beginning because these fiscal measures covered by headlines of the worldwide or at least European press did not represent the main factor of calming the markets in the winter 2011/2012. The European Central Bank performed this job becoming the lender of last resort. Its monetary intervention was represented by two longer-term refinancing operations (LTRO) in December 2011 and February 2012. Within these operations 1019 billion EUR was injected into European Banks at 1% rate with a maturity of three years. By doing this the ECB bought time for European politicians to deepen the European integration among others in terms of banking market regulation and supervision. Unlike the loans provided to the countries in trouble the strengthening of banks liquidity in form of LTRO operations could have had a direct impact on enterprises. They can borrow financial means at very low rates. Their unwillingness to do so is influenced by many factors including the negative economic expectations that are especially in the Czech environment followed by the very conservative approach.

As stated above the Stability and Growth Pact and Pact for the Euro are political commitments of the Member States and as such have had a minimal real impact on calming the markets. However they can indirectly improve the situation of enterprises in the long-term.

In case of economic aspects of the TSCG and bank union it is premature to estimate the impact of those new EU institutes neither on enterprises situation nor the economic crisis solution.

CONCLUSION

The timing of preparation for the euro adoption is in the competence of the Member States, however the final examination of convergence criteria and the abrogation of the derogation is made by the EU authorities. The Czech government that is responsible for setting the date of adoption of the euro prefers currently the "wait and see policy" emphasizing especially the permanently increasing costs of the Eurozone states due to the deeper EU economic integration. In order to analyse the future economic impacts especially on microeconomic sphere it is necessary to understand the legal background of these integration measures. On its basis the several hypotheses for further search were defined in the discussion.

SUMMARY

This paper is based on the synthesis of the pieces of knowledge of various legal and economic texts. Other methodological instruments are scientific description and comparison. The scientific comparison is applied in the case of the comparison of primary and secondary legislation of the European Union. Also other scientific disciplines as economic politics are used in the synthesis. The main materials are scientific publications, articles, documents of the Czech government and the EU institutions and legal order of the EU, i.e. the Treaty on European Union and the Treaty on the Functioning of the European Union.

The timing of preparation for the euro adoption is in the competence of the Member States, however the final examination of convergence criteria and the abrogation of the derogation is made by the EU authorities. The Czech government that is responsible for setting the date of adoption of the euro prefers currently the "wait and see policy" emphasizing especially the permanently increasing costs of the Eurozone states due to the deeper EU economic integration. The paper analyses the legal background of these new integration measures and defines several hypotheses of future economic impact especially on enterprises in the Czech Republic but also solution of the economic crisis as such.

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