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### Europe Set to Vote on Tougher Rules for Currency



Petros Giannakouris/Associated Press

Greek Finance Ministry workers confronted police officers on Tuesday while protesting austerity measures in Athens.

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BRUSSELS - Amid a debt crisis that threatens to engulf the global economy, the European Union this week will try again to address a serious flaw in the construction of the euro: the lack of fiscal rules tough enough to provide a foundation for the currency.

While steering far clear of transferring actual authority over national budgets here, the revamped rules, scheduled for a vote Wednesday in the European Parliament, are described as tougher, more credible and more sophisticated than the original set, on paper at least.

Laid out in six pieces of legislation and known as the six-pack, the rules contain the same targets for euro zone members as the old ones: budget deficits of no more than 3 percent of gross domestic product and a maximum debt level of 60 percent of gross domestic product.

But this time, the drafters hope the policing system will be more credible. In part, that is because countries that break rules will face the prospect of sanctions sooner, and a new voting system will make it harder for finance ministers to block them, as has happened.

"We cannot go back in time and prevent the current crisis," said Guy Verhofstadt, a former Belgian prime minister and leader of the centrist deputies in the European Parliament, "but we finally have armed ourselves with the right measures to avoid future ones."

Yet nobody can predict whether the new rules will stand up better than the old ones if challenged by the euro zone's two big members, Germany and France. That is crucial because, in the history of euro rule bending, Greece's concealment of its true public finances - which came to light almost two years ago - was only the most flagrant example.

When the euro was created, France met the rules set by the currency's founders because of a

windfall from the state-owned utility, France Télécom. Overnight, the French budget deficit shrank by 0.5 percent of G.D.P.

In 2003, Paris and Berlin exceeded the deficit limits set in the rule book, the Stability and Growth Pact. Faced with the prospect of sanctions and potential fines, Paris and Berlin used their political muscle to tear up the pact, and a weakened version was adopted in 2005.

The new sanctions system is even tougher than in the original because countries that break rules will be pressed early on to make a cash deposit - in a noninterest-bearing account - worth 0.2 percent of G.D.P.

If they then fail to correct their course, the deposit will be converted to a fine and forfeited.

And while the European Commission still must have the finance ministers' permission to punish errant countries, the voting system has been adjusted to make this significantly harder to block.

In another innovation, countries with high debt that resist reducing it by a specified amount may also be fined in a similar way. Had such a system been in place before, Italy - with a debt ratio of twice the maximum target - would have been required to consolidate more rapidly.

Instead, Italy concentrated on controlling its budget deficit. That was not enough, however, to keep it from getting caught up in the crisis as worries over sovereign debt levels spread around Europe's periphery.

The revised rules are expected to pass the Parliament, their final hurdle, though Socialist opposition to some parts could make for a close vote. Once enacted, the rules would begin to take effect in stages in January, with the rules on debt delayed until 2015.

If approved, an early warning system would be established to spot developments like asset bubbles, including the housing booms that later collapsed in Spain and Ireland. Countries thought to be at risk could find themselves in an "excessive imbalance procedure" that could also lead to sanctions.

Under the new rules, targets would apply to all 27 European Union members, but fines could be levied only on the 17 members that use the euro.

Supporters of the new rules contend that financial markets have overlooked their importance, because reaching agreement has been so tortuous and time-consuming.

But will the rules work?

"What we have is a very strict and very intrusive surveillance regime," said one European Union official not authorized to speak publicly. "You are only one decision away from potentially having to face sanctions."

But he also acknowledged the challenges ahead in identifying looming problems like asset bubbles because much will rely on interpretation of data.

"Analytically it is challenging," the official said. "You could have picked up the housing bubble in Ireland in 2006, no problem, but to pick it up in 2003 or 2004 would have been more difficult."

Perhaps the more pressing question is whether the European Commission's recommendations will be pushed through once they encounter inevitable political opposition.

The culture of European Union politics discourages countries from being tough on one another because every country knows that it might one day need to call in favors.

In the wake of the financial crisis only four European Union members - Estonia, Finland, Luxembourg and Sweden - now meet the bloc's targets, a reminder to the rest that, at some point, they might find themselves on the wrong side of the rules.

Some countries appear worried about this, too. Prime Minister Mark Rutte of the Netherlands recently proposed a system under which a powerful economic figure would be authorized to intervene in a member country's finances in the way that the European commissioner responsible for antitrust could act independently in that domain.

That reflects fears among some of the small and midsize countries that Germany and France cannot be trusted to obey the rules.




Some also continue to have trouble understanding the logic of fining a government in financial difficulty. Others say that the European Union should be trying to construct broader tools to integrate economic policy, including developing a common treasury and issuing bonds backed by the collective weight of all the countries in the euro zone.

Simon Tilford, chief economist at the Center for European Reform in London, said that, while positive, the new rules would not necessarily have prevented a crisis caused largely by the flow of huge sums of money from the euro zone's core to its periphery, aided by overleveraged banks.

"I think the discussion over rules is largely displacement activity," he said. "The euro is not in trouble primarily because the rules were broken. It is because it is institutionally incomplete, and because governments have an insufficient democratic mandate to introduce the changes needed."

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