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# SNAPSHOT

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## The EU fiscal compact ready to be signed

The new Treaty on Stability, Coordination and Governance in the Economic and Monetary Union was finalised by all EU member states with the exception of the United Kingdom and the Czech Republic on 2 February, 2012. It is expected to be signed by this March. The main rules of the fiscal compact are the following:

1) National budgets will have to be in balance or in surplus. In terms of numbers, this means annual structural government deficit not exceeding 0.5% of nominal GDP. If a member state deviates from this rule, an automatic correction mechanism will be triggered.

2) "Balanced budget rule" will have to be implemented into national legal systems, "preferably at constitutional level". The deadline for doing so is one year at the latest after the entry into force of the treaty.

The EU Court of Justice will have the right to issue a binding ruling against the member state with excessive budget deficit. If this ruling is not implemented the penalty of up to 0.1% GDP can be charged. This amount will be payable to the European Stability Mechanism if the country's currency is the euro or to the general budget of the EU otherwise.

**Assessment:** This is a long-awaited step towards a fiscal union. However, the significance of this compact remains to be seen. First of all, it is unclear how the "structural government deficit" is defined. The universal definition of a structural deficit is a deficit which is independent of the economic cycle. Hence there is lots of room for different interpretations whether a given country is or is not exceeding its structural deficit by 0.5% of nominal GDP. In addition, the strength of the punishment mechanism is questionable because "the mechanism will fully respect the prerogatives of national parliaments". In plain English this would translate to: "No one will be forced to comply". Nevertheless, the new fiscal compact can still work given a favorable stance of politicians at national parliaments.

Overall, this is positive news for the Baltic countries as the new compact aims at solving European sovereign debt crisis and restoring sustainable growth in the EU.

Best regards,

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