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Busted budgets, vented spleens

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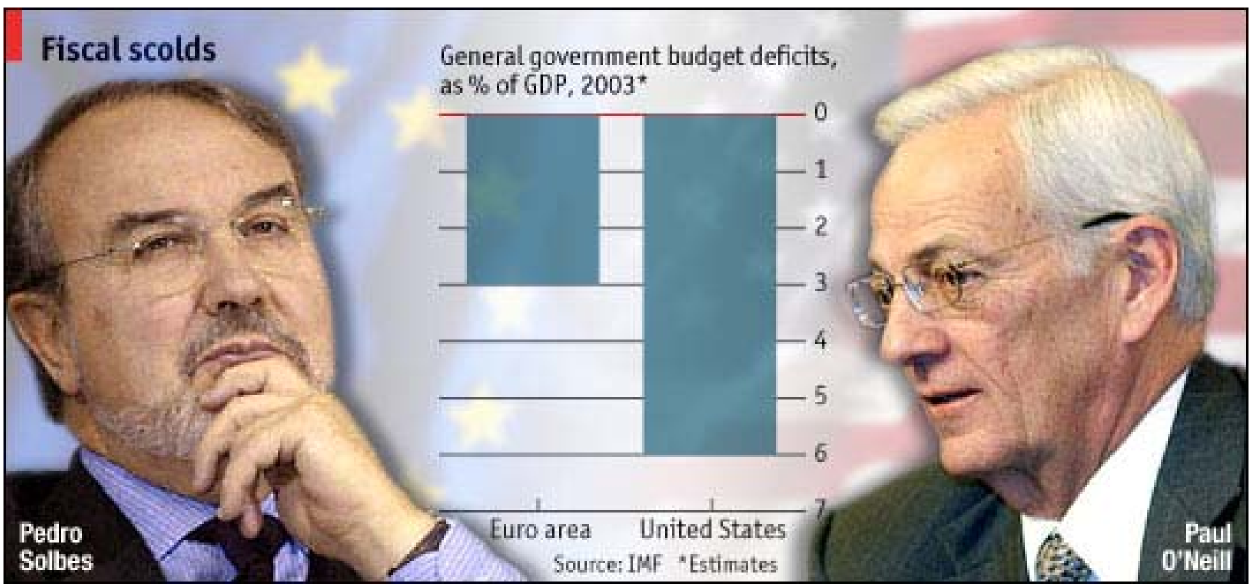
America's fiscal policy is dangerous, says the IMF. Europe's is illegal, say the bureaucrats in Brussels



"I CAN only advise the commission to come out of its corner and stop sulking," said Hans Eichel last November after he and his fellow European Union finance ministers defied the European Commission and suspended the stability and growth pact, which was supposed to deter euro-area members from running big budget deficits. The commission has now come out of its corner—waving its fists. Pedro Solbes, commissioner for economic affairs, thinks that what the council of finance ministers did in November was illegal: ministers twisted and broke treaty law to avoid punishing the single currency's two most powerful members, Germany and France, for breaching the pact. Rather than discreetly looking the other way, the commission agreed on Tuesday January 13th to take the matter to the European Court of Justice in Luxembourg.

On the other side of the Atlantic, the budget is even less balanced—thanks in part to three rounds of tax cuts enacted since President George Bush took office—and the controversy just as bitter. On Tuesday, Paul O'Neill, Mr Bush's former treasury secretary, published an as-told-to account of his two years in office written by Roy Suskind, a journalist. In that book, "The Price of Loyalty", Mr O'Neill laments Mr Bush's style of leadership (disengaged), his case for invading Iraq (disingenuous) and his fiscal record (dismal).

The last of those flaws has excited the attention of the International Monetary Fund, which gave a warning in a report last week that America's deficits, if left unchecked, posed a gathering threat to America and the world. Mr O'Neill says that when he raised his concerns about fiscal profligacy with Dick Cheney, the vice-president, he was told "deficits don't matter". The IMF insists they do. The decade of deficits that lies ahead for America will put upward pressure on interest rates, crowd out private investment and erode longer-term productivity growth, it says.

While America's fiscal shenanigans will be tried in the court of public opinion, Europe's will be tried in a court of law. How will the case unfold? The facts are undisputed. Under the stability pact, euro members agree not to run budget deficits greater than 3% of GDP. France and Germany will breach this ceiling for the third year in a row in 2004. The commission, which polices the pact, insisted they bring their deficits back into line in 2005 and find extra cuts in their budgets for 2004. Under the treaty, the commission can recommend, but it is the council of finance ministers that decides. At a meeting on November 25th, the ministers rejected the commission's prescriptions and passed some gentler, non-binding recommendations of their own. They also decided to hold the punishment proceedings of the stability pact in "abeyance for the time being".

The commission's complaint is procedural, not economic. It does not want to haggle with the ministers over whether France should cut its deficit by 1% or 0.8%. It concedes that the ministers can amend its fiscal prescriptions. But it has two gripes about the way they have done it. First, whatever finance ministers eventually do decide, it has to be legally binding: there is nothing in the treaty that allows them to come to non-binding, gentlemen's agreements with countries in the dock. Second, there is nothing in the treaty that allows finance ministers to suspend the pact's punishment proceedings as and when they see fit.

The commission's legal grounds may be quite strong but its political footing is less firm. Even those finance ministers who wanted to see the pact enforced, such as Karl-Heinz Grasser of Austria, think a lawsuit is the wrong way to settle the matter. The president of the European Parliament spoke out against a legal challenge, and the European Central Bank is reportedly against one also.

But the commission fears that the "legal clarity and predictability" of the rules governing the euro would be in jeopardy if it drops the case. Some cynics have always believed that the treaty says whatever the member states agree it says. But the commission cannot afford such cynicism. It sees itself as the guardian of

Europe's treaties, dedicated to "the principle of equal treatment" for all member states. It is keen to uphold the law, even stupid law, and equally determined to ensure that laws apply evenly to large and small states alike.

What will the court decide? It may say that finance ministers can reject the budget cuts recommended by the commission, but they cannot simply suspend the stability pact without renegotiating the treaty. Such a ruling would imply that the council of finance ministers is a sort of stability-pact referee—it doesn't have to blow the whistle unless it wants to, but it cannot simply rewrite or suspend the rules of the game as it sees fit. If the commission wins such a limited victory, the single currency might muddle along with the commission repeatedly recommending cuts and the finance ministers repeatedly rejecting them.

But the court may go further, ruling that finance ministers have to endorse the commission's recommendations, unless they have a very good reason not to—and political convenience would not count as a good reason. Such a ruling would be awkward indeed. The EU's big member states have shown that they cannot live with the letter of the stability pact. If they cannot bend the law, France and Germany would simply have to ignore it, defying the Court of Justice. It would not be the first time: France, for example, ignored a ruling that it should lift its ban on British beef for almost a year before the threat of fines finally forced it to back down.

Europe's famed "stability culture", which tries to enshrine fiscal prudence in law, is in the end not much better than America's fiscal framework. Fiscal scolds, whether in the European Commission or in the IMF, can harangue governments for busting their budgets. They can insist that deficits matter. But until deficits matter to the governments that run them, there is little anyone can do about it.