ECONOMIC POLICY COORDINATION

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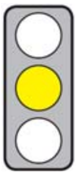
Centrum für Europäische Politik

MAIN ISSUES

Objective of the Communication: The EU is to be entitled to monitor "macroeconomic imbalances" and the "National Reform Programmes" of Member States and to coordinate their economic policies under the "European Semester". The Stability and Growth Pact (SGP) is to be reformed.

Parties affected: Entire populations, national governments and parliaments



Pro: The proposed reform of the SGP is reasonable, though not sufficient to prevent a new bail-out.

Contra: (1) The Commission neither develops insolvency proceedings for Member States nor does it call for automatic sanctions in the case of SGP infringements. Both measures would render the propagated coordination of economic policies superfluous.

(2) The coordination of economic policies will lead to a levelling of the reforms and of the the budget consolidations in Member States to mediocrity.

CONTENT

Title

Communication COM(2010) 367 of 30 June 2010: Enhancing economic policy coordination for stability, growth and employment – tools for stronger EU economic governance

Brief Summary

► **Targets and context**

– The EU is to be entitled to monitor and, if necessary, amend "macroeconomic imbalances" in and between Member States.
  - This is to ensure that "macroeconomic imbalances" are avoided in future.
  - "Macroeconomic imbalances" are characterised most notably by:
    - differences in "price or cost competitiveness" between Member States and
    - high public and private indebtedness in individual Member States.

– The Commission is to be entitled to carry out a "thematic surveillance" of "National Reform Programmes".
  - This is to ensure that the "National Reform Programmes" reflect the "Europe 2020 objectives" and that they are actually implemented.
    The "Europe 2020 objectives" [Communication COM(2010) 2020, cp. CEP Policy Brief] are: (1) To increase the employment rate to 75%; (2) to increase the research and development budget to 3% of GDP; (3) the climate and energy policy "20-20-20 targets" of the EU [cp. CEP Policy Brief, p. 8]; (4) to increase the share of university graduates to 40% and reduce the number of people leaving school without qualifications to 10%; (5) to reduce the number of people threatened by poverty by 20 million.
    These headline targets were substantiated in the Guidelines [Communication COM(2010) 193, cp. CEP Policy Brief, Communication COM(2010) 245, cp. CEP Policy Brief and Communication SEC(2010) 488, cp. CEP Policy Brief].
  - The Member States should through (non-binding) "National Reform Programmes" facilitate the attainment of these objectives.

– The Stability and Growth Pact (SGP) is to be reformed.
  - This is to ensure that Member States consolidate their state budgets sufficiently.

– The EU is to be entitled effectively to coordinate the economic policies of Member States. To this end, a "European Semester" is to be established.
  - This is to ensure that (1) Member States' economic policy plans are complementary and (2) that the Europe 2020 objectives are attained through a "solid economic and tax policy" (p. 3).

► **Surveillance and correction of macroeconomic imbalances by Commission and Council**

– The Commission proposes a two-step surveillance procedure in order to avoid macroeconomic imbalances in future. This includes:
  - as a preventive arm, an "alert system" to assess risks resulting from macroeconomic imbalances for the individual Member States and
  - as a corrective arm, an "enforcement mechanism" with which to implement remedies where macroeconomic imbalances occur.

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– The "alert system" is based on macroeconomic indicators and "expert analyses".
  - The indicators include, amongst other things: current account balances and capital transfers accounts, price level trends and unit labour costs, increases in real house prices, government debt and the ratio of private sector credit to GDP.
  - For each indicator "alert thresholds" will be defined; each level above or below such a threshold will trigger further country analysis.
  - If a Member State exhibits "macroeconomic risks", the Commission proposes to the Council to adopt country-specific recommendations. These are to comprise mainly measures regarding wages and labour market policies, measures to improve the functioning of the goods and services markets and measures regarding cuts in the granting of credits.
– The "implementation mechanism" is triggered if "significant risks" exist in a Member State and the Council establishes – at the Commission's recommendation – "excessive imbalances".
  - The Council may in such a case recommend to a Member State how to eliminate such imbalances. The Member State concerned must regularly report to the Council on the progress of the implementation of the recommended measures (p. 6).
  - For Member States of the euro-zone, inadequate implementation of these recommendations can have a negative impact on their evaluation within the framework of the Stability and Growth Pact (SGP).

► **"Thematic surveillance" of the "National Reform Programmes" by the Commission**
– The Commission is to assess the "National Reform Programmes":
  - in order to identify how each country plans to eliminate the bottlenecks it has identified and
  - to evaluate progress being made on achieving the Europe 2020 targets.
– Where progress is insufficient, the Commission proposes measures. This goes along with the proposals related to the surveillance of macroeconomic imbalances.
– If the strategies of a Member State are not in line with the Europe 2020 targets or they jeopardise the proper functioning of the economic and monetary union, the respective Member State is warned by the Commission directly.

► **Reform of the Stability and Growth Pact (SGP)**
– Member States must have national fiscal policy laws which:
  - prohibit a public deficit of more than 3% and a debt rate of more than 60% of GDP and
  - provide for a perennial budget plan.
– The preventive and the corrective components of the SGP are to be strengthened.
  - The preventive component affects Member States which do not attain the "medium-term budgetary objective" (Regulation (EC) No. 1055/2005 Art. 2a).
  - The corrective component affects Member States which are subject to a deficit procedure.
– In order to strengthen the preventive component the Commission calls for:
  - faster progress towards the 3% deficit threshold;
  - linking disbursement of cohesion policy support to structural and institutional reforms and
  - the requirement for euro-states to make non-interest-bearing deposits if they fail to meet their budget consolidation objectives.
– In order to strengthen the corrective component the Commission would like to:
  - "implement effectively" the maximum debt rate criteria of 60% of GDP and
  - extend existing financial sanctions by a two-step procedure, which is particularly efficacious in the early stages of a deficit procedure:
    - Step 1 provides that the payment of EU subsidies is temporarily "suspended" until the relevant Member State has implemented the Council's recommendation. This can affect payments (notably reimbursements) within the scope of common agricultural policy, the European fishing fund or cohesion policy. However, such cuts must not lead to losses in revenues for farmers and fishers.
    - Step 2 provides for a definite cancellation of commitments for a certain year where a Member State fails to comply with the initial recommendation of the Council (Step 1) within the prescribed period.
  - The Commission is considering creating further incentives for budget consolidation by:
    - modulating co-financing rates or
    - rewarding the commitments cancelled under Step 2 to Member States with solid budgets.

► **Coordination of the Member States' economic policies through a "European Semester"**
– The Commission sees the coordination of economic policies as:
  - an ex ante coordination of the economic policies of all 27 Member States which ensures that the individual economic policy plans are complementary before the Member States take final budget decisions;
  - the bundling and synchronising of the existing and planned surveillances of the Member States through the EU in order to coordinate the country-specific recommendations:
    - surveillance of the "macroeconomic imbalances";
    - "thematic surveillance" of the "National Reform Programmes" and
    - surveillance of the compliance with SGP.

In future, Member States must submit their Stability and Convergence Programmes and "National Reform Programmes" simultaneously. Legally, however, they are treated as separate procedures.

– The "European Semester" is planned as follows:
  - In January, the Commission will submit an "Annual Growth Survey" reviewing economic "challenges" in the EU and the euro area.
  - By the end of February the European Commission will adopt the general guidelines prepared by the Commission, which Member States must take into account when drawing up stability and convergence programmes and "National Reform Programmes". This is to ensure the complementarity of the economic policy plans of the individual Member States.
  - By mid April – not, as is the case at present, by the end of the year – Member States must update their stability and convergence programmes and "National Reform Programmes". The former are to facilitate conclusions regarding the budgetary plans for the subsequent year. If the budgetary plans are inadequate, a revision may be "recommended".
  - At the beginning of July, the Council will adopt country-specific guidelines drawn up by the Commission. The recommendations contained therein are based on the stability and convergence programmes and "National Reform Programmes" and the knowledge gained from the macroeconomic and thematic surveillance.
    - In the field of fiscal policy recommendations are made for the subsequent year.
    - In order to promote growth and to reduce macroeconomic imbalances, "key reforms" can be proposed and deadlines set for their implementation.
  - "In the second half of the year", Member States are to close their budgetary plans for the subsequent year.
  - In the Annual Growth Survey of the subsequent year, the Commission assesses if and how the Member States have taken account of the guidelines.

Commission's Statement on Subsidiarity

The Commission does not address the issue of subsidiarity.

Policy Context

The Communication is a response to the national debt crisis of spring 2010. However, it also substantiates the Strategy "Europe 2020" and, in so doing, meets the Council's requirements (EUCO 13/10, p. 4 sqq.). In a "roadmap" the Commission announces several follow-up actions (cp. Annex 1 of the Communication). For instance, it wishes to present rules on macroeconomic imbalances and minimum requirements for national fiscal policies at the end of September 2010. In addition, it wishes to propose amendments to the Regulations on preventive and corrective components of the SGP [(EC) No. 1466/97 and (EC) No. 1467/97].
On 7 September the Council only consented to the time schedule for the "European Semester"; in 2011 it will be initiated for the first time. However, it is controversial whether or not sanctions should be enforced where Member States do not follow EU recommendations.
Even more controversial are the Commission's proposals regarding the reform of the SGP. The German proposal to establish rules on insolvency proceedings for insolvent states has been rejected.

Options for Influencing the Political Process

Leading Directorate General: DG Economic and Financial Affairs

ASSESSMENT

Economic Impact Assessment

Ordoliberal Assessment

Reasonable but not sufficient is the proposed **reform of the Stability and Growth Pact (SGP)** in order **to** safeguard fiscal stability in future and to **prevent a new bail-out**.
The proposals regarding the strengthening of preventive components increase the pressure on national governments to carry out savings earlier and more decisively. Also, the two-step sanction mechanism to strengthen corrective components increases the incentives for a solid fiscal policy.
That being said, it is not the case that the SGP has so far lacked sanction opportunities. The fact that such sanctions are subject to case-by-case decisions by the Member States, however, has systematically led to their being avoided politically. Therefore, **the Commission should have prescribed as a mandatory condition that sanctions are imposed automatically** where the requirements of the Pact are not met. **Moreover, the Commission should have proposed an insolvency procedure for euro states**. Only this gives credibility to the idea of national bankruptcy and thus reduces the political pressure on the EU to rescue Member States from insolvency after 2013. **If these two measures were implemented consistently**, **the coordination of economic policies** which goes beyond the compliance with SGP as propagated by the Commission **would become superfluous**.

Furthermore, the provided coordination of economic policies within the framework of the macroeconomic and "thematic" surveillance **incorporates significant risks**. First, there is a risk that the EU recommendations are not oriented towards high-performance Member States. **We can already see today, as demonstrated by the massive resistance of low-performance Member States to the necessary reforms of the SGP, how through a coordination of economic policies these states are explicitly promoting a levelling to mediocrity.** So the planned coordination, accompanied by political trade-offs and mutual consideration, would actually make fundamental reforms in Europe even more difficult. This is, for instance, demonstrated by the repeated demand addressed to Germany to strengthen domestic consumption through an expansive fiscal policy. However, measures not oriented towards high-performance Member States would lead to excessive unit labour costs in these countries and to a drop in wealth. Additionally, Europe as a whole would lose its attractiveness as a business location compared to the rest of the world.
Secondly, there is a risk that Member States only accomplish inconvenient economic reforms if requested by the EU to do so. In this way they can shrug off all responsibility and do not have to answer to their voters. To this end, the coordination of economic policies reduces the personal responsibility of national governments.
Thirdly, the EU has had to coordinate the fiscal policy of Member States up until now anyway; it is well known that this has not been successful. It is therefore highly questionable if the EU could push through even more demanding economic recommendations, such as a social insurance reform or wage cuts in the public sector, especially as the EU has only supporting competences in these areas (cp. Art. 156 TFEU).
The macroeconomic surveillance presents further problems. Thus it is questionable whether or not the Commission will be able to fully recognise macroeconomic imbalances. Problems are created notably by the attempt to recognise price bubbles in the real estate market or other capital investment markets. Central banks, banks and insurance companies have been trying for some time to detect "too high" real estate prices. Due to the impossibility of determining a "real" price of a commodity, this is rather pointless. Moreover, it is problematic that the insufficient implementation of the recommendations to reduce macroeconomic imbalances can have a negative effect on the fiscal assessment under the SGP. **The mixing of economic and fiscal recommendations** bears the risk that the Member States concerned will weigh macroeconomic imbalances against strict budgetary consolidation. In addition, the recommendations related to the strategy "Europe 2020" must also be included into the country-specific guidelines. This additional politicization **exacerbates the already difficult enforcement of stability criteria**. Therefore, the enforcement mechanism of the macroeconomic surveillance is to be rejected. Despite the mentioned issues, the proposed "alert system" is a reasonable tool since it offers the option to address national decision-makers regarding macroeconomic imbalances before they create fiscal effects.
Due to these fundamental concerns, a coordination of European economic policies should only be considered if a strengthening of the SGP is not enforceable politically.

Legal Assessment

Legislative Competence

The EU may recommend economic policy guidelines to Member States, monitor their compliance and express warnings and country-specific recommendations (Art. 121 TFEU – Economic Policy Guidelines). It is further entitled to coordinate and monitor the budgetary discipline, notably of euro-zone countries (Art. 136 TFEU – Functioning of the Economic and Monetary Union). Regarding the reforms of proceedings related to excessive deficits (Protocol No. 12 TFEU), these can be based on Art. 126 (14) TFEU (public deficits; budgetary discipline). Whether the design of the measures envisaged by the Communication complies with this framework, or whether instead amendments to the primary law are necessary, cannot be assessed until concrete proposals have been made.

Subsidiarity

National economic policies continue to be a matter for the Member States. However, they are viewed as a matter of common interest (Art. 121 (1) TFEU). A coordination of the economic policies of several Member States can only be implemented effectively at EU level.

Proportionality

Cp. ordoliberal assessment.

Conclusion

Reasonable though not sufficient is the reform of the SGP. The Commission should have proposed the requirement that sanctions be imposed automatically. Moreover, the Commission should have proposed an insolvency proceeding for euro-zone countries. If these two measures were implemented consistently, the propagated coordination of economic policies would become superfluous. The coordination of economic policies will lead to a levelling of the reforms and budgetary consolidation to mediocrity in Member States.

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