

Improving the economic governance and stability framework of the Union, in particular in the euro area

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PURPOSE: Communication on reinforcing economic policy coordination.

CONTENT: the global economic crisis has challenged the current mechanisms of economic policy coordination in the EU and revealed weaknesses. The functioning of the Economic and Monetary Union has been under particular stress, due to earlier failures to comply with the underlying rules. The existing surveillance procedures have not been comprehensive enough. This Communication proposes measures that should be taken on the basis of the Treaty of the Functioning of the European Union (TFEU) to remedy the situation. It sets out a three pillar approach to reinforcing economic policy co-ordination.

The Communication stresses the case for making full use of the surveillance instruments available under the Treaty. Where necessary, existing instruments should be modified and complemented. The Communication calls for reinforcing compliance with the Stability and Growth Pact and extending surveillance to macro-economic imbalances. To do this, it proposes the establishment of a European Semester for economic policy coordination, so that Member States would benefit from early coordination at European level as they prepare their national stability and convergence programmes including their national budgets and national reform programmes. Lastly, it sets out the principles that should underpin a robust framework for crisis management for euro-area Member States.

Reinforcing compliance with the Stability and Growth Pact and deeper fiscal policy coordination: despite the Stability and Growth Pact, Member States failed to build up adequate buffers in good times. Reinforcing the preventive dimension of budgetary surveillance must be an integral part of closer coordination of fiscal policy. The preparation and assessment of Stability and Convergence Programmes forms the core of the preventive work under the Pact. Its effectiveness should be decisively strengthened by **increasing the ex-ante dimension of the process**, and by giving it teeth. The former is addressed through the introduction of a "European Semester". The latter could be done, for example, by including the possibility of **imposing interest-bearing deposits** in case of inadequate fiscal policies when Member States make insufficient progress towards their budgetary Medium-Term-Objectives in good economic times. Furthermore, national fiscal frameworks should better reflect the priorities of EU budgetary surveillance. To give concrete meaning to the complementarity between the EU and national fiscal frameworks, the obligation in Protocol Nr 12 TFEU for Member States to have in place budgetary procedures that ensure compliance with their Treaty obligations on budgetary discipline could be specified through legally binding instruments. The debt criterion of the excessive deficit procedure should effectively be implemented. Member States with debt ratios in excess of 60% of GDP should become subject to the EDP if the decline of debt in a given preceding period falls short of an appropriate benchmark.

The Commission proposes the following:

Improving the functioning of existing mechanisms under the Stability and Growth Pact:

- increase effectiveness of Stability and Convergence Programmes assessments through better ex-ante coordination;
- national fiscal frameworks to better reflect the priorities of EU budgetary surveillance.

Addressing high public debt and safeguarding long-term fiscal sustainability:

- give new prominence to the debt criterion of the Treaty;
- take better account of the interplay between debt and deficit.

Better incentives and sanctions to comply with the rules of the Stability and Growth Pact

- interest-bearing deposits in case of inadequate fiscal policies;
- more rigorous and conditional use of EU expenditure to ensure better compliance with the rules of the Stability and Growth Pact;
- recurrent breaches of the Pact to be subjected to more speedy treatment and more rigorous use of the Cohesion Fund Regulation.

Broader surveillance of intra-euro area macroeconomic and competitiveness developments: the accumulation of large macroeconomic imbalances among euro-area Member States has the potential to undermine the cohesiveness of the euro area and hamper the smooth functioning of EMU. To prevent the occurrence of severe imbalances within the euro area, it is therefore important to deepen the analysis and expand economic surveillance beyond the budgetary dimension to address other macroeconomic imbalances, including competitiveness developments and underlying structural challenges. It is proposed to upgrade the peer review of macroeconomic imbalances now carried out by the Eurogroup into a structured surveillance framework for euro-area Member States.

The Commission proposes the following:

- building on [Europe 2020](#), develop a framework for enhanced and broader macroeconomic surveillance for euro area Member States in form of a regulation based on Article 136 TFEU;
- develop a scoreboard of indicators to identify alert thresholds for severe imbalances;
- formulate country-specific recommendations;
- recourse to formal Council acts, by the Council voting in euro-area configuration

Integrated economic policy coordination for the EU: a "European Semester": the current cycle of economic surveillance consists mainly of an ex-post assessment of the appropriateness of economic policies with the rules of the SGP and the broad economic policy guidelines. The currently missing ex-ante dimension of budgetary and economic surveillance would allow the formulation of genuine guidance. A system of early peer-review of national budgets would detect inconsistencies and emerging imbalances. For the euro area a horizontal assessment of fiscal stance should be carried out on the basis of the national Stability Programmes and the Commission forecasts.

A European Semester should encapsulate the surveillance cycle of budgetary and structural policies. It will:

- align submission and discussions of Stability and Convergence Programmes (SCPs) and National Reform Programmes (NRPs) to assess the overall economic situation and improve timing with national budgetary cycles;
- ensure effective and timely policy advice from the European Council and the Council based on the Commission assessment;
- more effective integrated surveillance, reaping the full benefits of peer review.

Framework for crisis management for euro area Member States: the unravelling of the Greek crisis showed that a robust framework for crisis management for euro area Member States is needed. On 9 May 2010, ECOFIN decided on the establishment of a temporary European stabilisation mechanism to deal with the immediate needs of the crisis. This mechanism was created to respond to the current exceptional circumstances and entails an overall financial support of up to EUR 500 billion. Financial assistance will

be subject to strong conditionality, in the context of a joint EU/IMF support, and will be on terms and conditions similar to the IMF. This mechanism will be financed through two complementary sources. The first can mobilise up to EUR 60 billion. In addition, the euro-area Member States stand ready through an intergovernmental agreement to complement such resources through a Special Purpose Vehicle. This SPV would borrow using financial guarantees of the participating Member States up to EUR 440bn.

This mechanism largely respects the basic principles for a permanent robust crisis resolution mechanism. Therefore, the Commission considers that the first priority must now be to make this mechanism fully operational, and it intends to make a proposal for a permanent crisis resolution mechanism.