

Brussels, 30 June 2010

A toolbox for stronger economic governance in Europe

The Communication approved today by the Commission builds on the principles presented on 12 May to reinforce the economic governance in the European Union (see MEMO/10/204). It presents a set of tools to effectively strengthen the preventive and the corrective arms of the Stability and Growth Pact, extend surveillance to macro-economic imbalances and enforce effectively economic surveillance through appropriate sanctions and incentives. The establishment of a "European Semester" from January 2011 would become the cornerstone of economic policy coordination. By aligning in terms of timing the examination of national budgets and reform programmes, better ex ante coordination of economic policies will be ensured. The proposals in this Communication can all be agreed under the terms of the Lisbon Treaty and are meant for the 27 Member States of the EU, although more demanding rules will be applied for euro area Member States

1. The point of departure: appropriated rules but lack of compliance

The recent crises and the risk for the stability of the euro area have underlined the interdependence among EU economies and exposed the vulnerability of Member States, in particular inside the euro area. However, fiscal discipline, competitiveness gaps and private sector imbalances are issues for the EU as a whole, so there is a clear need for closer economic policy coordination across the EU and the euro area.

Rules and procedures for economic policy coordination, which are sound, have not been sufficiently respected. Peer pressure lacked teeth, good times were not used to reduce public debt sufficiently. Moreover, the build-up of macroeconomic imbalances was not addressed appropriately, even though the Commission had been warning about it for some time. In a number of Member States, this translated into high current account deficits, large external indebtedness and high public debt levels, which are clearly above the 60% reference value set in the Treaty. The financial stability of the Euro area as a whole has been put at risk.

The Communication by the Commission on 12 May called for stronger economic governance, so as to reinforce compliance with the rules and principles set out in the Treaty and the SGP, especially for the euro area, and to establish formal procedures to deal with macroeconomic imbalances. The Commission based its approach on three pillars:

- reinforcing the Stability and Growth Pact;
- addressing macro-economic imbalances and divergences in competitiveness;
- working towards a permanent and robust framework for crisis management.

Today's communication develops further the policy ideas set out in the Commission's Communication of 12 May 2010 and builds on the orientations agreed at the 17 June 2010 European Council, reflecting the progress to date of the Task Force on economic governance. It responds to the invitation of the European Council to the Task Force and the Commission to develop its orientations further and to make them operational. It presents a first toolbox to achieve these objectives. It will be followed by formal proposals during September and October. However, Commission expects that the Ecofin Council of 13 July can already confirm the launch of the European semester in 2011.

2. The European Semester

With a view of achieving a more integrated surveillance of economic policies, it was suggested under the Europe 2020 initiative to synchronize the assessment of fiscal and structural policies of EU Member States in the so-called European Semester. This should allow Member States to benefit from ex-ante coordination at European level when they prepare their national budgets and national reform programs. The Communication specifies how the new surveillance cycle will work in practice.

The cycle starts in January with a Annual Growth Survey (AGS) by the European Commission, reviewing economic challenges for the EU and the euro area. The AGS will be presented to the European Parliament. Member States will submit their Stability and Convergence Programmes and their National Reform Programmes in April, so that the Commission can assess them simultaneously. Then the Council, based on Commission assessments, could issue country specific policy guidance in early July. Then, in the second part of the year, Member States will finalize their budgets.

Member States are not expected to present full-fledged budgets to the EU before they present them to their national Parliament. Rather, information to be transferred should allow for meaningful discussions on fiscal policy. This would require: (i) a update of the fiscal plans for the current year; (ii) a macroeconomic scenario underpinning budgetary projections; (iii) concrete indications on plans for the following budget; (iv) a description of the envisaged policies; and medium-term budgetary projections for main government variables.

3. Macro-economic surveillance

Building on the principles of the Communication of 12 May, the Commission proposes to develop a new structured mechanism for the detection and correction of emerging macro-economic imbalances, including competitiveness divergences. To better detect imbalances, the Commission will establish a scoreboard composed of economic and financial indicators. The Commission will carry out in-depth country-analysis and issue country-specific recommendations to tackle imbalances where necessary. If imbalances are perceived to be of a serious nature, the corrective arm of the mechanism would kick in and the Member State would be placed in an "excessive imbalances position". This would lead to the issuance of detailed policy recommendations and regular reporting from the Member State to the Ecofin Council and the Eurogroup.

4. Surveillance of structural reform

To have an effective **surveillance of structural reform** is important to identify bottlenecks, to attain the Europe 2020 objectives and the five headline targets (employment, social inclusion, research and innovation, education, energy and climate change).

Based on the National Reform Programmes of the Member States, the Commission will assess the way that each country progresses towards its national targets under Europe 2020. In case of insufficient progress, country-specific recommendations could be issued. The Commission may also directly address a warning to the relevant Member State.

5. Budgetary surveillance: anticipate, detect, correct

Countries saddled with high debt have been severely hit by the fallouts of the economic and financial crisis. Fiscal surveillance should better watch **debt developments** and make operational the debt criteria in the application of the Stability and Growth Pact in both its preventive and corrective dimension. In other terms, enforcement tools will be applied in case of failure to comply with recommendations on public debt.

In good economic times, Member States with high public debt should aim at more demanding targets, in the form of medium-term budgetary objectives. As part of the corrective arm of the SGP, Member States should be subjected to provisions of the existing excessive deficit procedure if the pace of debt reduction is not satisfactory. This would be decided on the basis of compliance with a numerical benchmark complemented with sound economic judgement.

EU fiscal surveillance would improve if fiscal rules and a credible enforcement mechanism are already well-embedded into national rules and institutions. A **national fiscal framework** is the set of elements that form the basis of national fiscal governance, i.e. the country-specific institutional policy setting that shapes fiscal policy-making at national level. These national fiscal rules should ensure the respect of the Treaty reference values on deficit and debt and be consistent with the Medium-Term Budgetary Objectives. National fiscal frameworks should also foresee the involvement of all levels of government to ensure clear and effective burden-sharing, in particular in Member States with strong local governments. The Commission will propose minimum requirements to ensure national fiscal frameworks are in line with Treaty obligations.

6. Sanctions and incentives

The Commission proposes a wider range of sanctions and incentives to strengthen the credibility of EU's fiscal framework. These should also be used preventively and would kick in at an earlier stage.

For the euro area member States, an interest-bearing deposit could be temporarily imposed to countries making insufficient progress with budgetary consolidation..

As regards the corrective arm, the EU budget should be used as additional leverage to ensure respect of the Stability and Growth Pact. This includes cohesion policy-related expenditures, agriculture spending (EAGF) or fisheries fund (EFF).

In case of non-compliance with the rules, two steps are foreseen, on top of the provisions of article 126(11). First, the detection of an excessive deficit should result in the suspension or possibly redirection of commitments related to multiannual programmes. This wouldn't affect immediately on payments and would allow time for correction. Second, in case of non-compliance with the recommendations to correct the excessive deficit, it would imply the cancellation of the budgetary commitments and the definitive loss of payments for the country concerned.

End-beneficiaries of EU funds (e.g. farmers and fishermen) would not be affected. Member States would have to continue to pay the farm subsidies, without being reimbursed by the EU budget.