

Towards a genuine Economic and Monetary Union

Towards an integrated
economic policy framework:
state of play of consultations

Presentation by President Herman Van Rompuy
the European Council, 28 June 2013

Mandate

Enhancing the coordination of economic policies in the EMU

- **Coordination** of national reforms
- **The social dimension** of the EMU
- Feasibility & modalities of mutually agreed **contracts for competitiveness, growth and jobs**
- **Solidarity mechanisms** associated with such contracts

Social dimension

How to better take into account the social dimension?

- **Role of social partners** and social dialogue, in particular at national level
- To **build on existing procedures** (European Semester: e.g., broaden Macroeconomic Imbalances Procedure with complementary social indicators)
- To **build on existing tools** (*Employment and Social Protection Performance Monitors*) to supplement economic surveillance with a social perspective (e.g. develop a social and employment scoreboard)
- **Invest in human capital and address skills mismatch**

Ex ante coordination of national reforms

Which guiding principles for the design of a framework for the coordination of reforms?

- All policy areas that are **essential for functioning of the EMU** (e.g., labour, goods and services markets, public sector, tax, education, pension...)
- Focus on **reforms with significant cross-border effects**
- **Embedded in existing procedures** (European Semester)
- **Reinforcing national ownership** of the EMU (role of national parliaments; role of social partners)

Contractual arrangements

Principles for the design of contracts for competitiveness, growth and jobs

- Policy **coherence**
- Focus on **key bottlenecks** to competitiveness, growth and jobs (*identified through appropriate set of indicators*)
- National **ownership**
- **Inclusive, but differentiated and tailored** to country-specific reform needs (open to all MS, but higher degree of commitment by euro area MS)
- Democratic **legitimacy**

Solidarity mechanisms

Issues relevant for solidarity mechanisms

- Clear **economic rationale** for financial support
- Target **major reforms** with a direct impact on the smooth functioning of the EMU
- **Conditionality and monitoring**

Financial support: **grants**, but also possibly **loans**.

Way forward

- **October:** focus on
 - 1) indicators and policy areas relevant for a strengthened economic policy coordination;
 - 2) social dimension of the EMU
- **December:** agree on the main features of contractual arrangements and associated solidarity mechanisms

Towards a Genuine Economic and Monetary Union

State of play of the consultations with Member States and institutional actors

Summary note prepared by the Cabinet of the President of the European Council

June 2013

In December 2012 the European Council invited its President, in close cooperation with the President of the Commission, to present to the June European Council, and after a process of consultations with the Member States, possible measures and a time-bound roadmap on the following issues: coordination of national reforms; the social dimension of the EMU, including social dialogue; the feasibility and modalities of mutually agreed contracts for competitiveness, growth and jobs; and solidarity mechanisms in support of such contractual arrangements. The focus of the exercise is to strengthen existing policies and institutional arrangements and build on current procedures and instruments to deliver more effective and integrated action in the policy areas that are key to the better functioning of the monetary union.

This note builds largely on ideas and proposals that were expressed during a series of consultations with all Member States and the European Parliament, including through three sherpa meetings, organised since January 2013, as well as on inputs from other major stakeholders. Its aim is to highlight points of convergence and to outline areas that would require further work.

This mandate followed the submission of the Report “Towards a Genuine Economic and Monetary Union” to the European Council in December 2012, which offered a comprehensive and time-bound roadmap for the completion of the EMU¹. In addition, the Commission issued a blueprint² and the European Parliament adopted a resolution³ on the issue.

The Roadmap rested on four building blocks: an integrated financial framework (the "banking union"); an integrated fiscal framework; an integrated framework for economic policy; and the measures necessary to ensure democratic legitimacy and accountability. The completion of the banking union is particularly urgent. The European Central Bank should assume its new role as

¹ Towards a genuine Economic and Monetary Union, Report and Roadmap by President Van Rompuy, in close collaboration with José Manuel Barroso, President of the European Commission, Jean-Claude Juncker, President of the Eurogroup, and Mario Draghi, President of the European Central Bank. <http://www.european-council.europa.eu/the-president/eurozone-governance?lang=en>

² 'A blueprint for a deep and genuine economic and monetary union - Launching a European Debate' COM(2012) 777 final/2.

³ European Parliament resolution of 20 November 2012 with recommendations to the Commission on the report of the Presidents of the European Council, the European Commission, the European Central Bank and the Eurogroup ‘Towards a genuine Economic and Monetary Union’ (2012/2151(INI)).

single supervisor within the Single Supervisory Mechanism as soon as possible, in line with the regulation in question. Meanwhile, the legislation setting up the Single Resolution Mechanism will be submitted by the Commission this summer. It should provide for strong and effective resolution powers at the central level and should be adopted within the current parliamentary cycle, as agreed by the European Council in December 2012. While progress towards the banking union is urgent, the linkages between the four building blocks require that progress towards integrated fiscal and economic policy frameworks continues, and that the necessary arrangements for democratic legitimacy and accountability be ensured at each step of the process.

1. The social dimension of the EMU

The crisis has shown that lasting financial and economic divergences, if not corrected in due time, may threaten the financial stability of the euro area as a whole. Yet increasing unemployment, growing poverty and exclusion are also harmful to the Union's economic potential and social cohesion. The promotion of a high level of employment, the guarantee of adequate social protection, the fight against social exclusion, and a high level of education, training and protection of human health are an integral part of Europe's global competitive advantage. These social objectives, set out in the Lisbon Treaty, are essential to sustain our social market economy and are pursued with instruments such as the Europe 2020 Strategy, which promotes convergence towards commonly defined headline targets.

These general objectives deserve a more specific attention in the context of the monetary union. While social policy remains an exclusive prerogative of Member States, lack of coordination can disrupt the functioning and the stability of the EMU. Indeed, high and persistent levels of unemployment and social exclusion weaken citizens' support for the monetary union. Severe unemployment and social problems in a Member State of a currency union undermine its ability to fully benefit from its participation in the EMU. There is ample room for improving the framework for the co-ordination of employment and social policies in the context of the European Semester. At the same time, there is a need for an enhanced social dialogue at both the EMU and the national levels. In this context, three complementary avenues have emerged from consultations with Member States and social partners.

First, the strengthening of analytical tools to upgrade the social pillar of the EMU as was suggested by the European Parliament. This could be achieved by identifying common benchmarks in the spirit of the social benchmarks already considered in the EU2020 strategy, to broaden the

macroeconomic imbalances procedure with complementary social indicators so as to better assess the interplay between social and economic policies and contribute to improve the sharing of best practices.

Second, one could build on existing tools like the Employment Performance Monitor and the Social Protection Performance Monitor to supplement the existing economic surveillance with a social and employment scoreboard in the European Semester. While not necessarily leading to specific policy recommendations, these indicators would nonetheless provide an important complementary perspective in the context of existing procedures (Annual Growth Survey, country specific recommendations) and further promote political discussions on the social dimension of the EMU.

Third, the existing underinvestment in human capital and skills mismatch, which have important negative consequences on the long term economic potential, call for a more systematic approach to education and training by the Member States. This includes a set of policy instruments to enhance the ability of citizens to adapt to change and upgrade skills and lifelong training and social inclusion, as suggested by the European Commission in its "social investment package" communication⁴. Drawing lessons from experience, it will be key to set out clearer guidance to improve the effectiveness of national policies, to support social protection and implementation of employment guidelines, and to preserve human capital. At the European Union level, this also necessitates a more effective mobilisation of existing resources and instruments.

2. Ex ante coordination of national reforms

The economic crisis has shown that unsustainable economic policies pursued in some euro area countries in the past and the rigidities existing in their economies have negative repercussions for all Member States of the EMU.

Economic policy coordination is a requirement of the Treaty on the Functioning of the European Union (Article 121). Article 11 of the Treaty on Stability, Coordination and Governance (TSCG) further requires systematic ex ante discussion and, where appropriate, coordination of major economic policy reforms. The EMU Report and Roadmap presented in December 2012 stressed the need to put in place a more effective framework for the coordination of economic policies to

⁴ Towards Social Investment for Growth and Cohesion – including implementing the European Social Fund 2014-2020, COM(2013) 83 final.

enhance competitiveness, and to guide policies towards strong and sustainable economic growth, job creation, and social cohesion.

As suggested in the consultations, and on the basis of the Commission communication 'Ex ante coordination of plans for major economic policy reforms'⁵, a number of principles could guide the design of a framework for ex ante coordination of national reforms.

First, all policies that touch upon the smooth functioning of the EMU are of common interest and hence should be subject to ex-ante coordination. This is particularly the case for reforms enhancing the efficiency of labour markets, of goods and services markets, of the public sectors, of tax systems, of education and vocational training systems, of pension and healthcare systems as well as for reforms improving the business environment and promoting social inclusion. The capacity of the economies of the Member States to adjust to shocks and to remain competitive is key for sustainable growth, employment and social cohesion.

Second, ex-ante coordination should primarily apply in the case of economic policy reforms that entail significant cross-border spillovers.

Third, such coordination should involve the institutions of the European Union as required by European Union law and in line with Article 11 of the TSCG. This implies that ex ante coordination should take place in the context of already established EU procedures, namely the European Semester, with some flexibility and pragmatism when the timing of national reforms does not coincide with the calendar of the EU processes.

Fourth, the establishment of a framework for ex ante coordination should reinforce national ownership of the EMU by strengthening the relationship between national decision-making processes and the necessary coordination of economic policies in a monetary union. Strong national ownership of reforms entails full respect of the role of national parliaments and appropriate involvement of social partners, with a view to taking into account the social dimension of the EMU through the coordination process.

3. Contracts for competitiveness, growth and jobs

⁵ 'Towards a Deep and Genuine Economic and Monetary Union - Ex ante coordination of plans for major economic policy reforms' COM(2013) 166 final.

The economic rationale for contracts for competitiveness, growth and jobs is expounded in the December Report and Roadmap, in the Commission's Blueprint, and in the Commission communication on 'The introduction of a Convergence and Competitiveness Instrument'⁶. Essentially, the coordination of national economic policies needs to be substantially upgraded to deal with spillovers and externalities inside the monetary union. The European Semester provides a strong basis for such enhanced coordination. Mutually agreed contracts would contribute to improving the coordination of economic policies and thereby the functioning and resilience of the EMU through measures enhancing the efficiency of labour markets, of goods and services markets, of the public sectors, of tax systems, of education and vocational training systems, of pension and healthcare systems as well as improving the business environment and promoting social inclusion. Mutually agreed contracts would aim at supporting the implementation of the country-specific recommendations related to the structural weaknesses of Member States. A number of key principles have been highlighted during the consultations and would need to be taken into account in the design of mutually agreed contracts for competitiveness, growth and jobs.

Policy coherence

Contracts for competitiveness, growth and jobs should be built on, and embedded in, the existing procedures for the coordination of economic policies. The EU has significantly reinforced its policy framework through the creation of the European Semester with country-specific recommendations and of a new Macroeconomic Imbalances Procedure. Contracts should not duplicate or compete with existing procedures and instruments, but complement and reinforce them.

Focus on competitiveness, growth and jobs

Contracts for competitiveness, growth and jobs should focus on key microeconomic, sectoral and institutional weaknesses in the economies of the Member States. They would need to be tailor-made to the reform needs of each Member State, and primarily concern areas where significant structural rigidities in services, products, and labour markets prevent a Member State to reap the full economic benefit of EMU membership or risk having negative repercussions for other Member States. Building on existing instruments for economic policy coordination, further work could be devoted to defining a set of indicators with a higher degree of granularity than existing indicators, with the aim of identifying the key bottlenecks to competitiveness, growth and jobs.

National ownership

⁶ 'Towards a Deep and Genuine Economic and Monetary Union - The introduction of a Convergence and Competitiveness Instrument' COM(2013) 165 final.

Contracts for competitiveness, growth and jobs should enjoy full national ownership. They should be the result of an intense dialogue between Member States and the EU level, in particular with the Commission. Indeed, there is a gap between the recommended course of policy actions set out in the context of the European Semester and their actual implementation at the level of Member States. To bridge this gap, full national ownership of reforms is indispensable, including full respect of the role of national parliaments and appropriate involvement of social partners, with a view to taking into account the social dimension of the EMU in the design of contracts. Contracts with the EU institutions should support a process of national reforms anchored in country-specific recommendations related to competitiveness, growth and jobs.

Inclusive, differentiated and tailor-made contractual arrangements

Contracts for competitiveness, growth and jobs should be open to all Member States while respecting national competences, but be generalised for euro area Member States. A higher degree of involvement and political commitment by euro area Member States would strengthen the economic resilience of the euro area as a whole and result in a higher degree of economic convergence in the EMU. Contractual arrangements could also support reform efforts in Member States not yet having adopted the currency of the Union and contribute to making their economies fit for its adoption by improving their ability to adjust to economic fluctuations in the absence of exchange rate adjustment possibilities.

Democratic legitimacy

Contracts for competitiveness, growth and jobs need to benefit from a double legitimacy grounded on full European and national ownership and accountability. National ownership of individual contracts is pivotal to their implementation, but involvement of the European Parliament is essential for the governance of a system of contractual relationships between EU institutions and individual Member States. This is in line with the general objective of ensuring democratic legitimacy and accountability at the level at which decisions are taken and implemented, as set out in the conclusions of the 13-14 December European Council.

4. Solidarity mechanisms

Lack of structural reforms towards competitiveness, growth and jobs suggests that impediments to their implementation exist in individual Member States. Peer pressure has proven insufficient to ensure prompt delivery of necessary structural reforms in Member States, while the high degree of interdependence within the EMU stresses the need for accelerating reforms. While the long-term

benefits from structural reforms are clearly established for each individual Member State and for the euro area as a whole, it is generally agreed that some reforms entail short-term costs, directly impacting the economic situation and prospects of specific households and businesses.

Solidarity mechanisms to support reform efforts undertaken by Member States entering into contractual arrangements raise concerns about the potential for "moral hazard". The design of solidarity instruments should ensure that they do not contribute to postponing reform to the point where financial assistance becomes available. Yet the case for a solidarity instrument under strict conditions can clearly be made.

In specific cases, the contractual arrangements could be accompanied with targeted, limited and conditional financial support, to facilitate reform implementation as suggested in the Commission communication on 'The introduction of a Convergence and Competitiveness Instrument'. Building on the consultations, the following principles for the design of a solidarity mechanism should be highlighted:

Clear economic rationale for financial support

Financial support should be extended to Member States that otherwise would not be in a position to implement the necessary structural reforms in time due to their economic costs. The case for financial support should therefore be clearly established.

Targeted to major reforms supporting the smooth functioning of the EMU

Not all reforms should be eligible for financial support. Priority should be given to reforms strengthening the smooth functioning of the EMU, i.e necessary to improve the economic adjustment capacity of a Member State.

Conditionality and monitoring

Financial support should be conditional on the implementation of a set of specific and detailed measures contained in an arrangement of contractual nature, including a timeframe for implementation. In this respect, contracts eligible for financial support would need to be of a more binding nature. Lack of timely implementation of the agreed measures could, for example, lead to a suspension of financial support.

To the extent that a main impediment to the implementation of reforms enhancing competitiveness, growth and jobs is related to the financing of short-term costs, further thoughts should be devoted to

the nature of the solidarity instrument. Limited budgetary resources also calls for further reflections on the financing of the solidarity instruments. Financial support could be made available in the form of grants or transfers, or in the form of long-term subsidised loans earmarked for the financing of short-term reform costs. Compared to grants and transfers, loans would present three advantages. First, they would not require fiscal transfers across countries, thereby not exerting pressure on the budget balances of contributing Member States. Second, they would reflect the genuine economic nature of the bottlenecks to growth-enhancing reforms, namely that economic benefits are of a longer-term nature than the costs. By providing access to reform funding at a subsidised rate to countries willing to set up an ambitious reform agenda, they would contribute to dealing with the short-term impact of reforms on certain segments of society. Third, loans are more incentives-compatible than grants, and would further strengthen national ownership.