Opinion of the European Economic and Social Committee on the 'Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions — Economic governance review — Report on the application of Regulations (EU) No 1173/2011, (EU) No 1174/2011, 1175/2011, 1176/2011, 1177/2011, 472/2013 and 473/2013'

(COM(2014) 905 final)

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Rapporteur: David CROUGHAN

Corapporteur: Carmelo CEDRONE

On 19 December 2014 the European Commission decided to consult the European Economic and Social Committee, under Article 304 of the Treaty on the Functioning of the European Union, on the:

Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions — Economic governance review — Report on the application of Regulations (EU) No 1173/2011, (EU) No 1174/2011, 1175/2011, 1176/2011, 1177/2011, 472/2013 and 473/2013

[COM(2014) 905 final].

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 2 March 2015.

At its 506th plenary session, held on 18 and 19 March 2015 (meeting of 19 March), the European Economic and Social Committee adopted the following opinion by 165 votes to 2 with 3 abstentions.

1. Conclusions and recommendations

1.1. The European economic governance rules, conceived in crisis, played an important role in fiscal consolidation, economic policy coordination and, with the introduction of draft budgetary assessment, the furtherance of fiscal integration. However, the EESC is concerned that the cost has been high in terms of growth and employment, and that the European Union has lagged behind the rest of the advanced economies in exiting the economic crisis, pointing to policy failures largely due to the incomplete nature of economic governance in an economic and monetary union.

1.2. The measures put in place under the European Semester began the process of fiscal consolidation and rebuilding credibility, but the rules-based approach, while appropriate for normal times, is now part of the problem. Member States in difficulties need greater resources to exit the dead-end road of recession and guarantee growth and job creation and, through growth, sustainable fiscal consolidation.

1.3. The EESC considers that the European Central Bank cannot be left to combat the current recession in the euro area on its own. The QE measures now being embarked upon by the ECB need to be matched by greater political initiatives by the Member States going beyond the Investment Plan for Europe announced by the Commission.

1.4. Differences in the relative competitiveness of Member States in an Economic and Monetary Union, which formerly would have been equilibrated through upward and downward currency adjustments, cannot simply be addressed by urging, under pain of penalty, recommendations and reforms only on those adjudged to be uncompetitive.

1.5. Concrete mechanisms and instruments for well-designed economic policy coordination leading to convergence and solidarity should be established urgently. This process should not involve Treaty change in the first instance but the EESC is of the opinion that in the long term Treaty change will be required.

1.6. In the review of the MFF in 2016, there is a need to **back urgent structural reforms** with a common EU interest, including macroeconomic rebalancing, **with some form of fiscal capacity** such as the Convergence and Competitiveness Instrument proposed in the Blueprint.

1.7. The EESC is concerned that the structural balance, a non-observable variable based on theoretical and disputed calculations of the output gap and prone to serious revisions, plays such a key role in the preventive and corrective arms of the Excessive Deficit Procedure.

1.8. In the Semester process, reductions in the government's annual deficit are given far more weight as a remedy to the high debt/GDP ratio than more fruitful measures to increase GDP growth. The Commission should monitor not only the implementation of CSRs but also carry out an *ex-post* analysis of its recommendations in achieving an increase in output, growth and high-quality jobs in the Member State in question.

1.9. The Committee welcomes the emphasis placed on the use of flexibility within the rules of the SGP, whereby the Commission will take into account certain public investments when calculating the fiscal deficit, but considers it a limited and partial measure. A reasonable deviation from the 3 % deficit parameter should be considered as a temporary exception for a given number of years and not be automatically liable to sanctions.

1.10. The democratic deficit of unelected bodies having an important say in the governance runs the risk of low ownership of recommendations and hostility to the European project. A lack of implementation of CSRs could be countered by real involvement of civil society and the social partners in drawing up CSRs.

1.11. The EP should have a strong role in establishing the economic priorities of each Semester and in the parliamentary oversight of CSRs. The Semester process should be more widely publicised by Member States and the Commission to ensure a better understanding by citizens.

2. **The Review of Economic Governance in brief**

2.1. The European Semester, introduced in 2011, was backed up by the reinforced Stability and Growth Pact (SGP) which came into force on 13 December 2011, with a new set of rules for economic and fiscal surveillance, which consisted of five regulations and one directive — together known as the 'Six-Pack'. On 30 May 2013 two more regulations, known as the 'Two-Pack', were added to further enhance economic integration and convergence amongst euro area Member States. This Review concerns the effectiveness of the seven regulations and the direction of future developments. It deals broadly with three strains of economic governance at EU level: fiscal surveillance ([1]), macroeconomic imbalances ([2]), and the monitoring and surveillance of euro area countries experiencing difficulties with financial stability ([3]).

([1]) Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area (OJ L 306, 23.11.2011, p. 1);
Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (OJ L 306, 23.11.2011, p. 12); and
Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (OJ L 140, 27.5.2013, p. 11).

([2]) Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area (OJ L 306, 23.11.2011, p. 8); and
Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (OJ L 306, 23.11.2011, p. 25).

([3]) Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability (OJ L 140, 27.5.2013, p. 1).

3. **Comments on existing Economic Governance**

3.1. *Fiscal Surveillance*

3.1.1. The Committee welcomes the focus in the Annual Growth Survey 2015, published contemporaneously with the Economic Governance Review, which points to a streamlined and reinforced Semester achieved by simplifying the various stages and their outputs as recommended by the EESC Opinion on the Annual Growth Survey 2014 ([4]).

3.1.2. The EESC believes that the Semester plays an indispensable role in the process of convergence and adjustment. The Committee has further called for the launch of a communication and simplification strategy as a joint effort by the Commission, European Parliament, Member States and civil society ([5]).

3.1.3. The Committee welcomes the furtherance of fiscal integration introduced by the establishment of a common timeline for Member States to submit and publish draft budgetary plans, monitored by national independent bodies, by mid-October each year for the Commission's comments prior to final adoption by Member States' governments. The process should become more democratic and transparent and be more widely publicised by the Member States and the Commission to ensure a better understanding by citizens. The Committee would welcome an assessment by the Commission of the role and quality of the national independent bodies.

3.1.4. The Committee notes, from the 2015 Draft Budget Plans, that the reduction in fiscal effort in 2015 will result in a broadly neutral stance in the euro area. It also notes that of the seven countries that pose a risk of non-compliance, three may face possible steps under the EDP in March. This procedure would also require greater transparency, consultation with national governments and civil society, in particular the social partners, and oversight by the European Parliament.

3.1.5. In the short period of review, the Committee believes that the reformed EU fiscal Rules under the relevant regulations on fiscal surveillance have undoubtedly played a role in addressing fiscal consolidation as evidenced by the deficit of the EU-28 falling from 4,5 % of GDP in 2011 to 3 % in 2014.

3.1.6. The cost, however, has been high for very limited success, pointing to EU policy failures in the contribution to economic growth and jobs. By contrast, in the same period the US deficit fell from 10,6 % to 4,9 %; US GDP growth **accelerated** from 1,6 % to 2,4 % (vs. EU **deceleration** from 1,7 % to 1,3 %); US unemployment **fell** from 8,9 % to 6,2 % (vs. EU **rise** from 9,6 % to 10,2 %) and importantly US employment **rose** by 6,3 % while that of the EU **stagnated** at — 0,1 %.

3.1.7. The EESC is much less sanguine than the Commission that the structural deficit targets under the EDP allow more precise and transparent policy advice. While the Committee accepts that this measure, stripped of the distortions of the economic cycle and one-off fiscal measures, offers the opportunity of a more transparent picture, it is nonetheless a non-observable variable based on theoretical and disputed calculations of potential output gaps, which is prone to substantial revisions, and likely in some instances to yield poor policy prescription.

3.1.8. The debt/GDP ratio is an important element of fiscal sustainability. It has two components: the amount of debt and the size of GDP, neither of which can be pursued without regard to the impact on the other. An approach which concentrates on too speedy a reduction in the deficit with the objective of further reducing the debt level will, if it results in stifling or reducing GDP, have a counterproductive effect in terms of the objective of reducing the debt/GDP ratio itself.

3.1.9. The Committee welcomes the emphasis placed on the use of flexibility within the rules of the SGP, whereby the Commission will take into account (when determining the soundness of a Member State's budgetary position): a) public investments in the Investment Plan for Europe; b) investments associated with co-financing under structural funds; c) reforms that have a long-term impact on public finance sustainability; and d) cyclical conditions ([6]). In the EESC's view, however, this represents a limited and partial measure.

([4]) OJ C 214, 8.7.2014, p. 46.

([5]) EESC Opinion on Completing EMU — the next European legislature (OJ C 451, 16.12.2014, p. 10).

([6]) COM(2015) 12 final.

3.1.10. The EESC warns that despite some enhanced engagement with the EP and increased engagement with national parliaments through on-site missions and in the euro area surveillance of draft budgets, the democratic deficit remains at the heart of the process with largely unaccountable EU institutions having a significant influence over national decision-making.

3.1.11. An input deficit (i.e. no real national involvement in decision-making) that is not offset by a good output legitimacy (i.e. good economic problem-solving) results in unenthusiastic ownership of economic programmes and increasing hostility to the European project as evidenced in the European elections ([7]).

3.1.12. The Commission should make *ex-post* assessments not only of the implementation of its policy recommendations by Member States, but also whether the recommendations effectively promoted the return of the economy to a sustainable path, not only in terms of financial and budgetary adjustments, but also in economic growth, development and the creation of high-quality jobs.

3.2. *Macroeconomic imbalance procedure*

3.2.1. The Committee recognises and supports the need for the MIP as surveillance of key non-budgetary variables can identify possible unhealthy trends before they become established. The crisis demonstrated only too well the failure of the SGP in monitoring only fiscal balances, while the questions of development and employment continued to be ignored or dealt with only marginally.

3.2.2. The EP should have a strong role in establishing the economic priorities of each Semester and in the parliamentary oversight of country specific recommendations ([8]).

3.2.3. Of great concern to the Committee is the one-sided approach to the correction of macroeconomic imbalances. The problem is viewed entirely as a national problem, with almost all the emphasis on the correction of harmful deficits and a benign view of surpluses. To be addressed meaningfully, an assessment of imbalances and their impact on the Europe-wide economy is needed.

3.2.4. To ensure that the MIP and by implication the Europe 2020 project is not a repeat of the failed Lisbon Agenda, the Commission needs to instigate a better method of assessment of the quality of implementation of the CSRs and be prepared to follow up the process and provide incentives to Member States (flexibility, golden rules, etc.) before using sanctions as a last resort.

3.2.5. In contrast with budgetary surveillance, which typically has short-term easily measurable outcomes, the policy recommendations that form a significant part of the CSRs refer to softer policies and outcomes such as competitiveness, or various aspects of the environment for doing business or welfare system reforms, the level of implementation or impact of which can be hard to measure.

3.2.6. In the review of the MFF in 2016, there is a need to **back urgent structural reforms** with a common EU interest, including macroeconomic rebalancing, **with some form of fiscal capacity.** The EESC urges consideration of possible instruments: the Convergence and Competitiveness Instrument to allow stressed economies to undertake urgent structural reforms of common EU interest, outlined in six pages of the Blueprint for a deep and genuine EMU, and then the subject of a communication ([9]); a revisiting of the Green Paper on Stability Bonds, which was called for in Regulation (EU) No 1173/2011, currently under review in this opinion; and some form of minimum social insurance scheme which would aid stressed economies.

([7]) CEPS Special Report No 98, Enhancing the Legitimacy of EMU Governance, December 2014.
([8]) Ibid.
([9]) COM(2013) 165 final.

3.2.7. The Commission says that in-depth reviews are at the core of MIP, the policy recommendations of which end up in CSRs. The EESC supports this practice which has the potential of producing more insightful analysis as it involves on-site missions, which add greatly to the knowledge of the economy under review, and also has the added value of Commission and national Finance officials establishing useful working relationships.

3.2.8. As the reforms under the MIP are of a longer-term benefit, there is concern that national governments may not regard them as priority and could pay only lip service to their implementation. A crucial part of the country specific recommendations to correct imbalances should focus on completion of the internal market.

3.2.9. Real involvement of civil society and the social partners in this area of the European Semester would be an important way of ensuring compliance as well as raising its political profile and ownership at national level.

3.2.10. The EESC suggests that lessons on how the Commission and Member States could best interact could be drawn from the experience of adjustment countries, where on-going and deep surveillance was carried out.

3.2.11. An ECFIN staff paper suggests that an unimpressive 41 % of CSRs were implemented over the two-year period 2012-13, and there was a minor deterioration between the years ([10]), which may sound some loud warning signals.. We need an evaluation of the reasons for the existing gap between the recommendations and their implementation.

3.2.12. The EESC warns that the scoreboard approach, which is backward looking and is a main tool for justifying In-Depth Reviews, does not necessarily identify the build-up of stock imbalances that might precipitate a future crisis. There is, therefore, a danger that policy makers may not be provided with solid bases to take effective action ([11]) and could even be distracted from a more crucial policy focus.

3.3. *Euro area countries experiencing difficulties with financial stability*

3.3.1. The EESC recognises the need to support, through focused surveillance, countries that 1) either experience or are threatened with serious difficulties with respect to their financial stability or to the sustainability of their public finances or 2) request or receive financial assistance from EU institutions, other Member States or the IMF.

3.3.2. The EESC fully supports that in the event of entering a macroeconomic adjustment programme all other obligations, including the European Semester, are suspended and such Member States are subject to ongoing post programme surveillance.

3.3.3. The process covering the period in which a Member State seeks to apply for financial assistance remains untested as this regulation only came into effect after the four programme countries had already entered an adjustment programme.

3.3.4. The EESC calls for the Commission to carry out and publish a study on the outcomes of the adjustment programmes in the four countries, in particular to discover if the apparently less successful outcome for one of them could have been mitigated by a different approach from the Commission.

4. **A more profound vision of EMU governance is needed**

4.1. The EU is one of the largest and most prosperous economic blocs in the world which so far has survived with a dysfunctional system of economic governance arising from the decision to form an economic and monetary union with a single currency and monetary policy while at the same time maintaining national fiscal and economic policies.

([10]) ECFIN Economic Brief, Issue 37, October 2014, Implementing Economic Reforms — are EU Member States responding to European Semester Recommendations.

([11]) Daniel Gros and Alessandro Giovannini, Instituto Affari Internazionali No 14, March 2014, The 'Relative' importance of EMU Macroeconomic Imbalances in the MIP.

4.2. The EESC considers that the European Central Bank cannot be left to combat the current recession in the euro area on its own. The QE measures now being embarked upon by the ECB need to be matched by greater political initiatives by the Member States. The Investment Plan for Europe announced by the Commission is a necessary but insufficient step in the right direction. Without further fiscal integration, the nationally-focused approach to economic coordination in the European Semester prevents the euro area from pursuing an appropriate fiscal stance.

4.3. The crisis exposed deep flaws posing an existential threat to the euro. The crisis forced major reforms to economic governance, hastily drawn up and brought into being through intergovernmental treaties rather than by the Community method. Differences in the relative competitiveness of Member States in an Economic and Monetary Union, which formerly would have been equilibrated through upward and downward currency adjustments, cannot simply be addressed by urging, under pain of penalty, recommendations and reforms only on those adjudged to be uncompetitive.

4.4. The measures put in place under the European Semester began the process of fiscal consolidation and rebuilding credibility, but the rules-based approach, while appropriate for normal times, is now part of the problem. The EESC considers that economic governance (particularly of the euro area) can no longer be entrusted solely to the regulations currently under review. Member States in difficulties need greater resources to exit the dead-end road of recession and guarantee growth and job creation and, through growth, sustainable fiscal consolidation.

4.5. The EESC shares the concerns triggered by the annual report on European social developments published recently by the Commission ([12]), which states that the measures implemented to tackle the crisis have 'increased financial distress and debt levels among households, exacerbated poverty and social exclusion' and that 'the deterioration of the social situation for a prolonged period of time had a negative impact on the public belief and trust in the ability of governments and institutions to address such problems'. The data set out in the Commission report on the quality of work (part time, insecure and unstable work) and unemployment, particularly among young people, are impressive.

4.6. The EESC asks that social indicators ([13]) feature more prominently in the scoreboard and be used to regulate budget policies, starting with the Semester, to avoid undermining the EU's fundamental principles — harmonious and balanced economic development, sustainable and environmentally-friendly growth, a high rate of economic convergence, high employment and social protection, economic and social cohesion, solidarity between Member States — as established by the Treaties of Rome and thereafter enshrined in the Maastricht, Amsterdam and Lisbon treaties but insufficiently taken into account by the Fiscal Compact and all related texts.

4.7. In order to give fresh meaning to the integration of the Member States, and particularly of the euro area countries, we need to propose a European governance approach which enables the countries with the heaviest debt loads and zero or negative GDP growth to carry out the investments needed to make their production systems competitive once again and kick start development. Such an approach should take in due consideration the principles of economic and social cohesion enshrined in the EU founding treaties.

4.8. A reasonable deviation in any Member State from the 3 % deficit parameter could be considered a temporary exception for a given number of years and thus would not automatically trigger sanctions. Under this new governance approach, the Commission must carefully examine the needs indicated by countries in difficulty, assess whether the investment plan proposed by the Member State is suitable and feasible in light of commitments undertaken (stability/convergence and national reform programmes) in the European Semester, and approve it with the oversight of the European Parliament.

4.9. Parameters used to develop budgets and interpret data must be uniform and aligned and must apply to all countries and their administrations, with a transparent, understandable and publicly-known procedure. One single regulation with clear, simple rules could suffice, ensuring the involvement of civil society, the social partners and national parliaments.

([12]) Employment and Social Developments in Europe, December 2014.
([13]) For example: GDP growth, unemployment, long-term unemployment, people at risk of poverty, public investment, the relation prices-wages, etc.

4.10. Following this approach, the Semester should be turned into a major opportunity for EMU with a view to restoring mutual confidence and launching a common process, both as regards structural reforms (which need to be agreed for all euro area countries) and for the budget. The regulatory framework should evolve towards a new euro area budget, testing a common development procedure with the greatest possible transparency and truthfulness as watchwords for European public opinion.

Brussels, 19 March 2015.

The President
of the European Economic and Social Committee
Henri MALOSSE