BRIEFING

Economic Dialogue and Exchange of Views with the President of the Council (ECOFIN)

ECON on 13 July 2016

Mr Peter Kažimír, Minister of Finance of Slovakia, is participating in the ECON meeting in his capacity as the current President of the ECOFIN Council during the Slovak Presidency (July - December 2016). According to the Treaty of the Union, Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council. This briefing covers the Slovak Presidency priorities, the implementation of the Stability and Growth Pact, the Macro-economic Imbalance Procedure, the Country Specific Recommendations and the latest developments in completing the Banking Union.

The Slovak Presidency: ECOFIN priorities

On 1 July 2016, Slovakia took over its first-ever Presidency of the Council since it joined the EU in May 2004. On the same day, the Slovak Prime Minister Robert Fico and the President of the European Commission Jean-Claude Juncker held bilateral meeting that revolved around three main issues, namely: migration, the Bratislava summit of 16 September 2016 and Brexit. President Juncker welcomed the priorities of the Slovak Presidency and considered they are "*in total harmony*" with the Commission own Work Programme.

The Programme of the Slovak Presidency, approved by Slovakia's government on 30 June 2016, recognises that the outcome of the UK's referendum brings a new challenge as *"we are required to concern ourselves with the practicalities and political ramifications of a Member State leaving the EU"*. In this context, the Presidency is to focus on four key priorities:

1) ***an economically strong Europe*** - creating an appropriate environment for investment and for further development of the Union;
2) ***a modern single market*** - further developing what is considered to be the "*greatest achievement of the EU*", such as the energy union and the digital single market;
3) ***sustainable migration and asylum policies*** - seeking to develop more sustainable migration and asylum policies against the backdrop of the current migration crisis;
4) ***a globally engaged Europe*** - strengthening the EU's position in the world.

As regards the ECOFIN Council agenda, the Slovak Presidency is to focus on the following issues:

- *Economic and Monetary Union (EMU)* - taking forward discussions on long-term measures to complete the EMU, including active participation in the Commission (COM) White Paper consultation process on the second phase of deepening the EMU (to be published in spring 2017); making the Stability and Growth Pact (SGP) simpler and more transparent, while striking the right balance between objectives of macroeconomic stabilisation and fiscal sustainability;
- *European Semester* - evaluating the 2016 Semester cycle, while continuing discussions on its further improvements, including by better implementation of Country Specific Recommendations (CSRs); in this context, the Presidency stands ready to start discussions with the European Parliament on the establishment of a programme to support structural reforms for the period 2017-2020;

Authors: J.Angerer, K.Hagelstam, M.Hradiský, A.Margerit and A.Zoppè

- *European Fund for Strategic Investments (EFSI)* - pursuing evaluation of the Fund's functioning while ensuring that its maximum investment potential is delivered (amid expectations that the Fund will mobilise at least one third of the EUR 315 billion target amount);
- *Capital Markets Union* - aiming to reach a political agreement with the European Parliament on money market funds, revision of the prospectus regime and securitisation;
- *Banking Union* - taking forward the work on completing the Banking Union, including seeking to make progress on the European Deposit Insurance Scheme (EDIS), while identifying measures to reduce risk within the European banking sector;
- *Taxation* - focusing on the fight against tax evasion; seeking political guidelines as regards modernisation of the VAT system based on the COM VAT Action Plan unveiled in April 2016; The Presidency also expects that a renewed initiative on a common consolidated tax base for corporate income tax will be presented before the end of 2016;
- *EU budget* - working towards a political agreement between the Council and the European Parliament on the 2017 EU budget, striking the balance between supporting the EU budgetary priorities (growth, employment, competitiveness and cohesion) and flexibility to address unexpected challenges.

Stability and Growth Pact: recent developments

- On 7 July 2016, the COM recommended to the Council to establish that **no effective action** has been taken by Spain and Portugal in response to the Council Recommendations of 21 June 2013, in accordance with Article 126(8) of the TFEU. Spain did not meet the intermediate headline deficit in 2015 and is not forecast to put an end to its excessive deficit by the 2016 deadline under the EDP; the fiscal effort falls significantly short of what was recommended by the Council. Portugal did not put an end to its excessive deficit by the deadline of 2015; the fiscal effort falls significantly short of what was recommended by the Council. The legal bases for the way forward for these countries under the fiscal framework of the EU are summarised in box 1.
- On 29 June 2016, the European Council generally endorsed (based on the approval by the Council of 17 June 2016) the **2016 Country Specific Recommendations** (CSRs) under Art. 121(2) of TFEU. The CSRs include the Council Opinions on the 2016 Stability or Convergence Programmes (SCPs) of the Member States, with the objective to implement the preventive arm of the SGP; see separate EGOV table for a presentation of the relevant parts by country. The final adoption of the 2016 CSRs is foreseen for 12 July 2016.
- On 17 June 2016, the Council **abrogated the Excessive Deficit Procedures** (EDPs) for Cyprus, Ireland and Slovenia as these countries have brought their deficits below the 3% of GDP reference value and are forecast to remain below this level in 2016 and 2017.
- Early June, the **President of ECOFIN and Euro group** remarked: "*It would be wise for the Commission to pay a little more attention to its credibility*," adding that Member States needed an "objective arbitrator" who upholds the budget rules manifested in the SGP Pact. "*You have to be a little careful if it is in your advantage that the commission* ***turns a blind eye*** *... In the end, if we turn a blind eye everywhere, we make a blind monetary union.*" These remarks were linked to previous public statements by the COM President Juncker indicating that COM gave leeway on fiscal rules to France "*because it is France*".
- On 18 May, the COM launched a formal consultation to the Member States that are contracting parties of the Fiscal Compact to enquire about their progress in implementing in national law the provisions of the Fiscal Compact. The Member States concerned have two months to submit their observations to the COM.
- The Member States submitted in April/May the 2016 **Stability or Convergence Programmes**, detailing the national fiscal plans for the next three years. The COM assessments of these programmes were published on 18 May 2016 (and the COM staff working documents on

26/5/2016). The COM also prepared reports on **Belgium, Finland** and **Italy** (under Art. 126(3) TFEU) on their compliance with the debt criterion of the Treaty.

Box 1: Extension of dead-line under EDP

Main procedural options to extend a dead-line to correct an excessive deficit are:

- Establishing that "effective action" has been taken by the Member State concerned under Article 126(7) of TFEU (and in accordance with Article 3(5) of Regulation 1467/97)) or
- Following a Council decision under Article 126(8) of the TFEU that "no effective action" has been taken by a euro area member State, the Council would adopt a decision under 126(9) (and in accordance with Article 5 of Regulation 1467/97) to give notice to the Member State concerned to take measures for the deficit reduction in accordance with Article 126(9) TFEU. See further related procedural steps below.

Council Regulation 1467/97 (Articles 4 and 5):

- Where the Council establishes, in accordance with Article 126(8) TFEU, that the Member State concerned has failed to take effective action, it shall report to the European Council accordingly.
- The Council shall make its decision public and report to the European Council accordingly;
- Any Council decision to give notice to the Member State concerned to take measures for the deficit reduction in accordance with Article 126(9) TFEU shall be taken within two months of the Council decision under Article 126(8) TFEU establishing that no effective action has been taken. In the notice, the Council shall request that the Member State achieve annual budgetary targets which on the basis of the forecast underpinning the notice, are consistent with a minimum annual improvement of at least 0,5% of GDP as a benchmark, in its cyclically adjusted balance net of one-off and temporary measures, in order to ensure the correction of the excessive deficit within the deadline set in the notice. The Council shall also indicate measures conducive to the achievement of those target

Council Regulation 1173/2011 (Article 6):

- The Commission shall within, within 20 days of adoption of the Council's decision, recommend that the Council, by a further decision (based on reversed QMV), require the Member State in question to lodge with the Commission an interest-bearing deposit amounting to 0,2 % of its GDP in the preceding year;
- However, the Commission may, following a reasoned request by the Member State concerned addressed to the Commission within 10 days of adoption of the Council's decision establishing that a Member State failed to take action, recommend that the Council reduce the amount of the interest-bearing deposit or cancel it.

For the measures referred to above only members of the Council representing Member States whose currency is the euro shall vote, and the Council shall act without taking into account the vote of the member of the Council representing the Member State concerned.

Regulation (EU) No 1303/2013:

- The Commission shall make a proposal for suspension of part of the commitments under the European Structural and Investment Funds.

Treaty on the Stability, Coordination and Governance in the EMU (Article 7):

- The contracting Parties whose currency is the euro commit to supporting the proposals or recommendations submitted by the Commission where it considers that a Member State of the European Union whose currency is the euro is in breach of the deficit criterion in the framework of an excessive deficit procedure. This obligation does not apply when a qualified majority is opposed to the decision proposed or recommended ("reversed QMV").

Box 2: Application of the debt rule

EU Regulation 1467/97stipulates that **the debt rule** (which is relevant for countries with a debt above 60% of GDP) **is applicable after a transition period of three years from the correction of the excessive deficit, if the country was in an EDP on 8 November 2011.** Member States within the transition period have to comply with a Minimum Linear Structural Adjustment. The COM staff working documents of 26 May 2016 state that the transition periods for Italy and Hungary expired end of 2015 and that they will expire for Belgium, Austria and the Netherlands end of 2016. Germany, Finland and Malta were already subject to the debt rule before 2016. As regards Ireland, Greece, Spain, France, Cyprus, Portugal, Slovenia and the UK, which are still in EDP (opened before 8 November 2011), it will become applicable after the transition period of three years following correction of the excessive deficit. For Croatia it will be applicable without transition period.

- On 9 March 2016, the COM reminded some Member States of the need to take measures necessary to meet their obligations under the SGP. For **Spain**, as the country is currently in EDP, the reminder took the form of an **Autonomous Commission Recommendation** (ACR), a tool introduced by EU Regulation No 473/2013 as an early alert to euro area Member States in the corrective arm. The COM also **notified Belgium, Croatia, Finland, Italy and Romania** of its concerns regarding their compliance with the SGP.

- The **Eurogroup of 7 March 2016** made an assessment of compliance of euro area Member States with the provisions of the SGP. Four countries (Germany, Estonia, Luxembourg and Slovakia) are assessed to be **compliant** with their obligations under the SGP, six (Ireland, France, Latvia, Malta, the Netherlands and Finland) are assessed to be **broadly compliant** with it and seven (Austria, Belgium, Italy, Lithuania, Portugal, Slovenia and Spain) are judged to be at **risk of non-compliance**. This assessment was **more pessimistic for some Member States** compared to the **COM Opinions of November 2015**, done in accordance with EU Regulation No 473/2013.

- On 19 April 2016, the **European Court of Auditors** (ECA) published a Special report on "*Further improvements needed to ensure effective implementation of the EDP*". The Court examined the COM's implementation of the EDP between 2008 and 2015, focusing on six Member States and made recommendations to the COM (both to Eurostat and to DG ECFIN).

- The **COM's answers** to ECA report are all included in the annex of the report. Below some elements of these replies: "*The COM is committed to equal treatment of Member States. Where shortcomings in this respect have been identified, the COM has taken action to ensure the consistent application of rules and will continue to do so*" (p. 2 of the Annex). "*The COM only partially accepts the recommendation. Due to the significant and effective achievements in recent years in codifying concepts and methodologies used in the assessment of compliance with the EDP and in making available to the Member States all the calculations underpinning its assessments, transparency has already been improved. The process of independent verification will be strengthened by the recently set up European Fiscal Board as a functionally independent body comprised of five experts, tasked with assessing horizontal consistency of the decisions and implementation of budgetary surveillance*" (p. 3 of the Annex).

Box 3: Council conclusions on the ECA special report on the EDP

The ECOFIN Council adopted on 20 June 2016 conclusions on the ECA Special report on improvements needed to ensure effective implementation of the EDP:

"*Agrees that when a Member State does not implement effective action in response to the recommendations of the Council and does not fulfil the nominal targets, the Commission should make a recommendation to the Council to step up the procedure, and, as a general rule, in accordance with the relevant provisions of the SGP, to initiate the imposition of sanctions*;

Welcomes the Court's conclusion that the Commission has taken significant steps towards rationalizing and simplifying its use of the EDP as a tool for better economic governance throughout the EU in a context of increasing complexity. CONCURS on the need to examine options for improving the predictability and transparency of the SGP, with the ultimate aim of improving the effectiveness and credibility of the European Union's fiscal framework".

The conclusions were preceded by various discussions on how to **improve the current methodologies of the SGP, see for instance** a Dutch Presidency note, a Commission note, and the **informal ECOFN of 23 April**. The latter indicated that a way to improve the functioning of the SGP would be to find a (complementary) indicator that would be less volatile to revisions than the structural balance indicator (which relies on estimates of potential growth, see separate EGOV note) and how to improve the medium-term orientation on the budgetary planning. The COM is currently working on technical level on ways to improve these elements. Given that the structural balance indicator is a central element of the Regulations on the preventive and corrective arms of the SGP, removing it could clearly incline a change of the rules themselves.

All the methodologies used for in the revised SGP framework, including the agreed flexibility parameters, are summarised in the **Vade Mecum on the SGP** of March 2016. The Vade Mecum will be updated annually in line with a commitment in the COM Communication of 21 October 2015 on Completing EMU.

Macroeconomic Imbalance Procedure: recent developments

In March 2016, the COM published the Communication on the "*2016 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews...*" which was updated on 7 April by including Cyprus (as it exited the financial assistance programme at the end of March). The document Implementation of MIP provides more detail on the state of play in 2016.

According to the COM, Members States are making **progress with rebalancing** their economies:

- As far as external imbalances are concerned, the COM points to the need that such rebalancing takes place both in countries with large stocks of external liabilities and in those with current accounts surpluses, given the importance of trade and financial links among EU countries;
- Concerning internal imbalances, they are essentially characterised by the high levels of debt, both public and private.

On the basis of the in-depth-reviews published in February, the COM concluded that **fewer Member States than last year are considered to present macroeconomic imbalances.** Of the Member States identified in November 2015 as at risk of macroeconomic imbalances:

- Six Member States are experiencing **no imbalances**: Belgium, Estonia, Hungary, Austria, Romania, United Kingdom;
- Seven Member States are experiencing **imbalances**: Germany, Ireland, Spain, the Netherlands, Slovenia, Finland and Sweden;
- Six Member States are experiencing **excessive imbalances**: Bulgaria, Croatia, Cyprus, France, Italy and Portugal.

It can be noted that the five Member States that were experiencing excessive macroeconomic imbalances in 2015 are still experiencing excessive imbalances in 2016. Croatia and Italy have been under this category since 2014 (See Table 1). However, the COM has not proposed to open the **excessive imbalance procedure** for any country.

Table 1: Commission's conclusions under MIP

No Imbalances					Imbalances*					Excessive imbalances*				
2012	**2013**	**2014**	**2015**	**2016**	**2012**	**2013**	**2014**	**2015**	**2016**	**2012**	**2013**	**2014**	**2015**	**2016**
CZ*	CZ*	CZ*	CZ*	BE	BE	BE	BE	BE	DE		ES	**HR**	**BG**	**BG**
DE*	DE*	DK	DK*	CZ*	BG	BG	BG	DE	IE		SI	**IT**	**FR**	**FR**
EE*	EE*	EE*	EE*	DK*	DK	DK	DE	IE	ES			SI	**HR**	**HR**
LV*	LV*	LV*	LV*	EE	ES	FR	IE	ES	NL				**IT**	**IT**
LT*	LT*	LT*	LT*	LV*	FR	IT	ES	HU	SI				**PT**	**PT**
LU*	LU*	LU	LU*	LT*	IT	HU	FR	NL	**FI**					CY
MT*	AT*	MT	MT*	LU*	CY	MT	HU	RO	**SE**					
NL*	PL*	AT*	AT*	HU	HU	NL	NL	SI						
AT*	SK*	PL*	PL*	MT*	SI	**FI**	**FI**	**FI**						
PL*		SK*	SK*	AT	**FI**	**SE**	**SE**	**SE**						
SK*				PL*	**SE**	UK	UK	UK						
				RO	UK									
				SK*										
				UK										

Source: European Commission, ECB and EGOV calculations.
Note: (1) The table refers only to the streamlined categories applied from the 2016 cycle onwards.
(2) The 2016 data are based on the COM Communication of 7 April 2016, which includes Cyprus.
(*) Countries not considered at risk of macroeconomic imbalances, therefore not subject to in-depth reviews according to the AMR.

In May 2016, the COM proposed its **draft 2016 Country Specific Recommendations and for** Member States considered as at risk of macroeconomic imbalances the CSRs are in most of the cases underpinned by the MIP (See a separate EGOV note on the MIP procedure). Among the 50 draft CSRs targeting the 13 Member States with macroeconomic imbalances, 45 have the MIP as a legal basis. All the draft 2016 CSRs targeting Member States with "excessive imbalances" are underpinned by MIP.

Box 4: The 2016 Council conclusions on the MIP

The ECOFIN Council, on 16 January 2016:

- *Agreed that the MIP procedure should be used to its full potential, **with the corrective arm applied where appropriate;***
- *Expressed concern about the inclusion of three additional employment indicators to the main scoreboard, given the need to preserve the effectiveness of the scoreboard as an early warning device...*
- *Underlined that social and labour market indicators are not relevant for identifying macro-financial risks and developments in these indicators cannot trigger steps in the MIP process; and*
- *Invited Member States to address in an ambitious and concrete manner the issues identified within the framework of the MIP*.

Moreover, in May 2016 the Council underlined that "*the MIP procedure should be used to its full potential, with the corrective arm applied where appropriate*".

So far, the **implementation of the CSRs based on MIP** has been rather disappointing: the Commission (May 20016) stated that **"***More progress in the implementation of country-specification recommendations is identified for Member States experiencing imbalances than for Member States without imbalances, presumably due to the larger need for reform, stronger policy dialogue and, in some cases, in response to stronger market pressure".* In fact, **only 7%** of the MIP-related 2015 CSRs have been **fully implemented**, a minor improvement compared to the previous Semester Cycles, when the "full" implementation rate was 5%.

Country Specific Recommendations: Recent developments

On 28-29 June 2016, the European Council generally endorsed the CSRs as approved by the Council on 17 June 2016. During the adoption process, the Council is expected, as a rule, to follow the Recommendations and proposals of the Commission or explain its position publicly (nota that the COM presented the draft CSRs on 18 May 2016[12]). This rule is to ensure a greater transparency and accountability of the multilateral surveillance process in the context of the European Semester. In 2016, aside a number of additions and factual or technical changes to recommendations with the full support of the Commission, the Council did not follow the COM proposal (in a sense that the COM did not agree to the proposed changes) only on one single occasion, namely CSR 1 for Germany (see box 5).

Box 5: Comply or explain

In line with Article 2-ab(2) of EU Regulation No 11757/2011 ("*comply or explain*" rule), the Council explained its changes to the CSR 1 for Germany (to which the COM did not agree) as follows (see the Council document 9327/16):

Commission text:
Achieve a sustained upward trend in public investment, especially in infrastructure, education, research and innovation, by using the available fiscal space and prioritising expenditure.

Agreed text:
Achieve a sustained upward trend in public investment, especially in infrastructure, education, research and innovation, while respecting the medium term objective.

Explanation:
It was agreed that the change would not alter in a substantive way the country recommendation, while it avoids reference to a concept (i.e. fiscal space) that is not defined in the SGP.

For the full list of all the changes introduced by the Council, see a separate EGOV document.

As outlined in the accompanying COM Communication, the draft 2016 CSRs were devised under the so-called **streamlined Semester**[3] that was first implemented in 2015. Besides reducing the number and better focusing CSRs, the streamlined Semester process is also characterized by an earlier assessment of implementation of CSRs adopted under the previous cycle. Building on these elements, the process has been further refined along several dimensions as from the 2016 cycle. First, the COM proposed its recommendations to the euro areas as a whole at the very beginning of the cycle, so as to allow for a better integration of the priorities defined at the euro area level into national policies and reforms. Furthermore, the number of CSRs has been further reduced (see Table 2 below). At the same time, recommendations put greater emphasis on the objective to achieve, while leaving definition of the measures needed to attain it to the discretion of national authorities. The dialogue with Member States and other European institutions has also been intensified. The intended goal of all these refinements is to increase the ownership of CSRs and thereby improve the low rate of reform implementation.

[1] The Commission does not propose country-specific recommendations to Member States receiving financial assistance so as to avoid duplication with measures set out in the economic adjustment programme.

[2] The COM proposals build on several elements, notably: (1) the three main pillars identified in the 2016 Annual Growth Survey[2], (2) the longer-term vision outlined in the Europe 2020 Strategy, (3) the COM's Country Reports (4) the COM's assessment of Stability/Convergence Programmes and National Reform Programmes submitted by Member States in April 2016, and finally (5) the outcome of dialogues with national authorities and stakeholders as well as the European Parliament.

[3] The streamlined Semester is characterised by an earlier publication of assessment of CSRs implementation and the in-depth reviews under the MIP in a single Country Report as well as a more intensive discussion between the Commission, national authorities and social partners on implementation of past recommendations and potential areas for future recommendations.

Table 2: CSRs - Some stylized facts

European Semester	Total number of CSRs	Number of Member States	Average number of CSRs per Member State	Minimum number of CSRs	Maximum number of CSRs
2012	138	23	6,0	4 (DE, SE)	8 (ES)
2013	141	23	6,1	3 (DK)	9 (ES, SI)
2014	157	26	6,0	3 (DK)	8 (ES, HR, IT, PT, RO, SI)
2015	102	26	3,9	1 (SE)	6 (FR, HR, IT)
2016	89	27	3,3	1 (SE)	5 (FR, HR, IT, CY, PT)

Source: European Commission and EGOV calculations.
Note: The 2016 CSRs are to be adopted by the Council in July 2016.

As shown in Tables 3, a single recommendation is typically underpinned by a single instrument of the EU secondary law. However, CSRs related to sustainability of public finances might refer to both the SGP and the MIP.

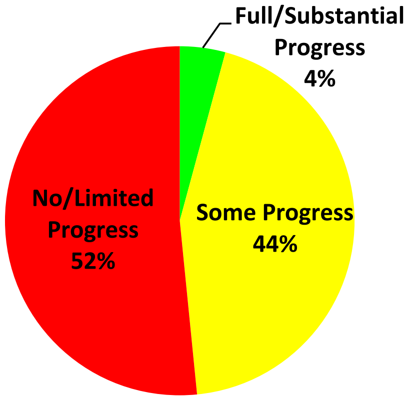
Table 3: Number of CSRs by secondary legal base

European Semester	Exclusively SGP		Exclusively MIP		Jointly SGP and MIP		Integrated Guidelines		Total	
2012	18	(13%)	31	(22%)	5	(4%)	84	(61%)	138	(100%)
2013	18	(13%)	50	(35%)	6	(4%)	67	(48%)	141	(100%)
2014	19	(12%)	58	(37%)	8	(5%)	72	(46%)	157	(100%)
2015	11	(11%)	48	(47%)	10	(10%)	33	(32%)	102	(100%)
2016	13	(15%)	36	(40%)	9	(10%)	31	(35%)	89	(100%)

Source: European Commission and EGOV calculations.
Note: Share of CSRs by secondary legal base for a given Semester cycle in brackets. The 2016 CSRs are to be formally adopted by the Council in July 2016.

While the total number of CSRs has steadily declined since 2014, the implementation rate has not significantly improved (see Figure 1), even taking into account the stronger focus on national ownership in the stream-lined semester process. Excluding the COM's assessment of the 2016 Stability or Convergence Programmes relating to the implementation of 2015 fiscal CSRs (see section of SGP) for seven Member States, EU Member States fully/substantially implemented 4 out of 95 (or equivalently about 4%)[4] of **the 2015 recommendations** (see Figure 1). Some progress has been registered on approximately 44% of the CSRs, while more than half of the recommendations have not been implemented at all or only in a limited manner[5].

Figure 1: Implementation of the 2015 CSRs by EU Member States



Source: European Commission Country Reports (February 2016) and EGOV calculations.
Note: Based on Commission's assessment of actions taken (rather than outcomes that may materialise with a lag), assigning identical weights to all recommendations irrespective of their institutional and political sensitivities.

[4] Out of 26 countries which received CSRs in 2015, only three implemented fully/substantially at least one recommendation (Spain, Italy and Slovenia).
[5] Four countries (Germany, Lithuania, Luxembourg and Sweden) made limited/no progress on all their respective CSRs.

For an overview on how Member States have made **progress in implementing the EU2020 targets**, please see a separate EGOV document.

Box 6: Council deliberations the 2016 European Semester

The **ECOFIN Council on 8 March** discussed the implementation of recommendations on the basis of the Country Reports. A horizontal assessment of CSR implementation showed that almost half of the CSRs have at least some progress in implementation. The discussion in the Council focused in particular on the implementation of reforms related to removing barriers to investment and improving the investment climate, which is the aim of the third pillar of the Investment Plan for Europe. They have agreed to hold a discussion on the implementation of CSRs each year at ECOFIN.

On **25 May the ECOFIN Council** welcomed progress made in addressing the 2015 CSRs and took note that reform implementation has been uneven across policy areas and countries and that in only a few cases has substantial progress been made in addressing the CSRs. It stressed that reform implementation needs to be stepped up to address the policy challenges outlined below and recalled the importance of a **timely assessment of the implementation of CSRs in the Council prior to the proposal of new CSR**s, in order to draw conclusions, increase national awareness and implement reforms effectively in each country.

It recognized the progress made by Member States in implementing CSRs in the **areas of improving the business environment and in fighting against tax avoidance and improving its administration**. Member states concerned should continue their efforts. it stressed that more progress could be achieved in generating a business and employment friendly regulatory environment, increasing female labour force participation, cutting red tape, strengthening both administrative efficiency and regulatory quality, and reducing the number of restrictions in the service sector, particularly by making it significantly easier for service providers to operate across borders. Progress in addressing existing gaps and weaknesses in some **national fiscal frameworks** has been made but are still limited in some Member States, and efforts should focus on ensuring their effective functioning to support the conduct of responsible fiscal policies. National fiscal frameworks should be brought in line with EU requirements.

It agreed that there is an urgent need to improve **investment conditions** in order to attract increased private investment in the real economy and ensure high quality public investment and infrastructures. Reform progress has been slow in tackling problems regarding sector specific regulation and other impediments to investment and in reforming public administration, judicial systems, insolvency frameworks and the business environment, including access to finance. It welcomed progress in **reforming labour markets**, but notes that significant challenges and implementation gaps remain. There remains potential to broaden tax bases and reduce the tax burden on labour. The successful integration of migrants and refugees in some Member States requires particular attention. While progress has been made in bringing back to the labour market the unemployed, further structural reforms to support employment and active labour market policies are needed.

Next steps in the Council: The final adoption of the 2016 CSRs is to take place on the ECOFIN Council of 12 July 2016.

Once adopted by the Council, Member States shall, according to EU law[6], take due account of recommendations addressed to them in their economic, employment and budgetary policies for succeeding years. Furthermore (and contrary to what is often presumed) many of the CSRs are based on EU legal acts (see separate EGOV briefing) which enables further procedural steps, if not sufficiently implemented. Failure by a Member State to act upon CSRs may result in legal procedures, including the possibility of imposition of fines and/or suspension of funds in the following areas:

- **Fiscal policies**: further procedural measures, including enforcement measures under the preventive arm and corrective arm of the SGP and closer monitoring of draft budgetary plans possible suspension of up to five European structural and investment funds under the so-called macro-economic conditionality.

[6]Art. 2-a of Regulation No.1466/97, "take due account of the recommendations addressed to them in the development of their economic, employment and budgetary policies before taking key decisions on their national budgets for the succeeding years" and Art. 3 of Regulation No. 473/2013: "Member States' budgetary process shall be consistent with […] the recommendations issued in the context of the annual cycle of surveillance".

- **Macro-economic imbalances:** further procedural measures on prevention and correction of imbalances, including enforcement measures for a Member State which is under the Excessive Imbalance Procedure; possible suspension of up to five European structural and investment funds under the so-called macro-economic conditionality.
- **CSRs implementing the integrated policy guidelines** (the BPGS and the Employment Guidelines): further policy recommendations or warnings.

Completing the Banking Union

Further to the Five Presidents' Report on the completion of the Economic and Monetary Union of 22 June 2015, the COM tabled on 24 November 2015 a **proposal on a European Deposit Insurance Scheme** (EDIS) and published a communication '*Towards the completion of the Banking Union'* which accompanies the EDIS proposal. Such communication identifies a **number of measures aiming at reducing the risks** in the Euro Area banking sector. These de-risking measures are presented as measures counterbalancing the mutualisation of risks that would result from a common deposit guarantee scheme. These measures are diverse and of various nature, i.e. some require legislative action while others relate to proper implementation of existing measures (See EGOV briefing on completing the Banking Union). The list comprises, notably, the reduction of national options and discretions in banking regulation, the harmonisation of national deposit guarantee schemes, the operationalization of the Single Resolution Fund, the consistent application of bail-in rules, the reform of insolvency law, the handling of non-performing loans, additional prudential measures such as the leverage ratio and the prudential treatment of sovereign risk.

In its initial work programme, the Dutch Presidency has presented EDIS and the completion of the Banking Union as a priority. The work in the Council is conducted by ad hoc working party (AHWP) on strengthening the Banking Union established in January 2016. The mandate of the AHWP is twofold: it should i) examine the proposed third pillar of the Banking Union, involving a European Deposit Insurance Scheme (EDIS) and ii) examine measures outlined in the COM's communication of November 2015 aimed at reducing risks in the banking sector.

On 17 June, the Council adopted a roadmap to complete the Banking Union. A number of steps are underlined:

- The **Council invites the Commission to put forward a number of legislative proposals by the end of 2016** covering a number of de-risking measures, i.e.
    a) a proposal implementing the **TLAC standard**, as part of the MREL review;
    b) a proposal on **a common approach to the bank creditor hierarchy** to enhance legal certainty in case of resolution;
    c) an amendment to the CRD IV/CRR framework in order to further harmonize or specify **national options and discretions (NODs)** granted to Member States;
    d) an amendment to CRD IV/CRR implementing the **remaining Basel reforms** including the introduction of a leverage ratio, possibly higher than 3 % for systemic banks, and the introduction of a net stable funding ratio;
    e) a legislative proposal for a **minimum harmonisation in the field of insolvency law** in the context of the Capital Markets Union (CMU);
- The Council also calls on the Commission to examine whether and **how harmonizing the rules and application of moratorium tools** can contribute to the stabilisation by the relevant authorities of an institution in the period before, and possibly after, an intervention;
- As regards the **common backstop to the Single Resolution Fund**, the Council takes note of the intention of Member States to start work in **September 2016**, if all participating Member States have fully transposed the BRRD. The common backstop needs to be fully operational at the end of the transition period but **it may be decided, depending on the progress made on the de-risking measures, to have it earlie**r;

- As regards the regulatory treatment of **sovereign exposures**, the Council agrees to wait for the outcome of the **Basel Committee**;
- **On EDIS, work will continue at technical level**; negotiations at political level will start as soon as sufficient progress has been made on the measures on risk reduction; Member States have the intention to have recourse to an inter-governmental agreement **(IGA)**;
- The Council will assess **annually** the progress made towards completing the Banking Union.

In its work programme, the Slovak Presidency stated it intends to continue the work on completing the Banking Union, seeking to make progress on both the EDIS and identification of measures to reduce risk within the European banking sector.

The Council roadmap reflects the fact that Member States are divided not only on the scope and on sequencing of the accompanying de-risking measures but also on how far EDIS should go and what exact shape it should take in the steady state (i.e. full common insurance, re-insurance etc...). The vote in favour of Brexit in the UK and its potential impact on the Euro Area financial and banking system (e.g. on the market value of Italian banks) may further complicate the debate. The roadmap does therefore not commit to any specific timeline to re-start the political negotiations on EDIS and puts de-risking measures first. According to the Council roadmap, the onus is on the Commission, which should table a series of legislative measures by the end of the year.

In parallel, the **European Parliament has designated a rapporteur** (E. De Lange, EPP), shadow rapporteurs and initiated its deliberations (Several rounds of discussion have been held in the ECON committee and a public hearing on EDIS was organised on 23 May 2016). On 16 June, the rapporteur published **her working document on EDIS.** The working document calls notably for an impact assessment on EDIS from the European Commission and concrete steps in the area of risk reduction.

A crucial issue from the European Parliament's perspective is the issue of the legal base. The fact that Member States challenge the legal base proposed by the Commission for EDIS and intend to have recourse to an IGA would exclude the EP from the adoption process. The article used by the Commission, Article 114 TFEU, is the article usually used for legislation dealing with the functioning of the internal market. Both the Commission and Council legal services have confirmed the validity of Article 114 TFEU for EDIS.

Box 7: Banking related CSRs

As announced in the COM's communication of November 2015 on the completion of the Banking Union, the 2016 "banking CSRs" primarily target the **high level of non-performing loans** (NPLs) in a few Member States and call for action.

The draft CSRs were published by COM in May 2016, agreed by the Council in June - with a few modifications- and endorsed by the June European Council. The Council should formally approve the 2016 CSRs on 12 July 2016.

According to the 2016 CSRs, nine Member States are recommended to take action vis-à-vis their banking sector. For seven of them, **the banking CSRs point to the high level of NPLs (BG, IE, HR, IT, PT, SI, CY)**. **For two countries, the banking CSR relate to cyclical vulnerabilities** in the real estate sector **(SE, NL**).

All the countries targeted by the 2016 banking CSRs were already addressees of similar banking CSRs in 2015, with the exception of CY, which was under a macro-economic adjustment programme in 2015.

Five countries have disappeared from the list of addressees of banking CSRs in 2016: ES and UK (where progress was assessed as 'substantial' by the COM in 2015) as well as AT, MT and HU where the COM assessed that 'some progress' was made in 2015 (See separate EGOV Briefing).