Background for Economic Dialogue and exchange of views with the President of the Eurogroup

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President Dijsselbloem has been invited for an Economic Dialogue in line with the new economic governance framework, in particular Article 2ab of Regulation 1466/97[1]. Previous exchanges of views with the President of the Eurogroup took place in ECON on 7 May (on Cyprus programme) and 21 March (regular Economic Dialogue).

This Economic Dialogue with the President of the Eurogroup is aimed at **addressing fiscal and macro-structural challenges and recommendations for the Euro Area and its Member States under the 2013 Semester Cycle**. According to the Work Programme for the Eurogroup for the second half of 2013 *"the Eurogroup should continue to play a key role in providing the necessary solutions to the macro-economic and financial challenges the euro area is facing, as also mentioned in the European Semester recommendations to the euro area. A large part of the work program for the second half of 2013 will be directly related to these challenges".*

Following the endorsement of the June European Council the Council (ECOFIN) adopted on 9 July 2013[2] the **Country Specific Recommendations (CSRs)**. A table, showing the recommendations for all Member States of the Euro Area (excluding Member States subject to an adjustment programme) together with the Euro Area wide recommendations, is available on ECON homepage.

According to EU law, Member States shall[3] *“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[4] *“Member States' budgetary process shall be consistent with […] the recommendations issued in the context of the annual cycle of surveillance”.*

Box 1: Country Specific Recommendations in 2013

Around 140 CSRs have been addressed altogether to EU Member State[5]:
* All Member States received a recommendation based on the implementation of the Stability and Growth Pact (always the first CSR per Member State).
* Member States that were subject to an "in-depth review" under the Macro-economic Imbalance Procedure (MIP) have received one or more recommendations based on the preventive arm of the MIP-Regulation.
* Many CSRs are based on the implementation of the Broad Economic Policy Guidelines in accordance of Article 121(2) of TFEU and the Employment Guidelines in accordance with Article 148(4) of TFEU.
* The Euro Area as a whole received in addition common policy recommendations (See annexed table)

[1] See table on Economic Dialogues as published on ECON homepage.
[2] All recommendations as adopted by the Council were published in the Official Journal on 30 July 2013.
[3] Art. 2-a of Regulation No.1466/97.
[4] Art. 3 of Regulation No. 473/2013.
[5] CSRs were not adopted for Member States subject to a macroeconomic adjustment programme (Portugal, Ireland, Greece and Cyprus) in accordance with Article 12 of Regulation No. 472/2013.

This is the first Semester Cycle when the implementation of the new EU rules requiring **Euro Area Member States to submit (by 15 October 2013) their draft budgetary plans** (based on independent macroeconomic forecast) to the Commission and the Eurogroup for their assessment. This common timeframe for draft budgetary plans should facilitate both the assessment of concrete measures Member States are undertaking to achieve their EU commitments and the overall fiscal stance of the Euro Area as a whole. This is also the first time that euro area Member States, subject to a new step (as decided by ECOFIN in June) in their Excessive Deficit Procedure, are required to submit (by 1 October) an Economic Partnership Programme (i.e. FR, ES, SI, MT, NL). These programmes should identify and select a number of specific priorities aiming to enhance competitiveness and long-term sustainable growth of the concerned Member State.

Box 2: Impact of the "Two Pack" on the remit of the Eurogroup

The Two Pack legislation that came into force at the end of May 2013 grants additional power to the Eurogroup and imposes additional obligations on it. It stipulates inter alia that:

- Member States shall submit annually their draft budgetary plan to the Commission as well as the Eurogroup
- The Commission's opinion on the budgetary plans shall be presented to the Eurogroup, which shall discuss the assessments and make the result public, where appropriate
- The Member States shall report ex-ante to the Commission and the Eurogroup on their national debt issuance plans
- The competent committee of the EP may invite the President of the Eurogroup for an exchange of view
- The Eurogroup WG, the EFC, and the relevant committee of the EP and the parliament of the Member State concerned where relevant and in accordance with national practises shall be informed by the Commission of measures aimed at addressing the sources or potential sources of difficulties with respect to their financial stability.

For this Economic Dialogue with the President of the Eurogroup for the first time, some **external briefing papers** have been prepared in a manner similar to the preparatory work for the regular Monetary Dialogues undertaken by ECON with the President of the ECB.

These briefing papers deal with different aspects of the fiscal and macro-structural challenges and recommendations for the Euro Area and its Member States under the 2013 Semester Cycle. The briefing papers have been distributed to Members in advance and will be published on ECON homepage in due course.

Some conclusions from the external briefing papers:

- In his briefing note, **Jacob Kirkegaard (Peterson Institute)** argues that the CSRs should focus on structural reform issues. Special emphasis should be put at the state level on banking sector and labour market reforms aimed at addressing, respectively, the upcoming asset quality reviews and stress tests ahead of the launch of the Single Supervisory Mechanism and job creation issues. In addition, a full-time Eurogroup President should devote time to meet the different national stakeholders in order to enhance national ownership of CSRs related to the Euro area as a whole. For instance, setting "annual, detailed and verifiable policy targets for Member States governments to accomplish" would foster CSR priorities' legitimacy while ensuring that "euro area's common economic interests are adhered to". Finally, the Eurogroup President, in liaison with the Commission, should make clear to Member States that implementing the CSR agenda reforms is a necessary condition to obtain any relaxation of national fiscal targets.

- The paper of **Daniel Gros and Cinzia Alcidi (CEPS)** deals with the trade-off between two main economic policy goals put forward by CSRs: the reduction of budget deficits and increasing competitiveness. It shows to what extent deflation (relative to the euro area average) is needed in specific countries to make them competitive (relative to the euro area average) and to what degree such a deflation makes the debt-to-GDP ratio of those countries higher than officially measured. It also provides figures on the ability of sovereigns and non-financial sectors of several Member States to service debt. It highlights that corporate sectors with low average firm sizes are more dependent on domestic markets and therefore from fiscal consolidation measures affecting internal demand and the availability of access to finance. It requests CSRs to take this feedback loop into account. Furthermore, it exemplifies that current CSRs are too vague and have so far had no or very limited impact.

- **Bruegel**'s paper (by **Zsolt Darvas and Erkki Vihriälä**) argues that the 2013 CSRs should go further in order to address all fiscal and macro-structural challenges faced by Euro area Member States and the Euro area as a whole. More specifically, recommendations for the Euro area as a whole should be assigned in a "to-do list at the country level" as the IMF recommends. Further coordination of national fiscal policies through the creation of a Euro area fiscal authority is also recommended to "achieve an adequate an optimal fiscal stance". In addition, the researchers claim that the Euro area would benefit from bolder recommendations aimed at reforming and repairing the financial sector beyond the cleaning of bank balance sheets and the completion of the Banking Union. Finally, spillover effects between Member States should be considered more explicitly whether it be fiscal-related or macro-related (i.e. trade).

- The paper of **Xavier Timbeau (OFCE, Siencespo Paris**) focuses on issues related to fiscal consolidation, fiscal multipliers and public debt and their impact on economic activity. The analysis relies on simulations used by independent Annual Growth Survey (iAGS) assuming that fiscal multipliers in the euro area would be high in the coming years. A small reduction in public deficit leads therefore to much higher unemployment rates and hence structural efforts needed to reach the deficit targets under the Stability and Growth Pact would be higher than expected by the Commission. A conclusion of the paper is to ease the fiscal consolidation path, especially for countries experiencing a large negative output gap. Furthermore, debt mutualisation is an answer to lost access to financial markets by some countries. While it acknowledges that 2013 CSRs issued for several Member States may have long-term positive impacts by reducing labour market rigidities and making economies more competitive, it argues that such reforms have downward pressures on wages, which in the short term would have negative economic impacts if the unemployment rate is much higher than the equilibrium level. Therefore, Mr Timbeau concludes that the timing of such CSRs is wrong, especially when combined with strong fiscal consolidation.

ANNEX: Council Recommendations 2013 on the implementation of the broad guidelines for the economic policies of the Member States whose currency is the euro.

Council Recommendations 2013 for the euro area as a whole
1. Take responsibility for the aggregate policy stance in the euro area in order to **ensure the good functioning of the euro area** to increase growth and employment, and to take forward the work on deepening economic and monetary union. Allow the **Eurogroup to play a central role** in the strengthened surveillance framework applicable to euro area Member States to coordinate and monitor reforms at national level and at the euro area level that are necessary for a stable and robust euro area and to ensure policy coherence, and in the preparation of the Euro Summits.
2. Ensure that the Eurogroup monitors and coordinates **fiscal policies of the euro area** Member States and the aggregate fiscal stance for the euro area as a whole to ensure a growth friendly and differentiated fiscal policy. To this end, the Eurogroup should discuss the Commission opinions of the **draft budgetary plans of each of the euro area Member States**, and the budgetary situation and prospects for the euro area as a whole on the basis of the overall assessment by the Commission of the draft budgetary plans and their interaction. The coordination should contribute to ensuring that **the pace of fiscal consolidation is differentiated** according to the fiscal and economic situation of the euro area Member States with the **budgetary adjustment** defined in structural terms in line with the Stability and Growth Pact, allowing the **automatic stabilisers** to function along the adjustment path and that, in view of reinforcing the credibility of fiscal policy over the medium term, fiscal consolidation is supported by an overall efficient and growth-friendly mix of expenditure and revenue and by appropriate structural reforms which enhance the economic growth potential.
3. Assess, in the framework of the Eurogroup, the reasons behind the **differences in lending rates** especially to SMEs across the euro area Member States; explore the consequences of the **fragmentation of the financial markets** in the euro area, and contribute to ways to overcome it.
4. Building on the recapitalisation and the restructuring of the past years, promote further balance-sheet repair among banks as a means to **reverse fragmentation in the single market and improve the flow of credit** to the real economy, particularly SMEs. To this end: (a) ensure that the balance sheet assessments and **stress tests** to be conducted by the **Single Supervisory Mechanism** (SSM) in cooperation with the **European Banking Authority** (EBA) are concluded in accordance with the agreed timeline; (b) ensure a level playing field in applying **burden-sharing** requirements in the recapitalisation of banks; (c) ensure the availability of **credible fiscal backstops** in the context of balance sheet assessments and stress tests; (d) remove **supervisory incentives** for banks to match asset and liabilities within national borders; and (e) accelerate the necessary steps to establish the **Banking Union**, as outlined by the European Council.
5. Coordinate ex ante the major **economic reform plans** of the euro area Member States. Monitor the implementation of **structural reforms**, in particular in the labour and product markets and assess their impact on the euro area, taking into account the Council recommendations to individual euro area Member States. Promote further adjustment in the euro area, ensuring a correction of external and internal imbalances, inter alia by following thoroughly the reforms that address distortions to saving and investment behaviour in Member States with both current account deficits and surpluses. Take the necessary steps for an effective implementation of the **Macroeconomic Imbalances Procedure**, in particular by assessing progress in reform commitments in Member States experiencing excessive imbalances and in reform implementation in Member States with imbalances requiring decisive action to limit **negative spillovers** to the rest of the euro area.
6. In line with the **AGS 2013** and by taking collective and significant measures, tackle the social consequences of the crisis and the rising unemployment levels. The situation of **unemployed young people** is particularly worrying and bold action is recommended along the lines of the **Compact for Growth and jobs** and the **EU Youth Guarantee**. Further reforms to facilitate access to employment, prevent early withdrawals from the labour market, reduce the cost of labour, combat labour market segmentation and support innovation are recommended.