IN-DEPTH ANALYSIS

European Parliament

Recommendations on the economic policy of the euro area under the European Semester

This note provides an overview of the Council recommendations addressed to the euro area as a whole under the European Semester, and presents information on the related Eurogroup's policy actions. The briefing is regularly updated.

Summary

Within the framework of the European Semester, the Council issues, on the basis of the Commission proposal, annual policy recommendations on the economic policy of the euro area in accordance with Articles 121 and 136 of the Treaty of the Functioning of the European Union. These recommendations typically cover fiscal, financial and structural issues, as well as institutional aspects of the Economic and Monetary Union.

The Council and the Commission monitor the implementation of the euro area recommendations, while the European Parliament oversees the European Semester, in particular by means of Economic Dialogues and contributes to the whole process via its resolutions.

Over the 2011-2017 European Semester cycles, the overall picture that emerges from the qualitative assessment provided by the Commission is that the speed and degree of progress made in implementing the euro area recommendations in a given policy area have been strongly linked to the urgency of policy action amid the prevailing macro-economic conditions (e.g. set up of the Banking Union, progress achieved by the net debtor countries in correcting their macroeconomic imbalances).

Under the 2018 European Semester, the Commission issued its proposal for euro area recommendations on 22 November 2017 as part of the "European Semester Autumn Package". The Eurogroup discussed and amended these draft recommendations at the meeting of 22 January 2018 in view of the approval by the ECOFIN Council of 23 January 2018. The European Council is to endorse the 2018 EA recommendations during the summit of 22-23 March 2018, paving the way for their formal adoption by the Council later in spring 2018.

ECONOMIC GOVERNANCE SUPPORT UNIT (EGOV)
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1. Implementation of euro area recommendations: Institutional perspective

Within the framework of the European Semester, the Council issues, on the basis of the Commission proposal, annual policy recommendations on the economic policy of the euro area recommendations in accordance with Articles 121 and 136 of the Treaty of the Functioning of the European Union (TFEU). These recommendations typically cover fiscal, financial and structural issues, as well as institutional aspects of the Economic and Monetary Union (EMU).

At the euro area level, as such, there is (1) no institutional body that bears formal responsibility for the implementation of EA recommendations and (2) no formal mechanism to ensure implementation of these recommendations. Nevertheless, the Eurogroup takes into account the euro area recommendations when drawing up its work programme and undertakes “thematic discussions” on issues raised therein (see Box 1).

At the Member States level, euro area countries are required to take into consideration these recommendations when (1) drafting their Stability Programmes and National Reform Programmes (to be submitted to the Commission and Council by April), and (2) implementing the country-specific recommendations (CSRs). In order to better take into account Euro Area wide considerations in the design of national policies, the EA recommendations are published six months ahead of the draft CSRs.

The Council and the Commission monitor the implementation of the euro area recommendations and take further actions as appropriate (see Table 1). The European Parliament oversees the European Semester, in particular by means of Economic Dialogues. It also contributes to the whole process via its resolutions, for example, on the European Semester for economic policy coordination (Annual Growth Survey) or on the economic policies of the euro area. Moreover, the ECON Committee regularly requests external research papers on various topical issues, for example, on how to improve the European Semester (see Box 2).

Box 1: Eurogroup’s work programme for the first half of 2018

According to an indicative work programme for the first half of 2018, released on 4 December 2017, the Eurogroup is to:

- Maintain its attention on structural policies to foster long-term growth and employment, with a view to improve the resilience of the euro area economy. To this end, the Eurogroup will continue its regular exchanges on best practices, including a focus on the three dimensions of resilience (vulnerability to shock, shock absorption capacity and speed of recovery).
- Closely monitor Member State’s efforts to ensure sound fiscal policies as well as an appropriate aggregate fiscal stance of the euro area.
- Closely monitor the implementation of the EDP recommendations to euro area Member States.
- Give strong prominence to the implementation aspects as regards structural and fiscal policies. This is a crucial element in order to move ahead with EMU deepening.
- Closely follow the progress of the adjustment programme in Greece and be involved in post-programme surveillance in Cyprus, Ireland, Portugal and Spain.
- Remain fully committed to monitoring issues relevant for financial stability in the context of the Banking Union and prepare international meetings as appropriate.
- Continue working on the deepening of the EMU (including on the role of the ESM, on completing the Banking Union and on the EMU’s fiscal framework) in the appropriate format.

Table 1: Overview of Eurogroup's policy actions as regards implementation of the 2017 euro area recommendations

2017 Council Recommendations	Policy actions taken by the Eurogroup
Structural reforms	
1. Pursue policies that support sustainable and inclusive growth in the short and the long term, and improve adjustment capacity, rebalancing and convergence. Prioritise reforms that increase productivity, improve the institutional and business environment, remove bottlenecks to investment, and support job creation. Member States with current account deficits or high external debt should raise productivity while containing unit labour costs. Member States with large current account surpluses should implement, as a priority, measures, including structural reforms and fostering investment, that help to strengthen their domestic demand and growth potential.	On 7 April 2017, the Eurogroup continued its discussion on **promoting investment**, which it started in July 2016, and adopted a statement setting out common principles to guide national policies in this area. These principles concern, in general terms: (1) promoting private investment; (2) prioritising productivity-enhancing public investment and (3) developing market-based sources of finance, broadening the sources of finance throughout the Eurozone.
3. Implement reforms that promote competitiveness, job creation, job quality, resilience and economic and social convergence, underpinned by an effective social dialogue. They should combine: (i) **reliable labour contracts** which provide flexibility and security for employees and employers; (ii) **quality and efficient education and training systems and comprehensive lifelong learning strategies** targeted at labour market needs; (iii) **effective active labour market policies** to support labour market participation; (iv) **modern, sustainable and adequate social protection systems** that contribute effectively and efficiently throughout the life cycle to social inclusion and labour market integration. **Shift taxes away from labour,** particularly for low-income earners and in Member States where cost competitiveness lags behind the euro area average, and make that tax shift budget-neutral in countries without the fiscal room for manoeuvre.	On 20 March 2017, the Eurogroup discussed and agreed on a **framework for benchmarking the sustainability of pension systems**: benchmarking against the best performers of the euro area based on a set of indicators and best national practices in order to provide a comprehensive and balanced view, and take account of country specificities. The ministers agreed to conduct this benchmarking exercise every three years, starting in 2018, within the context of existing processes and surveillance mechanisms, in particular the Ageing Reports and the assessment of the Stability Programmes. On 15 September 2017, Ministers exchanged views on how to **increase economic resilience in the EMU**. They identified a number of policy areas, where improvements could lead to increased economic resilience. These include the need for the diversification of the economy, the flexibility of labour and product markets, taxation incentives for investment, quality of institutions, and other areas. Ministers also discussed "***what is the responsibility of member states and what is the responsibility of the monetary union or the European Union****, and I think reducing vulnerability*", the President of the Eurogroup, Jeroen Dijsselbloem said. He also added "*there are 3 aspects regarding resilience. First of all, of course, how we can make sure that we are less vulnerable to economic shocks. Secondly, how we can increase the absorption capacity. So this is how when the economic shock occurs, how it is being dealt with, absorbed, by institutions, by markets, by households, by companies. And thirdly, about enabling a faster economic recovery after a shock. And that, of course, is one of the lessons learnt from the crisis. We were much too slow in absorbing the shocks. We weren't ready and fit to absorb the shocks, neither on the private nor on the public side, and it took a very long time to recover. Certainly, if you compare for example to how the US*

	recovered from the crisis. So the three phases: reducing vulnerability before the shocks, absorption of the shock when it occurs, and having a fast recovery after the shock." This initial discussion will guide the Eurogroup's more concrete thematic discussions on growth and jobs in the future. **Economic resilience** refers to a country's ability to prevent and address economic shocks. It is particularly important for the euro area, where countries share a single currency and are highly interdependent, and where a lack of economic resilience in one country may rapidly lead to serious consequences in other euro area economies. On 9 October 2017, Ministers exchanged views on and shared **national best practices in financing labour tax cuts** (in particular, Austria, Belgium and France shared the progress they have made on this topic). The Eurogroup is expected to discuss the subject again later this year, in the context of its annual review of euro area member states' 2018 draft budgetary plans. **Reducing the tax burden on labour** has been recommended to the euro area in the context of the European Semester, the EU's annual policy coordination process. The tax wedge on labour in the euro area is among the highest in the world, and reducing it could contribute to economic growth and job creation. How to finance labour tax cuts is therefore an important question, as labour tax constitutes a significant share of government revenues in a number of euro area countries. On 6 November 2017, meeting in euro area format, Ministers exchanged **national practices related to public investment in human capital** and, more concretely, **efficient spending on education systems**. Ministers are expected to continue the debate in early 2018. On 4 December 2017, meeting in euro area format, Ministers continued their discussion on how to further reduce **the tax wedge on labour** as a means to enhance economic growth. They evaluated progress towards the benchmark agreed in 2015 by looking into the measures foreseen in the 2018 DBPs of the euro area Member States.
Public finances	
2. Aim for an appropriate balance in fiscal policies between the need to ensure sustainability and the need to support investment to strengthen the recovery, thereby contributing to an appropriate aggregate fiscal stance and a more balanced policy mix. Member States that, according to the Commission assessment, are at risk of not meeting their obligations under the SGP in 2017 should, on that basis, take, in a timely manner, additional measures to ensure compliance. Conversely, Member States that have outperformed their medium-term objectives are invited to continue to prioritise investments to boost potential growth while preserving the long-term	On 20 March 2017, the Eurogroup assessed, in the light of the COM 2017 Winter Forecast, **how the euro area member states are implementing their draft budgetary plans for 2017 and the commitments set out in the Eurogroup statements of 5 December 2016 and 26 January 2017.** The Eurogroup's assessment did not significantly differ from the assessments made in December 2016 and in January 2017. On 15 June 2017, the Eurogroup further discussed the **quality of public finances**, including the practical implementation of the common principles to guide **national spending reviews** endorsed in September 2016. These spending reviews are to help governments detect areas where savings and efficiency gains could be made and where spending could bring greater value for money. This topic is particularly relevant to euro area member states given their current efforts to ensure fiscal responsibility and at the same time support

sustainability of public finances. Member States that are projected to be broadly compliant with the SGP in 2017 should ensure compliance with the SGP within their national budgetary processes. Pursue fiscal policies in full respect of the SGP, while making the best use of the flexibility embedded within the existing rules. Overall, Member States should improve the composition of public finances by creating more room for tangible and intangible investment, and ensure the effective functioning of national fiscal frameworks.	growth. Further work will be carried out in this area, with a view to developing an exchange of best practices. On 10 July 2017, the Eurogroup discussed **the euro area fiscal stance**. There was consensus among institutions and Ministers that a **broadly neutral fiscal stance would be appropriate for the euro area as a whole in 2018**. On 4 December 2017, meeting in euro area format, the Eurogroup discussed and agreed with the Commission's assessment of **the 2018 draft budgetary plans (DBPs)** of the euro area Member States.
Financial sector reforms	
4. In line with the roadmap of June 2016, **continue work to complete the Banking Union with regard to risk reduction and risk sharing**, including a European Deposit Insurance Scheme and making the common backstop for the Single Resolution Fund operational at the latest by the end of the Fund's transitional period. Devise and implement an effective euro-area wide strategy to complement prudential supervisory action to address viability risks within the banking sector, including as regards the high level of non-performing loans, inefficient business models and overcapacity. In Member States with large stocks of private debt, promote orderly deleveraging.	On 7 April 2017, the Chair of the ECB's Supervisory Board, **Danièle Nouy, presented the ECB annual report on supervisory activities in 2016.** The Board's priorities for 2017 include further convergence of national supervisory standards in the banking union, addressing the non-performing loans on banks' balance sheets, which remain problematic in some member states, and improving the profitability of banks and thus their ability to finance the economy. The Chair of the Single Resolution Board (SRB), **Elke König, informed the Eurogroup of the SRB's activities**, including the progress achieved in resolution planning and on banks' contributions to the SRF. On 15 June 2017, the Eurogroup was informed by the Chair of the SRB, Elke König, and the Vice-Chair of the ECB Supervisory Board, Sabine Lautenschläger, together with the COM, of "***the successful resolution of Banco Popular*** *last week* [7 June 2017] *in line with the newly established resolution framework. The authorities involved in the resolution acted in a very swift manner, ensuring a continuation of core functions and with no resulting costs for the taxpayers, and this is very good news*", the President of the Eurogroup said. On 10 July 2017, the Eurogroup discussed **insolvency frameworks in the euro area**, focusing on the role they play in national supervisory practices relating to non-performing loans. The President of the Eurogroup, Jeroen Dijsselbloem, remarked that "***there are still big differences* [in national insolvency frameworks] *which have again come forward in the Italian cases.*** *There is the topic of establishing sound buffers of bail-inable capital, the MRELs. A very important topic is the hierarchy of creditors, getting a very clear creditor hierarchy in the eurozone area, and the proposals of the Commission are being pushed forward at this point. The topic of protecting retail investors: this was of course part of the legacy issues that had to be dealt with. The importance of having sound asset evaluation in the process of dealing with banks to allow also outside investors to participate. They are helped by maximum transparency on the quality of assets. So having an AQR, when possible, is also very important. And finally, all of this could be put on our agenda to finalise the banking union. Some of the elements we have mentioned, the lessons that we can learn, can be taken forward* ***when we finalise the banking union. Inevitably, that requires both risk reduction and risk sharing.***"

	At the meeting of 10 July 2017, Ministers were also informed by the European Central Bank Banking Supervision, the Single Resolution Board and the European Commission briefed the Eurogroup about recent topical developments in the banking sector, in particular in Italy (**Banca Popolare di Vicenza and Veneto Banca**). The President of the Eurogroup, Jeroen Dijsselbloem, pointed out that "*the coordination between the institutions involved was efficient and that experience is being built-up as we go along. We are still in the early days of actually putting to work the new resolution frameworks. Clearly, to put emphasis first of all on the positive sides, we welcomed the ongoing work with the banks. The ongoing positive restructuring of banks having to deal with legacy issues in different banks makes it more complex and more challenging. Each case is different and has to be assessed individually. We welcomed the information provided by the institutions on the confirmation by the institutions that all decisions were taken in full respect of the European legal framework. However, **there is still work to do and lessons to be learnt in terms of possible policy implications. The recent cases have raised a number of issues today, and there may be other areas for improvement and fine-tuning, including the need to ensure consistency**. ... The institutions have also said that, later on, they will perform a post-mortem analysis of these resolution cases, in more details, and the Commission will review the BRRD in 2018.*" On 6 November 2017, meeting in euro area format, Ministers The Chair of the European Central Bank's Supervisory Board, **Danièle Nouy, gave an overview of the recent supervisory work and highlighted the recent addendum to the March 2017 ECB guidance to banks on non-performing loans** (NPLs), possible risks related to Brexit, and other key activities, such as supervisory stress tests. The Chair of the Single Resolution Board (SRB), **Elke König, informed the Eurogroup about the SRB's activities** over the past months: progress on resolution planning and priorities in this area, implementation of the minimum requirements for own funds and eligible liabilities (MREL) and the status of the building-up of the single resolution fund (SRF). On 6 November 2017, meeting in inclusive format, **the Ministers of 27 EU member states discussed possible steps towards the completion of the banking union.** The Commission presented the main elements of its recent communication on this topic. The President of the Eurogroup, Jeroen Dijsselbloem, acknowledged "*We had an interesting debate. I think there was general agreement that it is useful to take stock of the exact work: where are we? what have been done, for example, when dealing with NPLs or other issues on risk reduction**? And building up on the roadmap that we already have, to be more precise on what is then the next step, what more do we require in terms of risk reduction and how does that click into the next step on risk sharing.** And that is the work that we will have to do: make more precision on how the process will continue from here on using that roadmap from 2016.*"

Institutional reforms	
5. Make progress on completing EMU, in full respect of the Union's internal market and in an open and transparent manner towards non-euro area Member States. Further advance the ongoing initiatives and work on the longer-term issues for EMU, taking due account of the Commission White Paper on the Future of Europe.	On 10 July 2017, Ministers held a **general discussion on the further deepening of the EMU,** against the background of the reflection paper published by the European Commission on this topic on 31 May 2017. The President of the Eurogroup, Jeroen Dijsselbloem, remarked that ministers talked about "***the importance of convergence and what is needed to strengthen and speed up the process of convergence****. Some elements are, of course, about finishing off what we have started. So this is about the banking union, the capital markets union, deepening the single market. Second strand: structural reforms. How we can get the incentives right to support and push the structural reform agenda in the different member states. That can be supported by investment instruments, by using the EU budget, using benchmarks, etc. We have also talked, which is sort of the second big issue, about* ***creating long-term stability and shock-absorption*** *- of course, a number of proposals in the Commission's paper regarding the shock-absorption of our member states individually but also the Eurozone as a whole*." On 9 October 2017, the Eurogroup discussed the possible **future roles and tasks of the European Stability Mechanism (ESM)** in the context of the ongoing broader debate on the future of the EMU. This initial discussion focused on the ESM's possible role in crisis management and in relation to the banking union, as well as on how this possible new role would affect its governance structure and its place within the EMU setup. The President of the Eurogroup, Jeroen Dijsselbloem, pointed out that "*it was a very good discussion. Among the member states, the ministers, there was quite a strong agreement on that* ***we should work predominantly within the current legal framework, in the ESM treaty****. ... Secondly,* ***there was a strong positive sense about the work that the ESM has done.*** *The ESM has now existed for five years and has been very effective, both on the financing sides and in bringing in the money on both sides of the balance sheets so to speak. [...] I think everyone agreed that the ESM has a very strong role to play, not just in crisis management but possibly also in the prevention of the future crises. And, finally,* ***there was quite a broad support in involving the ESM in providing a backstop to the single resolution fund.*** *Of course, as you know, that's part of the roadmap for the banking union which outline number of actions that need to take place. I think next month we will discuss that whole agenda, that whole roadmap, but there seems to be a strong support for the ESM in the role of a backstop.*" On 6 November 2017, meeting in inclusive format, Ministers exchanged views on **the future of fiscal governance in the euro area**, including issues related to fiscal rules and ideas for possible new euro area fiscal policy instruments. In this regard, the President of the Eurogroup, Jeroen Dijsselbloem, highlitghted that "***Let's distinguish the current rules as we have them - are they efficient? are they effective? are they doing what they should do? - and the debate on the need for more fiscal instruments, a fiscal capacity or other ideas on that.*** *First of all, it's good to establish the fact that we don't just have rules, we also have institutions that play an important part in fiscal policy, and we have markets that give off incentives that create outside pressure for politicians to do the right thing. But there immediately, there is a word of caution to be used:*

	markets are not always rationale, they are not always well-informed, risks are not always priced in the right way, so we must not take guidance from the market but use them and enable them to be more effective in providing some outside pressure to us. *On institutions,* ***there was quite little discussion. Everyone fully acknowledges the fact that the Commission is the guardian of the Pact*** *and needs to keep playing that role also in the future. I didn't hear any discussion on that.* *On the rules themselves****, the returning issue is that they are complex, they are not predictable, they are sometimes not based on observable criteria.*** *That makes it difficult for national ministers to design their budgets, to explain what happens to their electorates, and that is an issue that keeps coming back. On the other hand, we all know why the rules are complex: because we want to take into account all different circumstances that may arise and we have allowed for a number of flexibilities. This has also made the rules more complex.* ***There is a trade-off between having simple rules and having rules that fit everyone. I think we have to be realistic there: when people say let's make rules much more simple, I am not sure that they want accept that they could also become much more harsh, in difficult circumstances.*** *So that is a trade-off that we must realise.* ***There was a general agreement that reducing debt levels would become more and more important****, and is already if you realise that fiscal deficit in the eurozone is now less than 1,5% and will continue to go down, looking forward. So debt will become a bigger issue. Of course to the extent that we are more successful in reducing debt in our member states, national governments will also be able to absorb shocks better and that is very useful, for example in the case of an asymmetric shock.* *That brings me to new instruments, such as* ***the fiscal capacity. Lot of debate there still: about the function of it, what should it do? How can member states make use of it? What is the actual character of the instrument? Is it funding, is it financing, is it transfer, etc?*** *So lots of debate there, but quite a large number of ministers feel that to complement our toolkit, a fiscal capacity as a stabilisation tool would be useful.* ***So more work to be done there, but some convergence perhaps can be foreseen****.* *As I said, all of those topics will come back next month. We will also return to the topic we discussed last month, which was the future of the ESM. So then we have the three blocks:* ***future of the ESM, completing the banking union and fiscal policy, including possible instruments****. We will bring those three together next month to prepare the Eurozone summit later on."* On 4 December 2017, meeting in inclusive format, Ministers continued their preparation of the Euro Summit meeting of 15 December, which will discuss matters related to **the deepening of the Economic and Monetary Union (EMU) and the completion of the Banking Union.** Jeroen Dijsselbloem, the President of the Eurogroup said in his press remarks following the meeting that a possible way forward would be to come to an agreement on a roadmap for the deepening of the EMU, starting from the roadmap for the banking union already agreed in 2016, As to the structure of work, he said three elements need to be discussed, namely the

	completion of the Banking Union, fiscal issues and the role of the ESM: 1) *Banking Union* - developing deeper the existing roadmap, in particular being more precise on the specific steps that need to be taken in terms of risk reduction. This would unlock next steps in terms of risk sharing; 2) *Fiscal/EU budget* - two elements to be discussed: a) new fiscal instruments - there is currently no broad agreement as to their purpose, size and design. Instruments from the EU budget or EU credit lines from the budget will have to be part, inevitably, of the multi-annual framework debate, which already will be complex, due to Brexit; b) the complexity and effectiveness of the current fiscal framework. In general terms, there seems to be an agreement this framework should be credible, effective and not so complex. However, Ministers have not succeeded to make progress on this issue. The President of the Eurogroup suggested a possible way forward could be to ask an independent experts' working group to come forward with an advice; 3) *Role of the ESM* - the ESM could act as a backstop to the Single Resolution Fund (there seems to be a broad agreement on this issue within the Eurogroup, though a progress would need to be made first on the COM banking package and the issue of non-performing loans). There is also a broad agreement the ESM should have an important role in financing, designing and monitoring programmes together with the COM (a joint approach based on an agreement between the two institutions). On 22 January 2018, the Ministers agreed that in light of the current economic expansion, there is **a useful window of opportunity to deepen EMU and that there is a duty to deliver on the guidance provided by the Euro Summit in December 2017.** There was agreement that the work should primarily focus on the **two priority areas** identified by leaders, namely the **completion of the Banking Union** and the **reform of the ESM**. On the former, the ECOFIN Council roadmap of June 2016 should be adhered to and eventually further developed, notably by adding more precision as regards the specific steps that need to be taken in terms of risk reduction and risk sharing. Ministers also agreed on the need to take stock of the developments already registered in these dimensions. As regards the second priority area, there was strong interest in further developing the ESM, focusing on issues related to its functions at this juncture. Some Ministers also argued in favour of exploring other issues, such as fiscal capacity and improved fiscal rule, in order to reach a comprehensive political decision by June 2018. Ministers concluded that sequencing will be essential to bring all views on board, as well as holding discussions in a stable and inclusive format as much as possible. They also agreed the Eurogroup has a key role to play in the ESM reform as well as in advancing on the completion of Banking Union by holding strategic discussions, without overlapping with the legislative discussions which will continue in the ECOFIN filière. Finally, Ministers asked the EWG to work on fiscal issues to better understand the different possible options and their respective merits and implications.

Source: EGOV based on Eurogroup statements published on the Council homepage.

Box 2: How to improve the European Semester?

This box provides a summary of two external papers requested by the ECON Committee in summer 2017 to assess achievements under the European Semester and suggest possible ways forward for its improvement.

Xavier Ragot *(OFCE and SciencesPo-CNRS)* acknowledges that the improvement of the European Semester is an on-going process. However, this process of annual coordination should focus more on macro-economic policies with potentially strong spill-overs, which can only be addressed at the European level. Among these, one can identify diverging nominal trends and deflationary pressures at the euro area level, an inadequate fiscal stance, and unsustainable current account imbalances. To address these issues, he puts forward seven specific suggestions on how to further improve the current economic coordination and surveillance process:

1. Request National Productivity Boards (NPBs) to focus more on nominal trends across tradable and non-tradable sectors and on the labour markets;
2. Based on the inputs of NPBs and the Commission, define a nominal wage stance in the euro area consistent with the European Central Bank inflation target. Use this nominal stance to provide relevant Country Specific Recommendations (CSRs);
3. Provide a hierarchy of CSRs based on a degree of spill-overs the requested reforms have onto other Member States;
4. Systematically add CSRs about environmental issues and possibly energy policy, as these recommendations tackle issues with clear externalities;
5. Add a temporal dimension to recommendations, with a possible medium-run time horizon, distinguishing between intermediate steps and final goals;
6. Start the European Semester with an assessment of the European economic situation on key aspects: Fiscal aspects (fiscal sustainability and fiscal stance), social aspects, financial aspects (based on current account imbalances) and nominal aspects (nominal and wage stance);
7. To improve democratic debate, a systematic communication on CSRs with externalities would considerably ease national ownership. The Commission has to be heard by national parliaments to discuss potential European externalities, while the European parliament should scrutinize the assessment by the Commission of these policies with strong externalities.

Cinzia Alcidi and Daniel Gros *(Centre for European Policy Studies)* argue that the emphasis of the European Semester should shift from economic policy coordination – intended as the process through which Member States commit to common rules and recommendations adopted by the Council of the European Union under the surveillance of the Commission – to a stronger national ownership. Coordination of national policies may be essential at times of crisis, when cross-country spillover effects tend to be large, but it may not be very effective when economic conditions return to normal, as spillovers tend to be small and the incentives for governments to coordinate lessen.

Stronger national ownership should lead to better enforcement of commonly agreed rules, regardless of economic conditions and should take away the perception that rules are hierarchically imposed. National ownership could be improved by involving the national fiscal councils and the national productivity boards explicitly in the elaboration of EU recommendations for national governments. This should be done without increasing the complexity of an already complicated EU governance system of governance or damaging their reputation as independent bodies.

Reforms aiming to improve the structural functioning of the EU's economies are of critical importance for Member States, yet the reasons why specific reforms should be embedded in the Semester are not always clear. Moreover, strengthening the Semester by further linking the EU budget to reforms undertaken in the Member States appears to be an appealing idea in theory but is very difficult to put into practice. Reforms cannot be 'bought' as such and it would be extremely difficult to measure the implementation of the CSRs precisely enough to make implementation a condition for funds.

The role of the Commission should remain predominant in (1) fostering coordination in case of

2. Euro area recommendations: A bird's eye view

Table 2 below provides an overview some stylised facts on euro area recommendations issued by the Council under the European Semester:

- The number of recommendations has varied over time, ranging from seven during the very first European Semester (2011) to four during the 2014-2015 cycles. Since the 2017 European Semester, the Commission has proposed five recommendations on the economic policy of the euro area;
- Irrespective of the number of recommendations, **four broad policy areas have been covered over the period 2011-2018**, namely structural, fiscal, financial and institutional issues. In particular, during the 2014 and 2015 cycles, the approach had consisted in addressing one recommendation per policy area. Since the 2016 European Semester, the approach has departed from this perspective, tackling structural challenges in two separate recommendations: one targeting policies supporting growth, improving the adjustment capacity, convergence and resilience, as well as correction of macroeconomic imbalances, while the other covering reforms promoting job creation and social fairness;
- As regards the assessment of **implementation of euro area recommendations**, the Commission approach has evolved over time. Starting with qualitative assessment provided within its Staff Working Documents (SWDs) on the euro area economy, the Commission also provided for 2014-2016 euro area recommendations a summary evaluation based on a "standardised" grid typically used for Country-Specific Recommendations issued to individual Member States. As from the 2017 European Semester, the Commission reverted to its original approach based on qualitative assessment without categorising progress made in the policy areas concerned. The overall picture that emerges from these assessments is that **the speed and degree of progress made in a given policy area have been strongly linked to the urgency of policy action amid the prevailing macro-economic conditions** (e.g. set up of the Banking Union, progress achieved by the net debtor countries in correcting their macroeconomic imbalances).

Table 2: Implementation of euro area recommendations

<table>
<tr><th rowspan="2"></th><th colspan="8">European Semester Cycle</th></tr>
<tr><th>2011</th><th>2012</th><th>2013</th><th>2014</th><th>2015</th><th>2016</th><th>2017</th><th>2018</th></tr>
<tr><td>Number of recommendations</td><td>7</td><td>6</td><td>6</td><td>4</td><td>4</td><td>5</td><td>5</td><td>5</td></tr>
<tr><td rowspan="3">Implementation of recommendations</td><td rowspan="3" colspan="3">Qualitative assessment within SWDs (no assessment grid)</td><td>1 (25%)</td><td>1 (25%)</td><td>-</td><td rowspan="3">Qaulitat assess. within SWD</td><td rowspan="3">Nov. 2018</td></tr>
<tr><td>3 (75%)</td><td>2 (50%)</td><td>4 (75%)</td></tr>
<tr><td>-</td><td>1 (25%)</td><td>1 (25%)</td></tr>
</table>

Source: EGOV based on the Commission Staff Working Documents (SWDs).
Notes: (1) For the sake of presentation, the assessment grid shown in the table is composed of three rather than five categories typically used by the Commission, namely **'full/substantial progress'**, **'some progress'** and **'limited/no progress'**.
(2) Based on the Commission assessment of actions taken (rather than outcomes that may materialise with variable lags); assigning identical weights to all recommendations, within and across cycles, irrespective of their institutional and political sensitivities.

3. The 2018 Euro Area recommendations

The 2018 euro area recommendations were proposed by the Commission on 22 November 2017 as part of the "European Semester Autumn Package". The Eurogroup discussed and amended these draft recommendations at the meeting of 22 January 2018 in view of their approval by the ECOFIN Council of 23 January 2018. As a general rule, the Council is expected to follow the Commission proposal or publicly explain reasons for not doing so (for those elements on which the Commission does not agree)[1,2].

The 2018 draft recommendations cover four key policy areas, namely: (1) implementing structural reforms (supporting growth and jobs); (2) delivering the planned, broadly neutral overall fiscal stance at the euro area level; (3) completion of the Banking Union and further developing the Capital Markets Union as well as addressing risks within the banking sector; and finally (4) making progress on completing the EMU. While these priorities were also covered during the previous cycle, some new elements have been introduced or the emphasis placed on the elements that were maintained has changed, as shown in Table 3. Note that the (1) 2018 AGS are fully reflected in the latest vintage of recommendations and (2) there is no one to one correspondence between AGS priorities and EA recommendations.

Table 3: Comparison of the 2017 and 2018 Euro Area recommendations

<table>
<tr><th>2017 Council Recommendations
(21 March 2017)</th><th>2018 Draft Recommendations
(ECOFIN Council, 23 January 2018)</th></tr>
<tr><td colspan="2">EA recommendation 1 (Structural policy)</td></tr>
<tr><td colspan="2">2018 EA recommendation 1 - New elements and partly changed emphasis, in particular:
• Improving resilience (rather than adjustment capacity)
• Making significant progress towards completing the Single Market
• Given the positive cyclical conditions, all Member States should prioritise reforms that increase productivity and growth potential [...] foster innovation, support the creation of quality jobs and reduce inequality
• Explicit reference to promoting wage growth (for Member States with large current account surpluses)</td></tr>
<tr><td>2017 EAR 1:
Pursue policies that support sustainable and inclusive growth in the short and the long term, and improve adjustment capacity, rebalancing and convergence. Prioritise reforms that increase productivity, improve the institutional and business environment, remove bottlenecks to investment, and support job creation. Member States with current account deficits or high external debt should raise productivity while containing unit labour costs.</td><td>2018 EAR 1:
Pursue policies that support sustainable and inclusive growth and improve resilience, rebalancing and convergence. Make significant progress towards completing the Single Market, particularly in services, including financial, digital, energy and transport, and by implementing relevant product market reforms at national level. Given the positive cyclical conditions, all Member States should prioritise reforms that increase productivity</td></tr>
</table>

[1] The so-called "*comply or explain principle*" established by Article 2ab(2) of Regulation 1466/97.

[2] See a separate EGOV note for a full review of changes adopted by the ECOFIN Council to the draft 2018 EA recommendations proposed by the COM. While all the five recommendations were amended, modifications vary in scope and ambition (in particular, as regards EA recommendation 2, the ECOFIN Council agreed with the COM proposal of a broadly neutral fiscal stance for the EA, although as part of a balanced policy mix. However, it introduced the notions of fiscal space and spillovers across Member States as elements to be taken into account, besides the full respect of the SGP, when designing fiscal policies that strike an appropriate balance between sustainability of public finances and support to the economy. Moreover, in the EA recommendation 5 concerning completion of the EMU, the ECOFIN Council considered that the COM initiatives launched in autumn 2017 should be taken into account in, rather than being the basis of, the reflection process on the way forward).

<table>
<tr><td>Member States with large current account surpluses should implement, as a priority, measures, including structural reforms and fostering investment, that help to strengthen their domestic demand and growth potential.</td><td>and growth potential, improve the institutional and business environment, remove bottlenecks to investment and foster innovation, support the creation of quality jobs and reduce inequality. Member States with current account deficits or high external debt should additionally aim at containing growth in unit labour costs and seek to improve their competitiveness. Member States with large current account surpluses should additionally create the conditions to promote wage growth respecting the role of social partners and implement as a priority measures that foster investment, support domestic demand and growth potential, thereby also facilitating rebalancing.</td></tr>
<tr><td colspan="2" align="center">EA recommendation 2 (Fiscal policy)</td></tr>
<tr><td colspan="2">2018 EA Recommendation 2 - Substantially changed, with several new elements, such as, explicit reference to:
• broadly neutral overall fiscal stance for the Euro Area
• fiscal space and spillovers across Member States, besides the full respect of the SGP, as elements to be taken into account when striking an appropriate balance between ensuring the sustainability of public finances and supporting the economy
• rebuild fiscal buffers on the back of improving economic conditions as well as to pursue policies which support investment and improve the quality and composition of public finances
• implement measures to reduce debt bias in taxation and fight aggressive tax planning (including further work on CCCTB)</td></tr>
<tr><td>2017 EAR 2
Aim for an appropriate balance in fiscal policies between the need to ensure sustainability and the need to support investment to strengthen the recovery, thereby contributing to an appropriate aggregate fiscal stance and a more balanced policy mix. Member States that, according to the Commission assessment, are at risk of not meeting their obligations under the SGP in 2017 should, on that basis, take, in a timely manner, additional measures to ensure compliance. Conversely, Member States that have outperformed their medium-term objectives are invited to continue to prioritise investments to boost potential growth while preserving the long-term sustainability of public finances. Member States that are projected to be broadly compliant with the SGP in 2017 should ensure compliance with the SGP within their national budgetary processes. Pursue fiscal policies in full respect of the SGP, while making the best use of the flexibility embedded within the existing rules. Overall, Member States should improve the composition of public finances by creating more room for tangible and intangible investment, and ensure the effective functioning of national fiscal frameworks.</td><td>2018 EAR 2
Deliver the planned, broadly neutral overall fiscal stance for the Euro Area, contributing to a balanced policy mix. Strike an appropriate balance between ensuring the sustainability of public finances, in particular where debt ratios are high, and supporting the economy, in full respect of the Stability and Growth Pact and taking into account fiscal space and spillovers across Member States. Use the improving economic conditions to rebuild fiscal buffers, while continuing to strengthen economic growth potential. Ensure the effective functioning of national fiscal frameworks. Member States should pursue policies which support investment and improve the quality and composition of public finances, also by making use of spending reviews and adopting growth-friendly and fair tax structures. Member States should take and implement measures to reduce debt bias in taxation and fight aggressive tax planning to ensure a level playing field, provide fair treatment of taxpayers and safeguard public finances and stability within the euro area. This includes continuing work on the Common Consolidated Corporate Tax Base (CCCTB).</td></tr>
</table>

EA recommendation 3 (Structural policy)	
2018 EA Recommendation 3 - Broadly unchanged emphasis, with new elements, such as a reference to: • Promoting ***quality jobs***, ***equal opportunities*** and ***access to labour market***, ***fair working conditions*** and supporting ***social protection and inclusion*** • smooth ***labour mobility*** across jobs, sectors and locations • effective ***social dialogue*** and ***wage bargaining***	
2017 EAR 3: **Implement reforms that promote competitiveness, job creation, job quality, resilience and economic and social convergence, underpinned by an effective social dialogue.** They should combine: (i) **reliable labour contracts** which provide flexibility and security for employees and employers; (ii) **quality and efficient education and training systems and comprehensive lifelong learning strategies** targeted at labour market needs; (iii) **effective active labour market policies** to support labour market participation; (iv) **modern, sustainable and adequate social protection systems** that contribute effectively and efficiently throughout the life cycle to social inclusion and labour market integration. **Shift taxes away from labour,** particularly for low-income earners and in Member States where cost competitiveness lags behind the euro area average, and make that tax shift budget-neutral in countries without the fiscal room for manoeuvre.	**2018 EAR 3:** **Implement reforms that promote *quality job creation*, *equal opportunities* and *access to labour market*, *fair working condition*s, and support *social protection and inclusion*.** Reforms should aim at: (i) **reliable labour contracts,** which provide flexibility and security for employees and employers, combined with adequate support during transitions and avoiding labour market segmentation; (ii) **quality, efficient and inclusive life-long education and training systems,** which aim at matching skills with labour market needs; (iii) **effective active labour market policies** that foster labour market participation; (iv) **sustainable and adequate social protection systems** that contribute throughout the life cycle to social inclusion and labour market integration and are responsive to new types of employment and employment relationships; (v) ***smooth labour mobility across jobs, sectors and locations***; (vi) ***effective social dialogue and wage bargaining*** at the appropriate level according to national specificities; (vii) **shifting taxes away from labour,** particularly for low-income and second earners**.**
EA recommendation 4 (Financial sector reform)	
2018 EA Recommendation 4 - Broadly unchanged emphasis, with new elements, such as a reference to: • Strengthening the ***European regulatory and Supervisory framework*** • Tangibly accelerating ***reduction in the level of non-performing loans*** • Further developing ***the Capital Markets Union***	
2017 EAR 4: In line with the roadmap of June 2016, **continue work to complete the Banking Union with regard to risk reduction and risk sharing**, including a European Deposit Insurance Scheme and making the common backstop for the Single Resolution Fund operational at the latest by the end of the Fund's transitional period. Devise and implement an effective euro-area wide strategy to complement prudential supervisory action to **address viability risks within the banking sector, including as regards the high level of non-performing loans, inefficient business models and overcapacity.** In Member States with large stocks of private debt, **promote orderly deleveraging.**	**2018 EAR 4:** In line with the Council (ECOFIN) roadmap of June 2016, **continue work to complete the Banking Union with regard to risk reduction and risk sharing,** including a European Deposit Insurance Scheme, making the common backstop for the Single Resolution Fund operational as agreed. Further ***strengthen the European regulatory and supervisory framework*** to prevent the accumulation of risks. Take measures to ***tangibly accelerate reduction of the levels of non-performing loans*** on the basis of the agreed Council (ECOFIN) Action Plan and **promote orderly deleveraging** in Member States with large stocks of private debt. ***Further develop the Capital Markets Union*** to support growth in the real economy while safeguarding financial market stability.

EA recommendation 5 (EMU institutional reform)	
2018 EA Recommendation 5 - Main changes include reference to: • Making ***swift*** progress on completing the EMU • Taking into account the ***Commission initiatives launched in autumn 2017***	
2017 EAR 5: **Make progress on completing EMU,** in full respect of the Union's internal market and in an open and transparent manner towards non-euro area Member States. Further advance the ongoing initiatives and work on the longer-term issues for EMU, taking due account of the Commission White Paper on the Future of Europe.	**2018 EAR 5:** **Make *swift* progress on completing the economic and monetary union, *taking into account the Commission initiatives launched in autumn 2017***, in full respect of the Union's internal market and in an open and transparent manner towards non-euro area Member States.

Source: EGOV based on the 2017 Council recommendations and the draft 2018 Council recommendations.

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