IN DEPTH ANALYSIS

Economic Dialogue with the President of the Eurogroup

ECON on 18 November 2019

Mário Centeno, has been invited to his first Economic Dialogue for the current legislative term of the European Parliament. The previous dialogue in the ECON Committee took place on 20 November 2018. During the 8th legislative term, 9 Economic Dialogues with the President of the Eurogroup took place in the ECON Committee.

This briefing provides an overview of the ongoing work of the Eurogroup as regards Council recommendations to the Euro Area as a whole, public finances, macro-economic imbalances, ex-post surveillance and the banking union.

Highlights

According to recent macroeconomic forecasts, the Euro Area (EA) is expected to continue growing, but at a slower pace compared to previous forecasting round. Economic projections were revised downwards due to high uncertainty related to trade conflicts, rising geopolitical tensions, persistent weakness in the manufacturing sector and Brexit (See Section 1).

Work on completion of the EMU was frequently on Eurogroups' (EG) agendas in 2019. EG addressed the reform of the European Stability Mechanism - notably the design of a backstop to the Single Resolution Fund and assessed ways forward on a European Deposit Insurance Scheme and other proposals to complete the Banking Union. It also discussed a new budgetary instrument to support EA Member States in reforms and investments (the BICC). The interplay between European Commission (Commission) proposals, negotiations in the EG and the Council, as well as their relationship with the Multiannual Financial Framework (notably in what concerns the BICC) is still unclear (see Sections 2 and 6).

After the agreement reached in October, work on the BICC is progressing, in particular as regards modalities for the modulation of the national co-financing rates (to be based on a trigger related to severe economic circumstances). The PEG summing up letter after the July meeting points to some Ministers having requested further technical work on a stabilisation function for the EA to continue.

As regards the coordination of economic policies of the EA Member States, the EG holds, since 2015, thematic discussions on the basis of external expertise and Commission technical notes on issues that are relevant for the EA as a whole. Those discussions focus on issues that are somehow reflected in EA recommendations, but no evident link to such recommendations and actual outcomes can be established (See Section 3).

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In the area of public finances, the Commission projects in its autumn 2019 forecast that the EA's aggregate public deficit rises from an historic low of 0.5% of Gross Domestic Product (GDP) in 2018 to 0.8% this year and to 0.9% in 2020. In 2019, twelve out of nineteen EA Member States are not expected to be close or at their Medium Term Budgetary Objective (MTO). By mid-October 2019, all EA Member States submitted their 2020 Draft Budgetary Plans (DBPs). The Commission thereupon sent a letters to six EA Member States: Belgium, Portugal and Spain were asked to resubmit an updated DBP; Belgium, Finland, France and Italy were requested to send further clarifications, since they seem to be at risk of a significant deviation from their obligations under the preventive arm. Commission Opinions on all DBPs are to be published by 30 November 2019 and the EG is expected to discuss them on 4 December 2019 (see Section 4).

As regards the implementation of the Macro-economic Imbalance Procedure, six EA Member States are experiencing macroeconomic imbalances, and three Member States are experiencing excessive macroeconomic imbalances, according to the Commission and the Council. Most imbalances are related to the external position: external debt or large current accounts surplus. The EA continues to have the world's largest current account surplus, and the Council recommendations to the EA, as well as some of the country specific recommendations, address this issue (See Section 5).

Box 1. The Eurogroup, its President and Transparency

The Eurogroup is an informal body that brings together the finance ministers of countries whose currency is the Euro. EG discusses issues connected with the EA shared specific responsibilities and, more recently, has been mandated to prepare the Euro Summits.

The EG is led by a President (PEG) - a finance minister of one of the EA Member States- selected in a personal capacity by its peers for a two and a half term. Mário Centeno is the PEG since 13 January 2018. The PEG is responsible for setting the agenda, chairing and steering EG discussions, presenting the outcome of EG meetings, representing the EG in international meetings. The PEG also participates in Economic Dialogues with the European Parliament at certain stages of the implementation of the European Semester and in the context of macro-economic adjustment programmes, including post-programme surveillance (see, in particular, Article 2ab of Regulation 1466/97 as amended). In recent years, the practice has been that the PEG takes part in an Economic Dialogue twice a year. The PEG has also occasionally been invited for an exchange of views with Members of the Parliament in the Plenary and to inter-parliamentary meetings relating to economic governance.

As PEG, Mr Centeno is also the Chairman of the Board of Governors of the European Stability Mechanism. The Finance Ministers of EA Member States are Governors of the ESM as well.

Following letters exchanged with the European Ombudsman dating back from 2015 and calls for further increasing its transparency, the EG undertook reforms in 2016 and September 2019. The September reform led to agreement to (i) create an online repository of publicly available EG documents; (ii) expand - whenever possible - the EG summing-up letters (which are already made available); (iii) increase the transparency of preparatory work in the Eurogroup Working Group, by publishing its meeting calendar and improving its webpage; (iv) reviewing the transparency policy at "*regular intervals to ensure they remain fit for purpose*".

In February 2019, Transparency International EU published a report on the EGs' accountability and transparency. One of their conclusions is that the EG continues to evade proper accountability: *"As a basic principle, "democratic control and accountability should aoccur at the level at which the decisions are taken" – i.e. European decision-making should be accountable at European level. This was the stated goal, in 2012, of the Presidents of the European Council, the European Commission, the Eurogroup, and the European Central Bank. While the Eurogroup's President regularly appears before the European Parliament to answer questions, this voluntary arrangement does not constitute an effective accountability mechanism. Thus, even while operating as a de facto gouvernement économique, the Eurogroup as such is not accountable to anyone"*. The report highlights various proposals to improve the transparency, accountability and integrity of the EG, namely the transformation of the EG into a formal body with direct responsibility at EU level.

For further information, please consult EGOV briefing on the role and accountability of the PEG.

1. Macroeconomic developments

> ***EG autumn 2019 work programme (WP)**:*
>
> *The EG will continue to follow economic developments attentively and will stand ready to re-examine policy strategies and provide coordinated, timely and differentiated policy responses if risks materialise.* (Autumn 2019 WP)

Based on the Commission Autumn 2019 Economic Forecast, the EA is expected to continue growing; however, growth expectations have been revised down. The EA GDP is forecasted to grow by 1,1% in 2019 and by 1,2% in 2020 and 2021 and these forecasts are 0,1–0,2% lowered compared to Summer 2019 Economic Forecast (one year ago, the growth forecast for EA was 1,9% and 1,7% for 2019 and 2020 respectively). Equally, for the EU as a whole, GDP is expected to expand by 1,4% in 2019, 2020 and 2021. It was also revised down by 0,2% for 2020 compared to the summer outlook (one year ago, the growth forecast for EU was 2,0% and 1,9% for 2019 and 2020 respectively). Table 1 below provides an overview of country specific figures and Annex 1 provides more data on selected EA indicators.

Table 1. Overview – the Commission 2019 autumn forecast

	Real GDP, %			Inflation, %			Unemployment rate, %			Current account, %			Budget balance, % of GDP		
	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021
Belgium	1,1	1,0	1,0	1,3	1,4	1,4	5,5	5,4	5,3	-0,8	-0,9	-1,0	-1,7	-2,3	-2,6
Germany	0,4	1,0	1,0	1,3	1,2	1,4	3,2	3,4	3,5	7,0	6,8	6,4	1,2	0,6	0,2
Estonia	3,2	2,1	2,4	2,4	2,1	2,2	5,1	5,4	5,8	1,4	1,6	1,6	-0,2	-0,2	-0,2
Ireland	5,6	3,5	3,2	0,8	1,1	1,4	5,2	5,0	5,0	0,8	1,3	1,7	0,2	0,3	0,6
Greece	1,8	2,3	2,0	0,5	0,6	0,9	17,3	15,4	14,0	-0,8	-1,1	-0,9	1,3	1,0	1,1
Spain	1,9	1,5	1,4	0,9	1,1	1,4	13,9	13,3	12,8	2,4	2,5	2,6	-2,3	-2,2	-2,1
France	1,3	1,3	1,2	1,3	1,3	1,3	8,5	8,2	8,0	-0,4	-0,6	-0,6	-3,1	-2,2	-2,2
Italy	0,1	0,4	0,7	0,6	0,8	1,1	10,0	10,0	10,0	2,9	2,9	2,9	-2,2	-2,3	-2,7
Cyprus	2,9	2,6	2,3	0,6	0,7	1,3	7,2	6,3	5,7	-8,1	-10,6	-11,1	3,7	2,6	2,4
Latvia	2,5	2,6	2,7	3,1	2,5	2,3	6,6	6,4	6,4	-0,8	-1,4	-1,8	-0,6	-0,6	-0,6
Lithuania	3,8	2,4	2,4	2,4	2,2	2,1	6,2	6,2	6,2	1,2	1,5	1,8	0,0	0,0	0,0
Luxembourg	2,6	2,6	2,6	1,7	1,6	1,9	5,3	5,3	5,3	4,4	4,4	4,4	2,3	1,4	1,4
Malta	5,0	4,2	3,8	1,6	1,7	1,7	3,6	3,5	3,6	9,0	8,5	8,2	1,2	1,0	1,0
Netherlands	1,7	1,3	1,3	2,6	1,4	1,5	3,5	3,7	4,1	9,8	9,0	8,6	1,5	0,5	0,4
Austria	1,5	1,4	1,4	1,5	1,6	1,6	4,6	4,6	4,6	2,2	2,1	2,2	0,4	0,2	0,4
Portugal	2,0	1,7	1,7	0,3	1,1	1,4	6,3	5,9	5,6	-0,4	-0,7	-1,0	-0,1	0,0	0,6
Slovenia	2,6	2,7	2,7	1,8	1,9	2,0	4,4	4,2	4,2	5,8	5,5	5,1	0,5	0,5	0,6
Slovakia	2,7	2,6	2,7	2,7	2,5	2,2	5,8	5,7	5,6	-2,4	-2,6	-2,3	-0,9	-1,2	-1,3
Finland	1,4	1,1	1,0	1,2	1,4	1,5	6,7	6,5	6,4	-1,3	-1,5	-1,7	-1,1	-1,4	-1,6
Euro area	1,1	1,2	1,2	1,2	1,2	1,3	7,6	7,4	7,3	3,3	3,2	3,1	-0,8	-0,9	-1,0
EU	1,4	1,4	1,4	1,5	1,5	1,7	6,3	6,2	6,2	1,9	1,8	1,8	-0,9	-1,1	-1,2

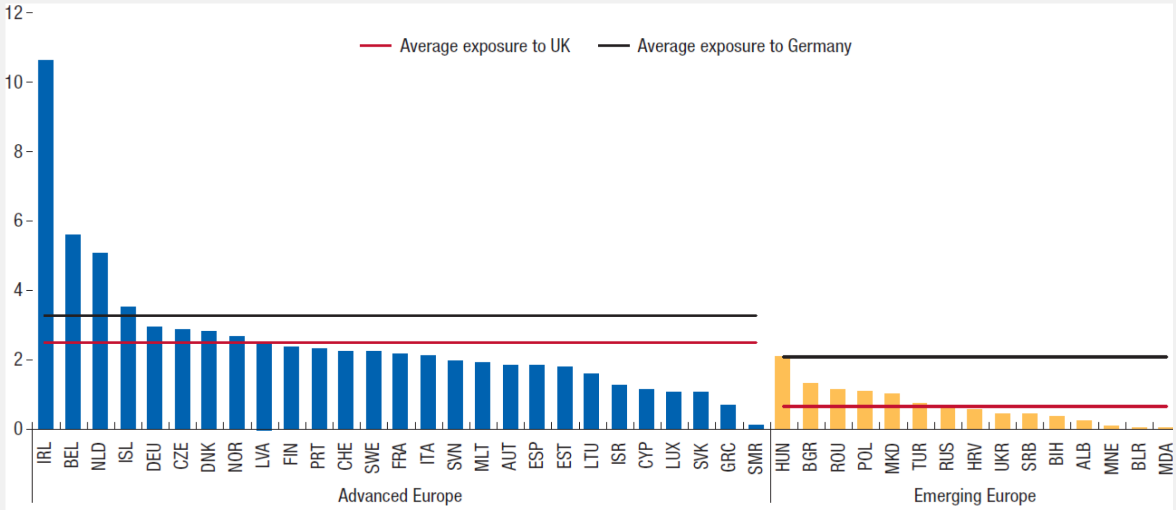
Source: Commission.

As Vice-President Valdis Dombrovskis commented, these revisions were caused by *"high uncertainty related to trade conflicts, rising geopolitical tensions, persistent weakness in the manufacturing sector and Brexit"* (see Box 2 on Brexit implications).

Box 2. Brexit implications on European growth projections

According to the IMF Regional Outlook for Europe, November 2019, *"amid high uncertainty, risks to the forecasts for the Europe are to the downside. In the near term, the modalities of Brexit are key for the European outlook. A no-deal Brexit could have a sizable impact on activity in the United Kingdom and the European Union—with output lower by about 3½ and ½ percent in two years, respectively, relative to the April 2019 forecast (see Box 1.1 of the April 2019 World Economic Outlook). Value added trade exposure of European countries to the United Kingdom, though smaller than to Germany—the main European hub—is sizable* [Figure below]. *Further escalation of trade tensions and related uncertainty when combined with tighter financing conditions can weigh significantly on European investment and growth. More broadly, the weakness in manufacturing and trade could spread to other sectors—notably services—and could occur faster and to a greater extent than expected. Other risks include abrupt declines in risk appetite, a build-up of financial vulnerabilities, and the re-emergence of deflationary pressures in advanced economies. Country-specific factors (such as domestic weakness in some large EA countries) and geopolitical tensions could exacerbate the effects from weak global trade and manufacturing. Delays in the implementation of structural reforms, demographic challenges, climate change, rising inequality, and declining trust in mainstream policies could also dampen growth in the medium to long term."*

Figure A. Trade Exposure to the United Kingdom
(Percent of GDP)



Sources: EORA Multi-Regional Input-Output database; and IMF staff calculations. Note: Lines refer to simple averages across countries in each region. The latest year available in EORA is 2013. Country list uses International Organization for Standardization (ISO) country codes. Advanced and emerging countries are classified by the IMF taking into account such indicators as i) per capita income level ii) export diversification iii) degree of integration into the global financial system.

In the Autumn 2019 Economic Forecast, the Commission stresses that economic growth rebound in the coming two years is no longer expected as more and more signs of persistent global slow down are observed. As economic outlook is expected to be more uncertain, despite still robust wage growth and historically low levels of unemployment, both households and corporate sector already increase their precautionary savings and postpone investment spending, which will have a negative effect on the GDP.

The negative external shocks are partially counteracted by expanding domestic demand and by growth-enhancing fiscal measures introduced by some EA Member States.

The Commission projections are more conservative compared to the latest IMF World Economic Outlook published in October 2019, where GDP growth expectations are 1,2% and 1,4 % for 2019 and 2020 respectively for the EA countries and 1,5% and 1,6% for 2019 and 2020 respectively for the EU as a whole.

The PEG noted, after its October 2019 meeting, the readiness of Ministers to adjust policy if risks to the downsize scenario materialise. He mentioned, in particular, "*If there is a more marked downturn, we should not tighten our policies and make it worse. Where possible, fiscal stance should be more accommodative if downward risks materialise*".

Box 3. Economic consequences of climate change

According to the Commission forecast, climate change is expected to matter most beyond the forecast horizon, but this does not exclude the occurrence of devastating effects already in the forecast years both in the EU and globally. Unusually bad weather conditions could directly impact on agricultural output and commodity prices, but also distort production chains and impact thereby negatively on economic growth. This could trigger cascading effects in the financial system by affecting financial assets and the liabilities of financial institutions. In the absence of appropriate policies, risks related to climate change would increase.

See also IMF Fiscal Monitor, October 2019 that emphasises the environmental, fiscal, economic, and administrative case for using carbon taxes, or similar pricing schemes such as emission trading systems, to implement climate mitigation strategies. It provides a quantitative framework for understanding their effects and trade-offs with other instruments and applies it to the largest advanced and emerging economies.

President-elect Ursula von der Leyen pointed out in her political guidelines six key political fields. Among them, the first one is to build a European Green Deal for a climate-neutral EU during her first 100 days in office, which is further elaborated in the mission letter to Frans Timmermans. This includes the launch of a "sustainable Europe investment plan" capable to mobilise up to €1 trillion of private investment over the next decade, and the creation of a "Just Transition Fund" to support people and regions to switch to cleaner energy while maintaining robust economic growth and creating jobs.

The ECOFIN Council adopted conclusions on 8 November 2019 reiterating that public climate finance will continue to play an important role for climate action, while underlining that the bulk of financing to drive the shift to a climate-neutral and resilient global economy will need to come from domestic and private sources and that further efforts are required in this respect. It further underlined, in this context, the need to better target public finance to leverage more effectively and efficiently private sector funding to finance mitigation and adaptation action, as well as the need to ensure enabling environments.

2. Enhancing EMU governance: latest developments

***EA 2019 recommendations and EG autumn 2019 WP**:*

5. Make swift progress on completing the Economic and Monetary Union, also with the perspective to strengthen the international role of the euro, taking into account the Commission proposals, including those concerning the financial sector as well as the Reform Support Programme and the European Investment Stabilisation Function under the proposal for the 2021-2027 Multiannual Financial Framework. (2019 EAR)

Finally, the EG stands ready to contribute to further work on the deepening of the EMU, following up on the results achieved in June, including on the ESM Treaty, the budgetary instrument for competitiveness and convergence (BICC) and EDIS and the Banking Union, as necessary. In this regard, the work programme will be further refined according to the outcome of the June 2019 Euro Summit. (Autumn 2019 WP)

As part of the on-going on the deepening of the EMU and mandated by EU leaders, the EG delivered on December 2018 a political agreement on a *''comprehensive plan to strengthen the Euro''* that materialised in:

- a report to the Euro Leaders, meeting on 14 December, together with 3 annexes, dealing with (a) the terms of reference for the Single Resolution Fund backstop, (b) the ESM Term sheet and (c) the ESM-COM cooperation agreement,
- a proposal for the establishment of a High Level Working Group on a European deposit insurance scheme (HLWG on EDIS), with a broad mandate encompassing other missing elements such as liquidity in resolution, and
- a possible budgetary instrument for the EA (the BICC[1]).

This section covers the ESM Terms sheet (including the revision of the ESM Treaty), the cooperation agreement between the ESM and the Commission and the BICC. The other subjects mentioned above are covered under section 6 below on the Banking Union.

2.1. The revision of the ESM Treaty

Following discussions held at various meetings, in June, the EG reached a broad agreement on revising the text of the ESM Treaty[2], covering issues such as the common backstop for bank resolution, the precautionary instruments, debt sustainability assessment, as well as institutional aspects, including the cooperation between the ESM and the European Commission (within and outside assistance programmes). The ESM revision does not foresee accountability towards the European Parliament, but it includes an acknowledgement that the ESM Managing Director is heard at the European Parliament.

In July, the EG discussed the ESM again, and notably agreed to finalising the package of documents related to the revision of the ESM Treaty by December 2019. In their November meeting, Ministers were updated on technical progress (according to information available an amended ESM Guideline for precautionary instruments and the common methodology on Debt Sustainability Analysis seems to be agreed and the Memorandum of Cooperation between the Commission and the ESM almost closed). There, the PEG noted that "*work is advanced on the Guideline and Board of Governors resolutions*" and that Ministers would "*come back to the backstop, including the early introduction, at our next meeting, on 4 December*".

[1] As explained by the Council, the BICC "*establishes a new fiscal tool dedicated to the EA. By promoting convergence and competitiveness, this budgetary instrument intends to help bring economies closer into line and increase the efficacy of monetary policy and, in so doing, to ease concerns about the need for permanent fiscal transfers*".
[2] For a detailed presentation of the proposed amendments to the ESM Treaty, please see this specific EGOV paper.

2.2. The budgetary instrument for convergence and competitiveness

Ministers held discussions in January, February, March, April and May on BICC. In their June meeting, Ministers reached agreement on the instrument term sheet, but nevertheless could not agree on appropriate options for its financing and no consensus emerged in relation to a stabilisation function either. PEG further noted, in its remarks after the meeting, that "*More work is needed, but today we have taken a number of small steps that combined result in real progress*". In its Communication on the Multiannual Financial Framework (MFF) addressed to the June European Council[3], the Commission also noted that "*Substantial progress has also been achieved on the features of a budgetary instrument for convergence and competitiveness for the EA. (...) work is progressing rapidly on the basis of the Commission's proposal for a Reform Support Programme. Positions are converging and agreement on the main features of the instrument is getting closer*".

Discussions continued in July[4] and September meetings, and agreement on all aspects of BICC, namely, governance and financing, the allocation methodology, key features of the modulation of the national co-financing rate and on defining appropriate arrangements for non-EA Member States not participating in the BICC was reached at the October EG meeting[5]. Annex 3 depicts the main elements of the BICC as agreed by the EG.

In its November meeting, the Ministers were informed that the "*legislative acts that set up BICC are underway*", as PEG reported after the meeting. He also underlined that "*several members asked for a dedicated regulation on the BICC on the grounds that it is a standalone instrument*" and that work would continue of the various work streams, namely on the Intergovernmental agreement to underpin Member States additional contributions. Ministers will come back to the issue in 2020.

2.3. Review of the EU economic governance framework

According to its autumn 2019 WP, the EG had planned to discuss the review of the EU fiscal rules at its November meeting. Eventually, the subject was finally not added in the agenda of the meeting. The informal ECOFIN held a discussions on the topic in September 2019 and according to the Presidency the views were rather divided among the Ministers[6]. In accordance with the legislation in force, by 14 December 2019 the Commission shall publish a report evaluating the effectiveness of the rules and progress in ensuring closer coordination of economic policies and sustained convergence of economic performances of the Member States in accordance with the TFEU.

Further reading:

- The European Semester for economic policy coordination: A reflection paper - October 2019
- The European Stability Mechanism: Main Features, Instruments and Accountability – October 2019
- The 2019 proposed amendments to the Treaty establishing the European Stability Mechanism – October 2019
- Recommendations on the economic policy of the euro area under the 2019 European Semester - November 2019

[3] "Roadmap to an agreement on the Union's long-term budget for 2021-2027".
[4] One should note that the PEG summing up letter after the July meeting points to some Ministers having requested work on a stabilisation function for the EA to continue. Nevertheless, no further references are found to that on EG public information.
[5] No decision is yet made on the financial envelope for the BICC. Leaders will decide in the framework of the Multiannual Financial Framework discussions. It is nevertheless expected that the BICC will draw on funds assigned to the Reform Delivery Tool (RDT) in the Commission proposal for the 2021-2027 European Union budgetary package. According to this proposal, the RDT would have an envelope of €25 billion, of which €17 billion would be allocated to the 19 EA countries (at this stage, the amounts are purely indicative).
[6] On Saturday 14 September 2019, Niels Thygesen, the Chair of the European Fiscal Board, was at the informal ECOFIN to present the Board's recent report on the effectiveness of EU fiscal rules.

Box 4. Euro enlargement: Bulgaria and Croatia

Recently, Bulgaria and Croatia requested access to the European Exchange Rate Mechanism II (ERM II) and the Banking Union (BU). ERM II participation during at least 2 years is one of the criteria for Euro adoption. Such criteria are assessed every two years by the Commission and the ECB. Joining ERM II requires complying with some conditions, a decision by the ERM II parties and is based on opinions from the European Central Bank (ECB) and Commission.

Bulgaria announced in the first half of 2018 its intention to join the ERM II and, in a letter of 29 June 2018 to the Commission, EG and ECB, proposed a number of commitments to be achieved before a formal application. On 18 July 2018, as part of those commitments, Bulgaria required to establish a close cooperation with the ECB. An Annex to the PEG summing up letter of July 2018 details the "common understanding" of the six commitments (notably on insolvency framework, non-banking financial supervision, state owned entreprises and anti-money laundering). Bulgaria was expected to join ERM II (and BU) by July 2019. Most of the actions foreseen in the country plans for accession are, in accordance with the Bulgarian Finance Ministry, completed, but assessments by the Commission and the ECB are not yet available. On 26 July 2019, the ECB published the results of its comprehensive assessment, where it still found capital shortfalls in two banks under the stress tests adverse scenario, which were required to present restructuring plans. The latest available Commission Convergence Report on Bulgaria (May 2018) concluded that the country was still lacking compliance with two of the accession conditions, in particular the ones related to legislation surrounding the national central bank. The ECB has also pointed to supervisory concerns in its own latest Convergence Report (May 2018). As set out in the PEG summing up letter of July 2018, Bulgaria may commit to additional measures upon joining ERM II. No definitive information is available on the status of Bulgaria accession.

Croatia sent a letter requiring ECB to establish a close cooperation on 27 May 2019. In its letter of 4 July 2019 to the Commission, EG and ECB, Croatia makes a number of commitments, namely to reinforce its banking system and supervisory framework. The country is expected to join ERM II and BU by mid-2020. The latest available Commission Convergence Report (May 2018) concluded that the country was fulfilling all the criteria to join the euro, except (for not) being part of ERM II. The ECB Convergence Report (May 2018) notes, in addition, that the country needs to address shortcomings in auditing, governance and accounting standards. The ECB announced on the 7th of August that the following banks were undergoing a comprehensive assessment: Zagrebačka banka, Privredna banka Zagreb, Erste & Steiermärkische Bank, OTP banka Hrvatska and Hrvatska poštanska banka. Results are expected in May 2020.

3. Euro Area recommendations and country specific recommendations

> ***EA 2019 recommendations and EG autumn 2019 WP**:*
>
> *1. Deepen the Single Market, improve the business environment, and pursue resilience-enhancing product and services market reforms. Reduce external debt and pursue reforms to boost productivity in EA Member States with current account deficits and strengthen the conditions that support wage growth respecting the role of social partners and implement measures that foster investment in EA Member States with large current account surpluses.* (2019 EAR).
>
> *2. Shift taxes away from labour and strengthen education systems and investment in skills, as well as the effectiveness of active labour market policies that support transitions. Address labour market segmentation and ensure adequate social protection systems across the EA.* (2019 EAR).
>
> *...will keep focusing on structural policies aimed at strengthening growth and promoting convergence to enhance resilience. The EG will also continue to foster regular sharing of national experiences and enhance common understandings of the structural challenges ahead. The participation of distinguished external experts will continue to enrich these exchanges of views.* (Autumn 2019 WP).

Since at least 2015 the EG holds thematic discussions on growth and jobs in the EA, focussing on specific items and supported by technical analyses and presentations provided by the Commission, as well as by academic experts. In 2019, the EG held debates on - the housing markets and their impact on macroeconomic stability, the quality of public finances, competitiveness developments, inequality in the EA and investment in innovation and research as means to boost EA productivity and competitiveness. Although the 2019 EG WP refers to the EAR, no clear link was been established to EAR or CSR in the EG discussions.

In October 2011, the leaders of the euro area Member States stated "*The EG will, together with the Commission and the ECB, remain at the core of the daily management of the EA. It will play a central role in the implementation by the EA Member States of the European Semester. It will rely on a stronger preparatory structure*".

> **Box 5. How are euro area recommendations implemented?**
>
> At the EA level, as such, there is (1) no institutional body that bears formal responsibility for the implementation of EAR and (2) no formal mechanism to ensure implementation of (or enforce) these recommendations. Nevertheless, the EG takes into account the EAR when drawing up its work programme and undertakes "thematic discussions" on issues raised therein. The Council considers the EG as the appropriate forum for Member States to "take action", individually and collectively*, to follow up EAR.
>
> For further information, please see separate EGOV briefing on the EAR (November 2019).
>
> * In fact, the EA recommendations include, after the recitals and preceding the recommendations themselves, a sentence stating that the Council recommends "*euro-area Member States take action within the EG, individually and collectively, (...)*". This is a clear mandate for Member States to reflect the EA recommendations in their economic policies, to consider them as a matter of common concern and pointing to a coordination and monitoring role by the EG.

3.1. The 2019 Euro Area recommendations

The Commission made a proposal for the 2019 EA recommendations (EAR) on 21 November 2018. After discussion by the EG and the Economic and Financial Committee, it was discussed and adopted at the 21-22 January 2019 EG and ECOFIN meetings and endorsed by the 21-22 March 2019 European Council. The 2019 EAR were published on 12 April 2019.

As part of the discussions preceding adoption of the EAR, some amendments were made to the Commission proposal. These mainly relate to the commitments to debt reduction and rebuilding fiscal buffers and the framing of discussions regarding EDIS and the deepening of the EMU. References were added to the Capital Markets Union (CMU), fight against aggressive tax planning and to promote "quality job creation".

The 2019 EAR address:

- Structural reforms: product, services and labour markets (recommendations 1 and 3);
- Fiscal policies (recommendation 2);
- Financial sector/Banking Union (recommendation 4);
- Deepening of the EMU (recommendation 5).

Most of the actions covered by the EAR need implementation at national level (in particular, the EAR covering fiscal and structural issues) even if such national actions are coordinated *de facto* by the EG within the EMU economic governance framework[7]. As proxies to understand what is done at European level, one can look at (a) the publicly available information on EG discussions and (b) Commission's analysis.

In 2019 EG focused namely on:

- The EA fiscal stance and economic situation in general. Ministers affirmed their readiness to take measures if risks to the downside, as identified by the institutions, materialise;
- Thematic discussions (with the assistance of expert speakers) on topics related to housing markets and its impact on macroeconomic stability, quality of public finances, competitiveness developments, inequality in the EA and investment in innovation and research as means to boost EA productivity and competitiveness;
- Completing the Banking Union, namely following up on the HLWG on EDIS;
- Deepening of the EMU, addressing, in particular, the budgetary instrument for the EA (the budgetary instrument on competitiveness and convergence), reaching agreement in October on the main elements and characteristics, and the reform of the European Stability Mechanism, where agreement was reached in June.

Table 2. Implementation of EA recommendations

<table>
<tr><th rowspan="2"></th><th colspan="9">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><th>2019</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><td>5</td></tr>
<tr><td rowspan="3">Implementation of recommendations</td><td colspan="3" rowspan="3">Qualitative assessment within SWDs (no assessment grid)</td><td>1 (25%)</td><td>1 (25%)</td><td>-</td><td colspan="2" rowspan="3">Qualitative assess. within SWD</td><td rowspan="3">N.A.</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 SWDs accompanying the proposals for EAR.
*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.*

Since 2017, the Commission has refrained from assessing implementation of the EAR on the basis of a quantitative grid, similar to that used to assess the country-specific recommendations. The relevant information on how the Commission evaluates developments in the EA can be found in the Staff Working Documents (SWD) that accompany the proposed EAR for the incoming cycle (see table 2). This is clear from the 2018 assessment, which accompanies the proposed 2019 EAR and looks

[7] In fact, the EA recommendations include, after the recitals and preceding the recommendations themselves, a sentence stating that the Council recommends "*EA Member States take action within the EG, individually and collectively, (...)*". This is a clear mandate for Member States to reflect the EA recommendations in their economic policies, to consider them as a matter of common concern and pointing to a coordination and monitoring role by the EG.

back at developments in the EA to build recommendations going forward, and thus providing the underpinning of the new cycle EAR. The assessment of 2019 EAR is expected to be reflected in the SWD accompanying the proposal for the 2020 EAR (2020 winter package).

One may note that in the proposed governance framework for the BICC the Commission put forward in July 2019, it is foreseen that the Commission will annually assess the implementation of the specific EAR[8] setting out the strategic orientations on the reform and investment priorities for the EA.

3.2. The Country Specific Recommendations

On 9 July 2019, the Council (ECOFIN) adopted its 2019 recommendations and opinions on the Member States' economic, employment and fiscal policies. For the first time and following Greece's exit from its third economic adjustment programme in August 2018, the 2019 CSRs are addressed to all 28 Member States. The Council did very limited modifications to the draft 2019 CSRs as proposed by the Commission (see separate EGOV table). This may reflect uncontroversial analyses of the economic challenges of the respective Member States, a close consultation of the respective Member States authorities during the preparatory stage, and/or that the annual recommendations due to their generic nature have attracted less political attention over time.

Those EA countries that had not reached their fiscal targets under the preventive arm of the Stability and Growth Pact received a recommendation to take measures to reach their targets (see next section on public finances). Similarly those EA Member States that have been assessed to have macro-economic imbalances received recommendations under the preventive arm of the Macro-economic Imbalances Procedure. Those countries assessed to have excessive macro-economic imbalances received all their CSRs under the preventive arm of the MIP (see next section on macro-economic imbalances). The EA Member States received between 5 and 2 CSRs each (Italy and Cyprus received 5, while Germany and Greece received 2 each).

The assessment by the Commission of the implementation of the 2019 CSRs will be published in spring as part of the 2020 Country Reports. The implementation of the SGP-related recommendations will be assessed in May, together with the verification of budgetary data for 2018 and the assessment of the 2020 Stability Programmes.

Table 3. Comparing implementation of CSR in EA and non-EA Member States

Year / CSRs	Full/Substantial		Some		No/Limited	
	EA	Non-EA	EA	Non-EA	EA	Non-EA
2018	4,0%	0,0%	34,0%	42,9%	62,0%	57,1%
2017	1,9%	0,0%	56,6%	30,4%	41,5%	69,6%
2016	3,3%	0,0%	44,3%	40,0%	52,5%	60,0%
2015	6,3%	0,0%	46,9%	38,7%	46,9%	61,3%
2014	6,3%	6,6%	55,2%	27,9%	38,5%	65,6%
2013	7,6%	11,3%	50,6%	37,1%	41,8%	51,6%
2012	9,5%	14,8%	63,1%	53,7%	27,4%	31,5%
2012-2018	**6,0%**	**6,9%**	**51,3%**	**38,6%**	**42,7%**	**54,5%**

Source: EGOV based on Commission.

[8] See article 4(2) of the proposed regulation.

As indicated in Table 3, EA Member States made at least some progress on about 38% (4% + 34%) of the 2018 CSRs (as compared to 58,5% (1.9% + 56,6%) under the 2017 Semester cycle). In implementing the 2018 CSRs the EA States had, taken together, a weaker implementation record than non-EA Member States. However, looking at a longer trend the EA Member States have performed relatively better in implementing the recommendations.

Further reading:

- Country-specific recommendations: An overview - September 2019
- The legal nature of Country-Specific Recommendations – September 2019
- Country-Specific Recommendations for 2018 and 2019: A tabular comparison and an overview of implementation – September 2019
- Country-Specific Recommendations in banking - November 2019
- Recommendations on the economic policy of the euro area under the 2019 European Semester - November 2019

4. Public finances

***EA 2019 recommendations and EG autumn 2019 WP**:*

2. Rebuild fiscal buffers in EA countries with high levels of public debt, support public and private investment and improve the quality and composition of public finances in all countries (2019 EAR)

The EG will continue to closely monitor Member States' efforts to ensure sound fiscal policies, as well as the overall fiscal stance of the EA as a whole. As customary, the EG will assess, in the second part of the year, the draft budgetary plans (DBPs) and the aggregate EA budgetary situation and prospects, which provide an opportunity for ex-ante budgetary coordination in a EA dimension. It will also be involved in the general assessment of the EU fiscal rules, from the perspective of the EA, as appropriate, in the context of the planned review of the legislation. (Autumn 2019 WP)

4.1. Latest relevant data

On 7 November 2019, the Commission released the autumn 2019 forecast, which projects in the area of public finances the following key developments:

The EA's aggregate public deficit is forecast to rise from an historic low of 0.5% of GDP in 2018 to 0.8% this year and to 0.9% in 2020; the deterioration is attributed to the impact of lower growth and slightly looser discretionary fiscal policies in some Member States (e.g. Belgium, Germany and Finland). Like in the previous year, all EA Member States are expected to achieve nominal budget deficits which are lower than 3% of GDP.

Despite lower GDP growth and thanks to very low interest rates on outstanding debt, the EA's aggregate public debt-to-GDP ratio is forecast to continue declining for the fifth year in a row to 86.4% in 2019 and 85.1% in 2020.

The fiscal policy stance for the EA, as measured by the change in the structural balance, is expected to turn slightly expansionary in 2019 and 2020, after strong consolidation achieved between 2011 and 2014 and either slight consolidation or expansion in the years 2015-2018, (see Table 4, positive changes of structural balance indicate consolidation and negative changes fiscal stimulus/expansion).

Table 4. Structural balance and fiscal stance of the euro area as a whole

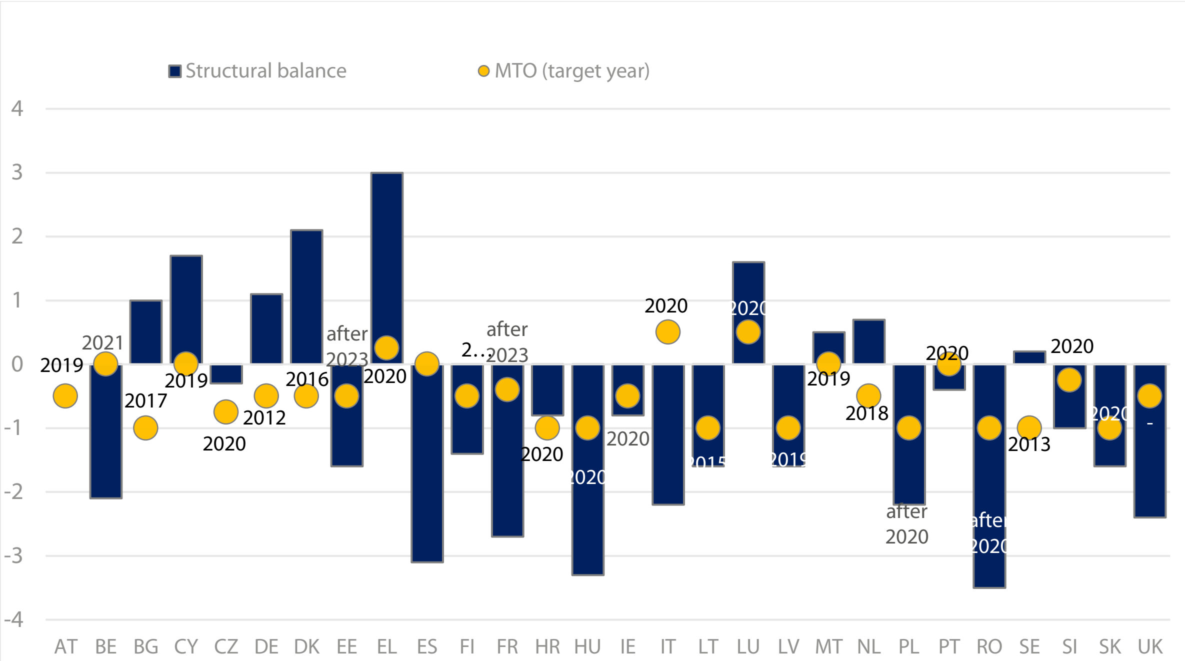
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Structural balance	-3,5	-2,0	-1,1	-0,8	-0,8	-1,0	-1.0	-0,8	-0.9	-1.1
Annual change of structural balance (=fiscal stance)	0,8	1,5	0,9	0,3	0,0	-0,2	0,0	0,2	-0,1	-0.2

Sources: Table 41 of the statistical annex to the Commission autumn 2019 forecast (and for the years before 2014: Commission online database AMECO); n.a. = 'not available'.

However, as acknowledged in the EA recommendations for 2019, the 2019 annual report of the EFB and statements by Mario Draghi, policy guidance does not anymore focus on the average fiscal stance of the EA, but for a differentiated fiscal stance in individual Member States: consolidation where needed and higher public investment where possible.

Figure 1 shows that, according to the Commission autumn 2019 forecasts, 12 out of 19 EA Member States are not expected to be in 2019 close or at their Medium Term Budgetary Objective (MTO), which shall ensure sound public finances: Belgium, Estonia, Spain, Finland, France, Italy, Ireland, Lithuania, Latvia, Portugal, Slovenia and Slovakia; slight improvements of the structural balance, compared to 2018, are expected for Estonia, Italy, Latvia, Austria, Portugal and Slovakia. See also separate EGOV briefing on structural balances.

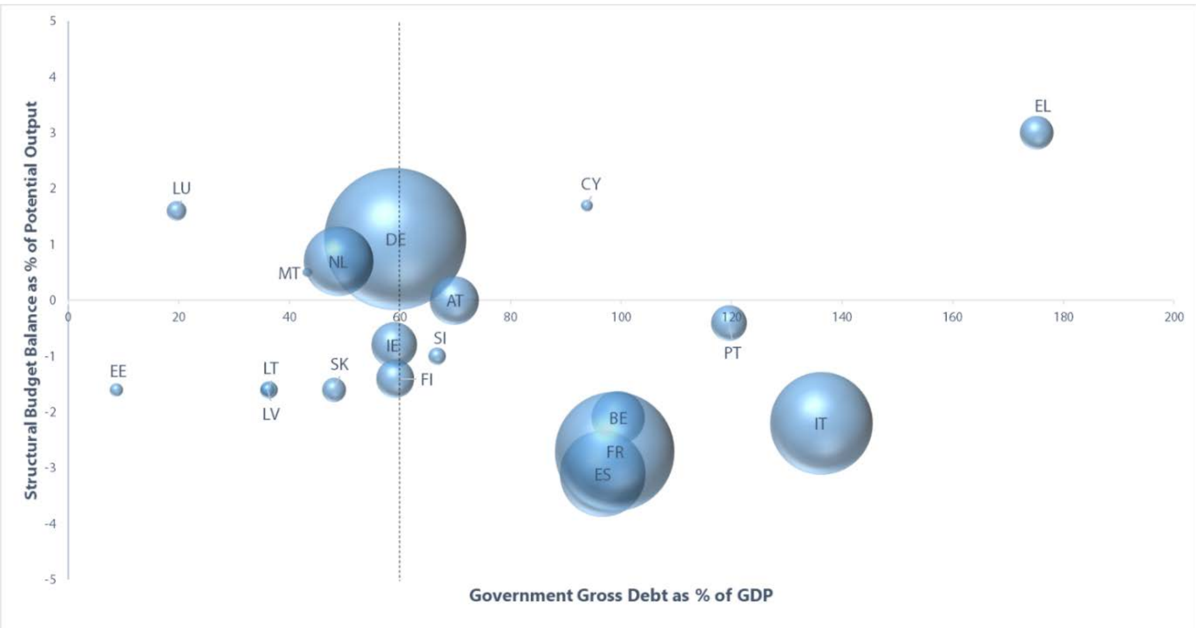
Figure 1. Comparison of structural balances in 2019 with the MTOs and their target years



Sources: Table 41 of the [statistical annex](#) to the Commission autumn 2019 forecast (structural balances), Country Specific Recommendations [2012](#), [2013](#), [2014](#), [2015](#), [2016](#), [2017](#), [2018](#), [2019](#) and [Stability and Convergence Programmes 2012-2019](#) (levels and target years of the MTOs; the one for the UK is the minimum MTO calculated by the Commission - see page 92 of the [2019 edition of the Vade mecum on the SGP](#), since the UK did not submit a MTO).

Figure 2 presents synthetically the 2019 performance of EA Member States in terms of structural budget balance and public debt level and at the same time relative GDP size of the Member State. It can be noticed that relatively many economically big Member States (France, Italy and Spain) are in the category: high debt and a negative structural balance.

Figure 2. 2019 Structural Budget Balance vs. Government Gross Debt and EA19 GDP share



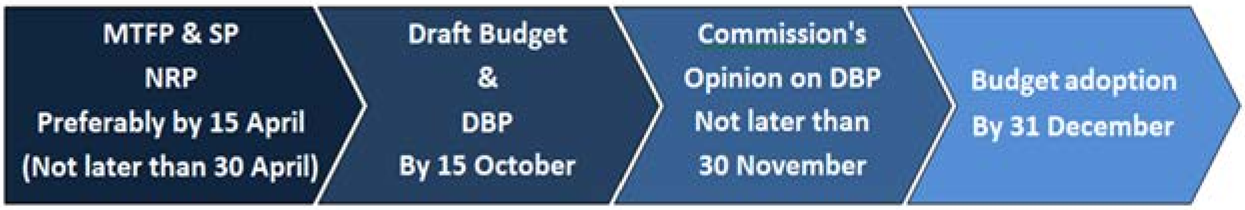
Source: EGOV based on Commission autumn 2019 forecast, data extracted in November 2019.
Note: Size of bubbles is proportional to shares of Member States' respective GDP in total EA 19 GDP.

4.2. Draft Budgetary Plans (DBPs)

The EU Regulation 473/2013 (subsequently called "DBP-Regulation") establishes provisions for enhanced monitoring and surveillance of EA Member States budgetary policies with the objective to ensure that national budgets are consistent with the policy guidance provided under the Stability and Growth Pact (SGP) and the European Semester (including the macroeconomic imbalances procedure as set out in Regulation EU 1176/2011).

In particular, the DBP-Regulation establishes a common budgetary timeline for all EA Member States (see Figure 3), rules on the monitoring and assessment by the Commission of all EA Member States' draft budgetary plans (DBPs) and more stringent assessment and reporting provisions for EA Member States under the Excessive Deficit Procedure (EDP). See separate EGOV briefing for more details on the budgetary coordination during the autumn cycle of the European Semester).

Figure 3. Common budgetary timeline (normal process)



Source: EGOV.

By mid-October 2019, all EA Member States submitted their 2020 Draft Budgetary Plans (DBPs). The Commission thereupon sent a letters to the following EA Member States asking them for an updated DBP (Belgium, Portugal and Spain) - since these countries submitted no-policy change DBP for 2020 - and/or for further clarification or further measures in order to ensure compliance with their fiscal obligations under the SGP as stipulated in the Country Specific Recommendations of July 2019 (Belgium, Finland, France, Italy). The Commission points out in the letters that according to the latest Commission projections these countries seem to be at risk of a significant deviation from their obligations under the preventive arm (fiscal effort and compliance with the expenditure benchmark) recommended by the Council in July 2019. Furthermore, the projections in Belgium's DBP do not ensure compliance with the debt reduction benchmark in 2020. Further information on the exchange of letters, including the replies from the concerned Member States, is available in a separate EGOV briefing.

When comparing the figures included Commission autumn 2019 forecast with the figures submitted by the EA Member States in October 2019 in their DBPs, one notes that Member States are in general more optimistic than the Commission; for 2019, significant differences between Member States' and Commission forecasts occur notably for (1) the deficit forecasts for Malta, the (2) structural balance forecasts for Slovenia and Italy and (3) the debt forecasts for Greece and Cyprus; for 2020, significant differences occur notably for (1) the deficit forecasts for Ireland and Slovakia (2) the debt forecasts for Cyprus, Ireland, Belgium, Spain, Latvia, Italy and Greece and the (3) structural balance forecasts for Slovakia, Italy, Spain, Slovenia and the Netherlands. The details on the comparisons carried out are available in a separate EGOV note.

Next steps on the 2020 DBPs: in accordance with the DBP Regulation, Commission Opinions on all DBPs are to be published by 30 November 2019 and the EG is expected to discuss them 4 December 2019.

4.3. Assessment(s) of EU fiscal rules

The European Fiscal Board (EFB) in its report of August 2019 "*Assessment of EU fiscal rules - with a focus on the six and two-pack legislation*" (EFB August 2019) [9] analyses Member States' compliance with the various fiscal rules in place within the EU from an evolutionary and broad approach. It concludes that compliance has been mixed and differs markedly depending on the concrete fiscal rule considered and the periods of comparison and notes that evidence of what would have happened if the EU had continued to rely on the pre-crisis rulebook is not available, so conclusions are necessarily tentative.

The 2019 Annual report of the EFB (of October 2019) focuses on implementation of the fiscal rules in the 2018 surveillance cycle (ending with Commission assessments of implementation in February 2019). It highlights that Commission established some new elements of flexibility and discretion:

- Commission lowered the fiscal adjustment requirements for **Italy and Slovenia** by applying the margin of discretion with the stated aim of balancing public finance sustainability against macroeconomic stabilisation needs. Both countries fell short of the reduced requirement.
- For **Italy**, the Commission did not propose corrective measures despite the country's significant deviation and non-compliance with the debt benchmark. In contrast to established practice, a commitment by the government was used as an argument not to launch an EDP.
- Although a significant deviation from the required adjustment was identified, the Commission did not propose action for **Latvia, Portugal and Slovakia**. The decision was motivated by taking into account new elements in the overall assessment, such as the headline deficit and debt developments.
- In the case of **Belgium** the Commission considered that, due to measurement uncertainty surrounding revenue increases, there was not sufficiently robust evidence to conclude that a significant deviation existed.

4.4. Review of the SGP

The review by the Commission of the 6- and 2-pack legislation, which includes the legislation on the SGP, is due in the coming months[10]. As regards the SGP rules, already in December 2017, J. Dijsselbloem, as the PEG, concluded after the EG meeting that: "*As regards fiscal governance, there was broad agreement that the credibility of our fiscal framework should be enhanced by making it more effective, less complex, and by increasing shared ownership while some have been advocating a stronger reliance on developing market-based fiscal discipline mechanisms. In my view, a possible way forward, which could merit further discussions, could be to ask a high-level working group of independent experts to provide advice along those criteria.*" However, no working group was established, while the European Parliament published in spring 2018 three expert papers on ways to simplify the SGP (on 11 December 2019, they will be presented by the authors in a workshop requested by the ECON Committee; the EFB will also be represented in the workshop).

[9] This document was requested by the President of the Commission, J.C. Juncker, in January 2019, who specified also the broad terms of references. The assessment was carried out against three main criteria: (1) ensuring the long-term sustainability of public finances; (2) stabilising economic activity in a counter-cyclical fashion; and (3) improving the quality of public finances.

[10] The wording of the review clauses in the relevant Regulations (473/2013 and 472/2013, amended by 1175/2011 and 1177/2011, and 1173/2011, 1174/2011, 1176/2011), are identical and require revision by 14 December 2019. The review of Directive 2011/85 was due in 14 December 2018, but has been postponed to better fit the review of the remainder economic governance framework. The Commission is generically asked to assess the effectiveness and the progress in ensuring closer coordination of economic policies and sustained convergence of economic performances.

Box 6. External experts' papers for the European Parliament

M. Dolls, C. Fuest, A. Peichl, F. Schleef conclude that while automatic stabilisers have played an important role in the early phase of the financial and economic crises in 2008/2009, their countercyclical effect was partly offset in some Member States by a pro-cyclical fiscal stance in other years, in particular throughout the period 2011-2016. The report concludes that Euro-area fiscal governance needs to be improved and that it is key to build up fiscal buffers in good economic times so that automatic stabilisers can operate freely in prolonged downturns.

P. Van Den Noord assesses that automatic stabilisers have possibly halving the amplitude of the cycle – in the first two decades of the EMU. However, he shows that in the context of the financial crisis many Member States again failed to abide by the spirit of the EU rules letting automatic stabilisers play freely (while respecting the 3% deficit ceiling). The standard policy prescriptions to prevent such a chain of events from repeating itself is for governments to consolidate their budgets so as to allow the operation of 'automatic stabilisers' within the limits set by the fiscal rules. However, it may well prove difficult for governments to resist the temptation to resort to fiscal leniency when cyclical fiscal windfalls re-emerge in good times, thus adding fuel to the cycle and sowing the seeds for a return to fiscal distress in bad times. In some sense this invalidates the consensus view that the Euro Area, owing to the comparatively large size of its Member States' public sectors, would benefit from stronger automatic stabilisers than e.g. the United States. Indeed, by extension, the perverse incentives for governments to 'spend' cyclical windfalls in good times and vice versa in bad times may well also be stronger in the Euro Area than in the United States.

He also notes that many observers have argued – even prior to the creation of the euro – that such incentives could be mitigated if the windfalls and shortfalls stemming from the operation of the automatic stabilisers would be used as cyclical buffers in a pan-European buffer fund, to which Member States contribute in good times and can draw on in bad times. However, while the economic rationale for such a device looks strong on paper, the operational challenges may be substantial and the political appetite for it is low.

A. Fatas argues that, since 2008, and as the result of central banks reaching the zero-lower bound, fiscal policy has come back as a potential, possibly primary, tool to stabilise business cycles. He shows that European countries have historically relied on automatic stabilisers for counter-cyclical policies, while discretionary fiscal policy has been pro-cyclical (unlike in the US). Pro-cyclical fiscal policies became so strong in the years 2010-14 that they completely eliminated the benefits of automatic stabilisers. He argues that automatic stabilisers should be strengthened and that the reasons behind the pro-cyclicality of discretionary policy should be addressed.

The EFB proposes in its publication of August 2019 (Assessment of EU fiscal rules with a focus on the 6 and 2 pack legislation) to overcome the complexity of the current EU fiscal framework by simplifying the EU fiscal rules and advocates for a reformed SGP, which would be based on:

- one single target (sustainable public debt), which could be made country-specific and cover a seven-year cycle;
- one single instrument (controlling net expenditure growth, to be linked to potential growth);
- one general escape clause, triggered based on independent economic judgement.

The EFB proposes the introduction of a limited "golden rule" to protect public investment.

Further reading:

- Implementation of the Stability and Growth Pact - November 2019
- Structural budget balances in EU Member States - November 2019
- Key features of 2020 Draft Budget Plans - November 2019
- The Advisory European Fiscal Board – November 2019
- The Euro area fiscal stance – September 2019
- Public finances in Euro Area Member States: selected indicators - November 2019

Box 7. Recent study on offshore wealth

A recent study commissioned by the Commission estimated that offshore wealth held by EU residents was EUR 1.5 trillion in 2016 (an average of EUR 1.2 trillion over 2001-2016). A decrease was noticed along the 2008 crisis (from 10.8% of GDP in 2007 to 6.6% in 2008), but EU offshore wealth increased again after 2011, to reach 9.7% of GDP and 20.5% of global offshore wealth in 2016. Member states with the largest offshore wealth are the EU largest economies - Germany, France, the UK, and Italy - make up more than 65% of EU-28 offshore wealth on average over the study period. Member States with the largest offshore wealth in GDP terms are Cyprus, Malta, Portugal and Greece, which are consistently above the EU-28 average in each year of the study period and above 20% of GDP on average. A third group of countries include Member States with estimated offshore wealth below 5% of GDP. In 2016 these include Denmark, Finland, Sweden and Slovakia and, on average over the period, Poland, Slovenia, Romania and Lithuania. The study also points out that the yearly revenue loss due to international tax evasion for the EU-28 is, on average over the study period, around EUR 46 billion (0.46% of GDP) and is also estimated at EUR 46 billion in 2016 (0.32% of GDP).

5. Macro-economic imbalances

EA 2019 recommendation and EG spring and autumn 2019 WPs:

1. Deepen the Single Market, improve the business environment and the quality of institutions, and pursue resilience enhancing reforms for the product and services markets. Reduce external debt and pursue reforms to boost competitiveness, in particular through productivity in euro-area Member States with current-account deficits or high external debt, and strengthen the conditions that support wage growth in a manner that respects the role of social partners. Implement measures that foster investment in euro-area Member States with large current-account surpluses. (2019 EAR)

EG draft agendas for 2019 featured discussions on housing markets (March), growth and jobs - inequality (June), quality of public finances - investment and expenditure reviews (September), competitiveness developments (October) and investment and innovation (November).

Since at least 2015, the EG holds thematic discussions on growth and jobs in the EA, focussing on specific items and supported by technical analyses and presentations provided by the Commission, as well as by academic experts.

In its March meeting, the EG discussed the housing markets, on the basis of a technical note by the Commission and an oral presentation by Professor Svensson. EG noted the importance of housing markets for macroeconomic stability.

The October meeting featured a discussion on competitiveness developments in the EA, on the basis of a Commission technical note. As the PEG concluded after the meeting, "*The Commission's analysis shows how demand-side factors have driven diverging competitiveness trends and external imbalances within the EA. Going forward, factors linked to technological changes or trade shocks could play a significantly stronger role. We need to build a common understanding of these challenges in the EG, particularly now, that we will set the strategic priorities for reform and investment under the BICC.*" (Please see also Section 2 on the Future of EMU).

At the November meeting, Ministers held a debate on investments, based on two contributions presented by Professor Bravo-Biosca. The EG endorsed the following principles:

- Reforms should aim at promoting private investment and facilitating resource reallocation.
- Productivity enhancing public investment can play a crucial role and should be prioritised to boost growth in the short run as well as potential growth in the medium to long run, while ensuring full compliance with the SGP.
- Market-based sources of business financing should be developed to widen the range of available forms of financing.

5.1. Some relevant elements on the MIP

In the context of the 2019 European Semester, the European Commission identified in November 2018 thirteen Member States that were at risk of experiencing macroeconomic imbalances. In March 2019, the Commission concluded that ten of these Member States are experiencing "macroeconomic imbalances" (six of them EA Member States: Germany, the Netherlands, France, Spain, Ireland and Portugal), and three Member States are in a situation of "excessive macroeconomic imbalances": Italy, Cyprus and Greece.

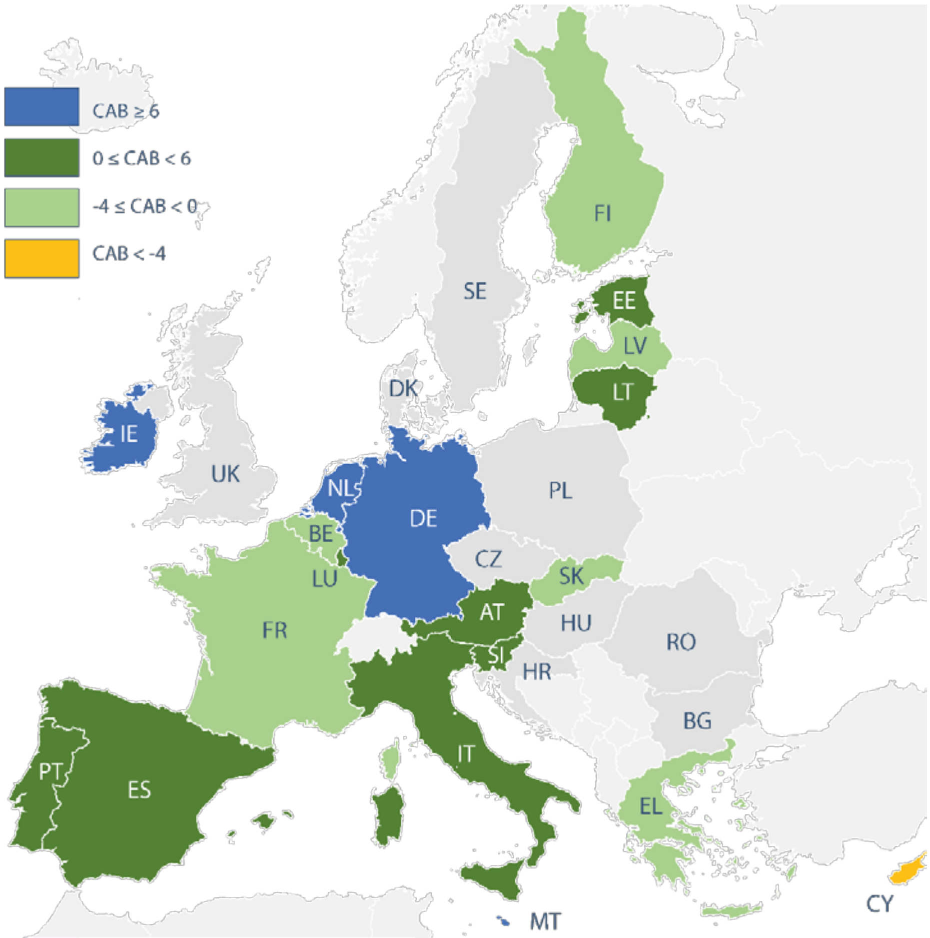
Since the MIP implementation in 2012, the Commission has not opened a procedure for excessive macroeconomic imbalances for any country. Nevertheless, Member States with macroeconomic imbalances are subject to "specific monitoring", which is a form of "*intensified dialogue between the European Commission and national authorities that aims to help EU countries address macroeconomic imbalances that could negatively affect their own economic stability or that of the EA or the EU*". Specific monitoring is adapted to the scope of the challenges and the severity of the imbalances.

If a Member State is experiencing macroeconomic imbalances (excessive or not), Country Specific Recommendations may be underpinned[11] by the preventive arm of the MIP legal basis (MIP-CSRs). In the latest set of CSRs adopted by the Council in July 2019 among the 33 CSRs targeting the nine EA Member States with macroeconomic imbalances, 30 have the MIP as a legal basis. All the CSRs adopted for the three Member States experiencing excessive macroeconomic imbalance are underpinned by the MIP (2 for Greece, 5 for Italy and 5 for Cyprus). As for the implementation of the 2018 CSRs (as assessed by the Commission), MIP-CSRs seemed implemented more than non-MIP CSRs, contrary to what was observed in 2017 and 2016.

5.2. Recent developments on Current Accounts

The EA continues to have the world's largest current account surplus: the Commission notes that it stabilised at a historically high level of 3.1% of GDP in 2017 and 2018, but is expected to narrow to 2.7%, 2.6% and 2.5% of GDP, in 2019, 2020 and 2021, respectively. External imbalances still represent a risk, for the EA as a whole and for some Member States: external imbalances are signalled by several indicators, including the current account (CA) balance and the net international investment position (NIIP), (see also Annex 2, with the most recent data of the MIP scoreboard).

Figure 4. Current Accounts balances in EA Member States, 2018 (% of GDP)



Source: Eurostat, data retrieved on 4 November 2019.

Member States with current accounts deficits have reduced such imbalances over recent years, while Member States with large current accounts surplus are further increasing or slightly decreasing it. As the current accounts balance equals the difference between national savings and investment, both the recommendations on the economic policy of the EA and the country specific recommendations

[11] See also EGOV note on "The legal nature of Country Specific Recommendations".

to Member States with large current accounts surpluses emphasise the need to increase investments (EAR 1). Member States with large accounts deficits, or with large negative external positions, are requested to implement structural reforms that increase competitiveness and to relate wages growth to productivity improvements.

Further reading:

- Implementation of the Macroeconomic Imbalance Procedure: State of play - September 2019
- Member States with Excessive Macroeconomic Imbalances - November 2019
- Implementation of CSRs under MIP - March 2019
- External imbalances in the Euro Area Member States – November 2019

6. Banking Union: recent developments

***EA 2019 recommendations and EG autumn 2019 WP**:*

4. Make the backstop for the Single Resolution Fund operational, set up a European Deposit Insurance Scheme and strengthen the European regulatory and supervisory framework. Promote orderly deleveraging of large stocks of private debt. Swiftly reduce the level of non-performing loans in the EA and prevent their build up, including by removing debt bias in taxation (2019 EAR).

"Careful consideration will continue to be given to the monitoring of financial stability issues and to the global economic outlook (...). The hearings of the Chair of the Single Supervisory Board and the reporting by the Chair of the Single Resolution Board will contribute to the exchanges of views on issues related to Banking Union, including on banking legacy issues. The EG (in its regular composition or in an inclusive format, as appropriate) will also continue its role in the preparation of the Euro Summit meetings as needed." (Autumn WP).

The EG has been mandated by Leaders to discuss the deepening of the EMU. At its meeting of December 2018, it delivered political agreement on a *''comprehensive plan to strengthen the Euro''* that materialised in:

(1) a report to the Euro Leaders meeting on 14 December and 3 annexes, dealing with (a) the terms of reference for the Single Resolution Fund backstop, (b) the ESM Term sheet and (c) the ESM-COM cooperation agreement,

(2) a proposal for the establishment of a HLWG on EDIS, with a broad mandate encompassing other missing elements such as liquidity in resolution, and

(3) a possible budgetary instrument for the EA (the BICC). This section provides information on points (1) (a) and (2) above. The other subjects are covered earlier in Section 2.

6.1. The backstop to the Single Resolution Fund (SRF)

In accordance with the agreement reached at the June 2019 EG, the draft revised ESM Treaty will allow the ESM to grant loans to backstop the SRF (i.e. liquidity support up to € 60bn). The December 2018 Euro Summit conditioned the early introduction of the backstop to "*sufficient progress [being] made in risk reduction, to be assessed in 2020*". According to EG's terms of reference "*This assessment will be made against the aim of 5% gross NPLs, and 2.5% net NPLs or adequate provisioning, for all SRB banks and progress thereto*"[12]. As illustrated below this level of NPL is not met in all Banking Union Member States. In addition, the revised draft ESM Treaty foresees a rather complex decision making process for the functioning of the backstop and includes the setting up of an early warning system for the ESM to be able to ensure timely receipt of funds disbursed. The draft ESM Treaty is expected to be finalised at the December 2019 Eurogrop meeting before being ratified according to national procedures.

6.2. Setting up a European Deposit Insurance Scheme

In line with the December 2018 Euro Summit, a HLWG on EDIS has been set up. By June 2019, no concrete conclusions were reached, but an interim report under the authority of its Chair outlined "*where further work could be done in the coming institutional cycle*" for a steady state Banking Union. This includes the design of EDIS, home/host issues (i.e. liquidity and solvency waiver), insolvency law and resolution as well as the regulatory treatment of sovereign exposures (RTSE). As the Chair of the HLWG *put it, "progress will be needed in all areas and therefore a comprehensive approach building on a package of measures is needed".*

[12] The difference between gross NPL and net NPL is that the latter is calculated by offsetting the amount of provisions; NPL ratios not specifically marked as gross or net, such as in Figure 5, are usually gross figures.

As explained in the report, discussions have particularly come up against the right sequencing of reforms, the design of EDIS (i.e. mutualisation vs co-insurance), home/host issue and the regulatory treatment of sovereign exposures.

The EG is expected to come up with proposals ahead of the December 2019 Euro Summit. At its November meeting, the PEG noted that "*this is still a difficult discussion and we will need to move step by step*".

6.3. Strengthening the European regulatory and supervisory framework

The EG reaffirmed in June 2019 the importance it attached to the roadmap to completing the Banking Union (BU), adopted by the Council on 17 June 2016, which conditions further risk sharing in the Banking Union (in particular EDIS) to progress made on risk reduction. Ministers therefore exchanged views with the relevant EU bodies: in their April and October meetings, Ministers met Andrea Enria, Chair of the ECB Supervisory Board, and Elke König, Chair of the Single Resolution Board. The SSM and the SRB regularly updates the EG, namely with a monitoring report on risk reduction indicators.

In terms of build-up of MREL, the SRB pointed in that report to appropriate progress: "*overall, banks have made progress in building up the MREL capacity in order to reach the steady-state requirement as set by the SRB. The total MREL still needed to reach the level of that requirement is [...] 7,3% of the total requirements.*" Three Global SIFIs (out of 8 in the Banking Union) experience MREL shortfalls. Information on individual banks is not disclosed, but shortfalls are, on an aggregated basis, particularly evident in five Member States (Spain, France, Greece, Italy and the Netherlands). Subordinated debt instruments (that are required to meet the new TLAC standards of the CRR) are particularly missing in France, Greece and the Netherlands.

Ministers have put a particular emphasis on the strengthening of the AML supervisory framework. According to press reports, the Council is expected to formally mandate the European Commission

Box 8. Recent proposals on a step-wise approach to completing the Banking Union

As part of that debate, the **ESM** outlined in an October 2019 discussion paper a **step-wise approach to completing the banking union** whereby home/host issue, EDIS and the RTSE would be addressed in the following way:

- Step 1: initiating the European backstop and insurance schemes (2021-2013). The remaining preparatory technical work necessary for the design of a common backstop to the Single Resolution Fund and EDIS would be completed;
- Step 2: deepening EDIS (2024-2027). Before moving to full mutualisation, the treatment of sovereign exposures in bank balance sheets would be addressed;
- Step 3: moving to a complete banking union (after 2017). Implementation of stage 3 of EDIS (full mutualisation) would be agreed upon as well as the implementation of a scheme to diversify sovereign exposures, and more lenient conditions for capital and liquidity waivers.

In a November 2019 non-paper on the goals of the banking union, the German Ministry of Finance put a particular emphasis on the development of an EU liquidation regime: "*Finalising the overarching structure of the banking union also requires a European deposit insurance scheme. It is necessary to first reduce and then continuously review the risks, which also determine the likelihood of recourse to the European deposit insurance scheme. This requires a consistent, effective supervisory regime and crisis management, which should be based on harmonised bank insolvency legislation and on the further development of a European resolution regime, which should serve as the foundation for a deeper integration of cross-border EU banking groups. We also need adequate regulation for sovereign bonds. Finally, we should keep working consistently to reduce non-performing loans on bank balance sheets*".

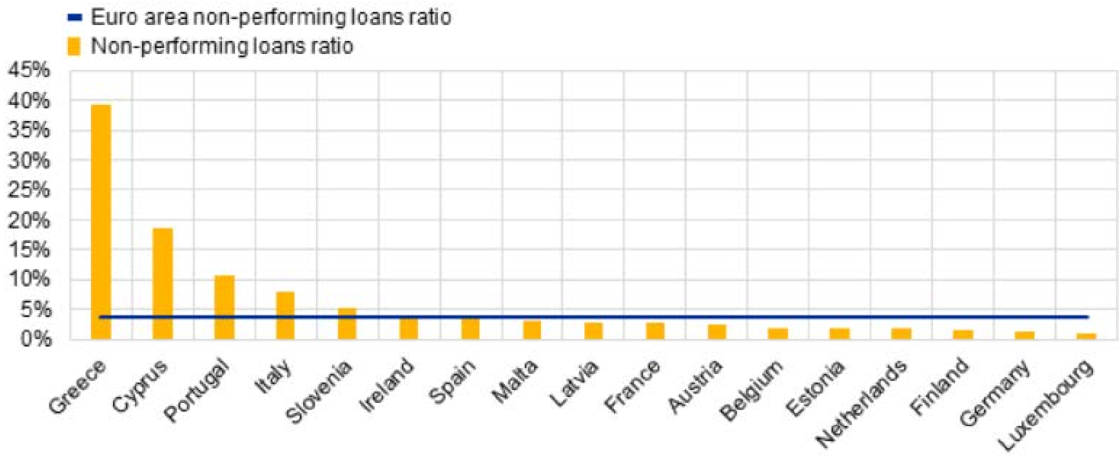
in December to make recommendations on a new "independent" enforcement body with direct

AML powers. Executive Vice-President designate V. Dombrovskis explained at his October 2019 hearing that he "*see[s] a lot of merit in conferring certain anti-money laundering tasks and their coordination to a Union body*". Also a set of Member States (Germany, France, Italy, Spain, the Netherlands and Latvia) published on 9 November a joint statement on the issue.

6.4. Reduction of the level of non-performing loans (NPL)

The average NPL ratio of significant institutions in the BU decreased in the second quarter of 2019 to 3.56%, the lowest level since the ECB started to published that time series in 2015; however, the level is much higher in some Member States (see Figure 5). In particular, it must be noted that five MS feature NPL ratio above 5%: Greece, Cyprus, Portugal, Italy and Slovenia.

Figure 5. Non-performing loans ratio by country Q2 2019



Source: ECB.

Further reading:

- Banking Union: what next? - July 2019
- Liquidation of Banks: towards a FDIC for the Banking Union? – February 2019
- Anti-money laundering – reinforcing the supervisory and regulatory framework – September 2019
- Towards a fundamental re-design of Banks' Stress Tests in the EU? – October 2019
- The 2019 proposed amendments to the Treaty establishing the European Stability Mechanism - October 2019
- Completing the Banking Union - February 2019
- Further harmonising insolvency law from a Bank resolution perspective - April 2018

7. Ex-post surveillance of macro-economic adjustment programmes

> ***EG autumn 2019 WP****:*
>
> *The EG will remain engaged in post-programme surveillance in Cyprus, Ireland, Portugal and Spain. The EG will also discuss the quarterly enhanced surveillance reports from the Commission on Greece. This will include, among others, an assessment on the progress with the post-programme commitments as attached to the June 2018 EG statement and on the continued implementation of key reforms agreed under the ESM programme. The enhanced surveillance reports will also serve as a basis for the EG to consider the further implementation of the policy contingent debt measures.* (Autumn 2019 WP)

The EG continued assessing on a regular basis the developments in Cyprus, Ireland, Portugal, Spain and Greece, following completion of the financial assistance granted to these countries. Cyprus, Ireland, Portugal and Spain are now under ex-post surveillance. Greece is under "enhanced surveillance", a tool defined in Regulation 472/2013 which was adapted to Greece after the conclusion of the ESM stability support programme, in August 2018. The next enhanced surveillance report on Greece by the Commission is expected in late November 2019.

Further reading:

- Macro-Financial Assistance to EU Member States State of Play – November 2019
- Key economic indicators for Cyprus, Greece, Ireland and Portugal - November 2019

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This document is available on the internet at: www.europarl.europa.eu/supporting-analyses

Annex 1: Euro area - Key macroeconomic indicators

	2016	2017	2018	2019 f	2020 f	2021 f
GDP growth – *% change on previous year*						
EA	1.9	2.5	1.9	1.1	1.2	1.2
EU	2.0	2.6	2.0	1.3	1.4	1.4
GDP per capita – *Purchasing power parities, Euro*						
EA	31,100	31,900	32,700	n.a.	n.a.	n.a.
EU	29,300	30,100	31,000	n.a.	n.a.	n.a.
General government budget balance – *% of GDP*						
EA	-1.4	-0.9	-0.5	-0.8	-0.9	-1.0
EU	-1.7	-1.0	-0.7	-0.9	-1.1	-1.2
General government structural budget balance[2] – *% of potential GDP*						
EA	-1.0	-1.0	-0.8	-0.9	-1.1	-1.2
EU	-1.3	-1.2	-1	-1.1	-1.3	-1.4
General government gross debt[1,2] – *% of GDP*						
EA	92.2	89.8	87.9	86.4	85.1	84.1
EU	85.3	83.6	81.9	80.6	79.4	78.4
Interests paid on general government debt – *% of GDP*						
EA	2.1	1.9	1.8	1.7	1.5	1.4
EU	2.1	2.0	1.8	1.7	1.6	1.5
Inflation (HICP) – *% change on previous year*						
EA	0.2	1.5	1.8	1.2	1.2	1.3
EU	0.2	1.7	1.9	1.5	1.5	1.7
Unemployment – *% of labour force*						
EA	10.0	9.1	8.2	7.6	7.4	7.3
EU	8.6	7.6	6.8	6.3	6.2	6.2
Youth unemployment – *% of labour force (15 – 24 years)*						
EA	20.9	18.8	16.9	n.a.	n.a.	n.a.
EU	18.7	16.9	15.2	n.a.	n.a.	n.a.
Current-account balance[3,4] – *% of GDP*						
EA	3.2	3.1	3.1	2.7	2.6	2.5
EU	1.4	1.3	1.3	1.1	1.0	1.0
Exports – *% change on previous year*						
EA	2.9	5.5	3.3	2.4	2.1	2.3
EU	3.3	5.7	3.0	2.5	2.3	2.4
Imports – *% change on previous year*						
EA	4.1	5.0	2.7	3.2	2.6	2.7
EU	4.4	5.1	2.9	3.3	2.8	2.8
Total investments – *% change on previous year*						
EA	4.0	3.5	2.3	4.3	2.0	1.9
EU	3.3	3.4	2.5	3.8	1.8	1.7
Total investments – *% of GDP*						
EA	20.3	20.6	20.8	n.a.	n.a.	n.a.
EU	19.9	20.2	20.4	n.a.	n.a.	n.a.
General government investments – *% of GDP*						
EA	2.6	2.6	2.7	2.8	2.8	2.9
EU	2.7	2.8	2.9	3.0	3.0	3.1
Total final consumption expenditure – *% change on previous year*						
EA	2.0	1.6	1.3	n.a.	n.a.	n.a.
EU	2.3	1.8	1.5	n.a.	n.a.	n.a.
Households final consumption expenditure – *% change on previous year*						
EA	2.0	1.7	1.4	n.a	n.a.	n.a.
EU	2.5	2.1	1.6	n.a	n.a	n.a.
Income Inequality (Gini coefficient) – *Scale 0-100: 0 = total income equality; 100 = total income inequality*						
EA	30.7	30.4	n.a.	n.a.	n.a.	n.a.
EU	30.8	30.6	n.a.	n.a.	n.a.	n.a.
Unit labour cost – nominal – *% change on previous year*						
EA	0.7	0.7	1.8	2.0	1.4	1.4
EU	-1.2	0.1	1.8	2.5	1.8	1.7

Source: Eurostat, data extraction on 08/11/2019 unless otherwise specified; (1) general government gross debt, non-consolidated for intergovernmental loans; (2) data from [AMECO](); (3) current account balance, Eurostat/ECB adjusted relative to intra-EU/EA imports; (4) and (f) data from [European Economic Forecast - Autumn 2019.]()

Annex 2: Euro area MIP-scoreboard

	External imbalances and competitiveness					Internal imbalances						Employment Indicators		
Year 2018	**Current Account Balance** % of GDP 3 year average	**Net International Investment Position** % of GDP	**Real Effective Exchange Rate with HICP deflator** 3 year pp change	**Export Market Shares** 5 year pp change	**Nominal ULC (2010=100)** 3 year pp change	**House Prices index deflated** 1 year pp change	**Private Sector Credit Flow** % of GDP	**Private Sector Debt,** consolidated, % of GDP	**General Government Gross Debt** % of GDP	**Unemployment rate** 3 year average, % active population	**Total Financial Sector Liabilities, non-consolidated** 1 year pp change	**Activity rate** % of total pop. aged 15-64 3 year pp change	**Long term unemployment rate** % of active pop. aged 15-74 3 year change	**Youth unemployment rate** % of active pop. aged 15-24 3 year change
Thresholds	**-4/+6%**	**-35%**	**±5% (EA)**	**-6%**	**+9% (EA)**	**+6%**	**14%**	**133%**	**60%**	**10%**	**16.5%**	**-0.2%**	**0.5%**	**2%**
BE	0.3	41.3	6.9	-1.5	3.7	1.0	0.8	178.5	100.0	7.0b	-2.9	1.0	-1.5	-6.3
DE	8.0	62.0	5.3	3.1	5.6	5.1	6.5	102.1	61.9	3.8	2.0	1.0	-0.6	-1.0
EE	2.1	-27.7	7.7	0.8	14.3	2.1	3.7	101.5	8.4	6.0	6.9	2.4	-1.1	-1.2
IE	2.3	-165.0	2.3	77.4	-2.8	8.3	-7.8	223.2	63.6	7.0	5.1	0.8	-3.2	-6.4
EL	-2.2	-143.3	3.6	6.9	1.4p	1.3e	-1.1p	115.3p	181.2	21.5	-5.0	0.4	-4.6	-9.9
ES	2.6	-80.4	4.1	4.6	0.7p	5.3	0.4p	133.5p	97.6	17.4	-2.2	-0.6	-5.0	-14.0
FR	-0.6	-16.4	4.5	-0.2	2.4p	1.5	7.9p	148.9p	98.4	9.5	1.6	0.6	-0.8	-4.0
IT	2.6	-4.7	3.3	0.3	2.7	-1.6	1.6	107.0	134.8	11.2	-0.1	1.6	-0.7	-8.1
CY	-4.6	-120.8	1.8	16.6	-0.4p	0.2	8.4p	282.6p	100.6	10.8	0.3	1.1	-4.1	-12.6
LV	0.6	-49.0	4.9	8.6	14.7	6.6	-0.2	70.3	36.4	8.6	-3.0	2.0	-1.4	-4.1
LT	-0.1	-31.0	6.4	3.5	16.5	4.6	4.3	56.4	34.1	7.1	8.2	3.2	-1.9	-5.2
LU	4.9	59.8	3.3	10.7	7.9	4.9	-0.5	306.5	21.0	5.8	-2.0	0.2b	-0.5	-2.5
MT	8.9	62.7	4.9	24.0	3.2	5.1p	7.5	129.8	45.8	4.1	2.3	5.9	-1.3	-2.5
NL	9.9	70.7	3.2	1.7	3.0p	7.4	4.5p	241.6p	52.4	4.9	-3.3p	0.7	-1.6	-4.1
AT	2.2	3.7	4.8	3.9	4.7	2.5	3.9	121.0	74.0	5.5	1.7	1.3	-0.3	-1.2
PT	0.9	-105.6	3.1	9.4	5.3p	8.9	-0.1p	154.3p	122.2	9.1	0.7	1.7	-4.1	-11.7
SI	5.5	-18.9	2.0	20.4	6.1	7.4	1.3	72.8	70.4	6.6	4.1	3.2	-2.5	-7.5
SK	-2.4	-68.1	2.5	3.2	10.9	5.0	2.0	90.9	49.4	8.1	8.9	1.5	-3.6	-11.6
FI	-1.4	-2.0	3.0	-3.0	-2.6	-0.2	1.6	142.1	59.0	8.3	19.9	2.1	-0.7	-5.4

Source: Eurostat. Grey boxes indicate values outside the threshold. Data as of 07 November 2019 (they differ from the data published in the 2019 AMR, which had data for reference year 2017).
(b= Break in time series; p= provisional)

Annex 3: Budgetary instrument for convergence and competitiveness

The agreed BICC term sheet details the (1) governance; (2) financing, (3) allocation and modulation. Previously, in June, the EG had already agreed on general principles, key features, financing and governance. The relevant details are depicted below.

(1) Governance: governance of the instrument will rest with the Euro Summit and EG (as already decided in June) and key principles will be reflected in a draft Regulation under Art. 136 of the TFEU. The process will start by a discussion on strategic priorities by the Euro Summit and EG and will result in a strengthened Euro Area Recommendation (EAR) including priorities relevant to the BICC, to be issued in the context of the European Semester and revised annually (as explained in the June term sheet). Member States would submit proposals ("*duly substantiated reform and investment proposals*", as indicated in the June term sheet) for financing in spring, which should as a rule consist of packages of reforms and investments, linked to the National Reform Programmes and compatible with the national budgetary process. Such proposals should cover the estimation of costs of investment and of structural reforms, and their justification, as well as the timeline for implementation (with milestones and targets). Such proposals would be analysed by the relevant (EG) preparatory committees and, if warranted, of the EG based on Commission initial feed-back based on transparent criteria. The use of the facility is subject to approval by the Commission, taking into account the strategic priorities included in the EAR and the previous year's Country Specific Recommendations. Member States' access to financing will depend on the implementation of structural reforms and investments, the respect of the applicable macro-economic conditionality foreseen in the Common Provisions Regulation and respect of horizontal rules applying to the implementation of the EU budget (where the instrument will be framed). Being entrenched in the EU budget, the BICC will be subject to Commission implementation and to the European Parliament discharge. The European Court of Auditors will scrutinise the instrument. EG commits to ensure the participation of ERM II Member States in meetings and to take their views into account to the largest extent possible.

(2) Financing

The size of the instrument will be defined in the context of the Multiannual Financial Framework (MFF), taking into account the EA share of the financial envelope of the Reform Delivery Tool, as in the Commission original MFF proposal. On the basis of Article 175 TFUE, an enabling clause** will be included in the Regulation to allow Member States to negotiate among themselves an Intergovernmental Agreement (IGA) to permit adding other funds to the facility. The EG will continue working on a report on the need, the content, modalities and the size of an IGA in due time to allow for a final decision in the context of the MFF.

Member States will receive financing in instalments, subject to complying with the agreed milestones and will report regularly on implementation of investments and reforms. Payments may be suspended or cancelled in case of unsatisfactory compliance. Support from the instrument will be delivered in the form of grants (direct financial contributions from the EU budget), as foreseen in the June term sheet.

(3) Allocation and modulation

For at least 80% of the funds, the allocation key of the funds will be based on population and inverse of GDP per capita, with a 70% floor. Up to 20% of the funds could be used on a more flexible basis to react to country specific challenges, by supporting packages of reforms and investments that are especially ambitious as measured against the EA priorities. The instrument will require a national co-financing rate of 25% that can be modulated on the basis of a trigger related to severe economic circumstances, as defined in the SGP, to be applied in a transparent and predictable manner by the Commission following a discussion in the EG. The modalities will be defined in the context of the legislative process, following further discussions in the EG. When warranted, based on the trigger, national co-financing rate should be reduced to half.

Appropriate arrangements are still to be defined for non-EA Member States not participating in the BICC. These arrangements should take the form of a dedicated instrument or a financial arrangement to address their full financial liability in relation to the BICC, depending on the circumstances of each Member State*, and should be reflected in MFF discussions.

** Sweden and Denmark are expected to decide on the latter option subject to decision in the national Parliaments*
*** Such enabling clause aims to authorise additional contributions by Member States to the budget of the Union and earmark them to finance expenditure arising from the BICC, as explained in a note by the Council Legal Services*