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Recommendation for a

# COUNCIL RECOMMENDATION

## on the implementation of the broad guidelines for the economic policies of the Member States whose currency is the euro

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Provisional Version

Recommendation for a

## COUNCIL RECOMMENDATION

### on the implementation of the broad guidelines for the economic policies of the Member States whose currency is the euro

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 136 in conjunction with Article 121(2) thereof, Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November on the prevention and correction of macroeconomic imbalances[2], and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission[3],

Having regard to the resolutions of the European Parliament[4],

Having regard to the conclusions of the European Council,

After consulting the Economic and Financial Committee,

Whereas:

(1) The Eurogroup has a special responsibility in the economic governance of the euro area. The economic crisis clearly exposed the close interrelations in the euro area, underscoring the need for a coherent aggregate policy stance which reflects the strong spillovers between countries whose currency is the euro, for effective arrangements for policy coordination to swiftly respond to changes in the economic environment.

(2) The Member States whose currency is the euro have committed themselves to a set of far-reaching additional policy reforms and policy coordination by signing the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union on 2 March 2012. The entry into force of the so called "Two Pack" regulations[5] in 2013 will further deepen budgetary and economic policy coordination within the euro area.

(3) Work is ongoing to deepen further the economic and monetary union. On 28 November 2012, the Commission presented a communication on a blueprint for a deep and genuine economic and monetary union[6]. The blueprint identified the rationale and objectives of a genuine EMU as well as the instruments and steps that would make it possible to reach them. The blueprint intended to launch the European debate. On 12

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1 OJ L 209, 2.8.1997, p. 1.
2 OJ L 306, 23.11.2011, p. 25.
3 COM(2013) 379 final
4 P7_TA(2013)0052 and P7_TA(2013)0053.
5 COM(2011)821 final and COM(2011)819 final.
6 COM(2012) 777 final.

September 2012, the Commission presented a roadmap towards a Banking Union[7]. This proposal was accompanied by a proposal for two regulations needed to establish the single supervisory mechanism[8]. On 5 December 2012, the President of the European Council issued a report which was developed in in close collaboration with the President of the Commission, the President of the Eurogroup and the President of the ECB, and which contained a specific and time-bound road map for the achievement of a genuine Economic and Monetary Union. It was structured around the areas of an integrated financial-, budgetary and economic policy framework and democratic legitimacy and accountability. On 14 December 2012, the Heads of State or Government decided on work to be taken forward on a roadmap for the completion of EMU, recognising the interdependence between the economies of the euro area Member States and the benefits that stability in the euro area can bring to its members and to the European Union as a whole.

(4) The European Parliament has been duly involved in the European Semester and expressed its views on the deepening of the economic and monetary union in its resolution of 20 November 2012 “Towards a genuine Economic and Monetary Union”[9].

(5) Crisis management in the euro area has been characterised by strong resolve. The commitment of all Member States and EU institutions to safeguarding the integrity of the euro area has been clearly put beyond question. However, the effectiveness of euro area governance as well as the conduct of crisis management by the Eurogroup need to be further improved to fully ensure effective coordination at the euro area level. Strengthened coordination is also needed to arrive at a coherent aggregate policy stance in the euro area and to ensure that the necessary policy measures are implemented. Achieving these goals will bolster the confidence of citizens and markets, and thereby contribute to economic recovery and financial stability in the euro area.

(6) The implementation of two-pack will further strengthen budgetary surveillance in the euro area. The two-pack legislation assigns a role to the Eurogroup in discussing the draft budgets of individual Member States as well as the budgetary prospects for the euro area as a whole in view of ensuring an appropriate overall fiscal stance. These discussions take place on the basis of the Commission's opinions of the draft budgetary plans of the euro area Member States and the of the overall euro area assessment by the Commission of the draft budgetary plans and their interaction. For fiscal consolidation across the euro area, the challenge is to put the debt-to-GDP ratio on a steadily declining path over time. This can be done by pursuing differentiated, growth-friendly fiscal consolidation policies while boosting the growth potential of the euro area. The corrective arm of the Stability and Growth Pact foresees budgetary adjustment as defined in structural terms taking into account cross-country country differences in risks to sustainability, both in short and medium term, and allows the automatic stabilisers to function along the adjustment path. The preventive arm of the Stability and Growth Pact foresees a gradual adjustment towards the Medium Term Objectives with the annual structural improvement of 0.5% as a benchmark. This can be modulated on a country specific basis taking into account cyclical conditions and debt sustainability risk. The credibility of fiscal policy over the medium-term would

[7] COM(2012) 510 final.
[8] COM(2012) 511 final and COM(2012) 512 final.
[9] The resolution of 20 November 2012 “Towards a genuine Economic and Monetary Union”, see P7_TA(2012)0430.

be reinforced by if the composition of government expenditure and revenues better reflecting the growth impact of the different spending items and revenue sources. Furthermore, the growth potential of the economy can be enhanced by further structural reforms and by exploiting available budgetary margins to foster public investment in the euro area, using the scope provided by the Stability and Growth Pact.

(8) Most risk indicators related to EU financial markets as well as market sentiment improved compared to 2012 as the intensity of self-fulfilling and destructive confidence spirals has dissipated. However, significant market fragmentation remains. Improved funding conditions for banks are yet to feed through to a pick-up of credit for the real economy and significant differences persist across Member States as regards bank lending activity and cost of funding to the private sector. Facilitating an orderly deleveraging of both the banking sector and the non-financial private sector while sustaining the flow of new credit for productive uses in the real economy and particularly SMEs, are the key challenge at the current conjuncture.

(9) Further repairing banks' balance sheets and continuing the strengthening of equity buffers, where needed, would contribute to repairing the credit channel. In this context, asset quality reviews and stress tests by the SSM and EBA will provide transparency of banks' balance sheets, help identify any remaining pockets of vulnerability, and hence reinforce confidence in the sector as a whole. The risk of further financial-market fragmentation and financial turmoil illustrates the importance for the euro area of rapidly moving ahead with the creation of the Banking Union while avoiding ad hoc approaches to bank resolution.

(10) Structural reforms are needed across the euro area to improve the functioning of product and labour markets in order to promote competitiveness, to strengthen the ongoing adjustment process and to guarantee a sustainable reallocation of resources. Moreover, structural reforms play an essential role in facilitating the rebalancing and deleveraging process. For deficit countries, competitiveness gains will increase net exports, which help in rebalancing the growth pattern towards more productive, less labour-intensive tradable sectors, while supporting economic recovery and bringing down debt ratios. At the same time, reforms to improve competition in countries with a current account surplus could contribute to the reallocation of resources and help boosting investment in non-tradable sectors. This would strengthen the role of domestic demand in the composition of growth making the adjustment in the euro area more symmetric. At the same time, the crisis had largely asymmetric effects on euro-area Member States' employment, with countries most hit being those with the most severe compression of domestic demand linked to current account reversals. In the absence of an effective and quick absorption of cyclical unemployment, hysteresis effects, whereby unemployment becomes entrenched and less sensitive to wage dynamics, may materialise. Structural reforms in the labour market therefore remain of particular importance to mitigate risks for social cohesion and future growth potential in the euro area. By signing the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, on 2 March 2012, the euro area Member States committed themselves to coordinating ex ante their national plans for major economic reforms. The impact of the measures already adopted should be monitored by the Eurogroup, with a view of encouraging further action where necessary, and to step up the ambition of reforms in line with the country specific recommendations.

HEREBY RECOMMENDS that euro area Member States take action, individually and collectively, without prejudice to the competences of the Council as regards the coordination of economic policies of the Member States, but in particular in the context of economic policy coordination in the framework of the Eurogroup, within the period 2013-2014 to:

1. Take collective action in the Eurogroup to ensure a coherent policy stance across the euro area, and to deliver the necessary policy decisions which are needed to ensure the good functioning of the euro area. Allow the Eurogroup to play a central role in the strengthened surveillance framework applicable to euro area Member States to coordinate and monitor reforms at national and at the euro area level that are necessary for a stable and robust euro area and to ensure policy coherence.

2. Ensure that the Eurogroup monitors and coordinates fiscal policies of the euro area Member States and the implied aggregate fiscal stance for the euro area as a whole to ensure a growth friendly and differentiated fiscal policy. To this end the Eurogroup should discuss the Commission opinions of the draft budgetary plans of each of the euro area Member States, and the budgetary situation and prospects for the euro area as a whole on the basis of the overall assessment by the Commission of the draft budgetary plans and their interaction. The coordination shall contribute to ensuring that the pace of fiscal consolidation is differentiated according to the fiscal and economic situation of the euro area Member States with the budgetary adjustment defined in structural terms, allowing the automatic stabilisers to function along the adjustment path and that, in view of reinforcing the credibility of fiscal policy over the medium term, fiscal consolidation is supported by an overall efficient and growth-friendly mix of expenditure and revenue and by appropriate structural reforms which enhance the economic growth potential.

3. Assess, in the framework of the Eurogroup, the reasons behind the differences in lending rates especially to SMEs across the euro area Member States; explore the consequences of the fragmentation of the financial markets in the euro area and advise on ways to overcome it.

4. Building on the recapitalisation and the restructuring of the past years, promote further balance-sheet repair among banks as a means to reverse fragmentation in the single market and improve the flow of credit to the real economy, particularly SMEs. To this end: (a) ensure that the balance sheet assessments and stress tests to be conducted by the Single Supervisory Mechanism (SSM) in co-operation with the European Banking Authority (EBA) are concluded in accordance with the agreed timeline; (b) ensure a level playing field in applying burden-sharing requirements in the recapitalisation of banks; (c) put in place credible fiscal backstops for possible recapitalisation of banks ahead of balance sheet assessments and stress; (d) remove supervisory incentives for banks to match asset and liabilities within national borders; and (e) accelerate the necessary steps to establish the Banking Union, comprising the SSM, a single resolution mechanism, a capacity for bail-in, a common resolution fund and a common fiscal backstop including the possibility for direct recapitalisation of financial institutions.

5. Coordinate ex ante the major economic reform plans of the Member States whose currency is the euro. Monitor the implementation of structural reforms, notably in the labour and product markets and assess their impact on the euro area, taking into account the Council recommendations to individual euro area Member States. Promote further adjustment in the euro area, ensuring that it proceeds in a balanced and structural way, by following thoroughly the reforms that address distortions to saving and investment behaviour in Member States with both current account deficits and surpluses. Take the necessary steps for an effective implementation of the

Macroeconomic Imbalances Procedure, notably by assessing progress in reform commitments in Member States experiencing excessive imbalances and in reform implementation in Member States with imbalances requiring decisive action to limit negative spillovers to the rest of the euro area.

Done at Brussels,

*For the Council*
*The President*