DIRECTORATE-GENERAL FOR INTERNAL POLICIES
ECONOMIC GOVERNANCE SUPPORT UNIT (EGOV)

BRIEFING

Economic Dialogue with the President of the Eurogroup

ECON on 4 September 2014

The Eurogroup President Jeroen Dijsselbloem has been invited for an Economic Dialogue in line with the EU economic governance framework, in particular Article 2ab of Council Regulation (EC) 1466/97 as amended by Council Regulation (EC) 1175/2011. He was appointed by the Eurogroup as its president on 21 January 2013 for a term of two and a half years. As the President of the Eurogroup, he is also chairing the Board of Governors of the European Stability Mechanism (ESM). List of all Economic Dialogues is available on ECON homepage.

1. Economic situation in the euro area

According to Eurostat's flash estimate, euro area GDP was flat in the second quarter of 2014 after expanding by 0.2% (q-o-q) a quarter earlier, mainly reflecting subdued output developments in the three largest euro area economies: both German and Italian GDP contracted by 0.2% (q-o-q) between April and June - with Italy falling back into recession (generally defined as two consecutive quarters of negative growth), while French economy stagnated for a second consecutive quarter.

In its summer update of the World Economic Outlook, the IMF maintained its euro area growth forecast unchanged at 1.1% for 2014[1], which is marginally below 1.2% growth expected by the Commission in its May projections. The next Commission forecast is scheduled for November 2014. The IMF pointed out that growth is expected to remain uneven across the euro area, reflecting continued financial fragmentation, impaired private and public sector balance sheets as well as high unemployment in some Member States.

Eurogroup work programme: 2nd half of 2014

On 19 June 2014, Eurogroup issued its indicative work programme for the second half of the year[1]. While recognising the need for further fundamental reforms to stimulate growth and for preventive policy coordination in the context of nascent, yet fragile, recovery, Eurogroup is to regularly monitor economic developments in the euro area as well as implementation of CSRs. Eurogroup will also assess the draft budgetary plans, discuss structural policy and review the adjustment programmes, including post-programme surveillance. Moreover, it will monitor financial and macroeconomic stability developments, focusing especially on Member States presenting excessive macroeconomic imbalances. Finally, Eurogroup will continue to prepare the Euro Summit meetings, including on discussions on the deepening of EMU.

On 30 July the Contracting Parties to the Treaty on Stability, Coordination and Governance in EMU appointed Donald Tusk as President of the Euro Summit for the period from 1 December 2014 to 31 May 2017.

Euro area annual inflation is expected to decline to 0.3% in August 2014 (the lowest level since November 2009), down from 0.4% a month earlier. As such, HICP inflation has been remaining below the ECB's inflation target (of below but close to 2%) for more than 18 months. At the same time, long-term inflation expectations have continued on their downward trend, dropping to a three-year low of just below 2% in late August[2]. These developments have continued to give reasons for concern about the risk of Japanese-style deflation. Addressing the Jackson Hole

[1] These projections do not take into account the impact of the Ukrainian crisis on euro area output growth.
[2] The 5year/5year swap rate (the average inflation rate expected over five years starting in five years' time), fell to 1.95% on 22 August 2014 (Source: FT, 24 August 2014, data compiled by Barclays).

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symposium, Mario Draghi, the ECB president, stressed that the ECB Governing Council will *"acknowledge these [inflation] developments and within its mandate will use all the available instruments needed to ensure price stability over the medium term"*. The next ECB Governing Council meeting is to take place on 4 September 2014.

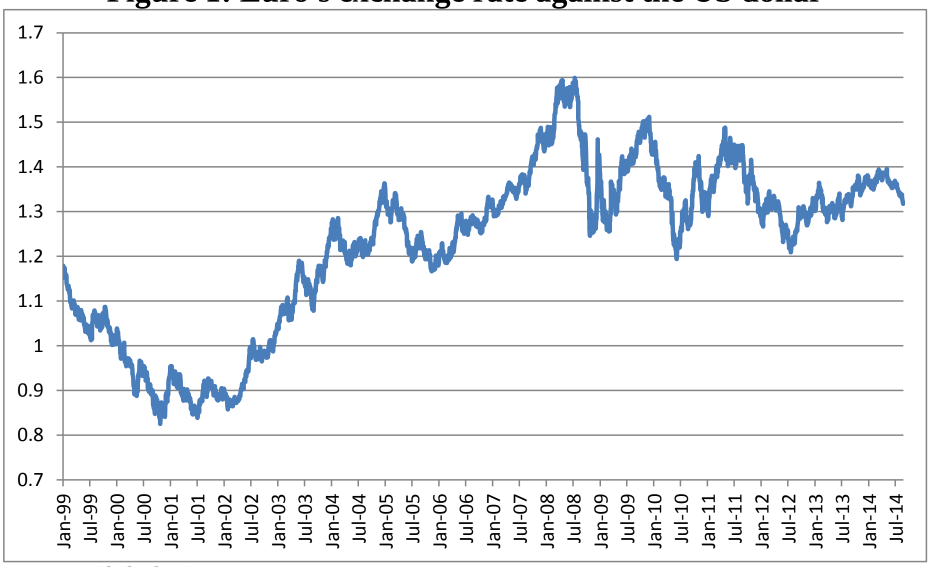
The benchmark **10-year German government bond** yield dropped below 1% by mid-August 2004, hitting record lows. These declines reflect a mix of both short- and long-term factors, such as weak economic data, geopolitical tensions in Ukraine, impact of recent regulatory changes under which financial institutions are required to hold more capital in safe assets and worldwide savings-glut (factors increasing the demand for government bonds, all other things being equal).

The euro area unemployment rate stood at 11.5% in July 2014, somewhat below the June 2013 peak of 12.0 %. The youth unemployment rate came in at 23.1% in July 2014, as compared to 23.9% in June 2013.

According to the latest available Eurostat's estimate, **euro area current account** recorded a surplus of EUR 55.6 billion (2.3% of GDP) in the first quarter of 2014, down from a surplus EUR 66.7 billion (2.8% of GDP). This decline reflects a drop in the balance of trade in services which compensated for a slight increase in the balance of trade in goods. In terms of the level of current account balances (expressed in billions of euro) in the first quarter of 2014, the largest current account surplus was registered by Germany and the Netherlands (EUR 48.6 and 20.5 billion respectively), while the largest current account deficits were observed in France and Spain (EUR 10.9 and 8.2 billion respectively).

The Euro has been on a downward trend since May 2014 and stood at around USD 1.31 at the end of August 2014. This is the weakest level since September 2013. The latest declines reflect weak euro area data and raise expectations by the Federal Reserve of an earlier-than-initially-foreseen increase in interest rates from zero by early 2015.

Figure 1: Euro's exchange rate against the US dollar



Source: ECB (daily data).
Note: Increase (decrease) in the EUR/USD rate corresponds to the euro's appreciation (depreciation).

Further reading:

- Annex 1: Table on main economic euro area indicators

2. Country Specific Recommendations (CSRs)

The 2014 CSRs were endorsed by the European Council on 26-27 June and finally adopted by ECOFIN on 8 July. In total, the Council addressed 96 CSRs to the euro area Member States and **4 common**

recommendations to the euro area Member States as a whole. In the case of the euro area, the key challenges identified are: 1) reform implementation in euro area Member States experiencing excessive imbalances and in the euro area Member States with imbalances requiring decisive action; 2) coordination of fiscal policies; 3) implementation of the Banking Union and 4) deepening of the EMU (see Annex 4).

According to the June 2014 European Council conclusions, the implementation of the CSRs is key to accelerate growth. Based on the principles of national ownership and social dialogue, Member States should respect the recommendations in their forthcoming decisions on budgets, structural reforms and employment and social policies. The Council and the Commission will further monitor CSRs' implementation and take action as required.

Table 1: Implementation of the 2013 CSRs based on the Commission's assessment as of June 2014[3]

	Full/Substantial Progress	Some Progress	No/Limited Progress	Total
EA 18	7	45	34	86
Non EA	6	18	31	55
EU 28	13	63	65	141

Source: EC and EGOV calculus.

Table 1 compares, based on the Commission's assessment of June 2014, the pace of implementation of the 2013 CSRs between euro area and non-euro area Member States. It shows that **euro area countries made full/substantial or some progress on approximately 60%** of the recommendations (52 out of 86), compared to about 44% in case of non-euro area Member States (24 out of 55). However, non-euro area countries fully/substantially implemented 11% of the CSRs, while euro area Member States did so only 8% of the recommendations. Finally, in addition to the 141 CSRs, the Council addressed 6 recommendations to the euro area as a whole. They are not included in Table 1 as the Commission does not provide an assessment of their implementation.

Further reading:
- CSRs for 2013 and 2014 for the Euro Area Member States: A comparison and an overview of implementation - July 2014 (on ECON homepage)
- Annex 4: Division of CSR based on their legal base

3. Surveillance of fiscal policies

The latest available plans for all euro area Member States' public finances and underlying forecasts are included in their Stability Programmes as submitted in April/May 2014 to the Commission and Council. In general (except for the Netherlands and Ireland), the Member States' forecasts were at the time more optimistic than the spring 2014 forecasts by the Commission which were published in May 2014 (see EGOV comparison table on ECON homepage).
In June 2014, the Council **closed the Excessive Deficit Procedures** (EDPs) for 4 euro area Member States (Belgium, the Netherlands, Austria and Slovakia), as these countries have reduced their deficits below 3% of GDP. As a result, 8 out of 18 euro area countries still remain subject to an EDP (Malta, Cyprus, Portugal, Slovenia, France, Ireland, Greece and Spain). According to the Council opinions stated in the 2014 CSRs, measures underpinning the budgetary strategies of some countries (incl. France and Slovenia) need to be specified and/or reinforced to comply with their current EDP recommendations.
The Member States which are not subject to the EDP are bound by the provisions of the Stability and Growth Pact (SGP), notably its **preventive arm and the debt reduction benchmark**. According to the 2014 CSRs, all euro area countries belonging to the preventive arm, except Germany, should reinforce their budgetary consolidation measures for 2014 and/or 2015 in order to comply with the Medium Term

[3] Each CSR may contain several sub-recommendations. The analysis in this table focuses exclusively at the assessment provided for each CSR as a whole (and not sub-CSR level).

Objectives and the required adjustment paths for reaching them. Furthermore, the 2014 CSRs request Belgium, Italy, Austria and Finland to ensure compliance with the debt rule.
According to the "Two Pack" Regulation 473/2013, euro area Member States, which are not subject to a macroeconomic adjustment programme, need to publish by 15 October 2014 a **Draft Budgetary Plan (DBP) for 2015**, based on an independent macro-economic forecasts. According to the same Regulation, euro area countries which are subject to an EDP shall in addition present an Economic Partnership Programme (EPP) detailing the measures and reforms which ensure an effective and lasting correction of the excessive deficit. Commission shall adopt Opinions on the DBPs and draft Opinions on EPPs in which it assesses the compliance with the current Council recommendations and the provisions of the SGP.
Further reading:

- Implementation of Stability and Growth Pact - July 2014 (on ECON homepage)
- Overview of the Stability and Growth Pact – July 2014 (on ECON homepage)
- Involvement of independent fiscal bodies in SCP and NRP - July 2014 (on ECON homepage)

4. Surveillance of macroeconomic imbalances

In the context of the Macroeconomic Imbalance Procedure, the Council may, on a proposal from the Commission, address the necessary recommendations to Member States to prevent or correct macroeconomic imbalances.

Among the 96 CSRs addressed by the Council to the euro area Member States in 2014 (excluding Greece and Cyprus, which are under financial assistance programmes), **45 CSRs** explicitly referred to the MIP as a legal base (i.e. around 47% of the total CSRs)

Based on the in-depth-reviews undertaken by the Commission:

- **Half of the 18 euro area Member States** has been experiencing macroeconomic imbalances (Belgium, Germany, Ireland, Spain, France, Italy, the Netherlands, Slovenia and Finland).
- In Italy and Slovenia imbalances are excessive, but no further procedural steps under the "excessive imbalance procedure" were proposed. However, all 2014 CSRs are linked to MIP;
- Ireland, Spain and France are experiencing imbalances requiring specific monitoring and decisive policy actions. Thus most of their 2014 CSRs are linked to MIP.
- Belgium, Germany, the Netherlands and Finland are experiencing imbalances, which require monitoring and policy action. A number of their 2014 CSRs are linked to MIP. Apart from Germany, where all of 2014 CSRs are linked to MIP.

Greece, Cyprus and Portugal were not subject to an in-depth review as they were under financial assistance programmes, while Portugal this year for the first time received CSRs under the European Semester Cycle, since it exit the programme in time for 2014 draft CSRs.

Further reading:

- Implementation of Macroeconomic Imbalance Procedure – July 201 (on ECON homepage)
- Overview of the Macroeconomic Imbalance Procedure – March 2014 (on ECON homepage)

5. Banking Union: recent developments

In August 2014, the ECB published its third quarterly report on progress in implementing the **Single Supervisory Mechanism (SSM)** regulation covering the period between 4 May and 3 August 2014. It states that the SSM governance is fully operational, with 117 Joint Supervisory Teams (JSTs) established by September 2014. JSTs will be the main operational structure for supervision of each significant institution or group (the number of 117 does not correspond exactly to the around 120 significant institutions, because some significant institutions are part of the same group).

Next main steps	
Publication of list of significant banks	Before 4 September 2014
Supervisory dialogue with banks on AQR and stress test results	Between 2nd half of September and early October 2014
Adoption of ECB regulation on supervisory fees	October 2014
Publication of ECB guide to supervisory practices	Before end-October 2014
ECB internal rules on separation of functions and exchange of information	Before 4 November 2014
Review of the ECB ethics framework	Before 4 November 2014
4th quarterly report on progress in implementing the SSM regulation	Early November 2014
Start of supervisory activities	4 November 2014

On accountability, the quarterly report notes among others, that once the ECB has assumed fully its supervisory tasks on 4 November 2014, the SSM accountability will be **granted to the Eurogroup** in the presence of representatives from non-euro area Member States participating in the SSM, rather than to the ECOFIN.

The ECB also published its comprehensive assessment stress test manual on **Phase 2 and 3 of the stress test** process, which are to follow bank-led stress test (Phase 1). Phase 2, harmonised quality assurance (i.e. checks on the stress test outcomes), which took place in July and August 2014, is to ensure level playing field and consistency across SSM banks. This will be followed by Phase 3 in September 2014, which will integrate the results of asset quality review (AQR) and stress test (join-up). During Phase 4, i.e. finalisation and disclosure, scheduled for September and October 2014, the ECB will together with the National Competent Authorities finalise the results and share partial, preliminary information on specific components of the comprehensive assessment with banks. Final results will be communicated to the banks shortly before publication.
As regards the **Single Resolution Mechanism (SRM)**, the respective regulation was published on 30 July (OJ L225) and will enter into force on 19 August 2014. The provisions relating to the cooperation between the SRM and the national resolution authorities for the preparation of the banks' resolution plans will apply from 1 January 2015 with the SRM fully operational from 1 January 2016.

Only recently it became clear once again that the EU needs a strong and reliable supervisory and resolution mechanism for its banks: in August 2014, Portugal had to inject almost EUR 5 billion into **Banco Espírito Santo** (BES) to stave off the collapse of the country's biggest bank, using money left in the fund provided by the EU and the IMF in 2011. In order to spare taxpayers from the full cost of the bail-out, BES´ assets and liabilities were split into a "bad bank part", which now belongs to BES´ previous shareholders and holders of subordinated debt, and a "good bank part", a new legal entity called “Novo Banco”. The latter has taken over all of the bank's infrastructure, its branches, staff, as well as the healthy part of the credit portfolio. Portugal injected fresh capital only into Novo Banco with a hope to someday recover the investment by way of a reprivatisation.

6. Financial assistance to EU Member States: recent developments

EFSF approved on 13 August 2014 the disbursement of EUR1 billion of the total EUR8.3 billion installment to **Greece** taking into account the implementation of the first set of milestones related to the fourth review (so called May milestones). In August 2014 Greece should have completed the second set of milestones linked to the fourth review. The fifth review will only start when all the milestones of the fourth review are met. EUR 1.8 billion of EFSF funds is the remaining amount to be disbursed.

ESM approved on 7 July 2014 disbursements of EUR 600 million **to Cyprus**, following the fourth review, concluding that Cyprus should commit further efforts to the removal of capital controls, reducing non-performing loans, generating sustained economic growth and reducing the level of unemployment. EUR 3.618 billion of ESM funds is the remaining amount to be disbursed with the fifth review already in progress.

Financial assistance concerns the EU Member States receiving funds from the ESM (Cyprus), the EFSF (Greece), Balance of Payments (Romania), some in combination with funds from other Member States or/and IMF. Member States that have exited a financial assistance programme may still be subject to post-programme surveillance (PPS) by the Commission and the ECB (Ireland, Portugal, Spain), some in combination with post-programme monitoring (PPM) by the IMF. For detailed information on **state-of-play** in those countries please see the latest version of the EGOV table on ECON homepage.

Notice

Key messages of three **external briefing papers** (commissioned by ECON Committee) in advance of the Economic Dialogue with the President of the Eurogroup are available in **Annex 5**.

The briefings papers have been provided to Members by e-mail and will be published on ECON homepage.

Annexes:

1. Main euro area economic indicators
2. 2014 Council Recommendations to the euro area
3. Scoreboard for the identification of possible macro-economic imbalances in euro area Member States
4. Division of 2014 CSRs based on their legal base
5. Key messages of briefing papers on the implementation of the macroeconomic adjustment programmes

ANNEX 1: Key economic indicators for the euro area

		2012	2013	2013(Q 3)	2013(Q 4)	2014(Q 1)	2014(Q 2)
Output							
Economic sentiment	indicator	90.8	93.8	95.3	99.1	101.6	102.2
Industrial confidence	balance	-11.7	-9.3	-8.3	-4.1	-3.5	-3.6
Gross domestic product	% ch. on prev. year	-0.7	-0.4	-0.3	0.5	0.9	0.7[e]
	% ch. on prev. period	--	--	0.1	0.3	0.2	0.0[e]
Private consumption							
Consumer confidence	balance	-22.1	-18.6	-15.9	-14.4	-11.2	-7.7
Private consumption	% ch. on prev. year	-1.4	-0.7	-0.5	0.1	0.5	--
	% ch. on prev. period	--	--	0.1	0.1	0.2	--
Investment							
Capacity utilisation	level, %	78.9	78.0	78.3	78.4	80.1	79.5
Gross fixed capital formation	% ch. on prev. year	-4.0	-2.9	-2.4	0.0	1.7	--
	% ch. on prev. period	--	--	0.5	0.9	0.2	--
Labour market							
Unemployment rate	% of labour force	11.3	12.0	12.0	11.9	11.7	11.6
Unemployment expectations	balance	38.1	34.4	29.6	29.8	23.8	16.6
International transactions							
World trade	% ch. on prev. year	1.9	2.7	3.1	4.1	2.6	--
	% ch. on prev. period	--	--	1.2	1.5	-0.7	--
Trade balance	merchandise, billion €	86.5	158.8	35.7	43.7	44.1	15.8
Current-account balance	billion €	138.5	230.2	49.9	66.3	66.8	21.5
Prices							
Consumer inflation expectations	Balance	25.0	16.8	15.9	15.4	13.2	8.6
Headline inflation (HICP)	% ch. on prev. year	2.5	1.4	1.3	0.8	0.7	0.6
Monetary and financial indicators							
Nominal interest rates (3 month)	(level)	0.57	0.22	0.22	0.24	0.30	0.30
Bilateral exchange rate EUR/USD	(level)	1.28	1.33	1.32	1.36	1.37	1.37
Nominal effective exchange rate	% ch. on prev. year	-5.4	3.9	6.3	5.4	3.1	2.9
	% ch. on prev. period	--	--	1.0	1.2	0.8	-0.1

Source: DG ECFIN, data update 3 July 2014 (next update 10 September 2014), [e] corresponds to Eurostat flash estimate of Q2 2014 GDP.

ANNEX 2: Council 2014 recommendations to the euro area as a whole

1. Promote and monitor, in close cooperation with the Commission, the **implementation of structural reforms in those areas most relevant for the smooth functioning of the euro area in order to foster growth and convergence and adjustment of internal and external imbalances**. Assess and stimulate progress in delivering on reform commitments in euro area Member States experiencing excessive imbalances and in reform implementation in the euro area Member States with imbalances requiring decisive action, to limit negative **spillovers** to the rest of the euro area. Foster appropriate policies in countries with large current account surpluses to contribute to positive spillovers. Regularly hold thematic discussions on structural reforms in the labour and product markets with potentially large spillovers, focussing on reducing the high tax wedge on labour and reforming services markets.

2. Coordinate **fiscal policies of the euro area** Member States, in close cooperation with the Commission, in particular when assessing **draft budgetary plans to ensure a coherent and growth-friendly fiscal stance across the euro area.** Improve the quality and sustainability of public finances by prioritising material and **immaterial investment at national and EU levels**. Ensure that national fiscal frameworks, including national fiscal councils, are strong.

3. Ensure the resilience of the banking system, in particular by taking the necessary action in the follow up of the asset quality review and the stress tests, and by implementing the **Banking Union** regulations and taking forward the further work foreseen in the SRM transition period. Stimulate private sector investment and increase the flow of credit to the economy via **actions to improve access to credit by SMEs,** deepening of capital markets, restarting the securitisation market, based on the proposals and the calendar in the Commission Communication on long-term financing of the European economy.

4. Take forward work on **deepening Economic and Monetary Union** and contribute to the improvement of the economic surveillance framework in the context of the reviews foreseen for end 2014.

ANNEX 3: Scoreboard for the identification of possible macro-economic imbalances in euro

Values for year 2013 (unless otherwise stated)	External imbalances and competitiveness					Internal imbalances					
	3 year average of **Current Account Balance** as % of GDP	**Net Interna-tional Invest-ment Position** as % of GDP	% Change (3 years) of **Real Effective Exchange Rate with HICP deflators**	% Change (5 years) in **Export Market Shares**	% Change (3 years) in **Nominal ULC**	% y-o-y Change in deflated **House Prices**	**Private Sector Credit Flow** as % of GDP	**Private Sector Debt** as % of GDP	**General Government Debt** as % of GDP	**Unemployment rate** - 3 year average	% y-o-y Change in **Total Financial Sector Liabilities,** non-consolidated
Thresholds	**-4/+6%**	**-35%**	**±5% (EA)**	**-6%**	**+9% (EA)**	**+6%**	**14%**	**133%**	**60%**	**10%**	**16.5%**
BE	-1.7	45.8	-0.3	-10.5	9	0	4.6	148.7	101.2	7.7	-3.7
DE	7.3	48.4	-1.9	-9.2	6.3	1.8*	1.5*	106.7*	78.4	5.6	4.4*
EE	-0.4	-47.5	3.1	7.3	10.3	7.0	4.7*	129.4*	10.0	10.3	12.9*
IE	4.0	-104.9	-3.9	-7.2	-3.0	1.3	-1.6*	306.4*	123.7	14.2	-0.7*
EL	-3.8	-119.3	-4.5	-27.3	-13.2	-8.9	-5.9	129.3	175.1	23.3	-16.8
ES	-1.4	-98.2	-0.4	-7.1	-5.5	-10.4	-10.4*	195.3*	93.9	24.1	3.5*
FR	-1.8	-21.1*	-2.3	-9.3	4.7	-2.5	3.5*	140.6*	93.5	9.8	-0.1*
IT	-0.7	-29.5	0.0	-17.8	4.5	-7.0	-1.0*	126.4*	132.6	10.4	7.1*
CY	-4.0	-85.7	-0.8	-27.2	-6.0	-6.4	10.0*	299.2*	111.7	11.9	-1.9*
LV	-1.8	-65.0	-1.7	11.4	8.4	6.4	-0.7*	64.4*	38.1	14.4	4.1*
LU	5.9	184.1	0.7	-6.8	11.3	3.6	-5.0*	317.4*	23.1	5.3	11.3*
MT	0.9	25.1*	-1.3	-4.0	8.1	-1.5	-1.5*	153.8*	72.6	6.4	4.1*
NL	9.8	46.3	0.4	-9.2	6.0	-7.7	0.2*	219.3*	73.5	5.5	4.9*
AT	2.2	0.5	0.7	-17.1	6.4	-7.8**	2.7*	147.4*	74.5	4.5	-0.9*
PT	-2.8	-118.7	-0.6	-7.3	-2.1	-2.2	-4.2	217.6	128.9	15.0	-5.9
SI	3.1	-38.7	-0.7	-16.6	-0.8	-6.1	-3.9	103.6	71.7	9.1	-10.4
SK	0.2	-65.1	2.0	-2.2	0.9	-0.4	3.2*	73.1*	55.4	14.0	2.6*
FI	-1.3	15.8	0.1	-29.9	8.9	-0.5	9.0*	157.9*	57.0	7.9	-0.2*

Source: European Commission, Eurostat specific site, data retrieved on 1 September 2014. The shaded cells indicate values above threshold. (* = 2012; ** = 2011).

ANNEX 4: Division of 2014 CSRs to Euro Area Member States according to their legal base

Member State	Total number of CSR	Number of CSR based on SGP	Number of CSR based on MIP	Number of CSRs based exclusively on the Broad Economic Policy Guidelines and the Employment guidelines
Belgium	6	1	3	2
Germany	4	1	4	0
Estonia	5	1	0	4
Ireland	7	2	4	2
Greece	0	0	0	0
Spain	8	1	7	1
France	7	1	6	1
Italy	8	1	8	0
Cyprus	0	0	0	0
Latvia	5	1	0	4
Luxembourg	5	1	0	4
Malta	5	1	0	4
Netherlands	4	1	2	1
Austria	5	1	0	4
Portugal	8	1	0	7
Slovenia	8	1	8	0
Slovakia	6	1	0	5
Finland	5	1	3	1
Total	**96**	**17**	**45**	**40**

Note 1: Some CSRs have both the SGP and the MIP as legal bases. In those cases, the sum of the CSRs based on the SGP, MIP and Integrated guidelines in the above table does not equal the total number of CSRs.

Note 2: Member States whose currency is the euro should in addition to the CSRs ensure the full and timely implementation of the recommendation addressed jointly to all Member States of the Euro Area.

Note 3: Member States subject to a macroeconomic adjustment programme is in accordance to Article 12 of Regulation No 472/2013 exempted from the monitoring and assessment under the European Semester. Once exiting from a programme a Member State is fully re-integrated into the Semester framework and shall be under post-programme surveillance as long as a minimum of 75 % of the financial assistance received has not been repaid.

ANNEX 5: Key messages of briefing papers on the implementation of the macroeconomic adjustment programmes

The paper by **Peter Bofinger (Universität Würzburg)** deplores that the current Country Specific Recommendations (CSRs) and the whole European Semester lack a systematic framework for policy coordination. It derives this conclusion from the following evaluations of the 2014 CSRs: (1) There is no comprehensive assessment of the challenges for macroeconomic targets and the issue of the aggregate fiscal policy stance is not addressed explicitly; (2) there is no discussion of whether individual countries could adjust their fiscal policies in order to generate a better, i.e. more symmetric, outcome for the whole system; (3) there is no awareness of potential negative spill-over effects from wage-related national structural reforms. These gaps would show that the need of a symmetric adjustment process in the Euro Area is not reflected in the CSRs. Instead, the main focus of the CSRs is, according to the paper, on the surveillance of a one-dimensional fiscal policy consolidation and of "one-size-fits-all" structural reforms.

Specifically, the author deplores that the current CSRs do not address or discuss the risks of deflation and economic stagnation. He suggests that a less restrictive fiscal policy stance could be warranted to counter these risks. In order to avoid deflation, he recommends inter alia that the President of the Eurogroup should prepare the outline of a coordinated programme for public investments in the Member States as soon as possible. Finally, he recommends that the European Parliament should establish an independent Council of Economic Experts. It should produce an annual report on the Euro Area with policy recommendations for the Euro Area Member States.

The paper by **Jacob Funk Kirkegaard (Peterson Institute of International Finance)** focuses on the need for euro area policy makers to sustain their recent crisis-induced reform eagerness to pull the region away from the threat of economic stagnation. The important policy challenge in ensuring that fiscal consolidation protects public investment spending is identified, and the to date erratic achievement hereof by member states is highlighted. It is suggested to amend the Macro-economic Imbalances Framework with data series to highlight the importance of public investments to achieve this goal. Secondly, the need to overhaul national bankruptcy procedures to facilitate private debt deleveraging and ensure the reduction of financial fragmentation in the euro area is discussed. While the Banking Union puts in place several important new institutions to integrate the euro area banking system, it will need to be complemented with national bankruptcy reforms to achieve its goal of comparable lending rates throughout the euro area and help the euro area private sector reduce its debt load to restore economic growth.

The President of the Euro Group should be made a full-time position, and the post could have its democratic legitimacy enhanced through an expansion of the spitzenkandidat-framework to also include it. This could see the President of the Euro Group selected by voters solely in the euro area members, based on the identification of spitzenkandidaten by the political groupings in the European Parliament. This proposal would require that the variable institutional geometry of the EU be extended to also the EP. It would have to create a new euro area-only institutional setting, including a new euro area-only committee in the EP in front of which the President of the Euro Group could regularly appear. The President of the Euro Group should if member state achievement of SGP fiscal consolidation goals and implementation of CSRs is in doubt publicly present a list of required CSRs to be implemented if any fiscal target flexibility under the SGP is to be possible.

The paper by **Daniel Gros and Cinzia Alcidi (Centre for European Policy Studies**) argues that when it comes to the new CSRs, the main challenges are correctly identified, but that the trade-offs between policy goals are generally ignored or papered over by generic formulations that prove difficult to operationalise ("growth-friendly fiscal consolidation", for example). The CSRs fail to acknowledge that in the short run there is an inherent conflict between the need to reduce debt-to-GDP ratios and the need to regain competitiveness, which requires lower wages and prices, thus worsening the ratio of debt to GDP.
One specific challenge, which in our view is not correctly identified, relates to the emphasis on investment as a pre-condition for sustainable growth. Our calculations suggest that the fall in growth rates of the working age population in the euro area, by diminishing its long-term growth rate, will imply a reduction in the rate of investment of about 2.5 to 3.5 percentage points of GDP (in the long-term). This means that part of the observed fall in investment after the 2008-09 crisis is thus likely to be irreversible.
Another problem that has not been sufficiently recognised is that speedy and efficient insolvency procedures are required especially in the periphery where private indebtedness exploded during the crisis. In the euro-area periphery, where large parts of the private sector (including households and small enterprises) are most likely to be unable to service their debt in full, insolvency procedures seem too inefficient to deal rapidly with the debt overhang. The payment obligations of households and small enterprises have become zombie debt, which remains their liability even if they clearly cannot service it. The banks might have written down the value of this debt on their balance sheets, but the debt remains legally in existence both for the creditor and the debtor. Creating fast procedures is one overlooked priority for structural reforms throughout the periphery (e.g. household insolvency in Ireland, corporate insolvency and mortgage debt in Spain). This issue is less of a concern in the core countries of the euro area, where debt levels are lower and the structural adjustment has largely already taken place.
In relation to CSRs, there is only a limited role for the President of the Eurogroup to perform. He exercises little influence in a body that has been more reactive to the crisis than pro-active and in which national policy priorities dominate the positions of most participants and collective action is only possible in times of acute systemic crisis. In the short term, however, he could play a role in promoting the completion of the banking union, which remains a high priority for the euro area, but also in fostering an informed debate about the issue of austerity, which could drive a strategic shift in the policy approach.