COUNCIL OF THE EUROPEAN UNION

Brussels, 26 March 2013

6849/13

ECOFIN 149
UEM 36

COVER NOTE

from:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
date of receipt:	22 March 2013
to:	Mr Uwe CORSEPIUS, Secretary-General of the Council of the European Union
No Cion doc.:	COM(2013) 165 final
Subject:	Communication From The Commission To The European Parliament And The Council Towards a Deep and Genuine Economic and Monetary Union The introduction of a Convergence and Competitiveness Instrument

Delegations will find attached Commission document COM(2013) 165 final .

Encl.: COM(2013) 165 final

EUROPEAN
COMMISSION

Brussels, 20.3.2013
COM(2013) 165 final

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

Towards a Deep and Genuine Economic and Monetary Union
The introduction of a Convergence and Competitiveness Instrument

EN EN

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

Towards a Deep and Genuine Economic and Monetary Union
The introduction of a Convergence and Competitiveness Instrument

1. INTRODUCTION

Background

The Commission's Blueprint for a Deep and Genuine Economic and Monetary Union adopted on 28 November 2012[1] contained proposals for short-, medium- and long-term measures on how to strengthen cooperation and integration in the financial, fiscal, economic and also in the political fields. Among the issues to be implemented in the short run to complete the governance framework for economic policy coordination in general, and for the single currency in particular, were "contractual arrangements" combined with a solidarity mechanism for national structural reforms for competitiveness and growth whose lack of implementation would have a spillover effect on other Member States but whose implementation would need to be done by the Member State concerned under particular stress. The aim is to help Member States facing a difficulty that may affect the entire Euro area to undertake the necessary reforms through the Convergence and Competitiveness Instrument (CCI), which is a combination of a contractual arrangement with a mechanism for financial support, sooner than they would be able to do on their own. On the basis of the Commission's Blueprint and the four Presidents' Report on a genuine Economic and Monetary Union[2], the 2012 December European Council agreed on a roadmap for the completion of the EMU. Up until the 2013 June European Council, work will continue in the areas of: coordination of national reform, the social dimension of EMU including social dialogue, the feasibility and modalities of mutually agreed contracts, and a solidarity mechanism[3]. In the December report of the four Presidents' the issues of contractual arrangements and a solidarity funding mechanism are also addressed separately.

The Commission's proposal

The Convergence and Competitiveness Instrument, as proposed by the Commission, encompassed both the ideas of mutually agreed contracts and that of a solidarity mechanism. The inter-play between the two pillars would provide solidarity in the form of financial help to support increased economic responsibility and fiscal discipline which would be set out clearly and with conditions through "contractual arrangements". Specifically, a Convergence and Competitiveness Instrument would be based on two pillars:

- Contractual arrangements which would lay down the key measures a Member State commits to put in place, with agreed timelines. These measures would be designed to

1 http://ec.europa.eu/commission_2010-2014/president/news/archives/2012/11/pdf/blueprint_en.pdf
2 http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/134069.pdf
3 http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/134353.pdf, par 12.

implement the Country Specific Recommendations agreed as part of the European Semester, in particular those emanating from the Macroeconomic Imbalance Procedure.

- Financial support for the implementation of the reforms in the contractual arrangement.

This Communication presents options and questions to elicit input from stakeholders on what should be the scope of the Convergence and Competitiveness Instrument, which Member States should be eligible, how it should be financed and how it should fit into the overall system of economic governance of the Euro area and the EU. The Communication aims to address these questions as part of the debate which is now underway between key stakeholders on the next steps towards the completion of the EMU, in particular the European Parliament, the Member States and the national parliaments.

2. A CONVERGENCE AND COMPETITIVENESS INSTRUMENT: CONTRACTUAL ARRANGEMENTS AND FINANCIAL SUPPORT

2.1. The rationale for a Convergence and Competitiveness Instrument

The interdependence of Member States participating in a single currency means that each has a vital stake in all the others following sound budgetary and economic policies. The crisis has shown that lack of necessary reforms or half measures in one Member State can have negative effects in others. As part of the new economic governance of the Euro area and of the EU, there is a need to ensure that the structural reforms which are needed to remove key weaknesses in some economies take place and take place earlier than has recently been the case. The Commission sees it as an instrument designed to meet the specific needs that arise from Euro area membership. Being bound together in a single currency area implies the need for timely and targeted reforms. Therefore, an additional instrument is needed to promote and support reforms that can also have a positive impact on others when individual Member States are under stress.

The ambitious implementation of structural reforms by the Member States in a coordinated manner, taking the Euro area dimension into account, can deliver a better result for all of them, contributing to sustainable growth, employment and social cohesion. High levels of adjustment capacity and competitiveness would better protect all Member States against the impact of economic downturns and avoid the development of harmful macroeconomic imbalances with their associated economic and social costs.

The current EU economic surveillance framework already provides incentives to undertake reforms, for example through the fixing of common targets to be reached by each Member State, the regular provision of policy guidance and surveillance, the use of peer pressure and the exchange of best practice to create an environment conducive to promoting convergence and competitiveness, as well as through more direct measures such as sanctions and macroeconomic conditionality.

In its Blueprint the Commission has explained why it considers that the existing framework should be expanded to include the use of a dedicated instrument that would assist Member States undertaking certain key reforms by providing financial assistance for flanking measures to overcome possible social and political difficulties in implementing these reforms. While such reforms are first and foremost in the interest of the Member State undertaking them, they are also in the interest of the wider Euro area and EU: more resilient Member States contribute positively to the wellbeing of their partners while delaying necessary reforms because of short term negative domestic impacts can have negative spill over effects on other partners. Financial support for a well-defined set of reforms would be of particular importance in cases where imbalances persisted in spite of full compliance with previous Country Specific Recommendations addressed to the Member State concerned.

The design of the Convergence and Competitiveness Instrument would have to include safeguards to prevent moral hazard arising from the perception that reforms would be rewarded once they were overdue, which could delay reforms until the moment they were eligible for financial support, as well as the risk of deadweight losses occurring by providing incentives for reform that would have been implemented even without that incentive. This new financial support mechanism should only intervene in support of significant reforms with a potential impact on other Member States and the Euro area and EU as a whole. Under these circumstances, it would help to deliver reforms that would either not be undertaken in the normal course of events, or that could not be undertaken in a particular time period because of their costs to the Member State undertaking them or would only be undertaken later at greater cost to the Member State and the wider Euro area and EU.

2.2. Contractual arrangements

Coverage: options on participation of Member States

As envisaged by the Commission the "contractual arrangement" under the Convergence and Competitiveness Instrument would build on the existing EU surveillance framework. It would link the policy guidance resulting from the Country Specific Recommendations in the European Semester and the national process of structural reform implementation.

A key question to be addressed is for which Member States the Convergence and Competitiveness Instrument should be established? This could include covering:

- All Euro area Member States (except those with a macroeconomic adjustment programme[4]).
- Ways should be also found to allow Member States that are not part of the Euro area to enter a contractual arrangement in particular regarding the Member States preparing for Euro accession taking also into account the preparation stage.

Another key question to be addressed is about when the use of the Convergence and Competitiveness Instrument would be triggered? Possible options include:

- The use of the Convergence and Competitiveness Instrument would be available to all participating Member States.
- The Convergence and Competitiveness Instrument would be used when a participating Member State is under the Macroeconomic Imbalances Procedure. Should participation be voluntary or obligatory?
- The use of the Convergence and Competiveness Instrument would be triggered by an invitation by the Commission to a participating Member State.

4 Proposal for a Regulation of the European Parliament and of the Council on the strengthening of economic and budgetary surveillance of Member States experiencing or threatened with serious difficulties with respect to their financial stability in the euro area - http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0819:FIN:EN:PDF

Which reforms should be covered?

Depending on the coverage chosen there are different options for implementing this new instrument. For example:

- In the case of voluntary participation, Member States could present a plan for a set of concrete reforms with clear deadlines building on the relevant Country Specific Recommendations[5]. This would form the core of the contractual arrangement.
- If the new instrument applies to Euro area Member States under the preventive arm of the macroeconomic imbalance procedure then the proposed reforms should include the recommendations issued under the macroeconomic imbalances procedure and in particular measures addressing competitiveness, promoting financial stability and improving the functioning of labour, product and services markets and thus the adjustment capacity of the economy.
- For Euro area Member States under the excessive imbalance procedure, in order to avoid overlapping surveillance tools the (mandatory) Corrective Action Plan would replace the contractual arrangement. In this case, the CCI would speed up the correction of imbalances. The procedure for the conclusion of the Corrective Action Plan, as well as the subsequent system of monitoring of implementation, would be the procedure defined in Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances.

Questions for consultation:

- To which Member States should the Convergence and Competitiveness Instrument apply?
- At what stage should the Convergence and Competitiveness Instrument be triggered?
- What kind of reforms should be eligible for support under the Convergence and Competitiveness Instrument? Should there be a threshold in terms of size or importance of the reforms to be supported? Do you agree with the categories described above? If yes, why? If not, why?
- Do you see other ways of defining reforms to be covered according to the situation of the different Member States to be covered by the new instrument?

Procedure

In keeping with the existing monitoring and surveillance systems Member State's reform plans would be assessed by the Commission. That assessment would focus notably on the appropriateness of the proposed measures, the additional reform effort and the extent to which they address the economic weaknesses which are taken up in the relevant Country Specific Recommendations. It would also look at potential spill-over effects on other Member States, as well as the feasibility of implementation also in the light of the proposed timelines. The assessment of the expected impact would include, where relevant, the impact on the sustainability of public finances and their social impact.

On the basis of its assessment, the Commission would negotiate the details of the plan with the proposing Member State before making a formal proposal to the Council to approve the

[5] Adopted by the Council in the context of the European Semester.

contractual arrangement. The reforms to be supported would vary according to the specific situation of the proposing Member State – for some they could be of short duration, for others they might take several years to implement fully.

The Council would approve (possibly with modifications) the specific actions proposed together with the agreed timetable. Should the proposing Member State and Commission fail to reach an agreement, or should the Council disagree with the arrangement, there would be no contractual arrangement and subsequently no financial support.

The Commission would monitor implementation of the arrangement on an annual basis as part the European Semester, with Member States reporting on progress in their National Reform Programmes. The Commission would assess progress in reform implementation and evaluate the adequacy of the agreed reform plans vis-à-vis the evolution of the economic situation and challenges faced by the Member State. Where needed, both the Commission and the Member State could propose changes to the contractual arrangement, leading to a new negotiating process.

Since the measures included in the contractual arrangements could be expected to include major economic reform plans in the sense of the envisaged ex ante coordination process there should be a strong link between the two instruments. For this reason the Commission is simultaneously launching a consultation on ex ante coordination of major economic policy reforms.

Questions for consultation:

- Do you agree that the proposed contractual arrangements should be negotiated by the Commission with the concerned Member State?
- Do you agree that they should be decided by the Council?
- Do you agree that both the Commission and the concerned Member State should have the right to propose changes to agreed contractual arrangements? Under which circumstances?
- Do you agree that there should be annual reporting on the contractual arrangements via the European Semester?

2.3. Democratic legitimacy and accountability

One of the main objectives of setting up the Convergence and Competitiveness Instrument is to support Member States in the sometimes difficult process of implementing major reforms necessary to tackle the weaknesses identified in the Country Specific Recommendations. Increased EU involvement in the reform process would necessitate a timely and active involvement of national parliaments and other relevant national stakeholders.

Member States would need to ensure national commitment to the implementation of the contractual arrangements by involving their national parliamentary assemblies, preferably before submission of their plans for a set of concrete reforms. In all circumstances, national parliaments should be involved before the endorsement of the contractual arrangements by the Council. Where appropriate, and depending on the specific nature of the envisaged reforms, other national stakeholders such as social partners should also be involved. Where relevant and appropriate, representatives of the Commission would be available to participate in dialogue with national parliaments on the application of the instrument.

In ensuring democratic legitimacy and accountability at EU level, the European Parliament should be fully involved. Given the importance of the reform measures expected to be covered by the Convergence and Competitiveness Instrument for the well-functioning of EMU as a whole, representatives of the Commission would be available for dialogue with the European Parliament whenever necessary. Arrangements could be envisaged for dialogue with representatives of the Council and the Member States.

Questions for consultation:

- How should national parliaments be involved in decisions on contractual arrangements?
- In which way should other national stakeholders be consulted? Which ones? At what stage in the process?
- How should representatives of the Commission be involved in dialogue with national parliaments on the contractual arrangements?
- How should representatives of the Council and of the relevant Member States be available to participate in dialogue with the European Parliament on contractual arrangements? At which stage in the process?

3. FINANCIAL SUPPORT TO FACILITATE REFORM IMPLEMENTATION

In its Blueprint for a Deep and Genuine EMU, the Commission considers that financial support will be needed to support the implementation of structural reforms. One option is that all participating Member States contribute to a financial support mechanism. The Commission is considering different options, also with regard to the obligation to contribute to the new mechanism – it could be required of all participating Member States, obligatory for all Euro area Member States irrespective of whether they apply to draw from it etc. Irrespective of the option chosen the mechanism could either be based on dedicated contributions, for example on the basis of a GNI key, or on the proceeds of new specific financial resources dedicated to it. The Commission envisages that the mechanism would be included in the EU budget as external assigned revenues. This means they would not come under the ceilings set in the MFF Regulation. This mechanism would be defined in a new legal act which would define the potential beneficiaries (for example only contributing Member States could benefit) and authorise spending. The Commission envisages that the size of the mechanism would be limited at the outset. It could grow over time and with experience if it proves to be an effective and cost efficient way of promoting reform. Once such a mechanism is put in place the modalities for its operation need to be fixed. Options being considered by the Commission include the payment of a lump sum to be attributed per contractual arrangement, e.g. through a budgetary support. The definition and use of the amounts involved and of the disbursement would depend on <u>strict conditions</u> specified in the contractual arrangement. The conditionality would be linked to the implementation of the agreed reforms, but not to the achievement of a specific economic outcome of those reforms. The financial support would also strengthen EMU's social dimension. For example, funding by Member States could be geared towards support the modernisation of vocational training systems or increased effectiveness of active labour market policies but could not be directly linked to a defined number of people finding employment.

The new financial instrument would need to be consistent, coherent and complementary to the existing instruments, such as the Structural Funds, and in particular the European Social Fund. The value added of this financial mechanism in supporting such measures would be to provide targeted, limited in time and quick support. This is crucially important in the case of the macroeconomic conditionality foreseen under the Structural Funds for the period 2014-2020.

To maximise its potential impact, the Commission is considering proposing that the financial support would be committed up front at the moment of approval of the contractual arrangement and paid in regular instalments or instalments otherwise linked to the agreed timetable for reforms. The financial support would be conditional on the full and timely implementation of the reforms set out in the arrangement. The Commission could issue warnings if a Member State does not meet the contract, requesting the Member State to correct the deviation, including with a new timeline. When this is not met, the financial support would be withheld. Instances of non-compliance would be reported in the Commission's annual assessment, and depending on the gravity could be followed by the suspension of payments. Similar arrangements would apply in cases where previously implemented reforms are reversed or where other measures are taken which negate the impact of the agreed reforms.

Questions for consultation:

- Do you agree that the Convergence and Competitiveness Instrument needs a new financial instrument?
- Do you agree that it should be inside the EU budget but not subject to the ceilings of the MFF as described above? If not, what would you propose?
- Do you agree that the financial mechanism should be financed by direct contributions from Member States? Should all Euro area Member States be obliged to contribute?
- Would you agree that some form of specific financial resources should be identified to finance the mechanism? Do you have any other proposals?
- Do you agree that only those Member States that contribute to the fund should be able to benefit from it?
- Do you agree that failure to implement the agreed reforms correctly could lead to suspension of payments?

4. NEXT STEPS

On the basis of further discussion with the European Parliament and the Council, the Commission will make a proposal in the course of 2013.