



**COUNCIL OF
THE EUROPEAN UNION**

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LEGISLATIVE ACTS AND OTHER INSTRUMENTS

Subject: COUNCIL RECOMMENDATION on the implementation of the broad guidelines for the economic policies of the Member States whose currency is the euro

COUNCIL RECOMMENDATION

of

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 policies¹, 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 2011 on the prevention and correction of macroeconomic imbalances², and in particular Article 6(1) thereof,

¹ OJ L 209, 2.8.1997, p. 1.

² OJ L 306, 23.11.2011, p. 25.

Having regard to the recommendation of the European Commission,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

- (1) The Eurogroup has a special responsibility in the economic governance of the euro area. The economic and financial 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 Member States whose currency is the euro ("euro area Member States"), for effective arrangements for policy coordination to swiftly respond to changes in the economic environment.
- (2) The euro area Member States have committed themselves to a set of far-reaching additional policy reforms and policy coordination by signing, on 2 March 2012, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. The entry into force of the so-called two pack Regulations¹ ("two pack") in 2013 will further deepen budgetary and economic policy coordination within the euro area.

¹ Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability (OJ L 140, 27.5.2013, p. 1); Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (OJ L 140, 27.5.2013, p. 11).

- (3) Work is ongoing to deepen further the economic and monetary union ("EMU").
- On 28 November 2012, the Commission presented a communication on a blueprint for a deep and genuine economic and monetary union. The blueprint identifies a rationale and objectives of a genuine EMU as well as instruments and steps that would make it possible to reach them. The blueprint intended to launch the European debate.
- On 12 September 2012, the Commission presented a roadmap towards a Banking Union. This proposal was accompanied by a proposal for two regulations needed to establish the single supervisory mechanism. On 5 December 2012, the President of the European Council issued a report which was developed 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 EMU. 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 Member States' 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 Union as a whole.
- (4) The European Parliament has been duly involved in the European Semester and, in its resolution of 20 November 2012 "Towards a genuine Economic and Monetary Union", expressed its views on the deepening of the EMU.

- (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 reach 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 the two pack will further strengthen budgetary surveillance in the euro area. The two pack 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, with a view to ensuring an appropriate overall fiscal stance. These discussions take place on the basis of the Commission's opinions on the draft budgetary plans of the euro area Member States and of the overall euro area assessment by the Commission on 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 towards the nominal reference value taking into account cross-country differences in risks to sustainability, both in the short and medium terms, 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 be reinforced if the composition of government expenditure and revenues were to better reflect the growth impact of the different spending items and revenue sources.

Furthermore, the growth potential of the economy could be enhanced by further structural reforms and by exploiting the possibilities offered by the EU's existing fiscal framework to balance productive public investment needs with fiscal discipline objectives in the preventive arm of the Stability and Growth Pact.

- (7) Most risk indicators related to EU financial markets and market sentiment have 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 small and medium-sized enterprises (SMEs), are the key challenge at the current conjuncture.
- (8) 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 Single Supervisory Mechanism (SSM) and the European Banking Authority (EBA) will provide transparency of banks' balance sheets, help identify any remaining pockets of vulnerability, and, thus, 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.

- (9) 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 Member States, 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 Member States 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 Member States 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 discussing *ex ante*, and where appropriate coordinate, their national plans for major economic reforms with a view to benchmarking best practices and working towards a more closely coordinated economic policy. 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 responsibility for the aggregate policy stance in the euro area in order to ensure the good functioning of the euro area to increase growth and employment, and to take forward the work on deepening economic and monetary union. 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 level and at the euro area level that are necessary for a stable and robust euro area and to ensure policy coherence, and in the preparation of the Euro Summits.

2. Ensure that the Eurogroup monitors and coordinates fiscal policies of the euro area Member States and the 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 should 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 in line with the Stability and Growth Pact, 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 contribute to 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 cooperation 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) ensure the availability of credible fiscal backstops in the context of balance sheet assessments and stress tests; (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, as outlined by the European Council.

5. Coordinate *ex ante* the major economic reform plans of the euro area Member States. Monitor the implementation of structural reforms, in particular 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 a correction of external and internal imbalances, inter alia 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, in particular 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.
6. In line with the AGS 2013 and by taking collective and significant measures, tackle the social consequences of the crisis and the rising unemployment levels. The situation of unemployed young people is particularly worrying and bold action is recommended along the lines of the Compact for Growth and jobs and the EU Youth Guarantee. Further reforms to facilitate access to employment, prevent early withdrawals from the labour market, reduce the cost of labour, combat labour market segmentation and support innovation are recommended.

Done at Brussels,

For the Council
The President
