IMPROVING EURO-AREA GOVERNANCE,
SECURING THE LONG-TERM SUCCESS OF THE EURO

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AV. DE CORTENBERGH 168
BE-1000 BRUSSELS
BELGIUM
VAT BE 863 418 279

TEL +32(0)2 237 65 11
FAX +32(0)2 231 14 45
E-MAIL: MAIN@BUSINESSEUROPE.EU
WWW.BUSINESSEUROPE.EU

KEY RECOMMENDATIONS

1. Transposing the Stability and Growth Pact rules into national law and reforming national, regional and local fiscal institutions;
2. Granting new auditing powers to Eurostat for assessing the quality and reliability of national statistics in greater detail;
3. Broadening the concept of fiscal sustainability and stress-testing of public finances to assess their resilience;
4. Reinforcing the surveillance of national economic policies and triggering earlier discussions in the Eurogroup in order to better contribute to the national policy debate;
5. Ensuring that early warnings from the European Systemic Risk Board on excessive credit expansion lead to remedial actions;
6. Protecting the European Central Bank's independence and its overarching mandate to deliver price stability for the euro area as a whole;
7. Imposing obligatory interest-bearing deposits for Member States failing to consolidate sufficiently in good times;
8. Speeding up Excessive Deficit Procedures (EDP) and making full use of the instruments available in the Treaty of Lisbon;
9. Transferring pre-emptive deposits made in good times into a crisis resolution fund and considering the suspension of EU budget funds in case of persistent breach of EDP requirements;
10. Working on a more permanent crisis management system, including emergency loans with strict conditionality and a resolution scheme to allow for debt restructuring or orderly default in last-resort situations.

FOR FURTHER INFORMATION: **ECONOMICS DEPARTMENT**
MARC STOCKER, DIRECTOR AND **JOANA VALENTE**, ADVISER
TEL +32 2 237 65 23 – **FAX** +32 2 231 14 45 – **E-MAIL**: P.TROISI@BUSINESSEUROPE.EU

1. INTRODUCTION

The European business community is seriously concerned about the beleaguered state of public finances and its destabilising effects on the economy.

Heightened uncertainty and financial stress have severely undermined confidence in the euro and pushed up risk premia for companies across Europe. Moreover, rising public debt is already crowding out the availability of capital for private investment and raising the prospect of significantly higher taxes in the future.

The current instability has its origin in years of indulgence and poor economic governance, long before the financial crisis broke out.

It is revealing crucial failures of the institutional framework of the European Monetary Union (EMU) to enforce discipline in good times and prevent fiscal and broader macroeconomic imbalances from developing in the first place.

Both financial and sovereign debt crisis share important common causes:

- easy money (as markets barely differentiated risks amongst euro-area members);
- high leverage and pro-cyclical behaviours (high debts and deficits and insufficient consolidation in good times);
- poor accounting and misreporting;
- insufficient supervision (Stability and Growth Pact).

Severe deficiencies of the current governance structure must be addressed. A new stability culture for the euro must be put in place.

The unprecedented stabilisation programme agreed on 9 and 10 May to prevent the contagion from the Greek debt crisis to other euro area countries demonstrated a strong commitment to the single currency and to safeguarding financial stability at a critical moment.

While welcome, this agreement only buys time to address the real issues. To be effective in restoring confidence, it will need to be backed by immediate actions at national level in order to restore the long-term sustainability of public finances and to implement far-reaching structural reforms to boost the euro area's growth potential and hence facilitate the necessary process of fiscal consolidation.

The challenge faced today is immense and will require major adjustments. In order to bring public debt in the euro area back to the limit of 60% of GDP by 2025, we calculate that governments will have to sustain from 2015 onwards average primary surpluses (budget balance excluding interest payment) of close to 3% of GDP annually (from minus 3.5% currently) and undertake major reforms to raise the euro area's growth potential back to 2% at least.

In our March report “Combining Fiscal Sustainability and Growth: a European Action Plan” we recommended a comprehensive agenda combining an exit strategy to cap public indebtedness with an entry strategy to support investment in future growth areas. This agenda comprises the following broad orientations:

- Tighter fiscal rules and better budget processes and institutions
- Greater efficiency of public administrations and credible cost-cutting measures
- Increased scope for public-private partnership
- Reforms of pension and healthcare systems
- Higher return on education and training
- More and better targeted efforts in R&D and innovation
- Greater prioritisation of infrastructure investments
- Growth-enhancing tax reforms

Specific recommendations were addressed to both EU and national policy-makers.

But recent developments have stressed the need to rethink the governance structure of the European Monetary Union in order to guarantee the stability and long-term success of the euro and preserve the achievements of greater economic and financial integration.

The crisis clearly showed the limits of the current Stability and Growth Pact (SGP) in enforcing discipline and highlighting risk of instability in good times. Therefore, deeper and broader surveillance, including earlier warnings on fiscal and competitiveness imbalances, is an essential part of an effective prevention system. We strongly urge a greater role for coordination and enforcement of national country reporting.

This should be backed up with more forceful corrective measures in case of indiscipline**.** It includes faster and stronger enforcement of excessive deficit procedures and clear sanctions in case of non-compliance. A permanent crisis resolution mechanism and orderly defaults should also be envisaged in last-resort situations.

Our recommendations therefore address both preventive and corrective aspects, and foresee a gradual tightening of enforcement mechanisms to ensure compliance at the Member-State level.

2. PREVENTIVE MEASURES: *more reliable assessment of fiscal positions, greater focus on sustainability, more binding commitments, full independence of the ECB*

A. GREATER QUALITY AND RELIABILITY OF STATISTICS

Independence, integrity and accountability of the statistical system must be enhanced

Recent experience, and in particular the case of Greece, has shown that new steps must be taken to enhance the effectiveness and reliability of the European statistical system.

This requires (1) granting new auditing powers and full political independence to Eurostat for assessing the quality and reliability of national statistics in greater details and (2) strengthening the independence (also from a budgetary point of view), integrity and accountability of national statistical authorities (NSAs) for the correct reporting of public statistics. Increased sanctions should be foreseen in case of misreporting.

Entrusting independent boards for national statistical authorities, enforcing existing EU regulation on sector specific infringement procedures or imposing more stringent reporting requirements to those Member States with lower quality institutions are all important incentives to raise the quality and reliability of public finance statistics.

B. INCREASED FOCUS ON FISCAL SUSTAINABILITY

Deficit and debt rules are of the essence

Clear deficit and debt thresholds must remain at the centre of budgetary planning and control. As a benchmark, the objective should be to balance budgets over the cycle and allow automatic stabilisers to play their role in a downturn.

A more forward-looking approach is needed...

Their credibility must be reinforced by taking a forward-looking perspective and by strengthening the assessment of the true underlying fiscal position of Member States. The public debt dynamics will need to have a stronger influence on the targeted primary budgets and required consolidation efforts.

...as well as a broader surveillance process

This evaluation must be done through a credible and independent process at both European and national level. This must consider not only the initial structural budget position and debt level, but also medium term growth prospects, future contingent liabilities related to demographic trends and off-balance-sheet financial commitments, competitiveness imbalances and the accumulation of excessive private debt, which recent events have demonstrated to be an important hidden liability. The Commission must play its full role as an independent evaluator and adviser.

Stress tests should be generalised

Stress tests to assess the impact of worse-case scenarios on public finances should be generalised and exposure to adverse shocks such as housing market or asset price corrections appropriately factored in.

Greater flexibility for good performers introduced

On that basis, Member States which the Eurogroup / ECOFIN Council deem to have achieved greater sustainability, or to be undertaking substantial structural reforms to support it, should be allowed greater flexibility in running counter-cyclical budgetary policies.

And the quality of public finances duly considered

Consolidation efforts should be proportional to the underlying fiscal position and should privilege expenditure restraints, particularly those having a lasting effect on sustainability while minimising detrimental effects on growth. Higher taxation or new tax levies will have limited or even counterproductive effects on fiscal sustainability in the long term, given their dampening effects on activity, investment and job creation.

C. REINFORCED AND BROADER SURVEILLANCE PROCESS

The SGP remains the right instrument...

The Stability and Growth Pact (SGP) remains the appropriate European instrument to coordinate budgetary policies, but needs to be reinforced, complemented and enforced with rigour.

...but a better integrated approach is needed

A more closely integrated budgetary process at national and European level would provide an important added value. This would require earlier discussions in the Eurogroup / ECOFIN Council, a more integrated approach to the economic surveillance of Member States and further analytical input from the European Commission.

We support the European Semester proposal...

In this regard, we support the Commission proposal for a “European Semester” to discuss broad economic policy orientations at a sufficiently early stage to influence discussions in national parliaments and the idea of scoreboard of national economic performance.

...and the creation of a national performance scoreboard

Such a scoreboard should provide a timely and coordinated assessment of fiscal and broader macroeconomic imbalances, putting greater emphasis on both public and private debt sustainability, external competitiveness, productivity and labour utilisation.

The ESRB must have an important role to play

The European Systemic Risk Board should provide complementary information on the emergence of excessive credit expansion and asset price misalignments. Early warning signals should lead to corrective actions, including through the alteration of the budget stance in the countries concerned.

The Commission must assess the impact of reforms on fiscal sustainability

In addition, the Commission should further work with the ECOFIN Council on a framework to assess the impact of product, labour, health care and social security reforms on fiscal sustainability, and use it to strengthen the rational for medium-term objectives and the required actions to achieve them.

Country specific recommendations should be upgraded

Country-specific recommendations proposed by the Commission in the context of the "Europe 2020" strategy should be an integral part of the surveillance process and should encompass both fiscal policies and structural reforms and be more detailed and transparent than is currently the case.

At national level, independent fiscal institutes can play a positive role

At national level, independent fiscal policy institutes (like CPB in the Netherlands or German Council of Economic Experts in Germany), should ensure an informed national debate on current structural budget position, advice on medium-term objectives and ways of achieving them. A multi-annual framework should be put in place to ensure the credibility of commitments by central governments and sub-national entities.

D. MORE BINDING COMMITMENTS

Ensure greater responsibility in good times...

We recommend a mix of binding fiscal rules and strictly observed non-binding frameworks to ensure credible commitments towards long-term budgetary discipline and greater responsibility to reduce public debt in good times.

... based on stringent national rules

Ceiling on the budget deficit, on the debt level or on expenditures are all valid options to be decided by national governments, but these need to be at least as rigorous as those agreed within the Stability and Growth Pact. The rules of the Stability and Growth Pact should be transposed into national law and on all levels of public administration. The case of Switzerland and the German "debt brake" could serve as examples.

Deficit rules should be based on the structural balance in order to avoid pro-cyclical effects and pre-defined rules must be established regarding the allocation of unforeseen revenue windfalls towards debt reduction objectives.

National, regional and local authorities must be covered by ex-ante rules on deficit limitations and the budget process needs to be placed in a multi-annual framework focussing on fiscal sustainability.

In order to prevent further massive debt increase through off balance sheet commitments, debt-brake rules could also be applied to social security systems.

...introducing interest-bearing deposits;

Strong and automatic enforcement mechanisms are crucial for the effectiveness of fiscal rules. At EU level, we call for the introduction of obligatory interest-bearing deposits when Member States fail in good times to progress towards agreed medium-term budgetary objectives. At present such an instrument is only foreseen in the context of excessive deficit procedures, hence at a stage when fiscal imbalances have already become a severe drag on the health of the economy.

Activation of a pre-emptive deposit scheme would create the incentives to run prudent, counter-cyclical budgetary policies in good times and therefore have sufficient room to manoeuvre in bad times. The deposits could be returned once improvement has been verified or be extended under stricter conditions if excessive deficit procedures are launched.

E. FULLY INDEPENDENT EUROPEAN CENTRAL BANK

The ECB independence must be safeguarded

The long-term growth of all European economies needs a stable and trust-inspiring euro, low inflation and favourable financing conditions.

Only a strongly independent European Central Bank (ECB) will be able to fulfil these objectives through a credible monetary policy.

Given the importance of the euro for the smooth functioning of the global economy and its financial system, an independent European Central Bank with a clear mandate to deliver price stability for the euro area as whole is absolutely paramount for the European business community at large.

3. CORRECTIVE AND LAST-RESORT MEASURES: *Stronger enforcement of excessive deficit procedures, sanctions in case of repeated indiscipline and last-resort measures*

A. SPEED-UP EXISTING PROCEDURES

EDP must be accelerated

It is necessary to speed up excessive deficit procedures (EDP) and ensure that the Commission and the Council make full use of the instruments available in the Treaty of Lisbon. This includes faster decisions in the Council to open an EDP and agreeing on recommendations to those countries not fulfilling the requirements.

And additional measures introduced

If members fail to comply, the Council should agree at an earlier stage to take additional measures requiring member states to provide additional information; a member state to make an interest or non-interest-bearing deposit of an appropriate size and the EIB to reconsider its lending programmes to the country concerned.

B. AUTOMATIC COMPLIANCE MECHANISM AND SANCTIONS

Automatic mechanisms incentivise compliance

The introduction of automatic compliance mechanisms would create a greater incentive to undertake corrective actions and avoid political horse-trading as often happened in the past. Sanctions proposed below should be triggered automatically.

Sanctions such as non-interest-bearing deposits...

Obligatory deposits made in good times as a result of insufficient consolidation efforts (see proposal in section 1d) should become non-interest-bearing when an excessive deficit procedure is launched and be transferred to a crisis resolution fund in case of persistent breach of EDP requirements.

...or freezing EU funds should be considered

Payments from the EU budget could also be made conditional to progress towards agreed budgetary objectives. If progress is not achieved, EU budget funds could be temporarily suspended or permanently withdrawn.

C. PERMANENT CRISIS RESOLUTION MECHANISM

A crisis resolution mechanism is needed

A more permanent system of crisis management and resolution within the euro area should be agreed as a last resort instrument to fend off market speculation in times of severe financial stress while strongly preventing moral hazard situations.

This system should protect the ECB from compromising its independence in order to safeguard financial stability in the event of a sovereign debt crisis. In particular, situations where the ECB feels compelled to engage in the outright purchase of government debt should be avoided.

On the basis of senior loans

If a new emergency loan facility is decided for the euro area, it should be senior to other debt instruments, activated only when market access is proven to be insufficient, based on market interest rates and matched by a significant IMF contribution.

Containing strong disincentives to its use negotiated in coordination with the IMF

Emergency loans should be granted on the basis of agreement of all member states and the IMF and include strict conditions negotiated between the Commission, IMF and ECB, comprising clear consolidation targets and commitments to implement far-reaching reforms. These will have to be tailored to address the specific failings of each country and restore its ability to operate without the assistance of this mechanism.

Disbursements should be conditional

Actual disbursement should be linked to the fulfilment of an agreed multi-annual adjustment programme based on quarterly oversight. Payments should be suspended if conditions are not met.

Orderly defaults should be envisaged

A resolution mechanism allowing for a debt restructuring or orderly default should be made a precondition for the establishment of a permanent EU crisis mechanism.

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GO FOR GROWTH
AN AGENDA FOR THE EU IN 2010-2014

MEMBERS ARE 40 LEADING
NATIONAL BUSINESS FEDERATIONS
IN 34 EUROPEAN COUNTRIES

Austria	Belgium	Bulgaria	Croatia	Cyprus	Czech Republic
Denmark	Denmark	Estonia	Finland	France	Germany
Germany	Greece	Hungary	Iceland	Iceland	Ireland
Italy	Latvia	Lithuania	Luxembourg	Malta	Montenegro
Norway	Poland	Portugal	Portugal	Rep. of San Marino	Romania
Slovak Republic	Slovenia	Spain	Sweden	Switzerland	Switzerland
The Netherlands	Turkey	Turkey	United Kingdom		