25 Feb. 2011

ENHANCED ECONOMIC POLICY COORDINATION IN THE EURO AREA
MAIN FEATURES AND CONCEPTS

The objective of the "Pact" is to deepen the economic pillar of the monetary union by fostering convergence among the economies of the euro area. That requires a shift to a higher level of policy coordination, in particular in areas that fall under national competence to the extent that they are key for increasing competitiveness and avoiding harmful imbalances. In areas where the Pact touches on EU competences the legislative and other procedures provided in the Treaty will be fully respected. Competitiveness is essential to produce higher levels of income for citizens and to grow faster in the medium and long term.

1. Conditions for success

To be effective at the political level a "Pact" should meet four conditions:

a. It should be ***in line with the existing economic governance*** in the EU, while providing added value. The "Pact" should be consistent with and build on existing instruments (EU 2020, European Semester, Integrated guidelines, Stability and Growth Pact and new macro-economic surveillance framework). It should involve a special effort going beyond what already exists and include concrete commitments and actions that are more urgent, more ambitious than those already agreed, and accompanied with a timetable for implementation. These new commitments should thereafter be included in the regular surveillance framework. The Commission will be fully involved, in line with its competences. Non euro area Member States will be invited to participate on a voluntary basis.

b. It should be focused, action oriented, and cover ***priority policy areas that are essential for fostering*** **real convergence and competitiveness**. Therefore, it should concentrate on actions where the competence lies with the Member States. In the chosen policy areas ***common objectives should be agreed upon at the heads level. Participating Member States should pursue these objectives with their own policy-mix. Each year, concrete commitments will be undertaken by HoSG.*** In doing so, Member States will follow best practices and benchmark against the best performers, within Europe and vis-à-vis other strategic partners.

c. It should fully ***respect the integrity of the Single Market.***

d. The implementation of commitments and progress towards the common policy objectives under the Pact should be ***monitored politically by the HoSG*** of the euro area and participating countries, on the basis of a report by the Commission. In addition, in the context of the Pact Member States should commit to consult their partners on major economic reforms having potential spill-over effects before their adoption.

2. Objectives and policy areas

The pact will rest on country commitments to achieve a set of commonly agreed goals in key policy areas and its implementation will be monitored on the basis of a series of policy and quantitative indicators.

2.1 Key objectives

Euro area Member States undertake to take all necessary measures to pursue the following objectives:

- Foster competitiveness, notably through the alignment of wage and productivity developments;
- Foster employment by making work more attractive;
- Contribute further to the sustainability of public finances, notably as regards public debt as well as pensions and social security systems;
- Reinforce financial stability;

The choice of the specific policy actions necessary to achieve the above objectives will remain the responsibility of each country. Non-euro area Member States may join the process on this basis.

Each participating Member State should present the measures it will take to comply with the actions set out in section 2.2 below. If a Member State can show that action is not needed on one or the other measure (for example because it already has enshrined debt sustainability in national legislation) it will not include it.

2.2 Performance indicators and policy reforms

Progress towards the objectives mentioned above will be politically monitored by the HoSG, as explained in section 1.b, in the light of the commitments presented by Member States, on the basis of a series of indicators covering competitiveness, employment, fiscal sustainability and financial stability.

a. Foster competitiveness

Progress will be assessed on the basis of wage and productivity developments. Unit labour costs (ULC) will be monitored over a period of time, by comparing with the developments in other euro area countries, and in the main trading partners. For each country, ULCs may be assessed for the economy as a whole and for each major sector (manufacturing; services). Large and sustained increases may indicate the erosion of competitiveness. Countries facing major challenges in this respect should be identified and should commit to address these challenges in a given timeframe.

Each country will be responsible for the specific policy actions it chooses to foster competitiveness, but the following reforms will be given particular attention:

(i) respecting national traditions of social dialogue and industrial relations, measures to ensure costs developments in line with productivity, such as:

- review of the wage setting arrangements to enhance decentralization in the bargaining process and improve the indexation mechanism;
- ensure wage restraint in the public sector (considering the important signaling effect);

(ii) measures to increase productivity, such as:

- further opening of sheltered sectors by measures taken at national level to identify and remove unjustified restrictions on professional services such as quotas and closed shops, including in network industries, and restrictions in the retail sector, such as disproportionate limitations on opening hours and zoning, to foster competition and efficiency, in full respect of the Community acquis ;
- specific efforts to improve education systems and promote R&D which go beyond the targets set in the Europe 2020 strategy;
- overhaul of commercial legal systems to reduce red tape and to reduce by half the length of time it takes to get judgements on commercial cases.

b. Foster employment

A well functioning labour market is key for the competitiveness of the euro area. The indicators should be the long term and youth unemployment rates.

Policy reforms may include:

- labor market reforms, to promote "flexicurity", to reduce undeclared work and tie training and job benefits more closely to benefits;
- tax reforms, such as shifting taxes from labour to consumption through indirect taxation (make work pay), and taking measures to facilitate the participation of second earners in the work force;

c. Enhance the sustainability of public finances

In order to secure a full implementation of the Stability and Growth Pact, highest attention should be paid to:

- Sustainability of pensions and social benefits

It will be assessed on the basis of the sustainability gap indicator. This indicator measures whether debt levels are sustainable based on current policies, notably pensions schemes and benefit systems, and taking into account demographic factors. Countries facing major challenges as regards pensions and social benefit systems should be identified and should commit to address these challenges in a given timeframe.

Reforms necessary to ensure the sustainability of pensions and social benefits could include:

- aligning the retirement age with life expectancy;
- reducing early retirement schemes and using targeted incentives to employ older workers and promote lifelong learning;

- National fiscal rules

Going beyond the directive on national fiscal frameworks that is part of the governance package, Euro area Member States should take a more ambitious commitment to ensure full compliance with EU fiscal rules in the pact. They should retain the choice of the specific national legal vehicle to be used, but should make sure that it has a sufficiently strong binding nature (e.g. constitution or framework law). The exact formulation of the rule should also be decided by each country (e.g. it could take the form of a "debt brake", rule related to primary balance or an expenditure rule). In any case, the Commission should have the opportunity to review the precise fiscal rule before its adoption to ensure it is compatible with, and supportive of, the EU rules as agreed in the SGP.

3. EU initiatives

In addition to the issues under section 2 above, particular attention will be paid to the following matters on which the Commission has submitted, or will submit soon, a formal proposal:

a. Tax coordination

Developing a common consolidated corporate tax base could be a way forward to ensure consistency in the national tax systems, without harmonizing tax rates. The Commission intends to present a legislative proposal for a common consolidated corporate tax base in the coming weeks. If necessary this could also be done through enhanced co-operation.

b. Financial stability

A strong financial sector is key for the overall stability of the euro area. A comprehensive reform of the EU framework for financial sector supervision and regulation has been launched.

In this context, MS will commit to putting in place national legislation for banking resolution, in full respect of the *acquis*. In addition, HoSG should be regularly informed by the ESRB on the potential risks accumulated in the financial sector requiring specific action.

4. Specific commitments for the next 12 months

In order to demonstrate a real commitment for change and give the pact the necessary political impetus to reach the common objectives, each year MS of the euro area will agree at the highest level on a set of concrete deliverables to be achieved within 12 months. The selection of the specific policy measures to be implemented will remain the responsibility of each country, but the choice will be guided by considering in particular the issues mentioned under section 2 above. These commitments will also be reflected in the National Reform Programmes and Stability Programmes submitted each year and will be assessed by the Commission in the context of the European Semester.

5. Next steps [to be discussed]