# Table of Contents

1. Introduction ............................................... 1  
2. Evolution of surveillance since 1993 .................. 1  
3. Europe 2020 Strategy ...................................... 3  
4. Euro Plus Pact ............................................. 4  
5. European Semester ......................................... 4  
6. 2013 Guidelines ............................................ 5  
7. Analysis ..................................................... 8  
8. Conclusions ............................................... 10
Glossary

AGS  Annual Growth Survey
CSRs  Country-Specific Recommendations
ECB  European Central Bank
EMU  Economic and Monetary Union
GDP  Gross Domestic Product
MIP  Macroeconomic Imbalance Procedure
MTO  Medium-term Objective
NRP  National Reform Programme
SCP  Stability or Convergence Programme
SGP  Stability and Growth Pact
SPU  Stability Programme Update
1. Introduction

The global economic and financial crises in recent years have exposed shortcomings in economic governance and budgetary surveillance in the EU. The economic part of Economic and Monetary Union (EMU) was much less formalised than the monetary part, being left in the hands of the individual Member States with a rather loose coordination through setting economic policy guidelines and through the budgetary commitments of the Maastricht Treaty and the Stability and Growth Pact (SGP).

These recent crises have led to measures being taken to bring coordination and surveillance of economic policies to a new level, with a range of measures being adopted and further measures planned. This surveillance has now been brought under the umbrella of the European Semester. The aim of this paper is to look at how the surveillance of economic policies in the EU has evolved over the years and to see whether the present arrangements have led to any significant improvement in the process. In Section 2 it looks at the first Broad Economic Policy Guidelines (BEPGs) adopted in 1993 and how the process has developed since then. It then sets out recent changes through the Europe 2020 Strategy (Section 3), the Euro Plus Pact (Section 4) and the European Semester (Section 5). It focuses in Section 6 particularly on the position in 2013 for the euro area as a whole, for Ireland and for France, Germany, Finland and Belgium – these four selected as examples of two key large countries and two smaller countries.

The key question is whether the recommendations from the Commission, which are adopted or amended by the European Council, have substantial content and have a real impact on the economic policies of the Member States? This question is analysed in Section 7 drawing on the earlier sections.

Conclusions are set out in Section 8.

2. Evolution of surveillance since 1993

The formal process for surveillance of economic policy and the preparation of economic policy guidelines was introduced in the Maastricht Treaty and these Treaty provisions still stand.

Under these provisions (Article 121 of the Treaty), Member States are to regard their economic policies as a matter of common concern and are to coordinate them within the Council. The Council, acting on a recommendation from the Commission, formulates a draft of the broad guidelines of the economic policies of the Member States and of the Union. These are discussed at the European Council and then Council adopts a recommendation setting out the broad guidelines.

On the basis of reports submitted by the Commission, the Council monitors economic developments in each of the Member States and in the Union as well as the consistency of the economic policies with the recommended broad guidelines.

1 See reference 3 for a study published in 2008
Where it is established that the economic policies of a Member State are not consistent with the broad guidelines or that they risk jeopardising the proper functioning of EMU, Council may, on a recommendation from the Commission, make the necessary recommendations to the Member State concerned. However, no sanctions are envisaged, other than making the recommendations public.

The Broad Economic Policy Guidelines (BEPGs) were first prepared and implemented in 1993.

The BEPGs suggested by the Commission in 1993 had the overall aim of substantially increasing employment creation so as to cut significantly the then high unemployment levels. It proposed three guidelines:

- Price and exchange-rate stability: keeping a stable macroeconomic framework to reach an inflation rate of no more than 2 to 3% by 1996
- Sound public finances: Member States to prevent any further deterioration in their budgetary situations and aim to start the process of deficit reductions
- Creating more employment: Member States to improve the functioning of their economies, aiming specifically at improving competitiveness.

The BEPGs adopted by Council added four more guidelines covering:

- Pay, investment and employment
- Reducing the indirect cost of labour
- Active policies towards employment and
- Completing the internal market
- Being the first round of BEPGs, they were quite limited.

In the initial years, the BEPGs made only general community-wide recommendations but 1998 saw the adoption of the first country-specific recommendations (CSRs).

In 1999, the Commission presented the first BEPGs’ Implementation Report, looking at how the Member States had implemented the CSRs.

In March 2000, the European Council at Lisbon adopted what was known as the Lisbon Strategy. Under this Strategy, the BEPGs should focus increasingly on the medium and long term implications of structural policies and on reforms aimed at promoting growth potential, employment and social cohesion, as well as on the transition towards a knowledge-based economy. The Lisbon Strategy was designed to make the EU the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion, by 2010. The Strategy would be underpinned by the European Council taking on a pre-eminent guiding and coordinating role to ensure overall coherence and the effective monitoring of progress towards the new strategic goal. The European Council would accordingly hold a meeting every Spring devoted to economic and social questions.

In 2001, Council used for the first and only time the power to make a recommendation to a Member State whose policies were not consistent with the BEPGs. This involved Ireland and recommended that Ireland adopt a less expansionary budget policy. Coming at a time of economic boom and budgetary surplus, this recommendation was not well received and was not implemented, though in retrospect the expansionary fiscal policy was not what was needed in a booming economy.
In 2003, BEPGs were adopted for a period of three years. The BEPGs package for 2003–05 also included guidelines specifically addressed to euro area Member States as a whole for the first time. It reflected issues that were considered to be particularly salient for euro area members, including the need for a balanced macroeconomic policy mix and the importance of enacting structural reforms to address unwarranted inflation differentials.

Article 148 of the Treaty provides that the Council, on a proposal from the Commission, shall each year draw up employment guidelines which the Member States shall take into account in their employment policies. Since 2005 these employment guidelines have been in an integrated package with the BEPGs, embedding them within a new set of Integrated Guidelines for Growth and Jobs.

The three year BEPGs were also adopted for 2005-08 and 2008-10.

3. Europe 2020 Strategy

In 2010, the Europe 2020 Strategy was adopted as a 10-year growth strategy. This brought a change in the way economic governance is conducted in the EU, including the BEPGs. One of the features of the Strategy was the adoption of the European Semester, as set out later.

The Europe 2020 Strategy is designed to make the EU a smart, sustainable and inclusive economy. Five key targets were adopted and translated into national targets in the areas of employment, education, research and innovation, social inclusion and poverty reduction and climate/energy. Reporting on these targets was integrated into the Stability Programme and National Reform Programme processes and the BEPGs. The five targets are:

1. ensuring 75 % employment of 20–64-year-olds;
2. getting 3 % of the EU’s GDP invested into research and development;
3. limiting greenhouse gas emissions by 20 % or even 30 % compared to 1990 levels, creating 20 % of our energy needs from renewables and increasing our energy efficiency by 20 %;
4. reducing school dropout rates to below 10 %, with at least 40 % of 30–34-year-olds completing tertiary education;
5. ensuring 20 million fewer people are at risk of poverty or social exclusion.

Each EU country has adopted its own national targets in each of these areas.

EU leaders also identified the most important areas of action which they believe can be new engines to boost growth and jobs. These areas are addressed through seven ‘flagship initiatives’ viz:

- ‘Innovation Union’: aims to improve conditions and access to finance for research and innovation, so that innovative ideas can ultimately be turned into products and services and thereby create growth and jobs.
- ‘Youth on the move’: aims to enhance the performance of education systems and to facilitate the entry of young people into the labour market. This is done inter alia through EU-funded study, learning and training programmes, as well as platforms that help young jobseekers find employment across the EU.
- ‘A digital agenda for Europe’: aims to speed up the roll-out of high-speed Internet and uptake of information and communication technologies.
• ‘Resource-efficient Europe’: aims to help decouple economic growth from the use of resources. It supports the shift towards a low-carbon economy, an increased use of renewable energy sources, the development of green technologies and a modernised transport sector, and promotes energy efficiency.
• ‘An industrial policy for the globalisation era’: aims to improve the business environment notably for SMEs, for example by helping them to access credit and cutting red tape. It also supports the development of a strong and sustainable industrial base able to innovate and compete globally.
• ‘An agenda for new skills and jobs’: aims to modernise labour markets and empower people by developing their skills and improving flexibility and security in the working environment. It also aims to help workers seek employment across the EU more easily in order to better match labour supply and demand.
• ‘European platform against poverty’: aims to ensure social and territorial cohesion by helping the poor and socially excluded to get access to the labour market and become active members of society.

4. Euro Plus Pact

The Euro Plus Pact was adopted in March 2011 by the euro area countries, but open to other countries as well. It was designed to strengthen economic policy coordination and improve competitiveness. It involves a special effort going beyond what already exists and includes concrete commitments and actions that are more ambitious than those already agreed, and accompanied with a timetable for implementation. Each year concrete national actions are to be committed by the Head of State or Government in the following areas:

- Foster competitiveness
- Foster employment
- Contribute further to the sustainability of public finances
- Reinforce financial stability

These commitments are integrated into the SPU/NRP/BEPGs processes.

5. European Semester

In 2011 a new process known as the European Semester was adopted to streamline the economic policy surveillance process. This starts with the publication by the Commission of the Annual Growth Survey (AGS) and culminates in the adoption of CSRs for the Member States.

After the publication by the Commission of the AGS and ahead of the March European Council, the AGS is debated by the relevant EU Councils and bodies. The March European Council issues guidance for national policies on the basis of the AGS.

In April Member States submit their Stability Programmes Updates (SPUs) in the case of euro countries or Convergence Programmes in the case of non-euro countries, which relate to sound finances, and their National Reform Programmes (NRPs), which relate to economic policy and growth. The NRPs include information on how the Europe 2020 Strategy is being achieved and, in the case of the Euro countries, what commitments they are making under the Euro Plus Pact. They also report on progress in implementing the BEPGs for the previous year.
The Commission then assesses these programmes and proposes country-specific recommendations (CSRs). In late June or early July, the Council formally adopts these recommendations. These recommendations should be taken into account by countries in the development of their national budgets.

The European Semester has been backed up by a number of processes which have been introduced or strengthened in recent times viz:

- The Treaty on Stability, Coordination and Governance (TSCG), which provides a number of commitments on the overall budgetary position;
- Strengthened provisions for implementing the excessive deficit procedure under the Stability and Growth Pact;
- A new Macroeconomic Imbalance Procedure (MIP) designed to monitor a wider range of macroeconomic trends so as to identify potential risks early on, prevent the emergence of harmful imbalances and correct imbalances already in place;
- New requirements for the budgetary framework and for submitting draft budgets before adoption;
- New provisions for surveillance of Member States in bailout situations.

The semester process is illustrated in the Chart below.

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<thead>
<tr>
<th>European Commission</th>
<th>November</th>
<th>December</th>
<th>January</th>
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<th>April</th>
<th>May</th>
<th>June</th>
<th>July - Oct</th>
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<td>AGS &amp; AMR debated ahead of European Council meeting in March</td>
<td>Bilaterals with Member States</td>
<td>Bilaterals with Member States</td>
<td>Assesses NRP &amp; SCPs</td>
<td>Presents Country Specific Recommendations (CSRs)</td>
<td>Ongoing Bilaterals with Member States</td>
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Source: Presentation by Mr. Michael McGrath, Department of Finance, to IIEA, Dublin, March 13, 2013.

6. 2013 Guidelines

We are now going through the third cycle of the European Semester.

The AGS for 2013, which was published on 28 November 2012, suggested that, while EU policies are beginning to show results, continued reform is needed to generate sustainable growth and
jobs. It concluded that the five priorities outlined in the 2012 AGS remain valid viz:

- pursuing differentiated, growth-friendly fiscal consolidation
- restoring normal lending to the economy
- promoting growth and competitiveness for today and tomorrow
- tackling unemployment and the social consequences of the crisis and
- modernising public administration

At the Economic and Financial Affairs Council meeting in February 2013, Ministers agreed that these five priorities should be pursued and called on the Member States to present a comprehensive response in submitting their Stability/Convergence Programmes and their NRPs, with concrete, detailed and ambitious and effective measures. The European Council also endorsed these priorities at its March meeting. It said that particular priority should be given to supporting youth employment and promoting growth and competitiveness.

The Member States then submitted their Stability and Convergence Programme Updates and their National Reform Programmes. The EU Commission presented its analysis of these programmes and put forward its proposed euro area and Country-Specific Recommendations. The ECOFIN Council in June 2013 adopted a slightly amended set of Recommendations. These were endorsed by the European Council on 27/28 June and finally approved by ECOFIN on 9 July 2013.  

For the Euro area as a whole, the recommendations adopted by Council for 2013 include that

- the Eurogroup 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 of deepening EMU;
- the Eurogroup monitor and coordinate 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, including discussing the Commission opinions of the draft budgets of the euro area countries;
- the Eurogroup coordinate ex-ante the major economic reform plans of the euro Member States.

Ireland’s Stability Programme Update 2013 reflects the recommendations made for Ireland under the April 2009 Excessive Deficit Procedure decision in terms of the annual budget targets designed to get below the 3% deficit mark in 2013, subsequently extended to 2015.

Ireland’s National Reform Programme Update 2013 sets out progress on the headline targets under the Europe 2020 Strategy and also the priorities under the AGS.

The Commission’s CSRs for Ireland, published on 29 May 2013, simply provide that Ireland should implement the commitments in its adjustment programme. However the Commission assessment of Ireland’s 2013 NRP and SPU effectively makes a number of recommendations, including that further work is required to complete the restructuring of the banking sector, to put public finances on a sustainable footing, and reduce unemployment. It also points out in relation to the budget targets post-2013 that Ireland is bound under the Excessive Deficit Procedure recommendation to ‘seize opportunities, including from better economic conditions, to accelerate
reducing the gross debt ratio towards the 60 % of GDP reference value. This recommendation would encompass the savings generated by the promissory note operation.

**France** submitted a Stability Programme 2013-2017. It sought a delay to 2014 in the target date for a return to the 3% budget deficit level, arguing that adopting additional measures now would send France into recession. It also submitted its National Reform Programme, with three key aspects
- rectifying the public finances, including reform of the pension regimes;
- restoration of competitiveness and
- fight against unemployment, lack of security and inequality.

The CSRs for France adopted by Council include
- accept the delay in the achievement of the 3% deficit level, setting the target as no later than 2015 i.e. even more latitude than was sought by France;
- suggest a credible implementation of ambitious structural reforms to increase the adjustment capacity and boost growth and employment;
- urge France to take measures by the end of 2013 to bring the pension system into balance in a sustainable manner no later than 2020, for example by adapting indexation rules, further increasing the statutory retirement age and full-pension contribution period and reviewing special schemes, while avoiding an increase in employers’ social contributions;
- recommend measures to reduce labour costs and to improve the business environment and develop the innovation and export capacity of firms, in particular SMEs and enterprises of intermediate size;
- recommend implementation fully and without delay of the January 2013 inter-professional agreement, in consultation with the social partners.

In response to these CSRs, when originally published by the Commission, French President Francois Hollande is reported\(^3\) to have said that the Commission cannot “dictate to us what we have to do” to rebalance its ailing finances. “As far as structural reforms are concerned, especially pension reforms, it is up to us, and us alone, to say which is the best path to attain this objective.” This response by the President should be seen in the context of the commitment in the French National Reform Programme 2013 to introduce legislative proposals on pension reform in the second half of 2013 following proposals from a French Commission on the future of pensions which was to formulate different scenarios by June 2013. The CSRs adopted by Council were unchanged from the Commission recommendations.

**Germany** submitted its Stability Programme 2013, showing a small structural budget surplus in 2012 and the same expected for 2013. A debt brake now enshrined in the Constitution limits structural deficits to 0.35% of GDP. It is committed to growth-friendly consolidation of the public finances and says that sound public finances engender confidence. In its 2013 National Reform Programme, it states that German economic policy focuses on actively boosting growth and stability throughout Europe.

The CSRs adopted by Council for Germany recommend that it preserve a sound fiscal position as envisaged which ensures compliance with the medium-term objective, pursue a growth-friendly
fiscal policy through additional efforts to enhance the cost-effectiveness of public spending and sustain conditions that enable wage growth to support domestic demand. These are in line with Germany’s own policies.

**Finland** submitted its SPU and NRA for 2013. It put emphasis on achieving the MTO of -0.5% of GDP and tackling the effect of population ageing on the public finances.

The CSRs adopted by Council for Finland are quite short and include
- recommend that it pursue a growth-friendly fiscal policy and preserve a sound fiscal position as envisaged, ensuring compliance with the MTO.
- take further steps to increase the employment rate of older workers and implement and monitor closely the impact of on-going measures to improve the labour market position of young people and the longterm unemployed;
- continue to carry out an annual assessment of the size of the ageing-related sustainability gap and adjust public revenue and expenditure in accordance with long-term objectives and need.

**Belgium** submitted its SPU and NRA for 2013.

The CSRs adopted by Council for Belgium include
- adopt further measures to correct the excessive deficit by 2013 and pursue structural adjustment at an appropriate pace so as to reach the MTO by 2016;
- step up efforts to close the gap between the effective and statutory retirement age and increase the effective retirement age by aligning the retirement age or pension benefits to changes in life expectancy;
- to restore wage competitiveness, pursue the on-going efforts to reform the wage setting system, including wage indexation;
- establish concrete and time-specific proposals for shifting taxes from labour to less growth-distortive tax bases such as environmental taxes.

### 7. Analysis

The BEPG process has evolved over the years since 1993. The question to be answered is whether it is now making any significant impact on the conduct of domestic economic policy in the Member States.

The initial BEPGs were Community-wide and were thus at a very general level. With the advent of Country-Specific Recommendations (CSRs) in 1998, the guidelines could be made more specific but they still generally fell short of prescribing precise measures to be implemented. The objectives were set out but the means to achieve them was left to the individual country to determine. This was undoubtedly necessary given that responsibility for economic policy resides with the Member States. However it also made the recommendations less operational. For example, structural reform of the labour markets is a recurring theme in the BEPGs but there is little agreement on what precise reforms should be introduced in each country.

The themes of the BEPGs have remained essentially the same over the years, with some variations depending on the economic situation. Budget consolidation and the creation of employment were a key part of the first BEPGs and continue to feature now. Structural reform
has also been a consistent theme, both for the labour market and elsewhere. The effect of population ageing on the sustainability of the public finances has become an important ongoing theme at this stage.

The CSRs tend to reflect the concerns already set out in the Stability Programmes and the National Reform Programmes, rather than identifying totally new measures which Member States should take. However this does not necessarily mean that there is little input from the Commission and the other Member States into the CSRs. The CSRs are generally not just measures which can be implemented in one year. They tend to be structural issues which need to be addressed over time and so continue in the CSRs for some time. They may originate in common concerns across the Member States, such as the effect of aging on future budgetary positions or labour market reforms. By putting these issues into the CSRs for individual Member States and requiring a report in the SPU/NRAs on how they are being implemented, there is pressure put on the Member States to make progress on them.

The CSRs finally adopted by Council tend to be largely unchanged from those put forward by the Commission. This undoubtedly reflects significant interaction between the Commission and Member States in drawing up the CSRs, which helps to avoid conflict at a later stage. There is also significant discussion of the CSRs at EU Committees such as the Economic and Financial Committee and the Economic Policy Committee and in the European Parliament.

The surveillance process has got much more complex with the addition of the EU 2020 Strategy targets and the Euro Plus Pact commitments. There must be a question mark over whether the number of targets and measures being pursued at the same time is excessive at this stage and whether it would be better to focus on and deliver a smaller set.

In the current recessionary situation in the EU, a key issue is how the BEPGs deal with the overall budgetary and economic position. The current guidelines look for Member States to use what scope they have to foster growth. But this is circumscribed by the requirements of the Treaty on Stability and Coordination to keep moving towards a medium term budgetary position of a structural deficit of no more than 0.5 or 1 per cent, depending on the debt level.

The BEPGs for the euro area as a whole in 2013 recommend that the Eurogroup takes responsibility for the aggregate policy stance in the euro area to increase growth and employment and to ensure a growth friendly and differentiated fiscal policy. However, when it comes to the CSRs for Germany, where the MTO has already been achieved, the BEPGs simply recommend that Germany preserve a sound fiscal position which ensures compliance with the MTO while pursuing a growth-friendly fiscal policy. This effectively means changes to expenditure and tax measures with a neutral effect on the budget position. There is no attempt to look for a temporary deviation from the MTO for Germany and the other better placed countries in order to stimulate overall demand in the EU.

As the name suggests, the Broad Economic Policy Guidelines are not binding on the Member States. They operate through moral suasion rather than financial or other sanctions. There is provision for recommendations to be made by Council where a Member State's economic policies are not consistent with the BEPGs or risk jeopardising the proper functioning of the EMU but, as set out earlier, this provision has only been used once. However the way the BEPG process has developed, including the targets set out in the Euro 2020 Strategy, the commitments under the Euro Plus Pact and the requirement for Member States to report on their implementation of the
BEPGs, makes it difficult for Member States to ignore the guidelines. Governments may publicly emphasise that their economic policies are determined at home rather than in Brussels, but in practice it seems to be a collaborative process at this stage.

The adjustment programmes adopted by Member States as part of the bail-out process contain many specific measures to be implemented. These programmes did not come through the BEPG process, presumably partly because of the urgency involved but also because they had to be more detailed and involve firm commitments in return for the funding going with them, rather than the voluntary nature of the BEPGs.

Countries in adjustment programmes are to remain under post-programme surveillance as long as a minimum of 75% of the financial assistance received has not been repaid. While it is not yet clear what this additional surveillance will involve, it seems geared towards having more frequent monitoring visits to the Member States concerned by the Commission during the year to ensure that the economy is being kept on the right track.

The new Macroeconomic Imbalance Procedure (MIP) adds an additional dimension to the surveillance of economic policies. It widens the range of economic indicators covered in the surveillance process so as to identify potential risks early on, prevent the emergence of harmful imbalances and correct imbalances that are already in place. It may be the basis for identifying more specific recommendations for individual countries and has provision for financial sanctions where a Member State does not take any corrective action recommended by Council. It is not being used for the countries in adjustment programmes.

8. Conclusions

The process of economic surveillance introduced under the Maastricht Treaty has evolved into a complex mechanism at this stage.

The final decisions on economic policies still lie with the Member States. However they are circumscribed where a country is in an excessive deficit position or even more so where a bail-out is needed. The new Macroeconomic Imbalance Procedure will also require countries with excessive economic imbalances to take corrective action, with provision for financial sanctions if they do not.

Apart from these special processes, the Broad Economic Policy Guidelines have developed into a much deeper process with Country-Specific Recommendations and a requirement for Member States to report on how they have implemented the previous guidelines. They have been added to by targets set in particular areas by the Euro 2020 Strategy and commitments made by euro countries under the Euro Plus Pact. The combination of all of these may well result in an excessive number of targets being pursued at the same time but they certainly result in significant scrutiny of the economic policies of the Member States.

The recent economic crises will undoubtedly result in peer pressure being intensified to ensure that proper economic policies are being implemented in all Member States.

An important factor which is missing in the process at present is adequate action on the overall fiscal stance in the EU and in the euro area. While concern for the overall fiscal stance is included
in the guidelines for the euro area, in practice the focus is on all countries continuing to move towards the medium-term objective of a budget deficit of no more than 0.5/1% of GDP. There is no attempt to deviate temporarily from this path in the better placed countries so as to stimulate overall demand in the EU.

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