



**Contributions from the Sherpas
of the Member States to
the Five Presidents' Report**

UNITED KINGDOM

Second Contribution

Preparing for Next Steps on Better Economic Governance in the Euro Area

Questions for Sherpas ahead of the meeting on 27 April 2015

UK Written Response

General remarks

This note sets out the further contribution of the United Kingdom to the “4 Presidents” process on “Preparing for Next Steps on Better Economic Governance in the Euro Area”.

The UK welcomes the inclusive approach taken in preparing the Report, and looks forward to participating in the discussions on it ahead of its publication.

The underlying context to the Report is the EU’s need to ensure it delivers increased growth, employment and prosperity for its citizens.

All member states share a common interest in a successful single currency.

The steps taken in recent years to stabilise the single currency are significant, and it is important they are implemented in full.

But they are not sufficient. Successfully addressing the EU’s economic challenge will require further successful policy reform. Many of these are for member states themselves. At the EU level, that includes completing the internal market, especially in services; expanding external trade, most immediately with the USA, Japan and emerging economies; better regulation, especially for small businesses; and reforming the EU budget.

Ensuring the EU is equipped to meet its economic challenges and make the policy reforms required also requires ensuring the EU’s governance is fit for purpose.

The UK believes, over time, further steps to reform the governance of both the single currency and the single market are required. The proposal for a stage-based roadmap may be a useful way of identifying what such steps could be. Any changes should be made in a way that fully respects the integrity of the EU as a whole.

Therefore, any changes to the economic governance of the EU should recognise that while all member states are part of the single market, not all are part of the single currency. Changes to the governance of the single currency should be done in a way that fully protects the integrity of the single market, and ensures the interests of all member states, whether inside or outside the single currency, are respected. It is in the interests of all Member States to ensure stable and sustainable governance.

1. Many contributions call for a streamlined, simplified and better focused European semester. How could this be achieved concretely?

The European semester is the EU-level tool for coordinating the economic and fiscal policies of EU Member States. We note that recent changes to this year's process are a positive development, for example the new Country-Reports in late February/early March complementing the timetable which begins with the Annual Growth Survey each November and culminates in the annual Country Specific Recommendations (CSRs) in May/June.

But more can be done to improve it further. As set out in our response to the EU2020 mid-term review, the UK Government agrees with those contributions which call for a streamlined, simplified and better focussed European Semester, which is vital to ensure that the Semester is focused on economic policy priorities and secures greater national ownership of the CSRs.¹

Specifically, the UK's view is that a streamlined European Semester should have:

- A smaller number of CSRs, with a much tighter focus on the most important economic policy reforms in a MS that will deliver higher growth and jobs;
- A stronger partnership between the Commission and Member States, with enhanced dialogue, including sharing of analytical documents and draft CSRs prior to publication;
- Consideration of the case for setting targets with a longer review period than the present annual time-line, for example every two years, in order to allow for stronger focus on implementation and structural reforms;
- Consideration of a process for identifying at EU level where further action to complete the single market is required and a stronger process for ensuring this action takes place.

The Commission's approach to the 2015 Semester represents a step forward in streamlining the process, which we hope will lead to greater ownership, and we look forward to further improvements in the coming years.

2. The need to strengthen the momentum for structural reforms, particularly in the Euro Area Member States, is underlined in most contributions. What instruments should be employed to foster implementation of reforms? In particular, how to launch a process of real convergence in the areas that are considered key for the smooth functioning of EMU? Which areas would be concerned?

We agree with those contributions that have underlined the need to strengthen momentum for structural reforms. Increasing the EU's long-term competitiveness to create more growth, jobs and prosperity is essential and the main way to achieve this is through the delivery of ambitious structural reform.

Such reforms are primarily a matter for Member States at national level, reflected in the range of different priorities identified in CSRs. The European Semester is the EU surveillance mechanism designed to support the delivery of structural reform at national level and to ensure, where appropriate, a coordinated approach among the Member States. The reforms set out above (in response to question 1) to streamline, and in particular to focus the semester on economic reform would help to ensure that the Semester is directed at fostering

¹ http://ec.europa.eu/europe2020/public-consultation/contributions/index_en.htm

implementation of structural reforms. Consideration should also be given to the involvement in the Semester process of other external organisations with expertise on structural reform, for example the OECD and Bruegel.

It is important that surveillance under the Semester continues to take place among the EU28. At the same time, there may be a case for stronger enforcement mechanisms for the euro area Member States around structural reforms within the Semester process, as is already the case with the SGP and the Macroeconomic Imbalances Procedure.

At the EU level, the key priority for structural reform is to make progress on completing the single market across all 28 MSs. This will require an ambitious policy reform agenda, focusing on services, and building on the existing proposals on energy, digital and capital markets. The Council should also consider how it can ensure the necessary strategic direction for the EU's economic reform policy, in order to ensure a more coherent approach and sufficient momentum for delivering an ambitious growth and jobs agenda.

3. Regarding a prospective fiscal capacity for the Euro Area, should it be linked to progress on structural reforms, and if so in what form? What other functions should such a fiscal capacity serve (e.g. investment, asymmetric shock absorption)? How could it be phased in?

4. Several contributions refer to the need to take better account of the social dimension of EMU. How could this be done in practice?

The UK's view is that the questions of whether the euro area needs increased fiscal capacity and how to take better account of the social dimension of EMU are primarily a matter for the euro area itself to decide. At the same time we are clear that non-euro area Member States shall not be liable for any euro area fiscal capacity and, in line with the December 2013 European Council Conclusions, participation in the social dimension of EMU will be voluntary for non-euro area Member States.

Regarding the issue of a prospective fiscal capacity, a number of steps have already been introduced to strengthen the fiscal foundations of the euro area, including: a strengthened SGP to provide a stronger framework for policy; a new macroeconomic imbalances procedure for the early identification of emerging risks; the establishment of the Single Resolution Mechanism and Single Resolution Fund to end the adverse bank/sovereign feedback loop; and the establishment of the European Stability Mechanism as a backstop. As many other Member States have set out in their earlier contributions to the 4 Presidents' process, the overriding priority is to fully implement these mechanisms.

Looking beyond this, most other currency unions have closer fiscal integration than is currently the case for the euro area. Options that have been discussed to advance these objectives range from: stronger rules/limits on national fiscal policies; a more closely coordinated euro area fiscal policy to deliver an agreed fiscal stance; a counter-cyclical budget at the euro area level; common issuance of MS debt; and, a transfer union via a large euro area budget. The Commission also set out ideas in March 2013 in its Communication on a Convergence and Competitiveness Instrument to link implementation of structural reforms essential to the smooth functioning of EMU to payments from a euro area solidarity fund, recognising that there may be short-term costs of implementing such reforms. In addition, further moves toward closer fiscal integration would clearly need to be taken in tandem with

policies and mechanisms to address the economic and fiscal risks that would otherwise be created.

Regarding the social dimension of EMU, some have also put forward proposals for including social indicators in the European Semester through a new social scoreboard, building on the inclusion of auxiliary social indicators in the macroeconomic imbalances procedure in 2014. The UK does not support these proposals, which it considers would dilute the required focus of the Semester on key economic reforms. We also recall the December 2013 European Council Conclusions which are clear that “further measures to enhance the social dimension in the Euro area are voluntary for those outside the single currency and will be fully compatible with the Single Market in all aspects.”

In addition, some euro area Member States and commentators have raised the idea of a common social security mechanism, which could act as an automatic stabilizer, and which would be intrinsically linked to the idea of a fiscal capacity designed to smooth asymmetric economic shocks in the currency area. Again, this would be a matter for the euro area to decide. Perhaps more importantly, in a single currency area where national flexibility over exchange rates and interest rates has been given up, the economics points to a greater need to ensure wage and labour market flexibility as a means of adjustment to economic shocks.

5. Many contributions focus on the shorter term, but many also mention the need for a medium and long-term dimension. What should be the essential building blocks for the longer term? Pending further Treaty changes, could further steps of economic integration be envisaged on an intergovernmental basis?

As many Member States responded in their first contributions, the immediate priority should be to focus on implementing recent reforms, including crisis mechanisms, and to allow time for reflection on the operation of the strengthened Stability and Growth Pact and the Macroeconomic Imbalances Procedure.

At the same time, as set out above, further steps toward better governance for the single currency and the single market should strongly be considered. The proposed road-map is a potentially useful tool for setting out the necessary steps and their timing.

The steps needed for the single currency are primarily a matter for euro area Member States. However, as others have set out in their previous responses, an important part of any approach should be that reforms to the single currency’s governance should be done in a way which does not jeopardise the integrity of the single market at EU28 or in any way disadvantage those countries who are outside the single currency but inside the single market.

It is in the interests of all Member States to ensure stable and sustainable EU governance that enables the euro area to take the steps it needs to strengthen the currency in a way that ensures the integrity of the single market and respects the rights of all Member States. The strength of the single currency and single market depend on the strength of each other and it is vital that the EU’s governance structure reflects that.

6. Many contributions also make reference to the Capital Markets Union and banking union. What elements would be necessary to complete the banking union?

The creation of a Banking Union for supervision and resolution of the euro area's major banks was a core component of reform to stabilise and strengthen the single currency. It is important the necessary steps are taken to implement the banking union as soon as possible, with a review of the effectiveness of its mechanisms in due course.

At the same time, the UK supports the idea of improving the single market in Capital. In improving risk diversification and resilience to banking shocks, a Capital Markets Union (CMU) would be highly complementary to the Banking Union, even if the motivation and methods for delivering it are distinct. The primary objective of CMU is to strengthen the single market to increase growth and competitiveness across the EU, which is a matter for all Member States. With the right programme of reforms, CMU can be a key driver of growth in the EU. Flows of capital between Member States will increase, making it easier for businesses of all sizes to access capital both in their home market and elsewhere. Businesses will be better informed about their financing options and the financial sector better able to meet their funding needs.

7. The call for stronger political legitimacy and accountability is omnipresent in Sherpas' contributions. How to achieve this concretely?

Sustained improvement in its economic performance, along with effective economic governance, will be the foundation for public support and legitimacy of the EU. As a number of other responses have suggested, we also need a bigger and more significant role for national parliaments if we are to increase political legitimacy and accountability, as it is national parliaments that remain responsible for economic policy.