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

SLOVENIA

PREPARING FOR NEXT STEPS ON BETTER ECONOMIC GOVERNANCE OF THE EURO AREA

27 March 2015

– FIRST SLOVENIAN CONTRIBUTION –

Based on the exchange of views at the February 2015 European Council and the Sherpa meeting on 11 March 2015, the following text contains response of Slovenia to the questions in the Analytical Note on Preparing for Next Steps on Better Economic Governance in the Euro Area.

How can we ensure sound fiscal and economic positions in all euro area Member States?

The crisis has shown that it was the private sector and banking system credit that underpinned the boom and bust cycle. Government debt has soared in the aftermath of the crisis and primarily due to weak balance sheets of banks. This has narrowed fiscal space and thus limits economic convergence going forward as well as room for countercyclical policy in the future.

Moreover, some euro area Member States had as a starting position before the crisis limited capacity to absorb shocks due to relatively high government debts, high shares of public expenditures and high taxation. Accordingly, sound fiscal and economic positions should be ensured first and foremost through a proper application of the existing EU economic governance rules. Member States should focus on the implementation of structural reforms underpinned by limited number of most important CSRs in order to secure good environment for dynamic economic growth. Adherence to the SGP rules should contribute to sound fiscal positions. In similar manner, macroeconomic imbalances procedure should at an early stage help to identify those developments that could potentially lead to serious economic difficulties and demand appropriate policy response.

Much needed convergence also requires sustained growth in post crisis. Investment at EU level should be identified to attract needed private financing and underpin reform efforts, especially in countries with limited fiscal capacity. Focus should also be put on improving mobility of labour within EU as an important shock absorber and all efforts should be undertaken to complete the single market.

While the EU governance framework and banking union are important elements to underpin sound fiscal positions, we cannot discuss the future of EMU without touching upon the issue of fiscal union and the provision of fiscal buffer to mitigate shocks to Member States. This question has to be properly addressed in the Four Presidents Report.

How could a better implementation and enforcement of the economic and fiscal governance framework be ensured?

The implementation of existing framework could be improved through measures directed towards enhancing national ownership. Closer EU support to structural policies with benchmarking and "structural reforms hub" advising Member States according to best practices could also be beneficial. The process of evaluation of Member States' plans could be broadened from the existing Commission – Member State dialogue (with better involvement of national parliaments) to strengthened Member States’ peer review, which should not be limited to the ECOFIN ministers only.

More attention should also be given to the economic impact of other relevant EU and national policies (not just economic and financial), assessing of their influence on the stability of economy and ensuring that this is a relevant element in EU decision making processes. EU dimension could also be addressed in each Member State's member’s policy document and its contribution to economic performance and fiscal stability should be assessed.

In addition, simplification towards focusing on debt and conditions for sustainability as a key variable of fiscal surveillance would increase the credibility and accountability of fiscal policy making.

Is the current governance framework – if fully implemented – sufficient to make the euro area shock-resilient and prosperous in the long run?

Current governance framework, if fully implemented, provides a sound basis to ensure stability of the Euro and prevent future shocks. For that, it is important that the credibility of the system is preserved. This means not only adherence of the governments to the rules, but also equal treatment and equal application of the rules to all Member States.

The existing framework offers the necessary tools to ensure monitoring and surveillance of fiscal positions of the Member States and to detect harmful imbalances at an early stage. Major changes are therefore not required. Any proposals to fine tune the existing framework should, however, take account of the administrative burden for the Member States' administrations. In the medium term, simplification of fiscal rules should be examined to make them more user-friendly.

Strengthening the implementation of the governance framework is one aspect of enhancing the credibility and resiliency of the EMU. In the long run, however, further progress on fiscal union should be considered in particular risk sharing mechanisms.

To what extent can the framework of EMU mainly rely on strong rules and to what extent are strong common institutions also required?

Stronger common institutions could improve the functioning of exiting economic governance system and reduce the "implementation deficit" that exists despite strong common rules. Creating such institutions inevitably implies shifting of the competences from the Member States to the EU level, which could prove, at least in the short run, difficult to achieve.

The focus should also be placed in ownership and in raising awareness of the current governance framework.

What instruments are needed in situations in which national policies continue – despite surveillance under the governance framework – to go harmfully astray?

There are several strong instruments at the disposal in the existing framework, either in the corrective arms of EDP and MIP or in the provisions related to the macroeconomic conditionality in the use of European structural and investment funds (ESIF) that could be extended to use of other EU instruments.

These surveillance instruments could in principle be applied in cases of harmful divergence of the national policies. Nevertheless, some of the mentioned instruments (e.g. sanctions under the EDP or EIP) can have pro-cyclical effect, if enforced at late stage. Therefore, procedures should be more stringent in the early preventive part.

More consideration should also be given to the instruments that rely on political surveillance and peer pressure to prevent the national policies to go harmfully astray. More thought should be given for instance to strengthening the policy debate and surveillance at the ECOFIN, strengthened COMPET, EPSCO and/or European Council.

In the case of persistent violations of the rules it could be useful to consider additional dialogue tools on political level.

Has the fiscal-financial nexus been sufficiently dealt with in order to prevent the repetition of negative feedback loops between banks and sovereign debt?

The establishment of the banking union provides through strengthened and more centralized supervision of the financial system, through bail-in provisions, but also through EU wide stress tests, a more resilient system that should contribute to breaking the vicious loop between banks and sovereign debt. It is crucial that the rules are enforced vigorously and that the same rules are applied on equal footing to all participants.

Special attention should be given to reinforce insurance sector resilience and investments to SME's. Risk steaming from shadow finance/banking, hedge funds, and speculative capital movements should be contained. Besides the measures to ensure the stability of the banking sector and prevent the bank-sovereign vicious circle, more effort should be invested in ensuring the competitiveness of companies and availability of equity financing – this could help break the negative loop between sovereign, banks and corporate sector.

How could private risk-sharing through financial markets in the euro area be enhanced to ensure a better absorption of asymmetric shocks?

Recently adopted tools for addressing potential risk in banks seem appropriate, in particular since the Euro area relied heavily on banking financing in the past. A key remaining risk is the potential bail-in of large depositors in times of crisis.

The three pillar approach of the Investment plan for Europe is also a good way forward. Remaining obstacles to well-functioning of financial markets ensuring an appropriate absorption of asymmetric shocks should be addressed within the capital markets union project.

To what extent is the present sharing of sovereignty adequate to meet the economic, financial and fiscal framework requirements of the common currency?

The present sharing of sovereignty is sufficient for fine-tuning of existing system. Some minor changes to reinforce the implementation of this framework could be introduced without a Treaty change. There is definitely no need for the latter now.

However, in a long-term perspective, more ambition is needed. We should strive for a genuine and fully functioning EMU, along the lines of the 2012 Commission's Blueprint. This means going beyond the existing division of competences. A fiscal capacity of EMU to absorb shocks would for example open the questions regarding new own resources and sovereign debt risk sharing on the EU level. Similarly, a strengthened coordination of economic policies and stronger surveillance over national budgets could raise questions regarding the competences in the areas of employment, social policy, taxation, education or health system. A more ambitious approach for ensuring that national policymaking and domestic institutions sufficiently contribute to stability of the EMU would therefore require further transfer of competences and Treaty changes. This is why we should tackle the issue comprehensively with agreed vision ahead.

The crisis has shown that an integrated economic area requires strong governance framework and banking union. Nevertheless, in the long run more consideration should be given to necessary steps towards fiscal union.

Is a further risk-sharing in the fiscal realm desirable? What would be the preconditions?

Currently a room for independent policy action of Member States is very limited, since Member States are faced with a lack of independent monetary policy, constrained fiscal policy and banking union.

Further risk sharing would only be possible if the existing budget and economic policy monitoring and surveillance framework is vigorously enforced an implemented. Furthermore, it should be additionally strengthened to encourage sound fiscal positions and prevent moral hazard and the danger of lax implementation of reforms, which could arise as a consequence of existence of common risk sharing instruments. If the abovementioned conditions are met, options on potential risk sharing could be examined.

Under which conditions and in which form could a stronger common governance over structural reforms be envisaged? How could it foster real convergence?

The present system of economic governance contains measures (including sanctions) to discourage Member States from building of macroeconomic imbalances or unsound public finance. To encourage governments towards structural reform more thought could be given to creating various incentives. Further incentives (such as the more favourable treatment under the SGP procedure, which is already in use) could be explored in order to strengthen the resolve of government for implementation of the agreed reforms. However, when introducing more flexibility, equal treatment of all Member States has to be respected.

How can accountability and legitimacy be best achieved in a multilevel setup such as EMU?

Accountability and legitimacy should first and foremost be achieved through securing proper institutional balance and democratic control in more efficient decision making process in the EMU. A deeply integrated EMU would also imply a greater oversight and control over the decisions from the national parliaments. Because greater integration of EMU would per definition imply transfer of certain competences from Member States to the EU level, a role of national parliaments in EU processes would have to be strengthened.

Accountability and legitimacy could also be enhanced by better informing policy makers and public in general of the limited room of manoeuvre in terms of policies countries in the monetary union have and the advantages derived from such a set up.