



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

POLAND

First Contribution

The Polish answers to the questions of the Analytical Note (Preparing for Next Steps on Better Economic Governance in the Euro Area)

Jointly prepared by the Ministry of Finance and the Ministry of Foreign Affairs of the Republic of Poland

Introduction

There is a broad awareness of the need to further reform the Economic and Monetary Union. In Poland's opinion in order to refine the architecture of the EMU we should mainly focus on identifying realistic goals. Therefore the Four Presidents' report should present a roadmap of actions in the short and medium term within the framework of the existing Treaties. It should also serve to identify the necessary reforms to be introduced in the next EU political cycle. Therefore Polish answers to the questions set out in the analytical note are based on such a perspective.

Poland also sees the need for a deeper reform of the EMU in the long run (after 2019). As a country legally bound to join the Eurozone we will actively participate in such a process.

All the possible solutions related to the economic governance and to the prospective changes in the institutional framework of the Eurozone should be in accordance with: 1) the principle of the openness towards the non-Eurozone Member States and 2) the principles of the single market. Moreover they should not distort the competitiveness of the Member States and the EU as a whole.

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

Eurozone is currently facing two major challenges: 1) reviving the economic growth and 2) the implementation of the reforms aimed at strengthening the capacity of national economies. In Poland's opinion the current, still unsatisfactory economic performance of the euro area is a consequence of the lack of reforms, permanent macroeconomic imbalances and lack of effective correction mechanisms, ineffective coordination of economic policies, unsatisfactory level of enforcement rules, insufficient involvement of the Member States in the implementation of the objectives set out at the EU level and finally lack of ownership.

In order to prevent the fiscal consolidation from adversely affecting the economic growth, while at the same time preserving the credibility of the fiscal rules, it is required to enforce existing fiscal rules with the maximum use of the available flexibility. These rules should be taken into account in formulating recommendations that will ensure growth friendly consolidation among the Member States.

Therefore in the short term Poland considers that the enforcement of the existing rules is essential, while making full use of their flexibility. In our opinion **all Member States should be treated equally in this regard.** This approach would prevent depreciation of the established rules and would also increase the involvement of Member States in the implementation of rules/recommendations. It would also increase a sense of their ownership.

In the long term a possible option to boost still unsatisfactory level of investments in Europe is an introduction of a new **pan-European investment programme.** The European Fund for Strategic Investments, which is currently being established, should constitute a base for development of such

a programme in the long run. The new investment programme should be of a larger scale of operation, as compared to the EFSI, through the increased capital base by Member States' contributions. These contributions should become available within a fiscal space created in result of current fiscal consolidation efforts in the EU and should be excluded from the calculation of the general government deficit in the preventive and corrective part of the SGP. The programme should also offer an extended range of investment opportunities (equity investments). This programme, primarily addressed to the countries with the largest output gap, would require that its beneficiaries commit themselves to implementing structural reforms (conditionality). It should remain complementary to the European Structural and Investment Funds which should remain a major source of investment financing by the EU.

Furthermore, the effective coordination of the economic policies is a condition for the smooth functioning not only of the Eurozone, but also of the EU as a whole. In Poland's view supporting the coordination of major structural reforms among the MS should trigger their positive economic effects and should allow for more even cost distribution of the reforms among the Member States. The former attempts to use new instruments for economic policy coordination have not proved to bring the expected results. In order to break the current deadlock we should introduce improvements to the European Semester (see more: point 2).

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

In the short term in order to strengthen the EU economic governance Poland proposes to improve the functioning of the European Semester and supplement it with a capacity to enter into the voluntary contracts on the structural reforms between the Member States and the European Commission.

In this regard Poland proposes to concentrate and prioritize the country-specific recommendations (CSRs) and introduce additional mechanisms that would encourage the MS to implement reforms, ie.:

- **Limit the number of CSRs** – while formulating CSR the European Commission should reduce their number and identify 2-3 priority reform areas for each Member State in a given year, taking into account its current economic situation. The criteria for prioritization of the problem areas should be identified on the basis of the Country Reports (including an In-Depth Review on the prevention and correction of macroeconomic imbalances where appropriate). The Commission, in cooperation with the Member States, should identify recommendation to be implemented firstly and as a priority (to ensure appropriate sequential reform process). Only the measures taken jointly would strengthen the ownership of the process and the consistency of the CSRs. In each case the Commission should present economic estimates showing the potential costs and benefits of recommended reforms for the Member States and the EU.

Creating a fair dialogue between the Commission and the Member State should improve the level of CSRs implementation. This dialogue should start during the preparatory phase of the Annual Growth Survey and continue until the recommendations for specific countries are

officially approved. This would enhance the implementation of CSRs in political, legal and economic terms.

- **Contracts for priority CSRs** – Member States should have the opportunity to sign, on the voluntary basis legally binding contracts with the European Commission. Such a contract would include the obligation to implement structural reforms in the areas identified in the Country Reports and set out in CSRs. **On the incentive side, the contract should provide a possibility to fully deduct direct and indirect costs (jointly estimated and agreed between the Commission and the Member State) of the contracted reforms when calculating the deficit under the rules of the Stability and Growth Pact. This should exceed the requirements defined in the so-called structural reform clause.**

Moreover, in the short term further steps are needed to improve the transparency of actions taken in the framework of the current rules and principles of the EU economic governance. This is particularly important in cases when these rules/principles and objective evidence allow for a certain degree of discretionary decisions, e.g. under the EDP and MIP. It is therefore expedient for the EC to prepare draft recommendations and decisions in variant options with scenarios.

In the medium term, Poland suggests starting discussion on the evaluation of the existing rules of the economic governance in order to streamline the framework of the process and make the rules more realistic.

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

The existing economic governance framework constitutes a very extensive system of monitoring, coordination, corrections and sanctions. Therefore, it is crucial to ensure its proper implementation and handling. It is not a zero-one system since it allows to use its flexibility in different ways in a given situation.

However, taking into the account the current economic situation (a threat of secular stagnation: low economic growth, unemployment, deflationary pressure, very low interest rates) and the current fiscal and economic imbalances, it is necessary to take full advantage of the flexibility of the rules.

In the short term Poland suggests the enforcement of the existing rules (especially the EDP) while making full use of their flexibility.

In the medium term Poland proposes to launch a broad debate on the existing rules of the economic governance for the purpose of their realignment, simplification and coherence.

Moreover in the medium term Poland suggests initiating a debate on the need to establish a crisis management mechanism in the Eurozone - resembling the Single Resolution Mechanism. This mechanism could set up an efficient decision-making process for adjustment measures to be implemented by the troubled Member State. This would prevent uncontrolled tensions in financial markets and limit the spill-over effects.

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

The current rules of economic governance of EMU seem to be sufficient, however their flexibility is not properly used. Formulating unrealistic recommendations inadequate for economic situation implies that the rules are not respected and enforced in an effective manner.

In Poland's view, the establishment of new institutions is not required at the current stage of the EMU integration. What is needed is to make the agreed economic governance rules being duly enforced by the existing EU institutions (e.g. 6-pack). This approach means equal treatment of different Member States when their position is similar. It is also necessary to increase the Member States involvement in the implementation of the objectives set out at the EU level as well as to enhance a sense of their ownership (see point no 2 above).

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

Poland calls for uniform enforcement of fiscal rules towards all Member States, using the existing flexibility. We also call for a strengthening of the dialogue between the Commission and the Member States at all stages, in particular prior to making new recommendations/rules or interpreting the established ones.

Furthermore, in order to encourage the Member States to pursue sound economic policy it is also crucial to discipline the Member States by using the existing financial market mechanisms or via conditionality assigned to the EU financial support (eg. under the EU investment programme or the European Stability Mechanism).

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

In Poland's view the creation of the banking union has significantly limited the fiscal-financial nexus. However, the problem has not been yet completely solved.

Current challenges include incompleteness of the banking union, the lack of operational procedures within Single Supervisory Mechanism (particularly in terms of cooperation with national supervisory authorities). Furthermore a compromised eight-year transitional period for a mutualisation of the national compartments within the Single Resolution Fund (SRF) does not constitute an optimal solution in terms of stability requirements of the financial system, under which the establishment of the Single Resolution Board (SRB) should be accompanied by the fully operational SRF.

In the short term Poland proposes to improve cooperation between the ECB and National Supervisory Authorities as well as taking additional measures in order to accelerate the process of making banking union fully operational.

In the medium term it is desired to accelerate the process of making the banking union fully operational by shortening the transitional period of establishing the SRF and introduction of adequate measures to strengthen fiscal backstop.

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

The fragmentation of the financial markets in the euro area is a fact. This problem should be addressed by the establishment of Capital Markets Union to be completed by 2019.

In the long run a better absorption of asymmetric shocks could be addressed by introducing a new pan-European investment programme (already mentioned in the point no 1 above). Its aim is to enhance the private sector involvement in the investment projects located in the Member States experiencing the largest output gaps and the lack of investors' confidence.

Furthermore, ensuring the access to diversified sources of capital and its free movement between Member States should contribute to better absorption of asymmetric shocks. This efficient allocation of risk and capital should increase financial stability, which would result in smoothing of asymmetric shocks, particularly in the euro area countries.

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

In principle, Poland accepts the present sharing of sovereignty and considers it appropriate to meet the requirements of economic, financial and fiscal framework of the Eurozone. However we see an opportunity for strengthening certain elements of economic policy coordination by improving and simplifying the European Semester (ES). This proposal also comprises an incorporation, in the ES procedure, the concept of the voluntary contracts on structural reforms to be concluded between the Member States and the Commission (as mentioned in the point no 2 above).

In addition, in order to increase the involvement of the Member States in the implementation of the objectives set at the EU level as well as to enhance a sense of their ownership, Poland suggests improving a dialogue between the Commission and the Member States (see point no 2 above).

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

In Poland's view it is not necessary to further Europeanise fiscal policy ahead of 2019. In the long run such an action would be desirable provided that the Eurozone preserves the predominant role of the market mechanisms in disciplining the MSs to pursue prudent fiscal policies, the credibility of the *no bailout clause* is restored, the credibility of the rules at the level of particular Member States is maintained, the level of political integration is increased and some competences in the area of economic and fiscal policy are transferred to the European level. In the long term, the fiscal integration would also increase the effectiveness of adjustment mechanisms to asymmetric shocks in the Eurozone. However it would require an appropriate deepening of political integration.

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

The streamlining of the European Semester should serve to promote the convergence of the Eurozone economies and countries legally bound to adopt the single currency. In parallel any problematic issues should be identified on the basis of Country Reports (including an In-Depth Review on the prevention and correction of macroeconomic imbalances where appropriate). It

would be possible to identify, in this way, the areas where the value added is the greatest either for the Eurozone or for the EU as a whole.

Therefore the Member States should be able to enter into the voluntary contracts with the Commission on structural reforms in the areas identified in the Country Reports and set out in CSRs.

The Member States should initiate and choose reforms while the Commission should play a supportive role. Thereby the democratic legitimacy and public support for the implementation of the reforms will be increased.

Contracts should be legally binding with a duration up to several years dependent on the complexity of the reforms and agreed timetable. To ensure the effective implementation of the contract, the emphasis should be placed on the enforceability of the implemented reforms and safeguards against moral hazard.

In return for taking on the legally binding voluntary commitments the Member States should be allowed to fully deduct costs of the contracted reforms (estimated in cooperation with the Commission) when calculating the deficit according to the rules of the Stability and Growth Pact. This should exceed the requirements defined in the so-called *structural reform clause* and would translate into more flexible use of fiscal discipline rules with regard to Member States, which fulfill their commitments stipulated in the contract over the duration of thereof.

Another mechanism to be introduced in the long run could be a new pan European investment programme based on commitments to pursue structural reforms (see point no 1 above).

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

The process of increasing accountability and democratic legitimacy should correspond with the level at which decisions on the Members of the EMU are taken and executed.

Poland proposes to improve the communication between the Commission and Member States, social and economic partners, the European Parliament and national parliaments. In Poland's opinion an increased participation of the Member States in the formulation of recommendations as well as principles and rules applying to the Member States would enhance their chance of being implemented.

The dialogue between the Commission and the Member States (as well as social and economic partners and parliaments) should take place on every stage, in particular prior to formulating or interpreting the economic governance rules. As far as CSRs are concerned such a dialogue should start during the preparatory phase of the Annual Growth Survey and should continue until the recommendations for particular countries are officially approved. This would enhance the effectiveness of the implementation of reforms that remain sensitive in public perception and whose implementation could be put into question if they are inappropriately communicated.

The better use of the multilateral surveillance procedure could also translate into an increased accountability of Member States for the coordination of economic policies. Whereas a multilateral discussion on preventing an excessive deficit already takes place, the use of the multilateral surveillance procedure on coordination of economic policies still remains rather theoretical concept.