



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

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**CZECH REPUBLIC**

First Contribution

# Preparation of the Four Presidents Report

## Answers of the Czech Republic on questions formulated in the Analytical Note from 12<sup>th</sup> February 2015

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Generally, the envisaged Four Presidents Report should primarily focus on short-term measures aiming at simplification and improving effectiveness of the European Semester. We do not propose any new instruments or significant modifications of the current economic governance system. Stability of the existing rules should be maintained and we should work on their better enforcement as well as prevention of accumulation of imbalances within the EMU. The report should equally stress the importance of the integrated approach formulated by the Commission - implementation of structural reforms, increase of investments, fiscal consolidation - and necessity to conduct all debates related to EMU in the format of all EU Member States. Transparency of the process vis-à-vis the non-euro area MS is crucial. The integrity of the Single Market must be preserved. The report should also not avoid tackling the associated social questions. Social dimension of the EMU must remain an integral part of our debates and must be taken into account in case of any adjustments of the current economic governance system. All the proposed steps should not go beyond the term of the current Commission and they should not imply a modification of the EU primary law.

In the following part we present the answers on question from the Analytical Note presented at the Informal European Council on 12 February 2015.

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

The rules established by the Stability and Growth Pact (SGP) after its reform in 2011, the Directive on requirements for budgetary frameworks of the MS, the so-called Two-pack, and the TSCG, are, in our opinion, adequate instruments for strengthening fiscal discipline. It is essential to follow the principle of equal treatment of all MS during their implementation. Now the attention should be focused on the compliance with the rules, in terms of increasing transparency as well as fiscal consolidation. Therefore, we consider operating on the edge of the rules by putting in place investment or structural reform clauses undesirable if they are to justify a deviation from the existing rules. For strengthening the fiscal framework it is important to appeal to the European Commission to consistently exercise its role in assessing future benefits of the capital expenditures and structural reforms, and also to be strict about MS' return to the Medium Term Objective (MTO). To ensure the economic stability a new framework for macroeconomic surveillance was adopted in 2011. To make this framework fully functional, it is important to focus more on its proper use including the possibility of sanctions rather than on its further expansion.

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

Primarily, the economic and fiscal governance of the EMU must be prevention-based. In this spirit, the Macroeconomic Imbalance Procedure (MIP) and the Excessive Deficit Procedure (EDP) are steps in the right direction.

However, it would be particularly desirable if:

- the SGP was even more focused on the preventive arm - MTO;
- the "Code of Conduct" for the implementation of the MIP would be created to clarify the whole process;
- the set of indicators for the MIP would not be watered down by other indicators that are unable to alert in time to macroeconomic imbalance (e.g. additional social indicators in the role of the main indicators of the MIP).

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

In general, we recommend to leave the current framework of economic governance as it is, and to learn using it properly in its existing form. However, the MS and the European institutions should put emphasis on prevention and on respecting of the existing rules.

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

It is neither possible to separate the rules from the institutional arrangements nor it can be clearly said which establishment is more preferable because both aspects are closely related and complementary. If there is no further integration towards a federative structure of the EU, the rules should play a greater role. The CZ does not support creating any additional institutions which would further separate the euro area from the rest of the EU.

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

There already is a plenty of instruments set within reasonable limits, for instance programmes conditional on implementation of structural reforms. Therefore, other instruments are not, in our opinion, necessary at this moment. For these situations, sanction procedures have been set and they should be applied, which would also work preventively.

### **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?**

A number of measures have been taken in order to eliminate the negative feedback loops between the banking sector and the sovereigns, which was relevant mainly for the euro area. Nevertheless, because of its nature they can never be eliminated completely. Despite the large number of measures and mechanisms introduced in recent years, we are afraid that the improved economic governance may not make the euro area fully resilient to the shocks and to achieve a long-term prosperity. Stability and last resort mechanisms cover only a small share of MS' GDP. Therefore, a participation of the private sector is essential. In terms of financial markets, proper functioning of prudential regulation and, specifically in the context of its members, also the Banking Union could weaken the negative feedback loop. In this context a future need for further discussion on the modification of its mechanisms or addition of some further ones cannot be ruled out. These issues cannot be fully clarified before the Banking Union is fully functioning and the robustness of the entire system has been tested over a sufficient period of time.

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

First, it is not clear what exactly is meant by the "private risk-sharing". In the subsequent discussion a wide range of policy options should be considered. Generally, e.g. the appropriate macro-prudential measures may help to reduce the accumulation of imbalances among the euro area MS. Not necessarily should all financial fragmentation be viewed as fully undesirable. The ability of investors to adequately distinguish among the riskiness of assets may serve as an important information signal for the functioning of the economy and financial markets. In general, purpose-built adjustments of prudential regulation of financial markets aimed at artificially enhancing private risk-sharing through financial markets and public finance should be avoided; as such adjustments could undermine financial stability of the system, which could subsequently have a negative impact on the individual MS.

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

Objectively, the setting of the euro area is not ideal. Many weaknesses were revealed during the recent financial and economic crisis. However, a lot of changes aiming to improve the situation have been made subsequently. Economic and fiscal surveillance was enhanced by adopting 2 and 6 pack and TSCG. A proper functioning of the Banking Union and, in general, of the prudential regulation may also play a key role in increasing the alignment among MS sharing the common currency in the area of financial markets. Obviously, only time can reveal, to what extent it is possible to eliminate the risks without fundamental institutional changes that are currently not on the agenda.

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

To ensure that sharing of fiscal risks does not lead to a substantial moral hazard of countries because of their fiscally or in other way irresponsible behavior, it should be enabled only if there is a better enforcement of responsible behavior of national authorities. However, before any far-reaching steps are considered in this area, thorough discussion and analysis are needed.

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

Generally, individual MS should bear the responsibility for their own economic policies. In this regard, MS' ownership of structural reforms is absolutely crucial. Common governance framework should be limited to the areas where a smooth working of the EMU is at stake. Apart from the existing framework, strengthening of monitoring, focusing on key economic reforms and further discussions with the MS and all stakeholders could take place. However, proper and full use of existing rules should remain our priority, and only then it will be possible to evaluate the effectiveness of the current framework.

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

To maintain the democratic legitimacy and responsibility it is necessary to conduct negotiations transparently with the involvement of all EU MS. We do not support the creation of parallel institutions only for the euro area countries. An increase of the democratic legitimacy in the form of better involvement of parliaments should be based on and should match the division of competences

between the MS and the EU in the specific areas and in the process of making decisions on individual measures. The CZ supports deeper involvement of national parliaments in the European Semester.