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

CYPRUS

Cyprus' answers to the questions included at the end of the Analytical Note: Preparing for Next Steps on Better Economic Governance in the Euro Area

1. **How can we ensure sound fiscal and economic positions in all euro area Member States?**
2. **How could a better implementation and enforcement of the economic and fiscal governance framework be ensured?**
3. **Is the current governance framework – if fully implemented – sufficient to make the euro area shock-resilient and prosperous in the long run?**

These three questions are related. Therefore, some general remarks: In broad terms, we consider the economic policy framework which is now in place, with stricter rules and stronger institutions, sufficient.

It should be said that accession to the Euro area should be evaluated on a more strict analysis and safeguard that accession is allowed in cases where real convergence is achieved. This is essential as member states lose their monetary policy tool and the policy room to manoeuver is limited.

The enhancements in the governance framework adopted the last few years (since 2010) and their proper application will result in considerable improvements in management and co-ordination of economic policies in the Euro area. It is important to give these changes time to unfold and function in order to see the benefits.

At the same time, it is very important to ensure that the new rules are properly implemented and that the member states adhere to the rules, therefore more emphasis should be placed on this front.

It is also important that the rules are applied fairly and transparently. There is a need to establish confidence that the application of policy is consistent and that the rules cannot be modified or even differentiated each and every time. The issue of ensuring greater transparency on the application of the rules i.e., by limiting the degree of discretion on the decisions taken by the Commission is also very important, with a view to ensuring the credibility of the whole system and to increasing national ownership.

Moreover, simplification of the framework seems to be warranted in order to make it more transparent and easily enforceable, given the technical difficulties in calculating specific (fiscal) rules and measures (i.e,. output gap, structural adjustment effort, expenditure rule). The difficulties and subjectivity in assumptions that are needed for example to calculate potential GDP and the implied output gap, might encourage non-enforcement of the Fiscal Compact provisions regarding cyclically adjusted budget deficits.

Although we consider the current governance framework (ESM, Banking Union, new fiscal rules) – if fully implemented – sufficient to make the euro area shock-resilient and prosperous in the medium-term, we are ready to engage in a broader discussion as regards the future of the Euroarea as there are still issues which were related to the problems of the crisis that still remain to be addressed. Such issues/questions are for example how to achieve closer economic policy coordination in order to better address the next economic crisis, how to address the lack of political ownership and on how to better align the incentives and interests of various member states. Ideas for achieving better economic policy coordination could include for example the examination of the prospect of creating a Fiscal Union that would enable down the road fiscal transfers across Eurozone economies to counter idiosyncratic negative shocks to particular economies over the cycle in a similar way like the EU Budget essentially provides for fiscal transfers for the EU 28 member states.

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

   Both are important and need to coexist. Strong institutions are needed in order to ensure that the strong rules are implemented properly in member states, thus reinforcing the credibility of the governance framework.

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

   The instruments are already embedded in the framework (effective action, commission communications, sanctions etc). Furthermore, the framework also includes flexibility instruments (investment rule, structural reforms rule) that complement the whole process. Again, consistency of policy application and simplification of the rules included in the framework are of utmost importance.

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?**

   Indeed, the recent steps towards the establishment of the banking union are important contributions to reducing the detrimental sovereign-bank nexus and to protecting depositors, alongside harmonized national deposit-guarantee schemes.

   Nevertheless, a common Eurozone Guarantee Fund for deposits below €100.000 is missing. Although this outcome is politically understandable given objections from particular countries, this renders national banking systems in fiscally burdened Euro area countries potentially unstable and subject to panic attacks. This is the single most important missing link in current Banking Union design. This common Guarantee Fund is not only currently missing, but it's also not a part of the timeframe for further Banking Unification down the road anymore.

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

   It is too early to judge whether the bail-in tool is the answer to the moral hazard problems that arise when banks are deemed 'too big to fail' and taxpayers are forced to save them.

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

   Present sharing of sovereignty is adequate to meet the economic, financial and fiscal framework requirements of the common currency. Nevertheless, any ideas for assigning more powers from national to EU level, should always take into account national ownership parameters, political fragmentation and member states positions on the division of competences, especially in policy areas such as taxation, among others.

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

   Further risk sharing is not warranted at this stage. But we stand ready to discuss any proposals that could potentially contribute to the further deepening of the EMU. In this regard, a further risk-sharing in the fiscal realm between member states if examined, should of course be viewed in the context of an appropriate conditionality to address moral hazard problems.

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

    Stronger governance over structural reforms should be pursued under the existing framework, the European semester process. The aim should be to increase the degree of commitment for implementing structural reforms at national level. It would be equally important if large scale economic reforms could be accompanied by more solidarity/appropriate incentives, under certain conditions, at central (European) level. This would also help increase the degree of ownership of the economic policies at national level.

    Real convergence should be the overarching medium to long term goal and it could be fostered if the structural reforms are focusing mainly in areas which are mostly related with the functioning of the single market such as labour reforms, pension reforms, product market reforms, services reforms (i.e., opening up of services and professions). Taking into account all the above, we agree that a renewed political consensus at the highest political level is necessary to proceed with those structural reforms.

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

The general objective should be to ensure democratic legitimacy and accountability at the level at which decisions are taken and implemented. At national level, Member States should ensure the appropriate involvement of their parliaments and of relevant stakeholders in the whole process of economic policy coordination. Further integration of policy making and greater pooling of competences must be accompanied by a commensurate involvement of the European Parliament. New mechanisms increasing the level of cooperation between national parliaments and the European Parliament can contribute to this process. In this context, there is of course a need to address the issue of EU28 vs Euro area member states.