



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

MALTA

Second Contribution

Malta's Replies following the 2nd Sherpa Dinner of 27 April 2015 on Preparing for Next Steps on Better Economic Governance in the Euro Area

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

Malta believes that clarity and predictability are essential factors in order to make the European Semester a successful story. As such, the process needs to be further developed in a way that the building blocks of the process are clearly defined for the benefit of a more **streamlined** European Semester.

As a matter of fact, Malta views the Annual Growth Survey to be an essential element of the European Semester since, reflecting upon the 2015 AGS, it 'sets out what can be done at EU level to help Member States return to higher growth levels.'¹ However, Malta is of the opinion that the Annual Growth Survey should better reflect the diverging economic realities of euro area Member States and set priorities accordingly. This would be possible through a more thorough discussion at a technical level. Another practical example is the need for further guidance on the macroeconomic imbalance procedure. This would complement the already available guidance on the Stability and Growth Pact (i.e. the Vade Mecum on the Stability and Growth Pact). Clarity and predictability shall lead to equal treatment of Member States which is unequivocally warranted.

In terms of **simplification**, Malta is of the opinion that the process could be simplified through improving the dialogue with Member States, limiting the reporting requirements (if possible), enhancing the multilateral nature of the exercise and strengthening ownership at all levels. For example, Malta sees the aims of the National Reform Programmes and the Euro Plus Pact to be closely linked. In this regard and for the benefit of simplification, Malta believes that technical and political discussions with the aim of merging the two initiatives would be a step in the right direction.

Malta also believes that tailor-made policy recommendations that clearly reflect the challenges of the country are essential in order to make the European Semester close to national realities and thus **better focused** on its purpose. As such, more effort is needed to bring together the two sides of the spectrum, i.e. the national and European, making the process more transparent, democratic and thus more effective.

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 the continuous need to implement structural reforms in order to ensure a sound economic and financial environment within the EU. Structural reforms which increase the return on investment particularly in the Euro Area are required in order to retain the savings of surplus economies within the Euro Area to finance productive investment. They are also needed in order to attract foreign capital in the Euro Area. In the absence of a repatriation / inflow of such capital the growth and productivity of the Euro Area is likely to continue falling behind that of its competitors. We believe that the main instruments to encourage further structural reforms have already largely been put in place. These include the European Semester, the macroeconomic imbalance procedure, the strengthening of the SGP, all the elements of the Banking Union and the European Investment Plan which should also go a long way in stimulating the necessary investment in structural reforms particularly where spillover effects

¹ (European Commission)

between Member States are evident. We also believe that structural reforms which enhance the productive potential of the economy should generate enough returns to act as an incentive even in the absence of adjustment mechanisms. We believe that what is needed now is not more rules but to work within a rules-based framework which allows good economic judgement to tailor economic policies to the benefit of each Member State, taking into account spill-over effects on the rest of the members, particularly within the Euro Area. Furthermore, surveillance of programme countries as well as countries in the macroeconomic imbalance procedure and the excessive deficit procedure, further contributes towards anticipating and dealing with major problems in a country-specific manner. In this regard, we do believe that Member States should have a degree of flexibility on the specific measures to be implemented thereby catering for their specific needs and characteristics. Finally, we believe that the main areas of reforms should focus on fiscal discipline, stimulating investment, strengthening capital markets, addressing financial fragmentation, supporting SMEs and their access to finance and financing productive investment where market failures undermines access to funding.

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?

Malta is a firm believer in the principle of subsidiarity, particularly with regard to the imposition of taxes and the management of tax collection as well as social security and thus we are in principle against any form of additional fiscal capacity for the Euro Area other than that already provided by the EU budget. Malta believes that the positive results brought about by structural reforms should themselves act as an incentive for Member States to carry them out (e.g.: competitiveness goes along with productivity). Malta also believes that the existing instruments developed in the initial stages of the crisis (namely the ESM) together with the ECB's action as the only pan-European institution to "do whatever it takes" to sustain the Euro are enough to provide the necessary shock-absorption capability that the monetary union requires.

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

Malta believes that while the consolidation of financial and economic recovery across the EU remains an immediate objective, the social dimension must retain its importance so as to ensure that economic growth and development is also accompanied by social progress and wellbeing.

Having said this, Malta has consistently argued that further enhancement of the coordination of economic, employment and social policies, has to be in line with existing procedures while fully respecting national competences. This position also reflects what was stated in the European Council Conclusions of October and December 2013.

Similarly, Malta is cautious about formal ex-ante coordination in employment and social policies and considers that any such procedure should be voluntary while also respecting subsidiarity and national decision making procedures. With regard to reforms meriting 'ex ante coordination', Malta maintains that reforms must be major, with possible spillover effects on other Member States.

With regard to the employment and social scoreboard, Malta's remains in favour of maintaining this instrument as an early warning tool, and avoid creating a system which would trigger corrective actions through the establishment of thresholds or divergences levels.

Moreover, while Malta recognises that the strengthening of the monitoring mechanisms to take into account the social and labour market situation within the EMU, through the use of employment and social indicators as part of the European Semester to provide contextual background, constitutes a major objective in enhancing coordination, it is important that such monitoring takes into account the respective starting positions of Member States. Indeed, Malta

has also argued that the data generated should capture the actual progress of the Member States and should be used effectively to evaluate policies when the current policies are not adequately achieving the desired results. Malta also expressed its concerns on the proposals made to include thresholds and to add to the list of indicators.

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?

We believe this is not true. The European response to the economic crisis has too often focused on the long term (the need for structural reforms) and has not adequately dealt with the immediate issues of lack of demand including investment. Many a times the economic crisis has been used as a pretext for long-due structural reforms. Whilst this approach has its benefits, it should never have been at the expense of short-term demand management.

Nonetheless, we have always maintained that the building blocks of the EMU in the medium term should rest on the premise of implementing feasible and pragmatic measures that require no Treaty change.

On furthering steps of economic integration envisaged on an intergovernmental basis, we question what exactly the term economic integration constitutes. If economic integration encompasses the steps leading to a fiscal and political union, we have strong objections to move forward to this trajectory on an intergovernmental basis. We believe that these fundamental elements need to be discussed thoroughly. We are of the opinion that such direction would lead to an economic integration process driven by a ‘two-speed Europe’ which would complicate further the EMU framework. In this regard we believe that further integration to a fiscal and political union requires a Treaty change in order to be consistent and in view of its sensitivity to the national sovereignty of Member States. At this juncture Malta does not subscribe to any proposals that would lead to a fiscal union.

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

Capital Markets Union

The proposed Capital Markets Union has the aim of unlocking additional investment for companies (in particular for SMEs, as well as for infrastructure projects), to attract more investment into the EU and to improve the stability of the financial system, in particular by opening up a wider range of funding sources. While supporting this initiative, with regard to national initiatives, albeit noting that improving the business environment and enhancing the labour market responsiveness and competition in product markets may further promote investment, we have reservations on issues pertaining to aspects concerning taxation. In this regard, Malta is in favour of tax co-ordination, especially in the context of the sharing of technical knowledge and best-practices as well as enhanced co-operation with the view of identifying gaps in revenue collection. Indeed, the Maltese Government is committed to maintain the momentum of raising the level of efficiency of the taxation system, which is vital in order for a country to be able to sustain long term economic growth. However, Malta has strong reservations on coordination of reforms which fall strictly under national competence. In particular, taxation, especially in terms of rates, scope and tax bases remains the sole prerogative of the Maltese government, as it is a dynamic function of its economic, budgetary, environmental, competitiveness and social targets and is thus adjusted to suit the changing realms it is meant to tackle.

The Banking Union so far and what remains to be done

We acknowledge that the reforms in the financial sector, the macroeconomic imbalance procedure, the strengthening of fiscal institutions, the more active role of the ECB to preserve the functioning of the monetary transmission mechanism during crisis and the establishment of

the ESM should contribute significantly towards preventing the repetition of negative feedback loops between banks and sovereign debt and should go a long way in preventing another crisis. With respect to the financial stance, Europe underwent a transformation, which was brought about by the setting up of a Banking Union. Through the creation of the Banking Union, financial institutions are now in a better position to sustain future shocks given they have higher capital adequacy ratios and more conservative provisioning for unexpected losses. The recapitalisation and resolution mechanisms established recently (primarily the ESM and SRM) will further limit the negative disruptions to the broader economy as experienced in the past financial crisis.

A key issue still to be addressed is to target the right balance between eliminating unsustainable risks in the financial sector such as high leverage or large concentration risk, whilst at the same time allow financial sector to operate and channel funds to the general economy. The problem experienced today is that the financial sector is not taking on additional risks and limiting financial intermediation which in effect holds back economic growth. This itself could create macroeconomic imbalances as investment becomes sub-optimal and capital flows outside the EU/EA in search of higher yield but possibly higher risk outside the EU. Resilience should not be achieved at the expense of lower operability, flexibility and effectiveness of the financial sector.

Transfer of capital between different segments of the financial sector in the Euro Area is another issue which still needs to be better addressed. Facilitating transfer of capital between Euro Area Member States is crucial in particular in stressed conditions in one or more concentrated parts of the Euro Area. Fragmentation in the Euro Area financial sector brings about inefficiencies in the use of capital from one Member State to another. Thus, consolidation issues must be taken into consideration as well.

Additional steps in terms of the banking structural reform and structural separation of banks' trading activities can be seen as a continuation of efforts within the context of the Banking Union. Further efforts towards a capital markets union as well as towards improving access to finance and to sound securitisation also remain important steps in furthering financial sector resilience. Moreover, amongst others, and depending on the assessed level of urgency, further work is also warranted in terms of derivatives regulation, towards the recovery and resolution of central counter-parties (CCPs), as well as in terms of considerations vis-à-vis shadow banking activities.

In addition to the above, one needs to emphasise the need for the ECB as the only pan-European institution which can act immediately during an euro area crisis, to act as the lender of last resort and prevent a liquidity crisis or a confidence crisis from becoming a solvency crisis. However, it is also true that the actions of the ECB are unlikely, on their own, to be enough.

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

We believe that two necessary criteria for closer coordination of economic policies and sustained economic convergence are national ownership and democratic accountability.

In this regard, building a strong working relationship between national parliaments and the European Parliament is essential.

Ownership of reforms could also better be fostered through a more streamlined process. The aim of streamlining the decision process is to increase efficiency and effectiveness by employing faster or simpler working methods. In turn, streamlining increased political ownership, accountability and acceptance of the process, to strengthen credibility and comparability across Member States. In particular, the various stages and outputs within the process could be simplified through improving the dialogue with Member States, limiting the reporting requirements, enhancing the multilateral nature of the exercise and strengthening ownership at all levels, including Parliaments and social partners.