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INFORME
THE ECONOMIC GOVERNANCE OF THE EUROPEAN UNION

ANNUAL REPORT

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CONCLUSIONS AND PROPOSALS

The period since publication on 24 February last year of the ESC's 1/2016 report assessing the advances in the EU's economic governance has been marked by a context of political uncertainty and low rates of growth and investment.

Internal problems such as the United Kingdom's announcement that the country would be leaving the European Union (EU), the management of the asylum and refugee crisis, difficulties in signing a number of trade agreements with third-countries, and the increase in the priority given to defending national interests in the elections held in certain member states, along with the changes to global geopolitical balances concurrent with the change of leadership in the United States, have coincided with a period of very few advances in the economic governance of the EU, hampering the region's political, social and economic integration.

The EU's economic context and economic policy measures

The EU economy appears to have commenced a period of stable but moderate growth. The rate of growth slowed for demand for investment, with net exports contributed to this negatively to this trend. The economies of the member states grew at widely differing rates and a number of them are still troubled by the social and economic problems brought about by the crisis, a high unemployment rate, or high levels of both private and public debt.

Fiscal policy

The EU's economic situation calls for additional stimulation of internal demand, in particular demand for investment. Given this situation, the ESC believes that it is positive that the European Commission is proposing a less restrictive fiscal stance since this will be favourable to business and employment - as long as it simultaneously drives forward technological change, modernization of productive structures and long-term growth.

However, the EU budgetary framework and in particular that of the Eurozone offer neither rules nor instruments to facilitate direct management of the aggregate fiscal stance. It is this Council's view that, in fact, the instruments of the European Semester and rules of the Programme for Stability and Growth, designed to solve certain member states' deficit and debt problems, are ineffective in promoting budgetary expansion in countries where there is some margin for this. Nevertheless, the ESC does believe that there is room for improvement of member states' fiscal governance in terms of promoting evaluations of the effectiveness of public spending so as to ensure that it is focused on driving forward sustainable economic growth and job creation.

As 2016 drew to a close, there was a review of the Investment Plan for Europe, known as *Juncker Plan*, which sought to assess the positive results achieved in its first year of operations. In the light of said review, the Fund - launched as a response to the crisis in demand for investment in the EU, has been doubled, both in terms of its duration and financial resources, while a number of technical aspects have been updated in order to improve its efficacy. However, in spite of the fact that plan was evaluated in terms of operability, effectiveness and efficiency, the ESC believes that there is a need for an assessment in real terms of the impact of investment on growth and employment.

Furthermore, there remains the concern already aired by this ESC in regard to the unequal allocation of funds in favour of countries with a better technical structure for processing awards and with healthier public finances. In fact, the lack of a geographic allocation means that the optimism that the plan's good results have given rise to should be qualified, particularly in regard to achievements in promoting SMEs' access to funding. The programme focussing on the small business fabric does not seem to have had a particular impact in member states in which, comparatively speaking, SMEs face greater difficulties in accessing third-party funding, as is the case in Spain.

The Commission has echoed concern regarding the problem about existing financial capacity in the different member states, and as part of the extended plan, it has proposed facilitating the combination of the European Strategic Investment Fund (ESIF) with other sources of EU funding, such as the Structural Funds and European Investment Fund (EIF). In the ESC's opinion, such joint financing would ensure that investments made via the Juncker Plan would have a greater focus on the social, environmental or territorial cohesion issues inherent to the Structural Funds and other funding sources.

Other advances in the fiscal arena in 2016 were: 1) the Commission's presentation in April 2016 of the Action Plan on VAT, which envisages a single EU area for VAT and for combating fraud; 2) approval in July 2016 of Directive 2016/1164 establishing rules against practices of fiscal evasion which have a direct impact on the functioning of the internal market; 3) and the launch in October 2016, of *a draft directive on a common consolidated corporate tax base (CCCTB)*. Work on the draft CCCTB will not be initiated until such time as a political agreement has been reached on a common base. It is the ESC's standpoint that this delay might lead to a legal loophole which might actually undermine the overarching aim of this initiative.

Monetary policy

The ECB maintained the expansive tone of monetary policy, as it has done over the last few years, including very low rates of interest and the asset purchase programme (APP). In March, it lowered interest rates, such that the rate of interest of the main funding operations – the reference rate - was 0 percent, and the rate of interest for deposits was negative. Changes were also announced in relation to the size (it was initially increased to 80 billion euros, although this figure was later reduced to 60 billion euros) and duration of the asset purchase programme launched in 2014, with this being extended up to December 2017.

Since it was launched, the asset purchase programme has injected a large amount of liquidity into the financial system, and it has proved to be a substantial measure for supporting economic recovery and restoring confidence in the eurozone. However, despite the fact that the programme's initial impact was positive, its effectiveness is limited, and this means that there are doubts as to whether it will be extended for a further period. Indeed, the ECB has stated its concern in this respect, arguing that monetary policy on its own is not enough, and that it is vital for it to be complemented with firm action in the field of fiscal policy, whilst ensuring structural that policies become more agile, particularly those designed to increase productivity and employment and improve the business environment.

Other fields of economic policy

Throughout 2016, the EU continued to execute other economic policy priorities above and beyond the demand policies, which, since they are horizontal in nature, are equally as decisive when it comes to laying the foundations for the growth pathway in the medium and long-terms. To be specific, advances were evaluated in terms of the achievement of the internal market. Highlights included the presentation at the start of 2017 of a service package featuring Energy Union-related developments to drive forward clean energy; and, lastly, achievements attained with a view to establishing a single digital market which, in this ESC's opinion, should be accompanied by a parallel effort in the strategy's social dimension.

The long-term strategy for political and economic integration

There were very few advances in 2016 to add to the foundations laid in "*The Five Presidents' report,* or address the roadmap forecasts in relation to the four pillars identified as crucial to achieving the aim of long-term political and economic integration of the European Monetary Union (EMU). This will impede progress towards achievement of the first stage by the halfway point in 2017, which was the target included in said report.

Banking Union

In the field of Banking Union, the advances made in recent years appeared to stagnate in 2016. This seemed to be the case since the issues flagged up as pending in the previous update of the report remain so, and relatively little progress has been made, such that achievement of the objective of Banking Union by midway through 2017 appears impossible.

As the single supervisor, the ECB continued in 2016 to execute its supervisory tasks. However, it is crucial to prioritise preventive supervision, detecting problems in entities and applying corrective measures before the former become a reality, especially in view of problems which arose in the financial systems of certain member states. In terms of the Single Resolution Mechanism, which became fully operational in January 2016, emphasis was placed on addressing *ex ante* resolution of plans (preventive resolution), whilst there was also prioritizing of identification of the obstacles acting as barriers to processes of resolution, and on dealing with executive resolutions where such may be required.

The necessary steps were also completed in regard to the formal constitution of the Single Resolution Fund. As of January, the national resolution funds were integrated in the former, which since then has received contributions from the entities, which will be progressively mutualised in a common fund over an eight-year transition period, until there is total constitution. The final allocation to the fund seems very low (55 billion euros) if there is a real aim to meet the challenges of Banking Union in the areas of resolution and re-structuring of entities.

In addition, 2016 witnessed the launch of an interim bridging mechanism - which will prevail until the fund is fully constituted - by means of which each will sign up to a harmonized loan agreement with the Single Resolution Board and make available an individual credit facility to bolster its own national compartment of the Single Resolution Fund. However, in order to facilitate effective running of the Fund remains consensus is still pending regarding an acceptable definition for an effective common budgetary protection mechanism, or "*fiscal backstop*". The member states have agreed that such shall exist and have explicitly committed themselves to its creation, but until now they have not been able to move forward in agreeing a definition for it or in deciding the features it will have.

We are not aware of any progress vis a vis the European Deposit Insurance System (EDIS), given that the action plan proposed by the European Commission and the end of 2015 failed to achieve the necessary support. Mutualisation is the main sticking point preventing an agreement in this field. The German position is quite critical in this regard, largely because it would involve assuming a degree of mutualisation in a context in which risks differ between the financial systems of the different countries.

The Capital Markets Union

In 2016, a step was taken to accelerate completion of the Capital Markets Union (CMU), which would facilitate easier access to funding for companies and support investment in the real economy. As a continuation of the action plan launched by the Commission in 2015, the first CMU status report was published in April 2016. This revealed that there had been progress in some of the measures proposed and also encouraged the June meeting of the European Council to make quick gains in order to generate an impact as soon as possible.

In September 2016, the European Commission presented a plan including a firm drive to promote Capital Markets Union, which would, in turn, facilitate development of the whole of the Investment Plan for Europe. The target is to complete it by 2019.

An integrated budgetary framework

There was no progress in 2016 in terms of achievement of an integrated budgetary framework, in spite of the fact that the lack of a fiscal union constitutes one of the main deficiencies in the design of the EMU and one of the main reasons for the seriousness and persistence of the crisis in Europe. As the ESC has already argued, fiscal union in the eurozone should be built on two pillars: federal budgetary integration and, as a necessary condition but not as something which suffices in itself, the budgetary discipline of member states. The sole development in this field was the launch of the *Independent European Fiscal Board*.

An integrated framework for economic and social policy

In its previous reports the ESC has, generally speaking, argued in favour of attempting to secure a higher degree of coordination and convergence in the field of economic and social policy so as to achieve sustainable and equitable economic growth processes which will eliminate, or at least reduce, the substantial differences prevailing at the core of EMU in terms of competitiveness and social cohesion. In these terms, and in relation to the launching of the National Productivity Boards, the ESC's standpoint, as it has outlined in earlier reports, is that the factors that have an impact on competitiveness, including wages, should be addressed within a framework of social dialogue, both European and national.

The ESC has a positive view of the implementation of the European Pillar of Social Rights, although it is also of the opinion that it gives rise to a plethora of questions and doubts in terms of application, evaluation and the role of the social sphere. In this regard, this Council still considers that it is vital to strengthen coordination of economic and social policies and for these to be oriented towards further developing the single market and preserving the European social model.

In respect of external imbalances, the Commission has noted that unsustainable current account deficits have been eliminated in almost all member states, whilst excessive current account surpluses continue to rise. It is the ESC's view that this provides evidence of the very low impact and unequivocally unequal treatment of the EU recommendations issued in this field for coordination of economic policies.

A procedure for reinforced macroeconomic disequilibrium and coordination of economic policies

In regard to correction of internal imbalances, public debt levels remain one of the main imbalances in many member states, constituting one of the foremost obstacles to moving forward in the construction of an integrated budgetary framework. Moreover, deleveraging of private debt occurs slowly and unequally, and the low nominal growth of the economies in no way helps the process. In terms of the situation regarding social imbalances, it is noted that the job markets are continuing with their recovery in most of the member states, but that social difficulties persist, first and foremost in the countries most affected by the financial and debt crisis.

The new economic governance mechanisms proposed during the crisis have produced the indirect effect of a reduction in the role of trades union and business organizations in relation to the decision-making process in the European arena. This has given rise to a demand, on the part of the social partners, to encourage more active participation from them in economic cooperation and in the governance of the European Union (the European Semester). There is a consensus amongst the social partners in affirming that, despite the gradual improvement in their involvement in key stages of the European Semester process, it remains essential to further drive forward their full participation at EU level, and especially at national level. Strengthening their participation in the latter is essential to the whole process.

Strengthening of the role of the european social partners in economic governance of the EU

There have also been precious few advances in terms of implementation of concrete measures or actions in the field of democratic responsibility, legitimacy and institutional consolidation. It can only be said that the debate is ongoing in regard to the European Commission's legislative proposal referring to the establishment of unified Eurozone representation in the International Monetary Fund (IMF).

Democratic legitimacy and institutional consolidation

The main challenges in regard to the economic governance of the EU

Largely as a result of insufficient political and institutional construction, since the approval of the last ESC report there have been no changes to the contradictions in the institutional architecture of the European Union that had already been noted in earlier reports.

Current challenges in political and institutional construction

The institutional dysfunctions which were revealed especially during the crisis have generated a certain loss of legitimacy for EU institutions; the democratic deficit represents a risk for the viability of the European Project per se, and it has led to disaffection with Europe on the part of the citizenry, and even to a "collective European identity" crisis, as well as a loss of the specific weight wielded by the Union as a region on the international stage, over and above the member states' national roles.

In addition, the EU's decision-making system seems to function from an inter-governmental logic, meaning that, generally speaking, the member states themselves display greater leadership than the European institutions in reaching significant EU decisions.

These circumstances mean that the European Union face difficulties in taking operational and immediate decisions in regard to pressing situations requiring an effective response. Indeed, the European Union is seen to be overwhelmed, and even more so when problems requiring a solution become increasingly complex due to the member states different positions.

And if the truth be told, Europe is traversing a very delicate political situation. A whole set of events in recent times have shone a spotlight on a deep weakness affecting the European Union as a supra-national organization. In regard to its institutional system, the depth of the crisis and the seriousness of events that have occurred since the crisis, have above all made it clear that the institutional reform enshrined in the Lisbon Treaty was insufficient.

A certain lack of political, economic and social leadership of the European Union has also become evident, as pressure from the member states acts to substitute it. And this is a process that is even causing policy fragmentation within the Union.

In view of all of the above, there remains a need to drive forward a democratic political Union, which is also legitimate, and which adds up to something more than a union of manifold rules for supervision of matters including the correct functioning of the markets, the financial system and budgets. In order to achieve this, it is vital that there is a commitment to a greater degree of integration.

In addition, it would be appropriate for said drive, which will, in a sense, be "kick-start" for the EU, to take place in 2017, a year in which there will be commemorations of the sixtieth anniversary of the Treaties of Rome which gave rise to the current European Union based on the idea of a shared and prosperous future for the European countries and their citizens. It should nevertheless be noted that there is still a long way to go in this sense in view of the current EU outlook in both institutional and political terms.

Refugee and asylum crisis

One example of the difficulty in decision-making is the management of the refugee crisis. The massive arrival of refugees to the European Union, coupled with the inefficacy of the Common European Asylum System, has led to many European countries, instead of acting uniformly in a coordinated manner, choosing to act in accordance with their respective interests. Thus, they have augmented the restrictions for access to their territories, or decreed differences in access to the labour market. Hence, it will continue to be essential to move towards a really effective Common European Asylum System and adopt a fully effective, just and humane asylum policy - involving binding commitments from the member states, which works efficiently both in times of calm and in periods of high migratory pressure.

The British referendum ('Brexit')

Likewise, it will be necessary for there to be a coordinated response to the challenge brought about by the United Kingdom's decision to leave the EU. The referendum of 23 June 2016, in which a majority of British citizens voted for the United Kingdom leaving the European Union, gave way to a period of great uncertainty in regard to the exit process initiated by the triggering of article 50 of the Treaty of the Union, but also concerning relations between the United Kingdom and the European Union in the future.

Immediately the result of the referendum was published, the European Union manifested its concern and worry that one of its constituent member states would be leaving and also for the consequences that this might have for the Union as a whole. Above and beyond these inevitable consequences, it will be vital to ensure that the process is completed within a framework of transparency and reciprocity such as to minimise both medium and long-term uncertainty throughout the years what the process will run - a process which is likely to be long and complex. In any event, pragmatism must prevail, as opposed to vested interests, during the phase of negotiations, in order that the process does not become excessively long, and so as not to cause any unnecessary conflicts which would make it difficult to achieve an agreement.

Final conclusion

In view of the statements made throughout the present report and given the need to consolidate confidence in the European project, it is the ESC's view that it will be a priority to continue to make improvements to the EU's economic governance. It is therefore considered essential that the EU institutions make proposals and run actions, programmes and initiatives which go further than the necessary improvement of economic governance to underline their inescapable commitment to develop a project for the future for the European Union adapted to the current situation and to Europe's position in the new global circumstances. This is a project which harnesses the responsibility of all institutions and social partners, as well as European citizens themselves, in order to ensure the ongoing improvement of the democratic procedures covered by the Treaties and to reinforce the European model based on the social market economy.

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