EU Recommendation

GUIDELINES FOR THE ECONOMIC POLICIES OF EUROPE 2020

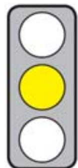
Status: 12 July 2010

cep Centrum für Europäische Politik

MAIN ISSUES

Objective of the Recommendation: The Commission recommends to the Member States guidelines for their economic and financial policies.

Parties affected: Taxpayers, employees and employers, the self-employed



Pros: (1) The Commission calls for a more solid consolidation of national budgets.
(2) The Commission requests that countries with a current account deficit should aim at restrained wage policies.

Cons: An effective Stability and Growth Pact would be preferable to the proposed approach of coordinating economic policies.

CONTENT

Title

Recommendation SEC(2010) 488 of 27 April 2010 for a **Council Recommendation** on **broad guidelines for the economic policies of the Member States and of the Union** – Part I of the Europe 2020 Integrated Guidelines

Brief Summary

► **Object of the Recommendation**
- The Commission proposes ten "integrated" guidelines for the implementation of the Europe 2020 strategy, [COM(2010) 2020; see CEP Policy Brief] which are aimed at coordinating the Member States' policies:
  - Nos. 1–6 are "broad guidelines for the economic polices" [SEC(2010) 488] and
  - Nos. 7–10 are for the employment policies [COM(2010) 193; see CEP Policy Brief]

  Together these ten guidelines set the framework for "reforms at Member State level".
- Member States should:
  - in shaping their economic policies take into account the guidelines (Proposal 1) and
  - design national reform programmes in line with the guidelines (Proposal 2).
- Member States should present the measures they are planning to take to implement the guidelines.

► **Guideline 1: "Ensuring the quality and the sustainability of public finances"**
- Member States should consolidate their budgets in line with the Stability and Growth Pact. They should in particular
  - reduce their "structural" (i.e. cleared of cyclical or one-off effects) new debts per year "well beyond" the benchmark of 0.5% of gross domestic product (GDP) (p. 8) and
  - start to consolidate their budgets in 2011 at the latest.
- In consolidating budgets, Member States should:
  - reform age-related public spending (e.g. pension and health expenditures);
  - reduce debts quickly and
  - raise effective retirement ages.
- In terms of revenue, Member States should
  - increase only those taxes that harm neither economic growth nor employment and
  - raise tax burdens for environmentally harmful activities at the same time as lowering those for labour.
- In terms of expenditure, Member States should prioritise growth-enhancing expenditure for education, research and development (R&D), innovation and investment in network structures.

► **Guideline 2: "Addressing macroeconomic imbalances"**
- Member States should avoid "unsustainable" macroeconomic imbalances which might arise from "developments"
  - in current accounts,
  - asset markets and
  - the "balance sheets of the household and corporate sectors".
- Member States with account imbalances rooted in their "prudential and taxation policies" or in their lack of "competitiveness" should take measures to tackle these issues. Possible starting points could be:
  - a restrained wage development and reforms in the labour market,
  - a consolidation of national budgets and
  - "structural reforms relating to product and financial services markets".

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- **Guideline 3: "Reducing imbalances in the euro area"**
  – Euro area Member States with current account deficits rooted in a lack of "competitiveness" should aim to achieve a "significant" yearly reduction (p. 9). They should do so notably by reducing the real unit labour costs.
  – Euro area Member States with current account surpluses should remove impediments to private domestic demand.
  – Moreover, Euro area Member States should combat "excessive private debt accumulation" and "inflation divergence" (p. 9).

- **Guideline 4: "Optimising support for R&D and innovation, strengthening the knowledge triangle and unleashing the potential of the digital economy"**
  – In order to optimise the support for R&D and innovation, Member States should orient their "innovation systems" towards "major societal challenges" (e.g. energy supply, resource efficiency, climate change, ageing, health and security (p. 9).
  – Member States should strengthen the so-called "knowledge triangle" (education, research and innovation).
    - Member States should improve the quality of education by:
      - equipping people with a broad range of skills and
      - ensuring a sufficient supply of science, mathematics and engineering graduates.
    - Member States should promote research by:
      - improving the opportunities for pooling public and private funds at EU level,
      - amending national funding and procurement schemes or
      - carrying out other reforms so as to facilitate the national and international cooperation between research institutes, improve knowledge transfer and reinforce a merit-based competition.
    - Member States should improve their innovative capability by:
      - facilitating access to private finance such as risk-capital,
      - boosting demand in eco-innovation through public procurement and
      - ensuring an efficient, affordable and effective protection of intellectual property.
  – In order to unleash the potential of the "digital economy", Member States should establish "appropriate framework conditions" for a "rapid development of a digital single market" (p. 9). Public funding should be targeted at:
    - the roll-out of the high-speed internet and
    - the use of modern online services through:
      - the further development of e-government and
      - e-signature, e-identity and e-payment.

- **Guideline 5: "Improving resource efficiency and reducing greenhouse gases"**
  – Member States should:
    - "decouple" economic growth from resource use,
    - phase out subsidies for environmentally harmful activities and
    - use taxation to:
      - support green growth and jobs in ecologically oriented sectors ("green employment"),
      - set incentives for the use of renewable energies and clean technologies and
      - promote energy savings and eco-innovation.
  – Member States should use regulatory, non-regulatory and fiscal instruments in order to:
    - promote recycling,
    - make the transition to a resource-efficient, low-carbon economy and
    - decarbonise transport and power generation.
  – Moreover, Member States should, in line with Guideline 4:
    - develop "smart, upgraded and fully interconnected" transport and energy infrastructures (p. 10) and
    - enhance the use of information and communication technologies.

- **Guideline 6: "Improving the business and consumer environment and modernising the industrial base"**
  – Member States should ensure that markets work for consumers by safeguarding well-functioning, open and competitive goods and services markets.
  – Member States should improve the business environment for enterprises by:
    - modernising public administration, in particular by upgrading e-government services, and cutting red tape,
    - ensuring stable and integrated financial services markets,
    - improving conditions for the enforcing of intellectual property rights and
    - supporting the internationalisation of small and medium-sized enterprises (SME).
  – Public procurement should incentivise notably SMEs.

Statemant on Subsidiarity by the Commission

The Commission does not address the principle of subsidiarity.

Policy Context

On 26 March 2010, the European Council approved most parts of the Europe 2020 strategy [COM(2010)2020; see CEP Policy Brief] as the successor to the failed Lisbon strategy. Thereby the European Council requested the Commission to "rapidly present more focused integrated guidelines".

Legislative Procedure

27 May 10 Adoption by the Commission
Open Adoption by the Council, publication in the Official Journal of the European Union

Options for Influencing the Political Process

Leading Directorate General:	DG Secretariat-General
Committees in the European Parliament:	Economic and monetary affairs (leading),
Committees in the German Bundestag:	Affairs of the European Union (leading); Finance; Economy and Technology
Decision mode in the Council:	Qualified majority (approval by a majority of Member States and at least 255 out of 345 votes; Germany: 29 votes)

Formalities

Legal Competence:	Art. 121 (2) TFEU
Form of legal competence:	Shared competence
Legislative procedure:	Adoption of a Council Recommendation; Art. 121 (2) TFEU in conjunction with Art. 16 (3) TEU

ASSESSMENT

Economic Impact Assessment

According to the Commission, "macroeconomic imbalances" are, above all, situations in which a country's export of goods and services systematically exceeds (current account surplus) or falls below (current account deficits) its imports. Countries with current account deficits must finance their import surpluses through foreign loans, i.e. the import of capital. Normally, this is unproblematic if loans are used for investments, since they generate the production potential with which the loans can be paid back later. However, many Member States have used foreign loans to finance domestic consumption, meaning they just consumed the imported capital. This was carried out not least through high fresh public debts from foreign countries. It was not until these debts started to threaten the solvency of several Member States and caused foreign investors to demand risk premiums for government bonds that reforms were introduced to curb debts. However, these came too late, and the Euro area Member States had to put together a rescue package to the amount of Euro 440 billion (plus aids provided by the EU and IMF), on which they promised mutual solidarity and, at the same time, infringed the bail-out prohibition (Art. 125 TFEU). With the present Recommendation, the Commission wishes to improve economic policies coordination between Member States in order to make sure that in future they take appropriate reforming action early enough.

The Recommendation illustrates the Commission's powerlessness regarding this target. **For the coordination of economic policies would not be necessary at all if the Commission was empowered to enforce** Member States' **compliance with the Stability and Growth Pact**; however, the European treaties do not provide for that competence.

An effective Stability Pact would impede macroeconomic imbalances up-front. It would eliminate the Member States' possibility to run into high debts. Necessary reforms would also be implemented in due time. Moreover, **it would ensure that economically weaker countries orient themselves towards stronger countries**. A weakening of successful economies, as demanded by France, is not possible under an effective Stability Pact. Besides, **it would leave Member States with greater room for manoeuvre in deciding which reforms are necessary and how they should be shaped**. Local business environments could thus be taken better account of and institutional competition would be increased. To this end, an effective Stability Pact is preferable to coordinating economic policies. However, **this solution is politically rather pointless** due to the repeated contract infringements by Member States – starting with Germany and France in 2003 and – for the time being ending with the latest rescue package.

Against this background, the Commission's attempt of coordinating national economic policies towards greater stability becomes comprehensible. But **as the** presented **Recommendation has no binding legal effect, there is no reason to believe that Member States will follow it**. Irrespective of that, the Commission's proposals can be assessed as follows:

Guideline 1: The order to Member States to consolidate their budgets in line with the Growth and Stability Pact is appropriate because the excess national debt of almost all Member States urgently needs to be reduced. The alleged objection that a reduction in net new debts would stall the revitalised boom is too limited in scope. On the one hand, new debts at existing levels are no longer possible for many Member States, as the capital

markets doubt their creditworthiness; on the other hand, there is a risk that economic growth funded through state credits only boosts consumption for a short time. In fact, in the absence of sustainable investments, the ground is prepared for the next economic crisis. The Commission's suggestion that budgets should be consolidated through cutbacks in expenditure is appropriate, as well as the stressed necessity to reform social welfare systems. For in view of the uncertain economic development, it is reasonable to not burden enterprises and citizens with additional taxation.

Guideline 2: The target of eliminating current account imbalances is also appropriate. The financial crisis clearly shows: imbalances lead to tensions which can suddenly erupt and trigger a worldwide economic crisis. However, it remains unclear when and for whom such imbalances are "unsustainable". This criterion is likely to be interpreted very differently by Member States. Moreover, the Commission fails to explain what exactly it means by "macroeconomic imbalances" as a result of "developments" in asset markets and in the "balance sheets of the household and corporate sectors". Admittedly, this inadequacy is relativised by the fact that the Commission does not give any recommendations for action in this aspect.

The proposal to remove account deficits through a restrained wage policy and through labour market reforms **is target-oriented, as it leads to reduced real unit labour costs**. Economically, real unit labour costs are the labour costs per production unit. If added up to the overall economy, they equal the pay share in the GDP. If, in comparison to other countries, real unit labour costs decrease, then domestic goods and services become cheaper. **This strengthens exports and reduces imports**. The counterargument that such a stimulus would weaken domestic demand is too limited in scope: countries with current account deficits anyway import a part of their domestic consumption. It is precisely through living beyond their means, i.e. excess consumption, that the current account deficits emerged in said countries. Hence, the decline in domestic consumption is the return to a level which corresponds to the actual performance of the respective country.

The request to reform "product and financial services markets" should be specified.

Guideline 3: It is appropriate that the Commission only calls upon those countries with current account deficits to cut current account imbalances in the Euro area, whilst merely recommending to countries with current account surpluses the removal of consumption impediments. In this way it does not follow the call for a reduction of competitiveness in countries with current account surpluses or for consumption funded by debts. Countries with current account surpluses are characterised by lower real unit labour costs and more efficient production methods. The Commission does not follow these calls and consequently the Member States with low real unit labour costs, i.e. the economically successful countries, set the benchmark for economically weaker Member States. This also strengthens Europe's position in terms of global competition.

Guidelines 4 – 6 repeat views already known to be held by the Commission. Their position on the respective guidelines was presented in a recent Communication COM(2009) 519 (cp. CEP Policy Brief), the Consultation for the Energy Strategy (cp. CEP Policy Brief) and the Communication COM(2009) 512 (cp. CEP Policy Brief).

Legal Assessment

Legislative Competence

The Recommendation is covered by Art. 121 (2) TFEU.

Subsidiarity

Unproblematic.

Proportionality

Unproblematic.

Compatibility with EU Law

Unproblematic.

Compatibility with German Law

Unproblematic.

Possible Follow-up Actions by the EU

On the basis of the draft by the Council, the European Council adopts conclusions. On the basis of the conclusions the Council adopts the final Recommendation.

Conclusion

The coordination of economic policies would be unnecessary if the Commission were empowered to enforce Member State compliance with the Stability and Growth Pact. For an effective Stability Pact would impede macroeconomic imbalances upfront. Irrespective of this, the Commission's recommendations regarding the removal of current account imbalances are appropriate. This applies notably to the proposal that Member States should consolidate their budgets and to the restrained wage policy.