Communication of the European Commission on Reinforcing Economic Policy Coordination

This file note was written by the
Centre for Strategy and Evaluation Services (CSES).
It does not represent the official views of the Committee of the Regions.

More information on the European Union and the Committee of the Regions is available on the internet at http://www.europa.eu and http://www.cor.europa.eu respectively.

Catalogue number: QG-32-12-486-EN-N
ISBN: 978-92-895-0630-4
DOI: 10.2863/60838

Table of contents

1. Executive summary

This report provides an analysis of the Commission proposals provided in the "Communication of the European Commission - Reinforcing economic policy coordination". It intends to support the Committee of the Regions in formulating its response to the Commission proposals.

The communication on economic policy coordination of 12 May, as further elaborated in the subsequent Commission communication of 30 June, proposes a set of measures to remedy this situation covering four interlinked areas of action:

1. *Reinforcing compliance with the Stability and Growth Pact;*

2. *Developing a broader surveillance framework for intra-euro area macroeconomic and competitiveness developments;*

3. *Establishment of an integrated surveillance cycle of both structural and fiscal policies of Member States;*

4. *Formation of a robust framework for crisis management.*

The proposals – as elaborated in the June communication - provide for the strengthening of preventive measures and corrective measures in these four areas. The most relevant, from the point of view of local and regional authorities, are:

- *Embedding fiscal discipline rules into national rules and the procedure to ensure that the Treaty reference values on deficit and debt are respected.*

- *Sanctions on Member States that go off track following the Excessive Deficit Procedures, including possible cancelation of payments, under the EU budget, from the Cohesion Fund, EAGF (agriculture) and EFF (fisheries).*

- *Establishment of a surveillance mechanism for the closer review of macroeconomic imbalances and competitiveness, to be linked to the review of policies to meet EU2020 objectives.*

- *Proposal of annual cycle (European Semester) where Stability and Convergence and National Reform Programmes will be subject to peer review and guidance before being presented to national (and in some cases regional) parliaments for approval.*

- *Establishment of a standard support mechanism and procedure for financial support for Member States conditional on policy measures for fiscal consolidation and the addressing of structural and competitiveness issues.*

The analysis of the Commission proposals against the existing legal framework indicates that ***the Commission has been careful to frame its proposals within the bounds of the Treaty as it currently stands.*** *The links with existing articles of the Treaty are set out. New legislation – or amendments to existing legislation – will be required to implement some of the proposals of the communications, but this is all secondary legislation.*

Concerning the question of subsidiarity, ***at a general level there is a clear argument for a strong surveillance mechanism and economic policy coordination at an EU level****. Discretionary fiscal policies have had negative spillover effects because of their influence on EU-wide interest and exchange rates. Specifically in terms of measures, however, there may be potential breaches of the subsidiarity principle, if the Commission is able to impose budget rules on national or regional authorities. Currently, the proposals are not specific enough to draw any conclusions on the matter.*

In relation to the issue of proportionality*, the financial markets have made it clear that the previous arrangements were insufficient and that additional measures are necessary. Taken as a whole, it appears that* ***just enough is being proposed*** *to achieve this objective. National administrations and also LRAs will still have an important part to play in addressing problems identified and there is an important degree of freedom in determining how this should be done.*

There are ***significant implications for LRAs in the developments envisaged by the communications****, in terms of their impact on LRAs and the areas for which they are responsible and in terms of the potential of the LRAs to have a major role in delivering better economic policy coordination:*

- *The fiscal discipline enforcement mechanisms proposed at the national level will affect LRAs and their expenditure programmes. The reduction of borrowing at national level and the fiscal rules to be imposed will feed through into reductions in the expenditure for which LRAs are responsible, irrespective of whether the LRA concerned raises the funding through direct borrowing or through grants from central government.*

- *Concerning macroeconomic and economic policy surveillance, there will be greater pressure for Member States to take action to address competitiveness problems. The main focus of measures intended to promote enterprise, innovation and improvements in productivity will be at a micro-level, where*

LRAs clearly have a major part to play. LRAs will have to fine-tune policies in order to make them more responsive to problems indicated by the surveillance mechanisms. A clear regional and local dimension to the system will add considerable weight to its credibility.

- *The withdrawal of Cohesion Fund support as a possible sanction could have very strong implications for LRAs. The nature of the Structural Funds means that* ***the most disadvantaged areas and groups are those that would be most affected by this, with programmes and projects that are designed to address the root causes of the economic imbalances likely to be hit****. In that respect, there are questions of proportionality that arise as the specific effects on particular groups and areas could be regarded as being disproportionate to the original aims.*

2. Introduction

The starting point of the Commission communication of 12 May 2010[1] is that the recent economic and financial crises and the risks they posed to the stability of the euro area have underlined the interdependence among EU economies and showed that there are gaps in the current economic governance system. The available instruments for the coordination of economic policy, as provided by the Lisbon Treaty have not been used fully and effectively. The Communication proposed a set of measures to remedy this situation.

In the subsequent communication of 30 June the Commission[2] aimed to flesh out its initial proposals for strengthening the economic governance system but also to integrate them into the broader framework of the Europe 2020 strategy, which was endorsed by the European Council on 17 June 2010[3]. The strategy provides the context for policies to support economic recovery, put public finances back on a sound footing and actively promote sustainable growth and jobs. At the same time, the Council confirmed the need for coordination of economic policies. The Commission communication proposals are based on the idea that instruments for strengthening economic policy coordination can serve the Europe 2020 strategy objectives and deliver a new and sustainable growth agenda for European citizens.

These Commission proposals are to be assessed by the Council in conjunction with the proposals of the Task Force on economic governance headed by the President of the European Council, Herman Van Rompuy[4].

[1] COM(2010) 250, Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions - Reinforcing economic policy coordination.
[2] COM(2010) 367/2, Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions - Enhancing economic policy coordination for stability, growth and jobs – Tools for stronger EU economic governance.
[3] European Council 17 June 2010: Conclusions.
[4] European Council President, Communiqué from Herman Van Rompuy, President of the European Council following the meeting of the Task force on economic governance.

3. Description of EC proposals

With the proposals of the communication of 12 May 2010, the Commission aimed to strengthen the way in which the Stability and Growth Pact functioned and to extend surveillance to macroeconomic imbalances in order to reinforce economic governance in Europe. The proposals of the Commission concerned four interlinked areas of action:

1. Reinforcing compliance with the Stability and Growth Pact;

2. Developing a broader surveillance framework for intra-euro area macroeconomic and competitiveness developments;

3. Establishment of an integrated surveillance cycle of both structural and fiscal policies of Member States;

4. Formation of a robust framework for crisis management.

In the communication of 30 June the Commission elaborated on these proposals and proposed tools and mechanisms that should help achieve these objectives.

According to the Commission, these proposals are in accordance with the provisions of the Lisbon Treaty although changes in secondary regulation will be necessary for the implementation of some of the proposed tools.

The following sections present the core elements of the Commission proposals.

3.1. Reinforced compliance with the Stability and Growth Pact

The first group of proposals are intended to address the failure of Member States to abide by the rules and principles of the Stability and Growth Pact and the absence of mechanisms and tools to ensure compliance. The communication suggests that debt developments should be closely monitored and the debt criteria in the application of the Stability and Growth Pact should be made operational. The proposals of the Commission describe both preventive and corrective tools and mechanisms.

The proposed **preventive actions** and measures include:

- Reinforcement of budgetary surveillance at an early stage, so as to allow early detection and early action. This surveillance should take place mainly through the assessment of the Stability and Convergence Programmes submitted by the Member States.

- In good economic times, Member States with high public debt should aim at more demanding targets. The Commission proposes that a faster pace of progress towards a general government balance be required, which will provide a safety margin with respect to the 3% of GDP deficit limit and ensure rapid progress towards sustainability, i.e. the so-called medium-term budgetary objective (MTO). Furthermore, the communication reaffirms the importance of the national debt criterion that, in the past, has been rather overlooked.

For the euro-area Member States, the Commission proposes the possibility of imposing an interest-bearing deposit in the case of inadequate fiscal policies, as an incentive to achieving the medium-term budgetary objectives.

- The Commission also proposes that Member States embed fiscal rules and credible enforcement mechanisms into national rules and institutions. These national fiscal rules will ensure that the Treaty reference values on deficit and debt are respected and will be consistent with the medium-term budgetary objectives. Multiannual budget plans will also be developed under this framework. The Commission suggests that the national fiscal frameworks must be comprehensive and involve all levels of government in order to ensure clear and effective burden-sharing and the successful implementation of the necessary monitoring and enforcement provisions. The development of such a framework could be of particular relevance to regional and local authorities, especially in Member States with strong local governments.

At this point, there is no information on what such a framework would look like and how this could affect local and regional authorities. Such frameworks are already present in some Member States (e.g. NL, SE, FI, DE)[5] with provisions for a balanced budget or ceilings built into legislation. The Commission is expected to propose in due course minimum requirements to ensure that national fiscal frameworks are in line with Treaty obligations but Member States will still be free to adopt different approaches and procedures beyond this.

Besides the preventive measures, the Commission proposals include **corrective actions** for Member States that go off track, which will be assessed on the basis of a clear and simple numerical benchmark. They will be based on the implementation of the Excessive Deficit Procedures[6] under Article 126 TFEU.

[5] Bofinger, P,. Ried, S. (2010), 'A New Framework for Fiscal Policy Consolidation in Europe', German Council of Economic Experts – Working Paper 03/2010.

[6] Member States with debt ratios in excess of 60% of GDP could become subject to the EDP if the decline of debt in a given preceding period falls short of this benchmark (fraction of the gap between the debt level and the

The Commission proposals include a wide range of sanctions and incentives for Member States that breach these criteria that would kick in at an earlier stage than is currently the case. The guiding principle is that sanctions should constitute an incentive for compliance with the rules.

- The communication makes reference to the tools already described in the Treaty (Article 126(11)) including the requirement for additional publication of information, changes in the European Investment Bank lending policy towards a Member State or the imposition of fines.

- The proposals refer also to the need for the greater and earlier use of the EU budget as a mechanism for ensuring compliance. Cohesion policy-related expenditure, agriculture spending (EAGF) or the fisheries fund (EFF) are all instruments under consideration. Member States may be asked to transfer expenditure in order to improve public finances. Two steps are proposed, on top of the provisions of Article 126(11). First, the detection of an excessive deficit should result in the suspension or possibly redirection of commitments related to multiannual programmes. This would not immediately affect payments and would allow time for correction. In the case of non-compliance with recommendations to correct the excessive deficit, it would imply the cancellation of the budgetary commitments and the definitive loss of payments for the country concerned.

Such restrictions and penalties may directly affect regional authorities, many of which rely primarily on EU funding for a number of investment activities. However, according to the Commission proposals the guiding principle should be that sanctions will not affect end-beneficiaries of EU funds but rather payment to Member States or payments for which Member States act as an intermediary.

As an incentive mechanism, the Commission also proposed modulating the co-financing rates or introducing a **performance Union reserve** to reward sound fiscal policies. Such a reserve could be funded with cancelled commitments under the step-2-procedure mentioned above.

The proposed changes concerning the use of the EU budget and other tools that will cover all Member States will be incorporated in the Commission's 2011 proposals for the next multiannual financial framework. However, in the meantime, a regulation based on Article 136 TFEU will be proposed for the euro-area Member States by the end of September. In addition, the Commission

---

60% of GDP threshold). The Commission suggests that additional criteria will need to be taken into consideration and the initiation of the EDP should be made on the basis of informed judgement.

intends to propose amendments to regulations 1467/97[7] and 1466/97[8] concerning the debt and deficit criteria and requirements under the Stability and Growth Pact.

3.2. Surveillance of macroeconomic imbalances and competitiveness developments

Beyond fiscal surveillance, the Commission argues for a **broadening of economic surveillance in order to prevent macroeconomic and competitiveness imbalances.** The macroeconomic imbalances will be examined in the broader context of the achievement of the objectives of the Europe 2020 strategy[9].

A key tool for improving surveillance will be the **establishment of a scoreboard** composed of economic and financial indicators that will reflect the progress of Member States in the areas of employment, social inclusion, research and innovation, education, energy and climate change. The role of the Commission will be to carry out in-depth country analysis of the Member States' National Reform Programmes and to issue country-specific recommendations to tackle imbalances where necessary on the basis of Articles 121 and 148 TFEU.

For euro-area Member States it is also proposed to upgrade the peer review of macroeconomic imbalances currently carried out by the Eurogroup into a structured surveillance framework by making use of Article 136 TFEU.

Where there is insufficient progress or policies are not consistent with the EU2020 integrated guidelines[9], the Commission will issue recommendations. Specifically in relation to the economic policies, consistency with the Broad Economic Policy Guidelines issued by the Council and any risk to the functioning of the Economic and Monetary Union will also be assessed. The recommendation of the Commission will address the functioning of labour, product and services markets, in line with the Broad Economic Policy and Employment Guidelines. They could also cover macro-prudential aspects to prevent or curb excessive credit growth or excessive asset price development, in line with the future European Systemic Risk Board analysis.

---

[7] Consolidated version of Council Regulation (EC) 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies - the preventive arm of the Stability and Growth Pact, http://eur-lex.europa.eu/LexUriServ/site/en/consleg/1997/R/01997R1466-20050727-en.pdf.

[8] Consolidated version of Council Regulation (EC) 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure - the dissuasive arm of the Stability and Growth Pact, http://eur-lex.europa.eu/LexUriServ/site/en/consleg/1997/R/01997R1467-20050727-en.pdf.

[9] EUROPEAN COMMISSION, Integrated guidelines for the economic and employment policies of the Member States, http://ec.europa.eu/eu2020/pdf/Brochure%20Integrated%20Guidelines.pdf.

If imbalances are perceived to be of a serious nature, the corrective arm of the mechanism would kick in and the Member State would be placed in an "excessive imbalances position". This would lead to the issuance of detailed policy recommendations and regular reporting from the Member State to the Ecofin Council and the Eurogroup.

3.3. Integrated surveillance cycle - European Semester

A further development that the Commission communication proposes is to synchronise assessment of fiscal and structural policies, on the basis of an annual cycle - the European Semester – that will start in January each year. The aim of this proposal is to integrate surveillance of policies but also to introduce an ex-ante coordination of economic policies in the EU and the euro area.

The European Semester will cover all elements of economic surveillance, including policies to ensure fiscal discipline, macroeconomic stability, and the fostering of growth, in line with the Europe 2020 strategy.

The key tools - the Stability and Convergence Programmes (SCPs) and National Reform Programmes (NRPs) - will need to be submitted by Member States simultaneously in the April of the previous year and will be subject to peer review and policy guidance by the Council. The Council, on the basis of the Commission assessments, could issue country-specific policy guidance in early July. Then, in the second part of the year, Member States will finalise their budgets[10].

According to the Commission, these documents need not be fully fledged budgets which would have to be validated before being submitted to the national parliaments – something that would breach the subsidiarity principle - but should allow for ex-ante discussions on policies and help shape a fiscal stance for the EU and the euro area as a whole. A synchronised assessment and coordination of both fiscal and structural policies at a European level is intended to help the Member States to pursue common objectives and address joint challenges more efficiently than is currently the case.

The Commission suggests that Member States should all seek to involve national parliaments - in full respect of national rules and procedures - in the process leading up to submission. No specific mention is made of regional

[10]European Semester Cycle, http://ec.europa.eu/economy_finance/articles/euro/documents/com_367_european_semester_en.pdf.

authorities, but is implicit for those Member States where regional authorities have a role in determining national budgets.

3.4. Robust framework for crisis management for euro-area Member States

The final pillar of the Commission communication proposals concerns the establishment of a clear and credible set of procedures for the provision of financial support to euro-area Member States where there is serious financial distress. The aim of such support will be to preserve the financial stability of the euro area.

The basic principle is that financial assistance to any specific euro-area Member State should be provided in the form of lending so that is does not contradict Article 125 TFEU. A specific policy programme and conditionality for the provision of the assistance both need to be put in place in accordance with Article 136 TFEU. Conditionality would involve a mix of fiscal consolidation, strengthening of fiscal governance, financial sector stabilisation and broader policy interventions to restore macroeconomic stability and external viability. Macroeconomic imbalances, including competitiveness developments and underlying structural challenges will also be part of the policy programme to be followed by the Member State. This will imply closer surveillance, more demanding policy coordination and stronger follow-up to ensure that necessary structural reforms are implemented swiftly.

This proposal was not elaborated further in the Communication of 30 of June. The Commission intends in the medium-to-long term to make a proposal for a permanent crisis resolution mechanism.

4. Analysis of Commission proposals against the legal framework

The Communication proposals aim to further develop the degree of European integration in the area of fiscal policy coordination. From a legal perspective two questions arise:

- whether these additional competences are within the scope of the EU Treaty, and
- whether, in particular, they are in accordance with the principle of subsidiarity.

This section will identify the legal basis and the relevant legal and political developments that will form the framework for macro-policy coordination. It will then assess whether the proposals sketched out in the communications fit within this legal framework. Finally, it will focus on the questions of subsidiarity and proportionality, and whether the proposals are in accordance with those principles.

4.1. Legal framework

The legal basis for EU economic policy is contained in the EU Treaty's Title VIII on Economic and Monetary Policy. Article 119 of the Treaty provides the basis for the coordination of economic policies. According to Article 119, the activities of the Member States and the Union shall include the adoption of an economic policy which is based on the close coordination of Member States' economic policies, on the internal market and on the definition of common objectives. Article 119 also defines the guiding principles and the objectives of the economic policy of the Member States and the Union, which include "stable prices, sound public finances and monetary conditions and a sustainable balance of payments".

Furthermore, Article 121 TFEU states that economic policies should be seen as a matter of common concern and require coordination within the Council. It also sets the basis for a system of multilateral surveillance, whereby the Commission monitors the Member States' economic policies to ensure that they comply with the broad guidelines and informs the Council, which is responsible for issuing recommendations.

In addition, Article 126 (together with Protocol 12 to the Treaty[11] and the Council regulation 479/2009[12]) provides the legal basis for the Excessive Deficit Procedure (EDP). This defines the measures that the Commission and Council can take to monitor the deficit levels of Member States, and to act when there is a breach of the rules.

Further to that, in the case of Member States that are also members of the euro area, the Treaty (Article 136) allows for the adoption by the Council of additional measures aimed at strengthening the coordination and surveillance of their budgetary discipline and setting out economic policy guidelines, while ensuring that they are compatible with those adopted for the whole of the Union and are kept under surveillance.

Besides the Treaty provisions, additional secondary legislation and guidelines are applicable:

- In relation to the application of the Stability and Growth Pact, Council regulations 1466/97 and 1467/97 determine the procedures relating to the surveillance of budgetary positions, the convergence programme and the coordination of economic policy measures to ensure consistency with the broad economic policy guidelines (preventive arm) and the speeding up of the implementation of the excessive deficit procedure (corrective arm).

- Council regulation (EC) No 479/2009 of 25 May 2009 determining the reporting requirements and procedures of Member States.

- The Code of Conduct endorsed by the Economic and Financial Committee on 10 November 2009 concerning the content and format of the Stability and Convergence programmes, defines the key issues, principles and procedures.

Finally, the EU2020 Strategy document and the Integrated Guidelines[13] adopted by the European Council on 17 June 2010 set the basis for the assessment of the Member States macroeconomic, structural and competitiveness developments.

The legal position with respect to the Communication proposals is set out in the following table. The legal basis in the Treaty for each of the main proposals is set out in the middle column and any necessary secondary legislation is set out in the column on the right.

---

[11] Protocol (No 12) on the excessive deficit procedure annexed to the Treaty, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:12008M/PRO/12:EN:NOT.

[12] Council Regulation (EC) 479/2009 on the application of the Protocol on the EDP, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32009R0479:EN:NOT.

[13]

Table 1 - The legal basis for the Commission's proposals

Proposal	**Treaty references**	**Other secondary regulation**
Reinforcing compliance with the Stability and Growth Pact		
Faster pace of progress towards a general government balance with respect to deficit levels of MSs and high debt levels	Article 126 TFEU.	Regulations 1467/97 and 1466/97: Commission suggests that changes to both regulations are necessary. Code of Conduct of the Stability and Growth Pact to be revised
National fiscal frameworks: Embed fiscal rules and credible enforcement mechanisms into national rules and institutions	Article 126(14)	Commission to propose legislation specifying minimum requirements for the design of domestic fiscal frameworks and reporting requirements
Interest-bearing deposit in case of inadequate fiscal policies for euro-area MSs	Article 126(6) and 138(1)(a)	Additional regulation to be proposed
Penalties including additional publication of information, changes to the European Investment Bank lending policy and fines	Article 126(11)	
Use of the EU budget as a mechanism to ensure compliance: Cohesion policy-related expenditure, agriculture spending (EAGF) or fisheries fund (EFF) are all instruments under consideration.		Additional provisions in the legal acts of EU expenditure programmes to be proposed
Performance Union reserve to reward sound fiscal policies		
Surveillance of macroeconomic imbalances and competitiveness developments		
Scoreboard for monitoring economic and financial	Article 121(3)	Europe 2020 integrated guidelines

Proposal	Treaty references	Other secondary regulation
indicators (different for euro and non-euro area MS) with alert thresholds		
Upgrade the peer review of macroeconomic imbalances into a structured surveillance framework (euro-area Member States)	Article 136	
Procedures placing Member State in "excessive imbalances position"	Article 121(6) Article 136 for euro-area MSs	Proposal for legislation
Interest-bearing deposit temporarily imposed on a euro-area Member State	Article 136 (1)(a) for euro-area MS	Proposal for a regulation
Surveillance of structural reforms relating to EU2020 objectives and BEPG based on National Reform Programmes and recommendations	Articles 121(3) and 148	EU2020 integrated guidelines
European semester		
Simultaneous annual cycle of review of Stability and Convergence Programmes and National Reform Programmes		Based on Code of Conduct of the Stability and Growth Pact – Commission to propose update
Robust framework for crisis management		
Financial assistance to euro-area Member State in the form of lending	Article 125	
Policy programme and conditionality for the provision of the assistance	Article 136	

4.2. Conformity to the Treaty

The particular form of the financial and economic crises of recent years has taken governments and major institutions around the world by surprise and the responses to the different phases of the crisis, as they have unfolded, have provoked substantially differing reactions. The responses in Europe, particularly to the sovereign debt crisis, have exposed differing approaches and positions. Some of the suggested solutions have involved proposals to strengthen economic governance that clearly go beyond the scope of the Treaty as it now stands. The French government, for instance, has long wanted strengthened coordination of economic policy by members of the euro area, while German governments have been in favour of the exercise of strengthened budgetary discipline in the form of automatic rules. The strongest form of both approaches could require Treaty changes, though recently the call for a Treaty change has been more associated with the German view[14] [15].

The preceding section makes it clear that the Commission has been careful to frame its proposals within the bounds of the Treaty as it currently stands. New legislation is required to implement the proposals in the communications, but this is all secondary legislation. Only a challenge in the courts would be able to establish if any aspects of the proposals go beyond powers established under the Treaty. A clear basis for such a challenge might conceivably be found in relation to the Treaty provisions on subsidiarity.

4.3. Subsidiarity

Subsidiarity (defined in Article 5 of the EU Treaty) states that the EU shall act only if and in so far as the objectives of a proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.

In the specific case of budgetary discipline and economic policy guidelines for the whole of the EU there is a clear argument for a surveillance mechanism at EU level, because that is a task that can be done more efficiently by an EU institution than by national ministries. The external or spillover effects of the national policies of individual Member States can have an impact at European level, primarily for the euro-area members, but also for the whole of the EU27 as was clearly illustrated in the recent Greek sovereign debt crisis. Discretionary

[14] Heritage, T. (2010), 'Currency Crunch', E! Sharp, July-August 2010, www.esharp.eu.

[15] However, in their recent joint contribution to the EU task force, Germany and France proposed political sanctions such as suspension of voting rights that would, most probably require changes to the Treaty. See: http://www.euractiv.com/en/euro/paris-berlin-issue-joint-plans-eu-economic-governance-news-496566.

fiscal policies have had spillover effects because of their influence on EU-wide interest and exchange rates.

From a legal perspective, although economic policy is not an area of exclusive competence of the EU vis-à-vis the Member States, the Excessive Deficit Procedure (EDP) and the Stability and Growth Pact (SGP) which govern Member States' budgetary and fiscal policies are the most binding procedures in the system of EU economic policy coordination. The wording of the Treaty, which requires Member States to 'regard their economic policies as a matter of common concern' (Article 121) is clear enough. The EDP and SGP entail detailed reporting, monitoring and assessment on a regular basis through bi-annual fiscal notifications and yearly updates of the Stability and Convergence Programmes. Thus, the institutional and legal basis and the means of coordination result in a degree of coordination which is very high compared to other EU governance procedures.

However, the 1997 Protocol of Subsidiarity[16] requires that the EU measures should leave as much scope for national (and regional) decision as possible and respect national arrangements and legal systems. In that respect any proposal on surveillance mechanisms and possible sanctions may, depending on the way they are implemented, be in breach of the subsidiarity principle, if they impose budget rules on regional authorities. At this point, there are no specific proposals on how sanctions are to be implemented. It is therefore very difficult to draw any conclusions on a matter, which may in any event only eventually be decided by the courts.

Furthermore, Article 5 of the EU Treaty states that an action should be "proportional" to what is needed. Thus, even if EU intervention in a certain area is justified, it should not go too far and should be limited to what is necessary to achieve the objectives of the Treaty. Thus, it is necessary to assess whether the new proposals go beyond what is needed to guarantee the objective of economic policy coordination and the achievement of "stable prices, sound public finances and monetary conditions and a sustainable balance of payments" as defined by Article 119 TFEU. In addition, it is necessary to ask to what extent they include policy measures that could be performed equally well at the national level or indeed at a regional level.

To an significant extent, these questions are answered by recent experience. Ultimately in these matters, it is the judgement of the financial markets that counts and it is clear that the markets found the previous arrangements to be wanting, largely because existing rules were not being observed. The measures

[16] Repealed by the Lisbon Treaty but the guidelines and subsidiarity tests it contains are still relevant. See also note of Mike Tomas to the UK parliament, www.parliament.uk/documents/upload/webdoc5.doc.

proposed in the Commission's communications are designed to address these shortcomings in a way that will reassure the markets. Taken as a whole, it appears that just enough is being done to achieve this objective, especially in view of the fact that national administrations and also LRAs will both have an important part to play in addressing identified problems and a large degree of freedom in determining precisely how this should be done. In that sense the principles of subsidiarity and proportionality are being observed. However, when it comes to the particular measures that make up the package that is being proposed, this conclusion does not have the same force. The issue, for instance, of appropriate sanctions against Member States that do not address identified problems is a particular case that will be looked at again after the next section.

5. The local and regional dimension and the role for LRAs

At first sight, the Commission's communications on economic policy coordination have little to say directly about the local and regional dimensions of the response to the current crisis. The main issues appear to concern macro-economic management and there is little reference to any role for government structures other than those at a national and European level. On closer inspection, this initial impression turns out to be very misleading. There are some very significant implications for LRAs in the developments envisaged by the communications, both in terms of their impact on LRAs and the areas for which they are responsible and in terms of the potential of the LRAs to have a major role in delivering better economic policy coordination. Essentially, these arise because macroeconomic events always have their micro-level counterparts.

The effects of the developments being promoted by the Commission's communications fall into three categories:

- the implications of fiscal discipline;
- the implications for LRAs in the follow-up to economic surveillance;
- the implications of any sanctions, especially those involving a withholding of Cohesion Fund support.

These are each considered in turn below.

5.1. Fiscal discipline

The crisis has left budget deficits of 7% of GDP on average and national debt levels that are over 80% of GDP. Clearly this is above the 3% and 60% of GDP reference values set in the Treaty.

High levels of public debt cannot be sustained indefinitely and are already straining the market credibility of sovereign debt instruments in a number of cases. There has to be a credible exit strategy and the extraordinary Ecofin Council of 9 May[17] decided on the establishment of a European stabilisation mechanism, supported by a strong commitment to accelerated fiscal consolidation, governed by the terms of the Stability and Growth Pact.
The preparation and assessment of the Member States' Stability and Convergence Programmes forms the core of the discipline to be exercised under

[17] European Council, Press release – Extraordinary Council meeting – Economic and Financial Affairs – 9/10 May, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/114324.pdf.

the pact, reinforced by the introduction of the "European Semester". The implications of this at a national level affect not only the national administrations, but also LRAs. Clearly the precise form of responsibility will differ depending particularly on the fiscal competences of the authority. Those that have devolved fiscal responsibility will share in the national responsibility for fiscal discipline. The June communication refers to this when it says that domestic frameworks must be comprehensive and cover the whole system of general government finance. It calls for a clear specification of budgetary responsibilities across all levels of government, together with the establishment of appropriate monitoring and enforcement provisions. This should be supported by the more widespread adoption of the European System of National and Regional Accounts (ESA 95) developed by Eurostat.

Furthermore, aware that there was too limited a response to the building up of fiscal imbalances that led to the current crisis, the communications envisage that over the longer term, a more proactive stance will be adopted in identifying future dangers. LRAs responsible for public debt will need to continue to cooperate with surveillance mechanisms beyond the current difficulties and give them greater depth by providing intelligence of what is happening on the ground.

However, no matter what their borrowing powers, nearly all LRAs will feel the impact of increased fiscal discipline in their expenditure programmes. The reduction of borrowing at any level will feed through into reductions in the expenditure for which LRAs are responsible, irrespective of whether the LRA concerned raises the funding through direct borrowing or through grants from central government. This will put LRAs at the sharp edge of budgetary discipline.

5.2. Addressing imbalances

The relatively novel aspect of the Commission proposals for economic policy coordination is to be found in those areas where the communication calls for an extension of surveillance mechanisms to cover macroeconomic imbalances. Making use of the surveillance instruments already available under the Treaty, the Commission proposes to pay greater attention to persistent competitiveness divergences and other elements of instability, such as asset price booms and excessive credit growth.

Transparency in this area will be enhanced by the use of a scoreboard reflecting developments, such as those in current accounts, net foreign asset positions, productivity, unit labour costs, employment, and real effective exchange rates, as well as public debt and private sector credit and asset prices.

Although it is not envisaged that there should be any mechanical link between the results of the scoreboard and the policy follow-up, the use of indicators will raise the profile of these issues and prompt Member States to take action. The greater transparency may also increase pressure from the financial markets.

The biggest challenge will arise for counties in the euro area. Divergences in competitiveness, evidenced by current account deficits, lower productivity, relatively high wage rates and unemployment cannot be accommodated by depreciation of the currency. In effect, governments are forced to tackle the real problems. This may involve some incentives at a macro-level; however, the main focus of measures intended to promote enterprise, innovation and improvements in productivity is at a micro-level, where LRAs clearly have a major part to play.

The new surveillance mechanisms therefore will have important implications for the economic development functions of local authorities, not so much in changing the nature of what is done, but rather in terms of the fine-tuning of policies, so that they are more evidently responsive to problems indicated by the surveillance mechanisms. In the first instance, a response to the priorities enunciated in the Europe 2020 strategy is required. Subsequently this has to be followed through into an increasing responsiveness to identified problems on the part of regional and local business promotion, innovation and training policies, starting perhaps with the framing and application of Operational Programmes under the Structural Funds. Ultimately it is the depth and cohesiveness of the mechanism as a whole that will convince financial markets or alternatively fail to do so. A clear regional and local dimension to the system will add considerable weight to its credibility.

5.3. The implications of any sanctions

At this point we should return to the question of the acceptability of the Commission's proposals to use the withholding of Cohesion Fund support as a possible sanction against Member States that fail to address fiscal and economic imbalances. The use of such a procedure would clearly have significant implications for those LRAs directly affected by any withdrawal of funds, by having a direct impact on their long-term multiannual planning of regional funds. Indeed the ultimate effects could be very local, if funds are withdrawn from particular projects as a result. Alternatively, if contractual commitments to projects already approved fall on the regional authorities, this will pose problems for their own budgets.

Furthermore, unless some protection can be introduced to safeguard farmers' income under any withdrawal of agricultural funds, the nature of the Structural

Funds means that the most disadvantaged areas and groups are those that would be most affected by this. Paradoxically, the withdrawal of Cohesion Fund support is also likely to hit programmes and projects that are designed to address the root causes of the economic imbalances that give rise to the discussion of sanctions. Finally, it could be argued that sanctions would hit the wrong target, primarily impacting at a regional and local level rather than on the authorities at a national level, whose actions the measure would seek to change.

Clearly any sanctions of the type envisaged in the communications could be a major concern for LRAs. If there is a large impact, the question of proportionality arises, in that in using one of the few financial sanctions that are directly available to the EU, the specific effects on particular groups and areas could be regarded as being disproportionate to the original aims. A lot will depend on the precise form that sanctions can take and especially on the extent to which the effects of sanctions can be directed at the 'guilty' party and spillover effects minimised.

When further details are provided on how it is proposed these sanctions will work, they will need to be examined carefully. One of the objectives of the CoR could be to ensure that the regulations adopted for the next multiannual framework will at least guarantee the payments for projects already contracted.
Overall, however, the issue of sanctions and their possible effects again underlines the point that that it makes a lot of sense for LRAs to take an active interest in the developments in economic governance at a European level and to seek to become actively engaged in the process of addressing imbalances, alongside national administrations.

6. Conclusions

The conventional view of macro-policy management envisages that the authorities have both fiscal and monetary policy at their disposal as instruments of economic management. Ever since the early development of ‘economic and monetary union’, the fact that central European institutions do not have responsibility for fiscal policy has been thought to pose problems. However, the introduction of a rules-based system, particularly with specific provisions relating to deficit and overall debt levels (as a proportion of GDP), has largely addressed this supposed difficulty. The recent European crisis mainly arose because Member States were not complying with the rules. However, as often in the past, this crisis has forced the Member States to take steps to strengthen processes and procedures at a European level.

The analysis in this report suggests that the Commission has been careful to develop the new procedures on the basis of existing Treaty provisions. These new procedures have yet to be agreed in detail and there are some questions about whether the detail will conform in all respects to the principles of subsidiarity and proportionality. However, with the possible exception of the proposed sanctions involving withdrawal of Structural Fund payments, the judgement overall is that politically the proposals in the Commission’s communications are likely to prove acceptable and sustainable. An important consideration here in terms of both political and economic viability and of the probability of successful implementation is the discipline imposed by the financial markets. On the one hand, this will force the initial adoption of the appropriate procedures and, on the other, will continue to exert pressure on the performance of the new system, acting in effect as a benchmark of success.

A major consideration over the longer term, especially for the euro area, will be the success of the EU in addressing macroeconomic imbalances. Since responding to some of the main factors that lead to these imbalances takes place to a significant extent at a regional and local level, LRAs will have an important part to play in ensuring their success. This can be achieved by modifications to existing economic development strategies to focus, in particular, on the core issues identified in the Europe 2020 strategy.

7. Bibliography, links and references

Bofinger, P, Ried, S. (2010), 'A New Framework for Fiscal Policy Consolidation in Europe', German Council of Economic Experts – Working Paper 03/2010

COM(2010) 250, Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions - Reinforcing economic policy coordination

COM(2010) 367/2, Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions - Enhancing economic policy coordination for stability, growth and jobs – Tools for stronger EU economic governance

Consolidated version of Council Regulation (EC) 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies - the preventive arm of the Stability and Growth Pact, http://eur-lex.europa.eu/LexUriServ/site/en/consleg/1997/R/01997R1466-20050727-en.pdf

Consolidated version of Council Regulation (EC) 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure - the dissuasive arm of the Stability and Growth Pact, http://eur-lex.europa.eu/LexUriServ/site/en/consleg/1997/R/01997R1467-20050727-en.pdf

Council Regulation (EC) 479/2009 on the application of the Protocol on the EDP, http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32009R0479:EN:NOT

Euractiv(2010), 'Paris, Berlin issue joint plans for EU 'economic governance'', Published on 22/07 in http://www.euractiv.com/en/euro/paris-berlin-issue-joint-plans-eu-economic-governance-news-496566

European Commission – DG Economic and Financial Affairs, 'European Semester of Policy Coordination', http://ec.europa.eu/economy_finance/articles/euro/documents/com_367_european_semester_en.pdf

EUROPEAN COMMISSION, Integrated guidelines for the economic and employment policies of the Member States, http://ec.europa.eu/eu2020/pdf/Brochure%20Integrated%20Guidelines.pdf

European Council, Press release – Extraordinary Council meeting – Economic and Financial Affairs – 9/10 May, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/114324.pdf

European Council 17 June 2010: Conclusions

European Council President, Communiqué from Herman Van Rompuy, President of the European Council following the meeting of the Task force on economic governance

Heritage, T. (2010), 'Currency Crunch', E! Sharp, July-August 2010, www.esharp.eu

Mike Tomas (Legal advisor) to UK parliament, www.parliament.uk/documents/upload/webdoc5.doc

Protocol (No 12) on the excessive deficit procedure annexed to the Treaty, http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:12008M/PRO/12:EN:NOT