Council of the
European Union

Brussels, 2 October 2017
(OR. en)

12674/17

LIMITE

ECOFIN 762
UEM 259
SOC 604
EMPL 464
COMPET 631
ENV 785
EDUC 350
RECH 318
ENER 375
JAI 848

NOTE

From:	General Secretariat of the Council
To:	Permanent Representatives Committee (part 2)/Council
Subject:	2017 European Semester Process: Peer pressure for better implementation

Delegations will find attached the letter by the President of the EFC to the President of the Ecofin Council setting out some important questions for the European Semester as discussed by the EFC and the EPC. In annex, delegations will find the reports from the EPC and the EFC Alternates which contain a number of wider recommendations for further smooth running of the European Semester.

ECONOMIC AND FINANCIAL COMMITTEE

THE PRESIDENT

Brussels, 29 September 2017
ecfin.cef.cpe(2017)5400982

Mr Toomas TÕNISTE
President of the Ecofin Council
General Secretariat of the Council of the EU
Rue de la Loi 175
1048 Brussels

2017 European Semester Process: Peer pressure for better implementation

Dear Toomas,

The way the European Semester runs continues to improve year-on-year. Important nuances introduced by the Commission, in particular through the sharing of large parts of the country analysis in advance of publication, helped for a more frequent and higher quality information flow and better common understanding of challenges.

Despite this, the real success of the European Semester can only be measured against actual implementation of the key reforms that we put down on paper and mutually agree through the Country Specific Recommendations (CSRs) we adopt every June. In this respect we cannot yet call the Semester a success.

The degree of implementation of CSRs varies across countries and policy areas, despite a welcome streamlining and focus of the CSRs. To turn this around national ownership is seen as crucial, but this requires that a good case be made to national audiences on why structural and financial sector reforms or fiscal consolidation are needed.

The issue to grapple with is why, for example, progress on the internal market remains patchy. What are the national, legal or institutional constraints? In trying to focus on key reform priorities for Member States: do we have the balance right or are some issues like the Business Environment being down-played too much?

Finance Ministers are perhaps uniquely placed to promote broad based reforms and to find a route around domestic constraints, promoting the mutual benefit of structural reform and encouraging peers to press forward with the difficult task of political persuasion and then implementation.

Is the reason for the only partial implementation of the CSRs that they are considered not sufficiently relevant? Or are there domestic pressures and political economy blockages that impede progress? In either case, what can Finance Ministers do to overcome such problems?

Perhaps a key component in this respect is to elaborate clearly why reform is of mutual benefit within the European Union. Of course Ministers have a preoccupation with the recommendations issued to their own Member State. But we need a clearer elaboration of why reforms in other Member States are essential to our own national development of growth and employment through positive spillovers across countries and sectors in the EU. This could encourage a broader debate among Ministers if this mutual interest in each other's recommendations and reform implementation were more clearly established.

This also is relevant for the link between the Euro Area Recommendations and the CSRs of the Euro Area Member States. How can we ensure that the focus, link and interdependence between the two are made more clear? And that the Euro Area CSRs are truly pertinent to the Euro Area as a whole.

Aside from the issues I draw to your attention, in annex please find the reports from the EPC and the EFC Alternates which contain a number of wider recommendations for further smooth running of the Semester.

Yours sincerely,

T. W.

Thomas Wieser

ECONOMIC POLICY COMMITTEE

Note from the EPC on the 2017 European semester process
- Lessons learned and ways forward -

Following the discussions in the June ECOFIN and subsequent endorsement of the country-specific recommendations (CSRs) by the June European Council, the 2017 European semester concluded with their formal adoption at the ECOFIN of July.

2017 represented another year of progress within the European Semester. In particular the more frequent and higher quality information flow between Commission and Member States contributed in this regard. The Semester process however remains constrained by the need for a timely adoption of the Commission's CSR proposals, thereby limiting the scope for EPC discussion on substantial issues.

This report provides a short set of recommendations for further improvements in 2018.

1) **Limited changes to the proposals but curtailed multilateral debate as a result of delayed adoption:**

The CSRs continue to focus on the right overall policy priorities and policy responses. The changes to the CSRs the EPC agreed upon are therefore rather limited, mostly aiming at clarifying expected policy responses and ensuring reforms can gather support within the Member State, and be implemented within a 12-18 month timeframe.

Members appreciated further improvements to the high quality Commission analysis throughout the Semester. This coupled with a partnership approach that allowed the sharing of analytical parts of the Country Reports in advance of publication, and more bilateral contact established a stronger common consensus on country challenges. However, some issues still provoked disagreement.

The process in 2017 was however constrained by the delayed adoption of the CSRs proposals by the Commission. This impacts negatively on multilateral discussion and gave Members little time to consider their views, to coordinate views across ministries, and to take position on the draft CSRs of other Member States. As a result, the peer-review process, which represents an important added value of the EPC discussions, was weakened. A further implication of the delayed adoption was that committee meetings had to run in parallel creating coordination and logistical and technical challenges, particularly in terms of the availability of Commission desks and consistency between the approved results of the committee's drafting.

2) Focused CSR proposals:

The CSRs continue to be more focused on policy priorities for the next 12 to 18 months. The number of CSRs has been reduced in an effort to further streamline. This focus is welcome and should allow for better peer review and peer pressure. Nevertheless it comes at the cost of either bundling a wide range of reforms into one recommendation or a more constrained range of issues being covered. In a number of cases, reform challenges that were assessed as only partially addressed have been dropped and the reasoning behind the choice of dropping some CSRs not fully clarified. This should not lead to a false impression of implementation or impede the multi-annual assessment of CSR implementation. In addition, decisions to drop reform challenges from the CSRs without full implementation were not in some cases sufficiently motivated and Member States wished to see more transparency in these decisions.

Some thematic policy priorities have been downplayed, including reforms to the business environment (identified as the most significant barrier to investment last year and with a disappointing implementation record witnessed since then), and reforms of product markets and the real estate sector.

This set of CSRs has some specific recommendations on wages. Whilst CSRs in this area are not new, their nature has changed somewhat from previous focus on the wage setting mechanism and the unit labour cost gap stemming from current account deficit countries, and are now more related to the rebalancing effect and the effect on aggregate demand, thus being rather different in nature, introducing wages as a policy variable. Whilst the same concerns remain in terms of respecting the role of social partners in setting wages, these are supplemented with further analytical and policy challenges including whether to express wages in nominal or real terms and the extent to which these are under the direct control of governments.

In a limited number of cases the language accompanying the recommendation proposals for a Member State stepped beyond pure structural economic reform issues into broader politics and political economy considerations. The EPC felt some unease with having to deal with such considerations in a European Semester designed to promote structural reform.

Specific time-bound deadlines have tended to be dropped in this set of recommendations, although not fully consistently. Some members wished to see more explicit deadlines particularly for Member States assessed as having excessive imbalances under the MIP although more CSRs with more timelines were presented for these Member States.

A number of Members also noted the potential future impact of the European Social Pillar on the Semester as indicated by the Commission's reflection paper on the deepening of the Economic and Monetary Union and the proposals themselves. This is clearly an issue that needs further reflection and discussion.

3) But guard against CSRs within recitals:

In the context of a better mutual understanding of the reform priorities, this year focus switched more to the recitals. The EPC felt that the recitals have to a degree become a "catch all" to explain the CSRs, report on progress, and in some cases address wider structural reform challenges not covered in the CSRs. In some cases the recitals led to misunderstandings that could be ironed out bilaterally and/or the consistency between the Country Reports and recitals and CSRs could be further improved, particularly through the use of consistent language.

The EPC particularly welcomed the more consistent (non) use of qualifiers ("continue"; "further") in the CSR proposals this year. Whilst further consistency is possible the EPC considers that the use of such qualifiers should, as a rule, not be used, for the sake of cross-country consistency and ensuring equal treatment, but also to avoid lengthy discussions.

4) Progress with implementation and MIP Specific Monitoring

The majority of reforms under the European Semester have seen at least some progress, but the pace and depth of reform implementation varies. This is also illustrated with the new multi-annual assessment of CSR implementation. Areas in which progress has been slower are often longer-term structural reforms such as health and long-term care, broadening the tax base, and improving the business environment.

With more concise and focused CSRs, more emphasis should be placed on improving the implementation of structural reforms. Implementation could benefit from stronger peer reviews. The Commission has taken important steps to enhance the dialogue with Member States, both at the technical and the political level, and should improve this dialogue in the forthcoming semester.

Building on the Specific Monitoring follow-up of previous years, and whilst ensuring a distinction according to the gravity of imbalances, the EPC should discuss implementation of CSRs in all imbalance Member States but ensure that such discussions are prioritised towards those categorised as having more severe imbalances. Furthermore the EPC will consider ways of further raising awareness of Ministers to Specific Monitoring findings. Council involvement has progressively increased in recent years and further steps could be justified given that specific monitoring is now a central element of MIP surveillance.

5) Cooperation amongst and between committees worked well

The well-established division of responsibilities between committees functions well and cooperation has further improved despite the increasing number of cross-cutting issues. The current arrangements for the division of responsibilities across committees are appropriate and fit for purpose. No institutional innovation would be required.

Members suggested some changes that can help deliver further progress:

For the Commission

- Ensure an earlier adoption of the CSR proposals to allow the Committee phase to operate at its most effective.
- The Commission could still explain more explicitly why a CSR is MIP-relevant, and ensure an appropriate identification of MIP-relevant CSRs from the viewpoint of what is relevant for the reduction of macroeconomic imbalances.
- Ensure that the reference to euro area recommendations in the recitals, introduced in the CSRs this Semester, is made more prominent.

- Ensure horizontal consistency of CSRs across countries with the aim of maintaining transparency.
- Ensure consistency over time, both in terms of CSRs with insufficient implementation remaining in the subsequent year, and in terms of the language used to describe the nature of imbalances within a Member State. Specify if a policy challenge extends over several years in the related CSR or recital, in order to clarify the expectations of the Commission on policy implementation over the medium term.
- Ensure that the enhanced focusing and streamline of CSRs does not impede the multi-annual assessment of CSR implementation which should capture reform challenges addressed to Member States throughout the European Semester cycles. This multiannual assessment of CSR implementation should be further developed alongside a clarification of the reasoning behind the choice of dropping some CSRs.
- Consider sharing the recitals with Member States in advance of publication and/or arrange bilateral meetings or teleconferences in the time between publication and submission of written comments, so that factual errors and misunderstandings are resolved between the Commission and the concerned Member State before discussions in the committees, and also to improve national ownership.
- More consistency between the recitals and CSRs, whilst refraining from making recitals too prescriptive. In some specific cases the consistency between the findings in Country Reports and recitals and CSRs could also be further improved.
- Some Members pointed to the need to avoid issues beyond the scope of the Semester.

For the Presidencies and the EPC

- Building on efforts by recent Presidencies, future Presidencies should consider how to engage Ministers in a genuine and timely discussion on improvements to implementation focused on a prominent policy strand within the CSRs.
- EPC and LIME chairs should continue to improve the organisation of the IDR discussions in order to avoid overlap.

For the Commission and the EPC

- The EPC will look at the analytical and policy aspects of wages and wage dynamics.
- Consider the impact of the European Pillar of Social Rights on the European Semester process.
- Further analytical and policy work is needed to develop a common understanding on the situation and applicable policy prescription required for Member States with current account surpluses.
    - When assessing Member States' economic developments in the context of the MIP, analysis need to consider both how quickly stocks of built-up imbalances are being reduced and whether further flows of imbalances have been stopped.
    - EPC and the Commission to reflect on the future shape of the European Semester in the context of the ongoing discussion on the European Union in the post 2020 perspective.
    - Further assess the pros/cons of moving further to multi-year assessments of CSRs implementation.

ECONOMIC AND FINANCIAL COMMITTEE

CHAIR OF THE EFC-ALTERNATES

22 September 2017
ecfin.cef.cpe(2017) 5266974

Report by the Chair of the Alternates to the EFC

European Semester 2017 – Lessons learned and suggestions for the next round

On 21 September 2017 the Alternates discussed the 2017 cycle of the European Semester and reflected on the lessons learned and possible improvements for the next round of the Semester. The Alternates are responsible for preparing the fiscal and the financial sector Country-Specific Recommendations (CSRs). Our discussion focused on the following questions:

1) What can be done to further improve implementation of fiscal policy and fiscal governance CSRs?

2) Are members satisfied with the quality of the multilateral dialogue and what can be done to improve it?

3) Are Members satisfied with the interactions between the fiscal surveillance framework of the Stability and Growth Pact and the European Semester?

4) Do Members agree with the style and formulation of the fiscal and financial sector CSRs? Do the recitals clearly provide and are they limited to the necessary explanation for the CSR? Or is there scope to streamline and shorten the recitals?

5) Which workstreams do Members identify for the Commission and the Alternates to prepare for the next European Semester cycle?

Supported by the ongoing recovery, public finances, and in particular headline balances, have overall continued to improve. Only three Member States are currently subject to the corrective arm of the Pact, down from twenty-three in 2011. Moreover, many Member States have achieved their Medium-Term Budgetary Objectives (MTOs). Nonetheless, among the twenty-six Member States that were expected to be in the preventive arm in 2018 based on the Spring Forecast, six countries were projected to be at risk of some deviation from SGP requirements and ten countries were projected to be at risk of a significant deviation from the MTO or the adjustment path towards it.

The Alternates agreed that overall the European Semester process in 2017 had improved compared to previous years. The cooperation between Committees has been excellent, the bilateral dialogue between the Commission and the Member States has further improved and the Commission's willingness to give due consideration to the changes suggested by the Committee on the proposed country recommendations was appreciated. Several Members expressed the view that points for improvement are the timely adoption of the CSR package and the need to better prepare potential process innovations, such as the Commission's announcement on its intention to apply discretion in the CSRs.

Implementation of Country-Specific Recommendations

Alternates agreed that there is scope to improve further the implementation of Country-Specific Recommendations and suggested that the Ministerial debate should focus on how to do so.

Alternates welcomed the further improvement in the bilateral dialogues between the Member States and the Commission. National ownership is seen as crucial for Member States' implementation of Country-Specific Recommendations (CSRs). The consultations with Member States on the country reports to allow for factual corrections were seen as a step forward. To improve further the bilateral dialogue, a number of Members asked to share the recitals with Member States in advance of the publication of the CSRs.

A number of Members noted that the increasing complexity of surveillance hampered national ownership as it is difficult to understand and communicate what is expected from Member States. Therefore, it was necessary to be as transparent as possible. In this context, while some Members welcomed the Commission's intention to apply discretion, several others indicated that it would not be helpful for ownership nor for the quality of the multilateral dialogue as it is unclear at this juncture which fiscal efforts are required in 2018. It was also noted that, while the country reports are published and discussed in the EPC well in advance of the CSRs, the assessment of the stability and convergence programmes comes somewhat after the publication of the CSRs.

Finally, improving the implementation record of the CSRs would also require enhancing the multilateral dialogue to allow for peer pressure and further improving the interaction between fiscal surveillance and the European semester.

Enhancing the Multilateral dialogue

All Alternates agreed that in order to enhance the multilateral dialogue it was necessary to ensure an earlier adoption of the CSR proposals to allow the Committee phase to operate at its most effective. The Commission replied that early adoption of the CSRs would be facilitated if all Member States submit their programmes by mid-April. Alternates acknowledged that the multilateral dialogue was not limited to the semester exercise. In this context, they were concerned that the planned late publication of this year's DBP opinions would jeopardise the multilateral nature of the exercise and asked the Commission to reconsider the publication date.

A number of Members suggested that the quality of the multilateral dialogue would be enhanced if more time was devoted to understanding the challenges and internal constraints in Member States. A discussion in the Alternates of the sections of the country reports in the remit of the Alternates following their publication in February could facilitate this.

Finally, the process on exploring the inclusion of country specificity in the Commonly agreed methodology on output gaps, for which first results should be available by the Spring 2018 forecast, should contribute to a higher degree of consensus on the cyclical situation of a Member State which could enhance the focus and the quality of the policy discussions of the Semester debate.

Interaction between fiscal surveillance and the European Semester

A number of Members stressed that a better implementation of CSRs can only be realised by an enhanced compliance with the Stability and Growth Pact. They asked that the debt rule would figure more prominently in next year's surveillance exercise and warned against a further erosion of the debt rule by the Commission's intention to apply discretion in the preventive arm.

A number of Members suggested that further work was necessary to ensure an appropriate coordination of economic policies: for that purpose, early discussions on the aggregate fiscal stance would need to be continued and the country recommendations would need to better reflect the common challenges referred to in the euro area recommendations. However, a number of other Members cautioned that the early publication of the euro area recommendations risked blurring the national responsibility for implementing CSRs and noted that there was a need to have a better balance between discussions on the fiscal stance for the euro area and those on the country specific situation.

There was also a request by a number of Members to work further on the interaction and consistency between the structural reform and fiscal recommendations, considering that structural reforms can have a short term cost but bring long term gains for public finance. A number of Members recalled that a lot of work had already been delivered on this with the structural reform clause integrated in the EFC opinion of 27 November 2015 on flexibility, on which the Commission is expected to submit a review report before 30 June 2018.

Formulation of CSRs and recitals

Most Members agreed that further progress was made on the formulation, focus and objectives of the CSR package. Moreover, several Members welcomed the multi-annual assessment of progress for CSR implementation and asked to further explore how the multi-annual timeframe could be enhanced for some CSRs. However, a number of Members were more critical on this year's fiscal CSR. All members could agree that the fiscal requirements in the CSR should be predictable, transparent and clearly formulated. In that respect, a number of Members felt that not having the quantitative requirement in the CSRs was a step in the wrong direction. Finally, it was suggested that in certain cases the Commission could have better justified why a CSR was dropped.

Different views were expressed on whether the CSRs identified the right country specific challenges. A number of Members asked for more attention to the debt rule and the related debt sustainability concerns. Other Members were satisfied that the Commission took into account the evolving economic situation in Member States, although another Member stated that the CSRs were too horizontal and did not take into account sufficiently the country specific situation.

With regards to the financial sector CSRs, it was suggested that Alternates could hold a discussion on progress with financial sector reforms and non-performing loans in the months before the European Semester exercise.

Alternates agreed that the recitals should not be considered supplementary CSRs. Instead, the recitals should provide a comprehensive and balanced explanation on why the Member State was being given a particular policy recommendation as the absence of an adequate explanation for CSRs undermines national ownership.

Yours sincerely,

Marketta Henriksson