Economic and Monetary Policy - Call for Evidence

Response by Sharon Bowles MEP, Chair of the Economic and Monetary Affairs Committee, European Parliament (7th legislature 2009-2014)

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Governance and policy making process

Question 1. Does the economic governance system provide the appropriate balance of competence between the European Commission and the Council?

In contrast with other areas of EU policy (e.g. internal market), economic policy is subject to the principle of close coordination of Member States. This 'coordination method' gives the Council the last word on many issues. Co-legislation is limited to the definition of the rules on the so-called multilateral surveillance (Article 121(6) TFEU). The balance of power between the Council and the Commission was a contentious issue in the context of the 6-pack negotiations, which were conducted under the Treaty co-decision rules. The view taken by the Parliament was that the Council, at least when it came to large member states, had been unwilling to endorse disciplinary measures proposed by the Commission. This had led to an undermining of the stability and growth pact. It had also been operated unfairly with France and Germany let off, while smaller member states such as Ireland and the Netherlands had been forced to make painful adjustments.

The Parliament objected strongly both to the undermining of the S&G pact and the unfairness and would have preferred the Commission to have had greater power. However some voting arrangements –favouring the Council's pre-eminence– were fixed in the Treaty and elsewhere Council was unwilling to give up its 'safety valve'. In the end some changes were made introducing. 'reverse qualified majority' (i.e. the Commission's recommendation is adopted unless Council decides otherwise) as regards procedural steps where the Treaty was silent in order to give momentum to the Commission proposals. This appears a good compromise given the expansion of the role of the Commission elsewhere and the Council's tendency to water down the Commission's macroeconomic recommendations on purely internal political grounds.

In the RQMV context the role of the UK changes when it chooses to abstain. These are Council decisions, not Eurozone decisions, and so silence or abstention (as I believe the UK has under the former rules in the past,) now keeps momentum with the Commission proposal rather than being passively against. However, no such decisions under the new rules have been taken so far. It is therefore premature to draw conclusions at this stage.

Within the constraints of the Treaty and bearing in mind the expansion of powers of the Commission through other legislation this is probably an

acceptable balance. In the event of a Treaty change it might be desirable to make more voting RQMV and not allow abstention to carry the day.

In should be recalled that the corrective provisions (e.g. fines) of the Stability and Growth Pact do not apply to the UK by virtue of Protocol 15 TFEU. This may underlie preference for abstention. Examination of where it may be desirable for the UK not to count in a vote in order to give comfort to Eurozone countries, as suggested in the context of the SRM, could be considered as part of a package where reciprocal comforts are given to the UK, for example on non-discrimination of market infrastructure.

When it comes to the role of the Commission and Council during the European Semester and Country Specific Recommendations, it does seem that there is a bit of a game going on. The Council tends to dilute the CSRs, and thus they seem initially constructed to be stricter than needed in anticipation of watering down. Some maturing of this process away from gamesmanship is desirable.

With regard to the Troika, there is concern over its role which has been called into question more than once by me and on which the European Parliament has completed a report. The often voiced defence is that it is not perfect but there is nothing better. Decisions have modified over time resulting in unfairness and hiding the true beneficiaries. Whilst the Treaties prohibit transfer of funds from one Member State to another the bailouts have protected banks in strong countries and put the cost on small populations in others. The unfairness of this is now recognised and contained in the Parliament's Troika report.

The failure of the Commission to protect the deposit guarantees in the 'Cyprus 1' package, along with other implications, was a major setback to confidence in the Commission. It was reprehensible for all parties but the Commission has a special duty to uphold legislation. For a couple of long days I was the only leading figure from any of the European institutions making public objections and demanding that deposit guarantees be upheld. The Commission stayed silent and officials were obviously ashamed as they telephoned the Secretary General of the ECON committee to say 'thank goodness your chair said what she did when she did'. My line was subsequently endorsed by the committee. Whilst it is hoped the experience will prevent any recurrence in other contexts, this is an area that could be examined further to make sure that the single market and other assurances contained in legislation, including in the SSM and SRM, cannot be forgotten in the heat of the moment.

Again as noted in the Parliament's report on the Troika, into which I made significant input, various factors (e.g. evolving nature of the EU's response to the crisis; the unclear role of the ECB in the Troika; the nature of the Troika decision-making process), have led to the Troika's mandate being perceived as unclear and lacking in transparency and democratic oversight.

The 2-pack regulations established a step in codifying the surveillance procedures to be employed in the euro area for countries experiencing financial difficulties, conferring a formal mandate on the Troika.

Currently, however, the Eurogroup gives a mandate to the Commission to negotiate on its behalf the details of the conditions attached to the assistance, while taking into account Member States' views on key elements of the conditionality and, in view of their own financial constraints, on the extent of financial assistance. This "conferral" procedure is not specified in EU law, as the Eurogroup is not an official institution of the European Union.

It is also alarming to note that the former President of the Eurogroup acknowledged before the European Parliament that the Eurogroup endorsed the recommendations of the Troika without extensive consideration of their specific policy implications. This admission sheds a worrying light on the blurred scope of the 'technical advising' and 'Eurogroup agency' roles devolved to both the Commission and the ECB in the framework of the design, implementation and assessment of assistance programmes. The lack of any clear and accountable case-by-case mandates from the Council and the Eurogroup to the Commission is not viewed by the Parliament as acceptable, nor in my view sustainable.

The Parliament has also questioned under my leadership the dual role of the Commission in the Troika as both an agent of Member States and an EU institution. There is a potential conflict of interest within the Commission between its role in the Troika and its responsibility as guardian of the Treaties and the acquis communautaire, especially in policy areas such as internal market and competition.

The report also endorses other criticisms that I have made about a potential conflict of interest between the current role of the ECB in the Troika as 'technical advisor' and its position as creditor of the four Member States, as well as its mandate under the Treaty as it has made its own actions conditional on decisions it is itself part of. The potential ECB conflicts of interest, especially as regards crucial liquidity policy, should be carefully scrutinised.

Throughout the crisis the ECB has had crucial information on the health of the banking sector and financial stability in general, and with this in mind it has subsequently exerted policy leverage on decision-makers, at least in the cases of the Greek debt restructuring (where the ECB insisted that CACs were to be removed from government bonds it held), the Cypriot ELA operations, and the Irish non-inclusion of senior-bondholders in the bail-in.

This confusing framework has also contributed to EU institutions being portrayed as the scapegoat for adverse effects in Member States' macroeconomic adjustment, when it is the Member States' finance ministers who bear the political responsibility for the Troika and its operations. This may lead to increased hostility to the EU, although responsibility lies with the national and not the European level.

Thus there has been more power given to the Commission through various legislative and conferral procedures, while the Council, Eurogroup and finance ministers have abrogated parts of their own responsibility.

Question 2 What is the appropriate role of the European Parliament in economic governance?

The European Parliament takes seriously both its role in holding the Commission to account and as a platform to examine actions of Member States. Legislation has enhanced this role and oversight hearings have been a regular feature with the potential to become more frequent and higher profile in the new mandate. There is no other vehicle for such oversight and the European Parliament has endeavoured to create not just a European level platform but to enable National Parliaments routes to join in.

In the 6-pack the European Parliament inserted a possibility to request the attendance of finance ministers to explain their positions before the Economic and Monetary Affairs Committee in a so-called ‘Economic Dialogue’. There is no power to compel attendance, but (used with discretion) naming and shaming recalcitrant Ministers tends to get attention by the media and potentially the markets: UK media of course is not interested even though Bloomberg and Reuters are avid followers and I have been quizzed on the content by well-informed City and US analysts. So the money knows what is going on even if it

is not carried to the people. Such events do of course get covered in the national media of attending ministers and more widely within the Eurozone.

The intention of the Economic Dialogue was not for it to be a haranguing event but a helpful platform for ministers to explain their viewpoint, to challenge the Commission if they wished, and to aid wider European public understanding of the measures taken to achieve stability, economic governance and convergence.

There have been some excellent exchanges, the Commission has been challenged on occasions and the Committee has positively supported some ministers in difficult times. It is these kinds of exchanges and hearings with the Commissioner that have led to noticing the 'gaming' of recommendations mentioned in question 1.

The European Parliament also conducts meetings in the context of the European Semester, including with the chairs and other representatives of the finance committees of the National Parliaments. The contributions are variable but along with other meetings with national MPs during delegation visits it has usefully informed MEPs during the process of legislation and in the analysis of Commission communications. The UK is represented by MPs and/or Peers from the European Scrutiny Committees and so there is not really a specialist economic engagement.

The ECON committee also engaged regularly via myself as chair, or when trialogues became too numerous via a vice-chair, with the program of meetings of the national finance chairs, again for the purpose of mutual understanding.

Expansion of the routine engagement of the ECON committee with its counterparts, both individually and collectively, is envisaged. The extraordinary workload of legislation in the 2009-2014 mandate made this more difficult, but a special series of visits to program countries was undertaken in the context of the Troika Inquiry Report, which was widely reported in those countries. On top of that it has been the custom to visit one country every six months, exchanges also take place with Parliaments of incoming Presidencies and on other ad-hoc occasions initiated from either side.

National Parliaments also come on fact finding visits on particular issues to Brussels. It does appear that the UK Parliament is under-represented compared with the permanent staff of other parliaments in Brussels, but that is a general issue and not specific to economic governance.

The European Parliament is also responsible for responding to the Integrated Guidelines on the economy and employment, and has repeatedly drawn attention to the fact that these are never issued in a sufficiently timely manner to allow the Parliament to do its work in a reasonable and public way.

Question 3: What do you consider to be the most appropriate role for National Parliaments in the economic governance system?

The EU institutional architecture foresees that the EU executive is accountable to the European Parliament. The rationale for the EU level and, more specifically, the Commission to play an important role in the governance framework is to handle the spill-over of national decisions, especially in the euro area. The crisis has confirmed this: decisions in Greece had an immediate impact for the stability of other euro area Member States, and indeed then more widely on the EU as a whole. So spill-overs mean that there has to be a system to address them at EU level. Handling spill-overs at national level only would be a risk for the economic and financial stability of the euro area as a whole and thence the EU.

Clearly National Parliaments have a special responsibility with regard to the preparation of fiscal and reform plans before their submission by national governments to the Union. In particular, National Parliaments are a key player to ensure a timely, informed and democratic scrutiny of their governments in this regard.

The European Semester in particular has caused concerns for National Parliaments and the feeling that their role has been taken over. This is one of the strongest drivers for National Parliaments wishing some return to them as a forum for collective decision making instead of the European Parliament. Given my experience of the detail and amount of legislation in the European Parliament it is hard to see reversion in general to such an arrangement, and it requires Treaty change. However on budgetary matters this should be an area for further examination to be more inclusive of National Parliaments. For Eurozone countries this seems all the more needed as there has been a considerable expansion in Commission powers and penalties, done in a manner deliberately avoiding Treaty change and referendums.

During the Semester the time-scales are very compact and, as with many things, the lion's share of time seems taken up by the Commission. If the Commission needs internal consultation and analysis time, what does it think others need, especially those at the forefront of communication with the public?

Question 4: Does the current governance structure strike the right balance between the institutions of the euro area (EWG, Eurogroup) and those of the European Union (EFC, ECOFIN).

First of all, it should be noted that neither the Eurogroup nor the EWG are EU "institutions"; they are informal subsets of the ECOFIN and EFC, respectively, with no decision-making power. Legislative procedures follow the classical Council working-group/EFC-Coreper 2-Council path. This has not changed with the establishment of the EWG (currently chaired by the EFC chair).

On the other hand, there has clearly been a great increase in the euro area institutional work because of the Eurozone sovereign debt crisis and the need to design and fund the bail-out systems. At the same time the UK has tended to keep out of those things it is not part of other than to ensure preservation of EU wide concerns such as the single market and state aid. Whilst the Commission is active in that role, the input from the UK and UK MEPs has proved valuable and that is recognised. There are also calls to 'replicate' the Eurozone structure within the European Parliament and that was put forward by the European Commission's Blueprint and, later on, by the EP Constitutional Affairs Committee in a report approved by the Parliament as a whole. However the ECON committee and the EP Conference of Presidents have so far rejected this notion and it has been left for the new mandate.

On balance the more that is done at the EU level the better and Eurogroup meetings being in advance of the ECOFIN is probably the wrong way around. Recent circumstances may have meant unusual times, but the line surely should be that things go to EU level first, then where there is a subset of issues that are an add-on that subsequently goes to the Euro level. Besides, nowhere in the TFEU it is said that the Eurogroup should meet ahead of ECOFIN meetings.

During the legislative process for economic governance, banking union and the revisions to statistics legislation the contributions of non-eurozone Member States and MEPs has been substantial. In many ways it has been more insightful, possibly because of distance from specific pressures, and there have been expressions of thanks especially at the technical level. It is also the case

that economic wellbeing is intertwined and even if the Eurozone wishes for greater formal coordination, it is not helpful for other Member States to be on the outside of discussions. Those member states that have to join the Euro should know what is in store, and those not obliged to join may be helpful with advantage to both sides from being involved in the discussion and the exchange of thinking. For example in the SSM legislation it was largely non-Eurozone MEPs that recognised and pushed for oversight of the ECB and preservation of inquiry rights of national Parliaments as far as possible. It is better for all sides to understand major trading partners even if not bound to do exactly the same. Thus the UK should seek reasons to be included in and attend discussions, not reasons to opt out, be absent or sent junior people. This would also compensate for the absence of a UK party in the EPP and missing out on important meetings that take place within that grouping.

Monetary, fiscal and economic policy

Question 5: Given the UK opt-out from the single currency, is the current level of UK participation in the EU's economic, monetary and fiscal policy coordination appropriate?

In part this is answered above in that being in the loop and hearing things first hand is better than being out of the loop and hearing things later. Provided that it is clear the participation is for reasons of better relations, good understanding and potential voluntary convergence or synergism, participation in meetings is desirable. Engagement rather than a defensive presence is more likely to improve relationships and outcomes.

Monetary policy has been developed around the world in response to the crisis and central banks are in good communication. However a visible good relationship between the Bank of England and the ECB would be helpful, especially now that the ECB is developing its macro-prudential policies. There is also overlap between upcoming Commission work in its roadmap for long-term investment and growth that references Solvency 2, pensions and SME credit scoring and similar Bank of England media announcements. Optimally communication starts early on these matters and does not await a final UK conclusion before engagement.

Question 6: What evidence is there of the indirect impact on the UK of economic and monetary union and the relevant EU competences exercised over the euro area Member States?

The economic condition of the Eurozone has a direct bearing on the UK economy, indeed of the world economy. That is why President Obama and the IMF have taken such an interest. There are benefits of there being a stable Eurozone.

In general Economic and Monetary Union has made it easier for UK businesses to trade in one rather than several currencies which is cheaper: this is something I experienced myself running an international patent attorney practice before becoming and MEP.

Although the financial crisis is blamed for exposing flaws in the Euro, and the UK is seen as an exporter of the crisis to the rest of the EU, some sovereign crisis was always going to happen in Greece and maybe elsewhere due to the macro-economic imbalances and inadequate controls. The UK will be affected if there is inadequate discipline in its trading partners and is also by the remedial austerity programs in as far as it reduces trade. For this reason the responses by way of new controls should be welcomed.

Question 7: What are the advantages and disadvantages of coordination of economic policy as a matter of 'common concern' between Member States?

The advantages of coordination are to achieve synergistic changes. The disadvantage is if coordination is taken to mean identical or removal of freedom of choices. Advantages are also meant to mean that policies that do harm to other Member States should be discouraged. However for the Eurozone there is greater necessity for convergence as also referenced in the spill-over responses in question 3, and this is seen as stronger than merely common concern.

In November the council formations will have a qualified majority from the Eurozone member States, but that was always going to happen eventually. However there is no way that the economies, from tourism to agriculture, will ever be the same in all Member States, whether Eurozone or not, due to the differences in climate and geology among other things.

Question 8: Have recent developments to the economic governance system as a response to the euro area crisis taken account of the interests of all member States (whether euro area, non-euro area or those with an opt out)?

All negotiations on the 6-pack and 2-pack have respected the opt-out of the UK and the corresponding protocols. In the banking union legislation non-discrimination has been specifically recited with regard to currency and location; duty of care for the single market has been imposed on the ECB, and state aid rules by analogy, where there is a 'hole' in the Treaty when the aid is joint resources, have been imposed so that the conditions are essentially the same. Without Treaty change it cannot be identical in terms of enforcement but the intent is clear.

Sometimes it has been an irritation during negotiations for protocol provisions, non-discrimination and state aid references to be re-recited at every available opportunity (done to make sure it gets in somewhere) and so the number of instances has been reduced in final texts to that which was necessary. This is a success and for the main part the Parliament, Council and Commission found comfortable agreement on this.

The economic governance provisions take account, as appropriate, of euro status. Clearly those that are about to join the Euro have to fulfil conditions for membership and the new tools help to measure that convergence.

When it comes to banking union and the fact that banks have branches and subsidiaries across borders, efforts have been made to make sure that there is the relevant consideration and safeguards. The situation with macro-prudential controls is still evolving with the ECB, Member States and the Commission all having potential roles. The ECB is seriously looking at use of macro-prudential controls, including variable geographical application, as a way to obtain more granular control alongside monetary policy. This granular approach may be easier for the UK to be alongside rather than wider ranging macro-prudential controls, but in any event the Commission has a role if there is disturbance of the single market. The fact that the ECB was given a duty of care for the single market in the SSM must also mean it should take that into account.

Question 9: What are the advantages and disadvantages of the current framework for coordinating economic policy through the European Semester?

This has been covered in part in response to questions 1 to 3. The main problem is getting sufficient time for National Parliaments to feel engaged in the scrutiny and in the process and for the European Parliament to have sufficient time for proper debate and exchanges with the Commissioner on the integrated economic guidelines and the country specific recommendations. However the timings have already been changed as problems have come to light in the early iterations.

Question 10. How effective is the European Semester framework at encouraging a growth enhancing economic reform?

Although it may be premature to draw conclusions at this stage, one striking outcome of the Semester so far is that, on average, only 10% of the recommendations from the Council (based on a Commission's draft) are fully implemented by Member States. This estimate comes from the European Parliament's policy services and is based on Commission's and Council's data.

The majority of effort recently has been on consolidation and debt and deficit reduction. However the country specific recommendations do point out factors that are constraining growth such as areas of non-competitiveness and restrictive practices. Reforms have been difficult where there are vested interests that are long established and the discipline of the semester has bolstered the efforts of governments.

The Commission also uses the Semester to look at the new flexibility allowed for long term investment.

On the subject of growth more generally DG ECFIN was slow to realise the effects of financial services legislation on growth and long term investment. I drew matters to their attention and to Commissioner Rehn on several occasions and was told they did not have the resources to look at it then. More resources have been made available for this recently and growth is more evident in their considerations than simply the mantra of 'regulate at any cost'. This is not unlike the evolution of the UK and Bank of England's own responses.

In the Commission's Roadmap for long term investment and growth there is an indicated intention to consider the tax bias for debt vs. equity in the Annual Growth Surveys and country specific recommendations. The European Parliament also wants to see elimination of all bias against equity in the national, European and global contexts and this is a matter that I have pressed

personally. This is more about fairness on equity than removal of tax relief for non-financial companies. The EU role here would seem to be one of analysis and sharing of best practice rather than mandating. However it is also worth observing that removing the tax benefit on debt within financial institutions above a certain leverage is a useful tool and there might be ways to counteract the tax advantage within financial regulation if desired.

Question 11: Do you consider that the Macroeconomic Imbalances Procedure is an appropriate system for detecting and correcting underlying economic imbalances?

Yes, the EU was lacking a system to detect the building up of imbalances that had an impact on the stability of the euro area as a whole and that went under the radar. Most of the EU periphery countries suffered from imbalances that could not be captured through the simplistic Maastricht fiscal rules. This was notably the case in Spain and Ireland, which had an impeccable fiscal position on the eve of the sovereign debt crisis. As a consequence, the European Parliament has been very supportive of a macroeconomic imbalances procedure and it featured in the questions asked of Commissioner Rehn in his appointment hearing. When it came to legislation it was not possible to get a totally symmetrical approach agreed because countries with macro-economic surpluses were not inclined to be admonished to reduce their exports. However, the Parliament managed to set out the symmetry principle, which operates with different intensity depending on the deficit/surplus context.

The fact of the scoreboard, monitoring, in depth analysis and comment has had a positive effect on the public awareness and on the policy responses to imbalances.

Question 12: Does the current operation of the stability and growth pact have the right obligations for all Member States (whether euro area, non-euro area or those with an opt out)?

The most significant point made here for the UK is that it says ‘endeavour to avoid’ rather than ‘shall avoid’ and there are no sanctions. There can of course be adverse comment but anyway the debt and deficit of the UK is well known and watched by markets.

There is always the fear that in calmer times efforts in the Eurozone will be reduced, which was part of the reasoning behind the Semester to monitor recovery and maintenance.

For non-eurozone countries, the majority are intent on meeting criteria for joining and hence there are additional incentives for discipline.

Question 13: What are the challenges in terms of implications for the UK of likely future developments in these areas?

The most obvious concern is if the Eurozone does more things either 'off Treaty' or via enhanced cooperation. Whilst occasional measures might be necessary, any systematic approach could risk damaging the single market and create a two tier Europe in an unplanned manner. The knock on effect of a whole series of enhanced cooperation measures within the single market sphere but in the interests of economic cooperation would seem to be counterproductive and/or end up with those standards de facto becoming the norm. Variable geometry can be a solution in some instances but they should be looked at very carefully for the cumulative effect.

Divisions on many policy areas, including financial services, do not fall along Eurozone in or out lines. Geography determines that economies will have different bases: there is no way that economic and monetary union will move the sunshine and oranges of Spain to Finland.

As noted before, from November 2014, the euro area Member States will be able to build a qualified majority within the ECOFIN.

EU financial assistance mechanisms:

Question 14: Do you consider that the EU's role in the use of Financial Assistance Mechanisms is appropriate and can the balance of competences in this area be improved?

Strictly speaking, the EU plays no formal role with regard to the European Stability Mechanism (and its predecessor, the European Financial Stability Facility) since they are not Part of the EU set up. Therefore, the question of the balance of competences does not arise in their regard.

The provision of the European Stability Mechanism and its predecessors has been vital in getting through the Eurozone crisis. If anything it has been criticised by the US and IMF as being too small and not available for direct bank recapitalisation. Nevertheless in terms of political constraints it was the best that could be done and has worked so far. Smaller countries outside the Eurozone wish that they had an equivalent.

The European Financial Stabilisation Mechanism, as well as the European Financial Stability Facility were set up at a time of crisis in May 2010. Prior to its proposal I had discussed with the then relatively new Commissioner Rehn that I considered Article 122.2 could be used in the context of the financial crisis as well as natural disasters when there was an element of 'beyond control' of the Member State. It is possible that this could be invoked again, but there are greater, or should be greater, limitations on its deployment as not everything that happened in the running up of debt can be said to be 'beyond control. Thus a general use of such a bail-out fund would seem to stretch the Treaty too far and the UK was correct to resist its extension. One might question whether the proportions of use of the EFSM, EFSF and IMF funding properly reflected the 'beyond control' element, but that looks hard to quantify in the circumstances. It is understood that the proportions were not an issue for the UK at the time.

There were also instances where the Commission wrongly stated that the EFSM was for the Eurozone only. I corrected this and alerted the UK to make similar representations.

Concerns have been raised by the Parliament relating to oversight of use of the EFSM as it comes from the budget and was deployed without any consultation. This issue has been raised by both the ECON committee and Budgetary Control committee and hearings have since been conducted. Dialogues concerning the EFSF and ESM have also taken place.

The main problems with deployment of the EFSF and ESM have been the 'unanimity' requirements which seem too precarious.

General:

Question 15: Do you have any other points to raise that are not covered above?

Competition policy is an important economic tool and whilst that has been dealt with in the context of other reviews it has relevance here in particular with

regard to State Aid and the deficiency of the EU Treaties when there is jointly resources aid that does not fall under the Treaty definition.

Further, in the context of the ECB it is not entirely clear that there is a full understanding of European State Aid rules which has been exposed more than once in the context of discussions of recapitalisation following the Asset Quality Review and Stress tests under the SRM.

The fiscal compact consequent on the UK veto of a broadly similar compact but with a UK opt out under the Treaty was not the optimum that could have been extracted from the situation. It seemed likely at the time that a different mode of negotiation could have meant a Treaty amendment not an independent Treaty and that single market and infrastructure protection could have been made more secure without the UK having to be subject to the terms of the compact. There are UK party political differences in how this is seen but going forward the same issue, which has been successfully included on a case by case basis in legislation, could be revisited.