EUROPEAN CENTRAL BANK

EUROSYSTEM

CONTRIBUTION OF THE EUROSYSTEM
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to the public consultation of the European Commission
on the mid-term review of the "Europe 2020 strategy"

Europe 2020: progress so far

The Eurosystem welcomes the opportunity to contribute to the public consultation launched by the European Commission on the mid-term review of the Europe 2020 strategy. Since 2010, significant progress has been achieved in adjusting fiscal and macroeconomic imbalances in Member States. Major steps towards a sounder financial system have been achieved notably with the Single Supervisory Mechanism and the Single Resolution Mechanism as the main building blocks of a Banking Union relying on a single rulebook, complemented by harmonised legal frameworks for both deposit guarantee schemes and the recovery and resolution of banks. Crisis management arrangements have been significantly strengthened with the establishment of the temporary European Financial Stability Facility and the permanent European Stability Mechanism. Important initiatives to deepen the Single Market, in particular through the Single Market Act, were also taken. Also, European fiscal and macroeconomic surveillance procedures have been strengthened as a result of the crisis, notably with the adoption of the Six-Pack and the Two-Pack as well as the Treaty on Stability, Coordination and Governance.

Overall, the Eurosystem continues to support the overall objectives of the Europe 2020 strategy, in line with the position outlined in the contribution to the public consultation on the set-up of the strategy in 2010. Yet, the insufficient progress toward the objectives of the Europe 2020 strategy calls for a stronger focus of this comprehensive strategy. Despite significant policy measures taken by vulnerable euro area countries, the Eurosystem observes that the lessons from the crisis still need to be fully translated into the necessary policy actions in all Member States. EU economies continue to face substantial structural challenges weighing on long-term growth potential, in turn limiting their ability to significantly reduce high unemployment. Such rigidities not only hinder economic growth and employment prospects, but also reduce the economies' shock resilience, in particular in the context of a monetary union.

Scope for reviving Europe 2020

The Eurosystem is of the opinion that the Europe 2020 strategy should focus on those reforms which increase potential growth and create high levels of employment. Such reforms should specifically ensure a well-functioning of labour and product markets and an improved business environment, but also sustainable fiscal policies and sound financial systems.

Elements for fostering flexibility of EU economies and for facilitating the efficient allocation of resources

Improving economic structures

Significant prevailing rigidities, which limit the adjustment capacity of European economies, still need to be addressed with determination. As long as inefficient economic structures - which prevent competition and thereby an optimal allocation of capital and labour - prevail, economies remain particularly vulnerable to external shocks. Inefficiencies not only increase vulnerabilities, but also limit the growth potential of EU Member States.

Against this background, the Eurosystem recalls the need to further enable the Europe 2020 strategy to point Member States towards necessary structural reforms with a view to achieve sustainably higher economic growth, efficient, flexible and in turn competitive economies. To this end, the Eurosystem particularly points to the importance of further structural reforms to improve the functioning of labour and product markets and the business environment. Sound institutions need to support appropriate wage-setting, facilitate mobility and matching in labour markets and create the right incentives to work. Moreover, more competition in product markets is needed. Structural reforms in this respect can address excessive rents, in particular in the sheltered professions, for instance by removing high entry barriers for new firms. At the same time, improving the business environment will create better conditions for investment, facilitating the start of new firms and making it easier for existing firms to grow and innovate. This would also allow European countries to remain competitive in an increasingly interconnected, global economy. Overall, several of these aspects are also covered in the Single Market Act which therefore needs to be implemented by Member States with determination.

The Eurosystem notes that some elements of the Europe 2020 strategy are already touching upon these avenues to improve economic structure. At the same time, it suggests that further emphasis should be placed on these policies, as increasing competition and flexibility will best facilitate the objective of sustainable long-term growth and employment.

The Eurosystem also stresses the importance of an inclusive, fair and socially balanced European economy. Against this background, the Eurosystem notes that significantly increasing sustainable potential growth, and thereby stimulating job creation, is the best avenue towards more social inclusion and higher living standards of European citizens. A competitive and flexible social market economy will create the value added necessary to pursue, in a sustainable manner, the social and also environmental objectives outlined in the Europe 2020 strategy.

Ensuring fiscal sustainability by continuing consolidation – designed in a growth-friendly way

The reduction in budgetary imbalances from high levels has progressed within the EU and the euro area. This is demonstrated by the reduction in the aggregate EU and euro area nominal budget deficits, which have more than halved from their crisis peaks under particularly difficult economic and financial conditions for some countries. Nonetheless with government debt ratios high and in several countries still rising, countries are still exposed to remaining fragilities in financial market sentiment and to adverse shocks.

To reduce fiscal vulnerabilities and to limit their potential negative impact on economic growth, it is essential that high public indebtedness is brought on a downward trajectory. The Eurosystem recalls that adhering to well-defined medium-term fiscal consolidation strategies based on prudent macroeconomic scenarios therefore remains of the essence. Learning the lessons from pre-crisis times, complacency in an improving economic environment must be avoided. The largest challenge for fiscal policies at the current juncture is thus to sustain fiscal consolidation over the medium-term, designed in a growth-friendly way to support increases in potential output growth, and to address the implicit liabilities deriving from ageing populations. To enhance the quality of public finances, the Eurosystem stresses that consolidation strategies shall focus on savings in unproductive government expenditure, while safeguarding growth-enhancing government expenditure on education, R&D and infrastructure and creating room for reducing the high tax wedge on labour.

Enhancing financial structures

The reform of the financial system was identified as a key element for the pursuit of the Europe 2020 objectives. With the establishment of Banking Union, significant progress has been achieved towards more integrated regulatory and supervisory framework to safeguard financial stability and minimise the costs of bank failures. Yet, differences in financial structures remain a major source of cross-country heterogeneity, for instance in terms of financial development. Further efforts are thus needed to fully integrate European corporate bond and equities markets. The Eurosystem recalls that genuine financial integration is essential in a monetary union as it allows a more effective transmission of monetary policy, a more efficient allocation of capital independent from location and risk diversification, thus creating the conditions for firms to invest and contribute to economic growth.

By the same token, the degree of legal protection of borrowers' and lenders' right or the availability of market-based financing continues to vary substantially and the persistence of such differences creates the risk of permanent imbalances. This structural source of financial fragmentation could be addressed as part of the establishment of a single market for capital (or capital markets union) eliminating the obstacles to larger and more robust cross border lending and investment flows. Building on the on-going reform of financial legislation, this initiative could entail steps towards common legal frameworks for rights in securities and corporate governance, as well as a streamlining of national taxation and insolvency procedures[1].

[1] For more details, see the ECB Financial Integration in Europe report (April 2014), "Initiatives to promote capital market integration in the European corporate bond and equity markets" (Special feature C, pp. 97-112).

As regards SME financing, initiatives at European level can help developing alternative funding sources complementing traditional bank lending. This requires removing the obstacles identified in the report *Finance for Growth*[2] *and* the Commission's Communication on long-term financing[3], for instance concerning the availability of credit relevant SME information and the harmonisation of regulatory requirements. Additionally, addressing the causes and roadblocks of the impaired securitisation market would allow developing this funding channel notably for SMEs.

Further strengthening economic governance

The success of the Europe 2020 strategy hinges upon an effective governance framework. A full, strict and consistent implementation of the strengthened economic governance framework established by the six-pack and two-pack legislation is key to ensure sustainable fiscal policies, prevent or correct excessive macroeconomic imbalances and raise growth and job prospects. In the near term, there is no need for new rules. At the European level the focus should squarely be on the thorough implementation of the commonly agreed rules which is essential to ensure their effectiveness and thereby their credibility in order to achieve a closer coordination of economic policies, especially within the euro area. At national level, not only continued fiscal consolidation but as well the implementation of far-reaching economic reforms by euro area governments as outlined above is crucial.

Against this background, structural reform recommendations issued at European level should focus on the key policy priorities that would be translated into ambitious structural reform plans at national level. Elements of successful structural reforms could be established through the development of best-practice benchmarks in the area of significant structural reforms and in particular in labour and product markets. Reinforced peer review and regular monitoring of the follow-up to the policy recommendations at national level would also provide further impetus for reforms. Enhanced communication with national stakeholders on the benefits of reforms and their importance for the smooth functioning of EMU would also be warranted. All these initiatives would foster the national ownership of reform recommendations issued at European level, ensuring that they are effectively implemented.

In the longer term, and given that structural reforms are not only in a country's own interest but also in the interest of the euro area as a whole, EU governance of structural reforms should be further strengthened to help countries to close the gap in terms of competitiveness and resilience within the euro area.

The Eurosystem looks forward to the Commission proposals for the mid-term review of the Europe 2020 strategy in early 2015 and for the discussions in the appropriate EU fora, in preparation of the 2015 spring European Council.

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2 On 11 December 2013, the EFC High Level Expert Group on SME and Infrastructure Financing issued its report "Finance for Growth".

3 See the European Commission's "Communication on long term financing of the European economy" published on 27 March 2014.