COUNCIL OF THE EUROPEAN UNION

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NOTE

From:	General Secretariat of the Council
To:	Delegations
Subject:	Follow-up of EU 2020

Delegations will find attached a note from the EPC on the structural reforms and smart fiscal consolidation - possible EPC work streams.

Encl.:

Structural reforms and smart fiscal consolidation – possible EPC work streams

The Europe 2020 Strategy presents a comprehensive and ambitious agenda for smart, sustainable and inclusive growth and employment that will also contribute to ensure long-term sustainability of public finances. The scale of the challenge is immense. Commission projections suggest that the average annual growth rates up to 2020 for the EU would be a sluggish 1.5 %, also reflecting prolonged levels of high structural unemployment. Even with the implementation of ambitious fiscal consolidation strategies, Commission calculations show that it would take more than 10 years for the debt ratio of the EU as a whole to fall below 60% of GDP, and longer for certain countries.

The current financial market situation suggests that the benefits of announcing credible and far-reaching structural reforms at this juncture should be very high for all MS, but especially for those countries which are facing, or risk experiencing in the future high(er) credit risk premia on their government debt.

For all EU countries, and in particular for those with high debt, fiscal consolidation needs to be complemented by decisive structural policy action to deliver growth, jobs and resilience. In view of the heightened focus in financial markets on sustainability, the commitment by Member States to ambitious and frontloaded structural reforms therefore provides a crucial complement to fiscal consolidation. However, in national policy debates structural reforms often tend to be presented in a negative light, as if they would hamper rather than promote the recovery. The positive aspects of consolidation and structural reforms would need to be communicated more forcefully. The EPC therefore considers it important that some clear messages on the benefits of growth-enhancing reforms are conveyed along the following lines.

- **The importance of combining fiscal consolidation with strong structural reforms for a successful exit from the crisis can hardly be overstated,** given persisting concerns about the capacity of the European economy to generate the rates of growth needed to sustain fiscal consolidation and put debt levels on a declining path. The prospect of persistently slow growth or declines in nominal GDP in countries with large fiscal consolidation needs raises the spectre of a "debt trap", where debt levels as a share of GDP continue to increase despite sharp budgetary consolidation. Without growth enhancing reforms the consolidation strategy might also be hampered by subdued domestic demand. More generally, unsustainable debt levels combined with challenges related to ageing populations will have to be dealt without delay, focusing on so called "win-win" measures or reforms that would directly contribute to improve the sustainability of public finances.

- **While frontloaded reforms could bring about desired growth-effects earlier, intensified concerted action could also lead to a sizeable increase in growth rates**. According to Commission's estimates, implementing a comprehensive structural reform strategy could lead to an increase in the growth rate over the coming decade by a third. The recent discussion with Member States on bottlenecks is a useful starting point for the identification of possible reform actions.

- **An intelligent combination of consolidation and structural reforms can boost confidence and deliver early growth.** The forceful implementation of possibly difficult and big-impact structural reforms early on as part of a comprehensive economic agenda can significantly bolster the credibility of the overall policy approach from the start. The resulting confidence effects can be immediate, leading markets to expect stronger fiscal positions, resulting in lower risk premia on sovereign debt and thereby lowering refinancing costs for governments, corporations, and households. More importantly, specific well designed reforms can have an impact on growth already in the near future, not only over the long term.

The Europe 2020 Strategy should therefore focus on reforms that will deliver results in terms of growth and jobs in the short to medium term as well as the longer term. It should be stressed that the early announcement and implementation of reforms can also contribute to the EU policy agenda in the shorter to medium term, in particular by supporting fiscal consolidation. Moreover, more effective communication on both the short and long term benefits of reforms is needed.

Against this background, the Economic Policy Committee (EPC) considers that the Europe 2020 strategy endorsed by the Heads of State and Government on 16-17 June provides an excellent and common framework for such smart and ambitious reforms. It will be important for Member States to take ownership of reforms, show commitment to the reform process and implement an effective communication strategy. Enhanced multilateral surveillance and peer pressure will also be necessary.

To demonstrate the broad benefits of frontloaded reforms in support of fiscal consolidation, the EPC stands ready to contribute in three main areas. First, the EPC could provide an input for the Ecofin in November on possible growth-friendly fiscal-consolidation strategies, so-called "smart consolidation", in line with the May Ecofin Conclusions on fiscal frameworks and planned work on revenue systems. Second, the EPC could explore whether there are a number of reform areas common to Member States where frontloaded reform efforts should be considered with the aim of having an impact on growth and jobs in the medium run, say up to 2014, and report back to Ecofin in October. To this end both supply and demand effects of reforms would be considered. Third, the EPC in cooperation with the Commission could develop a menu approach to identify , for individual Member States, some very significant and concrete reforms that could boost growth potential already in the short/medium-term, while also contributing to long-term sustainability of public finances and, where relevant, the unwinding of macroeconomic imbalances. This would provide a logical follow-up on the joint EPC-EFC report on macro-structural bottlenecks to sustainable growth an assist Member States in addressing national bottlenecks to growth. The work could be prepared bilaterally between the Commission and the individual Member State, starting in the early autumn and later be reviewed by the EPC, starting with countries with large consolidation needs and macroeconomic imbalances. Due care will be taken to keep these work-strands in line with the follow-up on the Europe 2020 strategy and the new governance set-up emerging from the work of the Task Force.

Member States would be expected to explicitly consider these areas of reform in their forthcoming National Reform Programmes, to be reviewed by the EPC and the EFC in the Spring 2011, on the assumption that this work is completed in time.

Following guidance by the Task Force and on the basis of Commission proposal the EPC also stands ready to contribute to enhancing economic governance, in particular as regards surveillance of macroeconomic imbalances.

Yours sincerely,

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