



# Economic Reforms in the Euro Area: Fiscal and Macro-structural Challenges

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## **Abstract**

This paper highlights how recent successful stabilization efforts in the euro area have shifted the main policy challenge from “acute crisis management” to fighting chronic stagnation. Critical policy challenges concerning euro area financial sector reforms and the upcoming banking sector balance-sheet assessment and stress test, as well as continuing reducing excessive inactivity levels are highlighted.

To streamline the Country Specific Recommendations (CSRs), it is advocated to focus the recommendations in the future solely on structural reform issues, including banking sector reforms, and leaving budgetary surveillance to dedicated EU procedures. Several proposals to enhance the role of the Euro Group President in promoting the CSRs agenda are also presented.

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## I Introduction

The multifaceted euro area crisis has since late 2009 exposed serious shortcomings in the common currency's institutional architecture, the fiscal sustainability of some Member States and structural economic performance and competitiveness of these and others. At the same time, the crisis have since 2010 summoned an unprecedented political will among Member State governments, the European Central Bank and other European institutions to – through new common institutions, concerted fiscal consolidation and deep structural reforms – overcome the worst economic crisis since the Community's foundation.

The combined effects of euro area crisis stabilization measures has since mid-2012 ushered in a period of relative financial market calm and gradually stabilizing macroeconomic performance. Sovereign bond spreads have narrowed and Target2 imbalances declined since the introduction of the ECB's Outright Monetary Transactions (OMT) program, while the coordinated fiscal consolidation among the euro members has reduced their aggregate general government deficit to an estimated 2.9% in 2013<sup>1</sup>. Pre-crisis external deficits in particularly Greece, Italy, Portugal and Spain has similarly via a combination of import-contracting recessions and gradually improving export competitiveness been largely eliminated, pushing the euro area as a whole to a recent record 2.1% current account surplus in the 12 months ending in Q2 2013<sup>2</sup>.

All told, European policymakers' have successfully managed to move the euro area crisis away from its earlier "acute phase", which saw the very survival of the common currency habitually questioned. Instead, today the main risk facing the euro area is "chronic stagnation" similar to the experiences of Japan after its big crisis in the early 1990s. In Japan, adverse demographic developments, a lack of expeditious government action to recapitalize the banking system and liberalizing structural economic reforms saw the economy languish for two decades. It is to this challenge – a more serious version of a similar pre-crisis policy challenge – of averting regional stagnation that euro area policymakers must now turn.

## II Main Fiscal and Macro-structural Challenges for the Euro Area

### Fiscal Policy:

As a result of the determined fiscal consolidation efforts in the euro area since 2009, it is in 2013 projected to run a cyclically adjusted general government deficit on just 1.5% and return to primary balance for the first time since the crisis began<sup>3</sup>. Very substantial fiscal consolidation has been implemented in the four euro area IMF program countries, Spain and Italy at the cost of prolonged recessions and elevated levels of unemployment. However, in contrast to the situation of "fiscal policy choice" in countries with continuous full private financial market access, it is unclear that a credible alternative fiscal path for these countries existed, despite the severe impact of austerity on their short-term economic growth and employment situation.

Loss of market access for a sovereign government – even in a currency union associated with very high degrees of cross-border interconnectedness among its members – amounts to a fundamental loss of trust and credibility in it among private creditors. Only immediate decisive

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<sup>1</sup> EC (2013:table 36).

<sup>2</sup> ECB Press Release August 16<sup>th</sup> 2013, table 1. Available at [http://www.ecb.europa.eu/press/pr/stats/bop/2013/html/bp130816\\_t1.en.html](http://www.ecb.europa.eu/press/pr/stats/bop/2013/html/bp130816_t1.en.html)

<sup>3</sup> EC (2013: table 38 and 39).

policy action (or the transfer of national economic policy making decisions and financing requirements to the IMF/Troika) can hope to restore such lost sovereign credibility and with it the ability of such a government to raise capital in the private markets.

Due to the delay in real economy effects of structural economic reforms to labour markets, pension systems and other societal institutions, a short-term confidence building effect among would-be creditors can – in countries of rapidly rising fiscal imbalances as in the euro area – best be secured through governments' decisive policy action to reduce their fiscal deficits, as well as undertake growth-enhancing reforms. The fiscal consolidation policies adopted in the euro area by Member States facing actual or potential loss of market access in recent years have thus generally been appropriate, despite their evident cost to the short-term growth and employment outlook.

Recalling the generally very high tax burden in the euro area and the urgent need to retain work and investment incentives for individuals and corporations in the common currency zone, Member State governments must, however, resist the political temptation to seek politically expeditious fiscal consolidation primarily through tax increases. While this has not been the case since the crisis began, fiscal consolidation in the euro area should as a general rule take place predominantly through general government expenditure cuts and under no circumstances increase the tax wedge as a percent of total labour costs. Other sources of new government revenue might be appropriate.

It is occasionally argued that with some euro area members in need of implementing substantial fiscal consolidation in the face of financial market pressure, other euro area members with more available fiscal space should simultaneously pursue more expansive compensating national fiscal policies. This, however, overestimates the positive cross-border spill-overs from increased fiscal spending in for instance Germany, France or the Netherlands on economic growth in the rest of the euro area. Only in small very open euro area crisis economies – such as Ireland – will such effects be material, but will in recent years invariably have been overwhelmed by the negative growth effects of required domestic fiscal consolidation<sup>4</sup>.

Euro area fiscal policies have consequently in recent years in all Member States been appropriately focused on national fiscal circumstances within the new and enhanced euro area fiscal surveillance framework. Only in Germany and France, which as the two largest members of the euro area have a special obligation to be able to act as credible fiscal anchors for the common currency, does any extra-territorial fiscal responsibility reside. This dictates that a certain degree of additional fiscal conservatism be preferable in both countries, beyond what strictly national circumstances would dictate.

### Banking Sector Reform:

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<sup>4</sup> See IMF (2011) and Ivanova and Weber (2011).

Overall, with the euro area exiting its longest ever recession in Q2 2013<sup>5</sup>, fiscal consolidation efforts having peaked in 2012 and a primary surplus restored, the basic euro area general government fiscal policy and sustainability position is today in mid-2013 much improved from earlier years. It is consequently another and more indirect issue that constitutes the euro area's main fiscal and macro-structural challenge in the coming 12 months; the imperative to credibly implement the Single Supervisory Mechanism (SSM) and the associated still to be negotiated single resolution entity for the banking system in the euro area and other potential participating EU members.

Despite the recent euro area macro-economic stabilization, persistent financial market fragmentation remains and undermines the monetary transmission mechanism and flow of credit to large parts of the euro area. This, in spite of the positive effects of the ECB's OMT program and changes to collateral requirements, manifests itself in still sizable differences in sovereign and private risk premia in the euro area. As a result, the generally pro-cyclical credit conditions for many small and medium-sized enterprises (SMEs) remain impaired.

Given lingering concerns over euro area bank balance sheet quality, aggravated by rising provisioning needs for non-performing loans built up during the long recession, this situation of restricted credit for substantial parts of the regional non-financial sectors is unlikely to improve even as the euro area recession has ended, and indeed greatly hamper the prospects for a vigorous recovery. Moreover, given the historical dominance of bank intermediated credit in the euro area<sup>6</sup>, it is unrealistic that alternative channels of credit through capital markets – like for instance asset-backed-securities (ABS) or other securitized SME loan instruments – could have a major short-term positive impact. In short, the current constraints on credit availability for the euro area non-financial sector will only be fixed, when doubts about the entire euro area banking system have been dispelled and banks have the capital buffers to resume timely lending to viable projects.

The importance of Article 27(4) in the final SSM compromise text<sup>7</sup>, which tasks the ECB to “*to carry out a comprehensive assessment, including a balance-sheet assessment, of the credit institutions of the participating Member State*” before the taking over its new banking sector regulatory responsibilities, is consequently immense. The approaching implementation of the SSM and the associated ECB/European Banking Authority (EBA) balance-sheet assessment and bank stress test represents not only the euro area's best chance to date to finally put half a decade of banking crisis behind it. It is a prerequisite for the region to have a sustained recovery, too. Without a well-capitalized banking system that financial markets have confidence in, the euro area non-financial sector will be unlikely to recover at a pace sufficient to produce large numbers of new jobs.

Aware of the economic importance and reputational risks to their respective institutions, senior officials at the ECB and EBA have repeatedly stated their intention to conduct a credible and

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<sup>5</sup> See Eurostat Press Release, August 14th, 2013. Available at [http://epp.eurostat.ec.europa.eu/cache/ITY\\_PUBLIC/2-14082013-AP/EN/2-14082013-AP-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-14082013-AP/EN/2-14082013-AP-EN.PDF)

<sup>6</sup> ECB president Mario Draghi assesses that 80 percent of euro area financial intermediation goes through the banking system. This is in direct contrast to the United States, where 80 percent of credit is intermediated by capital markets. See comments at ECB Press Conference on May 2<sup>nd</sup>, 2013 at <http://www.ecb.europa.eu/press/pressconf/2013/html/is130502.en.html>.

<sup>7</sup> Council of the European Union (2013).

rigorous balance sheet assessment and stress test ahead of the SSM launch<sup>8</sup>. European elected representatives at all levels of government must support them in these efforts to overcome the most important euro area economic policy challenge in 2013-14. This will involve at least four policy areas, which sensibly should be incorporated into the 2014 Country Specific Recommendations in a uniform manner:

- 1) Resisting excessive national discretion in banking regulation; balance sheet assessment and stress tests must be conducted based on a truly unified Single Rulebook and based on common accounting and capital standards and metrics.
- 2) Resisting excessive national discretion in banking resolution; no banking sector stress test can hope to be credible without a sound recovery and resolution framework to deal with any contingency uncovered. To ensure a level playing field in the treatment of different creditor classes across the euro area, the ability of national regulators and governments to exempt favoured creditor classes from bail-in requirements must be minimized to the greatest extent possible.
- 3) Ensuring the swift negotiated agreement and implementation of a Single Resolution Mechanism (SRM) for the Banking Union; with the clock ticking for a credible SRM to be agreed to secure the lasting return to economic growth in the euro area, the recent SRM proposal from the European Commission<sup>9</sup> must quickly be transformed into jointly agreed European legislation.
- 4) Establishing Credible National and/or ESM-based Financial Backstops; the ability of governments to deal with the balance-sheet assessment and bank stress test potentially uncovering large capital shortfalls in their national banks must be assured in two ways. First by requiring creditor bail-ins to proceed sufficiently up the creditor ladder to ensure adequate recapitalization. However, recalling 2) and the risk to undermine the Internal Market level playing field, it cannot be ruled out that individual banks examined by the ECB/EBA may need additional public funds to survive. The availability of such adequate funds must be made clear to all stakeholder participants ahead of the stress test exercise to safeguard its market credibility.

While the credibility of the upcoming ECB/EBA balance-sheet assessment and bank stress test must be beyond any doubt to succeed, and sufficient potentially accessible public money made available to guarantee this outcome, two additional issues of forward-looking euro area fiscal policy relevance must be recalled:

Firstly, that a substantial improvement in loss-absorbing capital levels throughout the euro area/EU banking system has been achieved since 2008 and the national banking systems in the four euro area Troika program countries and Spain has already been recapitalized with the involvement of bail-ins, Troika and ESM funds. Much of the costs of restoring adequate risk capital levels among European banks have therefore already been incurred by both private investors and taxpayers.

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<sup>8</sup> See speeches by EBA Chairman Andrea Enria and members of the ECB Executive Board during the spring and summer of 2013 - Enria (2013) and Draghi (2013), Asmussen (2013) and Coeuré (2013).

<sup>9</sup> See European Commission Press Release July 10th, 2013. Available at [http://europa.eu/rapid/press-release\\_IP-13-674\\_en.htm?locale=en](http://europa.eu/rapid/press-release_IP-13-674_en.htm?locale=en)

Secondly, that while the required public financial backstop must be adequate in 2013-14 to cover any capital shortfall found in the balance-sheet assessment and bank stress test, it need not be sufficient to deal with the cost of any potential future systemic banking crisis in the euro area. Financial history shows that major crises takes place with some regularity, and while recent regulatory reforms should help make the present-day European financial system more stable, future crises seem likely to occur at some point. As was illustrated in the United States in late 2008, where the \$US700bn TARP program was required to stabilize the situation, even in polities with strong centralized political institutions systemic financial crises invariably require a new political agreement on how to proceed. How to fiscally and financially deal with future systemic financial crises in the euro area in maybe 10 or 20 years' time is consequently most appropriately and legitimately left to the future elected officials of the time.

As such, the total potential fiscal cost of a successful ECB/EBA balance-sheet assessment and bank stress test in 2013-14 will likely be far lower than the most alarmist commentators suggest. Euro area policymakers thus have no excuse for not acting now.

#### Employment policy:

As a direct outcome of the prolonged recent recession EU and euro area unemployment rates have recently reached record levels at 10.9 and 12.1 percent respectively<sup>10</sup>, while equally elevated record levels of youth unemployment in several euro area members have attracted substantial media and policymaker interest<sup>11</sup>. The urgent need to foster faster job creation in Europe thus remains by far the most important structural economic challenge today. Unless more jobs can be created in Europe in the future, recent fiscal consolidation efforts will have been endured fruitlessly and on-going attempts to stabilize long-term fiscal sustainability and the financial system remain futile.

At the same time, it is important not to overdramatize the current employment situation in Europe and in the process lose sight of some of the encouraging labour market developments actually witnessed during the recent downturn. Take youth unemployment first, where headline unemployment rates in excess of 50 percent for the 15-24y age group in Greece and Spain have elicited concerns about “a lost generation”<sup>12</sup>.

Undoubtedly, youth unemployment is particularly damaging due to the life-long “wage scarring”, e.g. permanently lower wages earned throughout their working lives, often suffered by affected members of this group. Yet, particularly among the 15-24y age group, it is important to recall that headline unemployment rates are by statistical convention calculated as a percentage of the active labour force in this age group (i.e. the sum of the employed and unemployed), and therefore excludes non-labour force participants from the denominator. As for instance students and young people in training are not counted as part of the labour force, it is evident that the estimated unemployment rate for the 15-24y age group will be substantially “inflated” and provide a distorted picture of the true labour market situation.

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<sup>10</sup> See Eurostat Press Release 118/2013 on July 31st 2013. Available at [http://epp.eurostat.ec.europa.eu/cache/ITY\\_PUBLIC/3-31072013-BP/EN/3-31072013-BP-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/3-31072013-BP/EN/3-31072013-BP-EN.PDF)

<sup>11</sup> See for instance the European Council (2013).

<sup>12</sup> The most recent unemployment rates for the the 15-24y age group in Greece and Spain was 59.6 and 55.8 percent respectively. Source: Eurostat LFS at [http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search\\_database](http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database).



This can be illustrated by instead of the youth unemployment rate, estimating the youth unemployment ratio, as the share of the total 15-24y age cohort (including students and young people in training) that is currently unemployed. The latest Eurostat data show the euro area youth unemployment ratio to be 10 percent, while in Greece and Spain 17 and 21 percent respectively<sup>13</sup>. It is thus not more than half of Greek and Spanish youth that are at risk of wasting years of their lives to the crisis, but more like one-in-five. Still too high, but nonetheless far from the dramatic headline youth unemployment rate numbers.

The dominant role played by education and training in young people’s actual time use highlights how the real social and economic youth problem in Europe is not simply unemployment. Rather it is the share of youth that is neither in employment nor in education or training, the so-called NEET ratio, calculated as a share of the total 15-24y old age group. These are the youth without work income or the opportunity to improve their skills, whose future has been most severely dented by the crisis. Figure 1 shows the deterioration in the NEET ratio in the EU and euro area since the beginning of the crisis.

**Figure 1: NEET Ratio, Share of Total 15-24y Age Group**

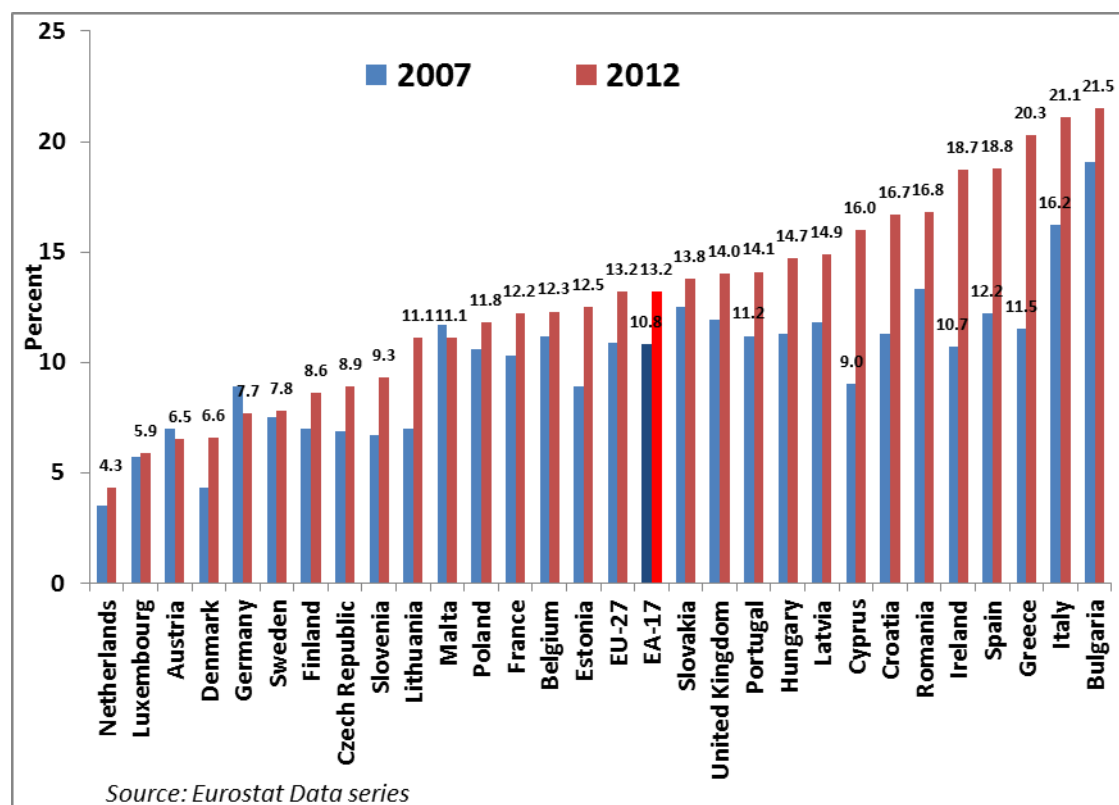


Figure 1 shows the large differences among EU members’ labour market performances during the crisis, but also how the range of EU NEET ratios is lower than published youth unemployment levels. Moreover, while a dramatic deterioration in the NEET ratio from pre-crisis 2007 to the latest data from 2012 is visible in Greece, Spain, Ireland and Cyprus, the highest European NEET ratios in 2012 were actually found in Italy and Bulgaria. These two countries also had the highest pre-crisis NEET ratios in the EU, illustrating how poor crisis performance on this crucial indicator

<sup>13</sup> Source: Eurostat LFS at [http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search\\_database](http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database).



is directly related to long-term and deep-rooted structural labour market and education system problems predating recent years' economic turmoil.

The policy challenge in reducing high European NEET ratios is two-fold, in so that both improved job opportunities and improved educational and training opportunities must be provided to young people. This is both an employment and education policy challenge. It is thus noteworthy that comparable NEET ratio data from the OECD show how the otherwise lower unemployment U.S. labour market has a higher NEET ratio – 15.8 percent at the latest comparable data<sup>14</sup> - than the 13.2 percent euro area average in Figure 1. The relative lack of access to affordable education and training opportunities in the United States accounts for the worse U.S. NEET ratio performance.

Excessive focus on recent cyclical unemployment rates is not only a concern for youth policy, but also risks drawing attention away from the related, but structurally much more important economic issue of reducing Europe's chronically high inactivity levels among the working age population. Reducing unemployment is important, but in most European countries, it is even more important to bring more people into workforce in the first place. Labour force participation ratios must be increased across the euro area before the necessary sustainable increases in employment can be achieved. Fortunately the euro area labour market performance during the crisis on these more important economic indicators has been quite encouraging.

At the launch of the euro in 1999, euro area labour force participation and employment ratios for the total 15-64y age group stood at 67 and 60 percent respectively. This was more than 10 percentage points lower than comparable 1999 data for the United States<sup>15</sup>. Figure 2 plots the developments of labour force participation ratios in the euro area, select Member States and the United States since the common currency launch.

**Figure 2: Labor Force Participation 15-64y<sup>16</sup>, Total Population Q1 1992-Q1 2013**

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<sup>14</sup> 2011 data from OECD Education at a Glance 2013 Indicator C5-6 in OECD (2013).

<sup>15</sup> U.S. Labor force participation and employment ratio in 1999 was 77.2 and 73.9 percent of the 15-64y age group respectively. Data from the OECD Labor Force Statistics database at <http://stats.oecd.org/#>.

<sup>16</sup> Data in figure 2 is non-seasonally adjusted data, which accounts for the regular jumps seen in some country time series.

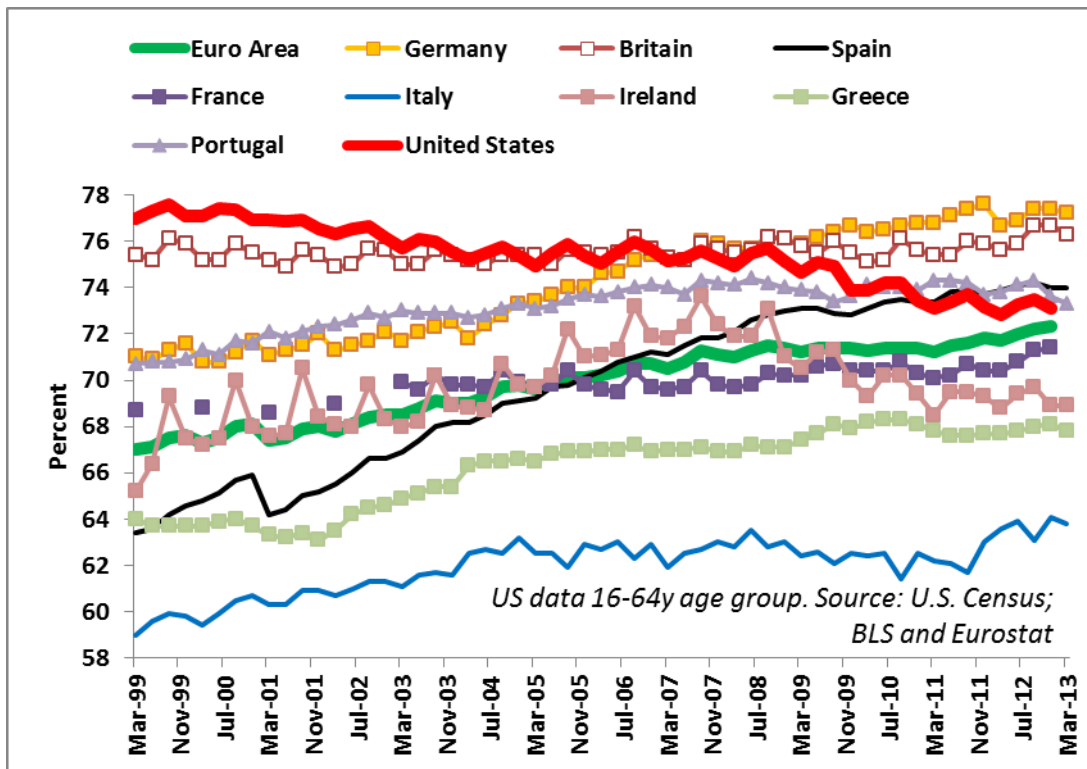


Figure 2 illustrates several important longer-term labour market trends. Firstly, it can be seen how the euro area and most Member States managed to increase their labour force participation substantially from 1999 to the beginning of the global financial crisis in 2008. Secondly, it is noteworthy how euro area labour force participation merely stagnated during the crisis and indeed since 2011 has continued to rise to a record over 72 percent in recent quarters. This indicates that reforms undertaken during the crisis in some countries are already having an effect, as well as the fact that one needs to be registered in the labour force to collect unemployment benefits. Thirdly, it can be seen how labour force participation developments in Germany stand out with a dramatic continuous rise since early 2004 at the time of the implementation of the German Hartz labour market reforms. Today Germany as a consequence of these successful structural reforms has higher labour force participation than both the United States and United Kingdom. The rise in Spanish labour market participation during the euro era is similarly noteworthy, as is especially the fact that Spain's labour force participation ratio has continued to increase even as the country's economy slumped. And fourthly, Figure 2 makes it clear how these continuous improvements in euro area labour force participation ratios stand in marked contrast to developments in the United States since 1999. Not only did U.S. labour force participation drop in the early 2000s (though from far higher levels than in the euro area), but did so precipitously after 2008, so that U.S. and euro area labour force participation rates for working age populations today are nearly identical at 72-73 percent.

The continuous improvement in the euro area on this fundamental long-term labour market indicator shows how first of all, the overall structural labour market situation is not quite as dire as indicated by record unemployment rates. While the cyclical downturn has been dramatic in recent years, euro area labour markets today do function better than before. Likewise, labour force participation ratio developments in the euro area – and especially in Germany – in recent years highlights the importance of continuing fundamental structural labour market reforms to reduce inactivity levels in Europe.

### III Suitability of Fiscal and Macro-structural Country Specific Recommendations (CSR)

The 2013 CSRs proposed by the Commission on May 29<sup>th</sup> 2013<sup>17</sup> appropriately contain no recommendations for Member States under Troika programs to avoid duplication with measures set out in these on-going national adjustment processes. Such avoidance of duplicative efforts can sensibly be extended to also include the CSRs directly related to fiscal policy. It could be more efficient also from a competence point of view to focus the CSRs on other (non-fiscal) structural economic reform issues. With as discussed in the previous section overall fiscal stability moreover gradually returning to the euro area today, a strict structural reform focus in CSRs is particularly appropriate in the 2013 and 2014 Semester cycle.

Completely removing (or perhaps replacing with a short reference to other fiscal surveillance documentation covering the Member States in question) all explicitly fiscal policy related CSRs should be considered. This would shorten CSR documentation and facilitate its widespread readership among the media and European publics. It would also remove what, given how medium-term fiscal targets are very similar for all euro area members, is often a quite repetitive section of the CSR documentation. Its removal would serve to enhance the CSR focus on the differences rather than the similarities among Member States and the country-specific structural reforms they are recommended to implement. This, too, would help CSR message dissemination.

In general, the 2013 CSRs maintain an appropriate focus on structural reforms. Yet, in line with the two main challenges in banking sector reform and employment creation identified in the previous section, more focus on the country specific challenges in these two areas is appropriate.

Recalling how the previous section identified the need for the euro and Member States to successfully implement the ECB/EBA balance-sheet assessment and bank stress test in 2013-14, the very limited focus on this crucial issue in the 2013 CSRs is dangerous.

To retain their policy relevance, the CSRs must at the Member State level address how each can help promote a coordinated acceleration of European banking sector reform in 2013-14. The 2013 CSR for the euro area itself appropriately includes a lengthy to-do-list related to the upcoming ECB/EBA balance-sheet assessment and bank stress test. However, in light of the importance of the issue in every Member State, including specific detailed CSRs covering how individual Member States can assist a successful ECB/EBA balance-sheet assessment and bank stress test is warranted. The detailed 2013 CSR for Slovenia's banking sector could in this regard serve as a template in terms of the desired specificity of the recommendation. Bearing in mind too, how banking sector regulation will remain a policy area characterized by split jurisdictions between euro area institutions and Member States, using the institutional competence of the CSRs to help ensure harmonized Member State actions towards common goals seems especially fitting.

Section II highlighted how recent structural labour market performance in the euro area is better than often assumed, but that most Member States still have substantial labour market reforms to implement to lower inactivity levels and achieve strong sustained job creation. The 2013 CSRs therefore rightly for most Member States contain substantial and detailed labour market reform proposals. To continue making euro area labour markets more flexible now even in the face of record unemployment levels is the right approach.

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<sup>17</sup> See Tables on 2013 CSRs was provided by the European Parliament's Economic Governance Support Unit. Available on <http://www.europarl.europa.eu/committees/en/econ/publications.html?id=ECON00012#menuzone>.

Critical labour market reforms liberalizing conditions for many prime age workers in protected sectors (e.g. insiders) were neglected by governments during the pre-crisis period and in several Member States only begun as a result of the crisis after 2008. Historical precedent in the euro area thus shows how the political economy of such labour market reforms dictates that they are generally only politically feasible during economic crises. Now in 2013-14 is the therefore right time to proceed.

Having the CSRs focused on continuing to enhance euro area labour market flexibility is suitable for several reasons. First of all, inflexible labour markets slow down adjustment to large economic shocks. This is true even at this late point in the euro area economic cycle, and introducing more flexibility will therefore assist euro area crisis economies in exiting their slumps faster. Secondly, inflexible labour markets raise the costs of workforce adjustments and invariably distort the composition of between temporary and regular workers disproportionately towards the former. This perverts the allocation of labour and ultimately reduces job creation, growth and productivity. Firms operating in inflexible labour markets are less likely to operate in sectors characterized by rapid technological change, and less likely to innovate and introduce new riskier experimental products. Instead, inflexible labour markets lead to sluggish technological change and a corporate focus on merely improving existing products. This is particularly detrimental to the multifactor productivity growth that ultimately must sustain lasting income growth in the euro area. And thirdly, more flexible labour markets characterized by the ability of individual businesses to negotiate their own firm-level wage and working conditions will – by improving firm competitiveness – help sustain the dramatic current account rebalancing experienced in a number euro area members in recent years, even after recessionary import compression abates.

While the implementation of many labour market related CSRs will generally enhance flexibility and work in the right direction, a surprising omission is the often critical role played by labour courts and broader employment dispute settlement. Costly, complex and protracted labour court proceedings can add materially to total labour costs and hence act as a barrier to hiring in several euro area members. CSRs should consequently for these Member States include recommendations to help reduce the costs of dismissal disputes through accelerated, fair and transparent processes.

#### **IV Avenues for the Euro Group President (EGP) to Facilitate the Implementation of CSRs**

CSRs are innately Member State specific and (should) focus on economic areas where Member States retain jurisdiction. National ownership is thus critical and the supportive role of the EGP in the CSR agenda linked to the broader governance reforms of the euro area. As securing enhanced national ownership of CSR reforms would benefit from involving as many national stakeholders as possible, the EGP should sensibly spend considerable time meeting with such entities in different Member States. This will logically require the position of the EGP to be full-time, and not carried out simultaneously with national policymaker responsibilities.

With national ownership of the CSR agenda of critical political importance, the EGP should aim to enhance the legitimacy of the CSR through their presentation as annual, detailed and verifiable policy targets for Member State governments to accomplish. An appropriate political balance must be achieved between legitimate desires to exercise a degree of national sovereignty over policy areas under national jurisdiction, and the equally valid economic needs for coordinated economic policies in the euro area as a whole. The EGP has a key role to play in on the one hand avoiding that CSRs are presented as prescriptive policy edicts for Member

States to implement in a manner reminiscent of a Troika Program. And on the other hand ensuring that the euro area's common economic interests are adhered to, when annual, detailed and verifiable CSR policy goals are formulated. The EGP must ensure that Member State governments are granted a genuine degree of guided or restricted policy choice in how they choose to achieve the CSRs commonly agreed priorities.

The EGP should further, in close cooperation with the Commission, strive to make full use of the coercive elements of euro area SGP fiscal surveillance. Times of economic crises and fiscal difficulties are periods of extra-ordinary politics, where previously blocked reforms on the CSR agenda will often be feasible. Recognizing this fact, the EGP and the Commission should make the political quid pro quos of "CSR reform implementation in return for SGP fiscal target flexibility" explicit and public. Member State governments would thereby be presented with a clear policy choice of reducing excessive fiscal deficits, or implement CSR agenda reforms.

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