Draft briefing

Structured dialogue of VP Katainen & Commissioner Creţu with the European Parliament

Disclaimer:

Introductory speaking points still need to be divided in two so as to be clear what will be covered by VP Katainen and Commissioner Creţu in their respective introductory statements

Scene setter

On 12 July 2016, the Council adopted two non-effective action decisions concerning Portugal and Spain in the context of the excessive deficit procedure (EDP). No fines under the corrective arm of the Stability and Growth Pact (SGP) were issued by the Commission. Spain and Portugal have to report to the Commission by 15 October on the action taken to address the Council recommendations of 8 August.

According to Article 23 of the Common Provisions Regulation (CPR), the Commission is legally obliged to propose to the Council to suspend part of the 2017 commitments for the ESI Funds programmes of Portugal and Spain. In making its proposal, the Commission shall give due consideration to the opinion expressed by the European Parliament in the structured dialogue.

The structured dialogue with European Parliament (EP) will take place on 3 October 2016. The hearing will last 2.5 hours and be conducted as a joint ECON-REGI meeting with representatives of the AGRI, BUDG, EMPL and PECH committees. Speaking time will be allocated equally between REGI and ECON. The representative of the four other Committees will have 5 minutes of speaking time each. The Conference of Presidents is to discuss the outcome of the hearing and the next steps to take in its meeting on October 6th. The EP may decide to issue a formal opinion after the structured dialogue.

As the meeting will be open to the public, it will be important for the Commission to keep in mind the negative reaction a discussion on suspension of commitments of European Funds may have. This is all the more true as both Spain and Portugal have been hit hard by the crisis and their citizens have

already made a lot of efforts and sacrifices for getting their country again on the right track. Therefore, the Commission will need to be in a position to pass the message that this suspension will not affect efforts to combat poverty and support to structural reforms.

Given the current state of the European Union, when more and more citizens are losing faith in the Union's project - as it fails to provide them with confidence and hope for a better future - it is very important that the Commission passes the message that it will apply this provision prudently and thus 'handle it with care'.

On the one hand, it is true that the Commission needs to respect and apply the provisions approved by the European co-legislators, including the Parliament, and needs to stick to the principle of sound economic governance. Therefore, the Commission has to make a proposal to the Council for suspending commitments.

On the other hand, when making its proposal for suspension to the Council, the Commission should also make use of the discretionary powers: it has to determine the level and scope of the suspension so as to ensure that the suspension is proportionate and takes into account the economic and social circumstances of Spain and Portugal.

It should also be borne in mind that the ESI Funds account for a substantial and increasing share of public investment in both countries estimated to reach 78% of national public investment in Portugal and 21% in Spain in 2014-2016. Therefore any suspension of commitments may risk delaying planned investments (i.e. those that have not yet started).

Objectives

- Listen to the views of the European Parliament.
- Explain the content of the rules that link the effectiveness of the ESI Funds to sound economic governance. According to the regulation, the non-effective action decision of the Council in the context of the EDP triggers a procedure regarding the suspension of part of 2017 ESI Funds commitments for the programmes of Portugal and Spain.
- Pass the message that ESI Funds suspension is part of the measures that link the effectiveness of the ESI Funds to sound economic governance agreed with the co-legislator. The suspension of ESI Funds commitments will not have any short-term impact on on-going projects/operations,

although it may delay the launch of new investments and will be lifted immediately after Spain and Portugal take effective action to reduce their deficit. The objective of this measure is to incentivise Member States to address their excessive deficits.

Introductory speaking points

First application of existing rules linking the effectiveness of the ESI Funds to sound economic governance adopted by Council and EP

- The close link between the ESI Funds and European economic governance, in particular the Excessive Deficit Procedure, has been agreed by the colegislators as a consequence of the economic and financial crisis. The crisis has shown that the effectiveness and sustainability of ESI Funds investments is undermined by unsound fiscal and macroeconomic policies.
- Consequently, the Council and the EP adopted legislation for 2014-2020 which establishes the principle of linking the effectiveness of the ESI Funds to sound economic governance. In particular, the use of ESI Funds has been tied to the respect of Council recommendations issued in the context of the EDP.
- We now have the first case of using this provision because the Council decided on 12 July that Portugal and Spain had not taken effective action to correct their excessive deficits, the conditions for the application of the regulation have been fulfilled.

No discretion for making a suspension proposal contrary to possible fines under SGP

- The Commission is legally obliged to make a proposal to the Council on the suspension of the part of 2017 commitments for the ESI Funds programmes of Portugal and Spain. This is fixed in Article 23 of the regulation governing the ESI Funds (the so-called Common Provisions Regulation).
- The legislation does not provide any room for discretion. Article 23 is a "shall" provision meaning that non-effective action under the EDP automatically triggers a proposal for suspension by the Commission.
- This is different from the corrective arm of the Stability and Growth Pact (SGP) where the stepping up of the EDP "may" result in the imposition of a fine.
- But the Commission can also propose to reduce or cancel the SGP fine if a country faces exceptional economic circumstances, or following a reasoned request from the Member State concerned.

- This is what happened on 27 July when the Commission recommended to the Council to cancel the fine for Spain and Portugal after both MS had submitted a reasoned request to cancel the fine, while reaffirming their commitment to comply with the rules of the Stability and Growth Pact.
- In consideration of this, and in acknowledgment of the reform efforts of Portugal during its economic adjustment programme and in the following years as well as in Spain in recent years following the financial assistance programme, the Commission proposed to the Council to cancel the fines.

A temporary measure which does not disrupt programme implementation

- It is important to understand that the ESI Funds suspension is not a sanction, contrary to possible fines for euro area Member States under the SGP. Contrary to SGP fines, the suspension of ESI Funds commitments does not have any short-term impact on programme implementation. The objective is to set the right framework conditions to ensure that the impact of the ESI Funds is maximised and to provide incentives to the Member State to address the excessive deficit.
- A suspension will only concern a share of next year's financial commitments and not payments. It also does not affect the financial commitments already made in 2014-2016. In view of the slow implementation of the 2014-20 programmes so far, there will be sufficient open commitments against which the Commission can make payments to the Spanish and Portuguese ESI Funds programmes. Therefore, there will not be any disruption in on-going project implementation and no beneficiary on the ground whose operation has already been selected will be negatively affected by the suspension.
- This means that a possible suspension will not put in question any investment project currently being implemented with ESI funding in Spain or Portugal. Of course, new investments may be delayed as planned calls for proposals may have to be put on hold. This is already the case for Portugal where there is already a slowdown in investments due to the uncertainties about the possible suspension of the European Social Fund.
- Moreover, the ESI Funds suspension is only a temporary measure. The Commission will lift the suspension immediately after Spain and Portugal have acted in compliance with the Council recommendations or the Council has decided that the excessive deficit has been corrected. The frozen commitments will then be re-budgeted and can be re-used by the two countries. There is no risk of losing any ESI Funds funding at this stage (i.e. as long as the 2017 commitments can be re-budgeted before the end of 2020).

Discretion on the level of the suspension

• In order to determine the level of the suspension proposal, the Commission will apply the criteria set out in the legislation.

- In determining the level of the suspension, the Commission will also take into account the economic and social circumstances of the Member States concerned, in particular the level of unemployment which is particularly high both in Spain and Portugal.
- This means that the Commission can make a suspension proposal which stays well below the maximum set out in the legislation.

Some discretion to exclude certain programmes

- In principle, the suspension will proportionally affect all ESI Funds programmes and priorities.
- However, the Commission has to exclude the ESI Funds programmes which are of critical importance to addressing adverse economic or social conditions from the scope of the suspension. The Regulation establishes that investments related to the Youth Employment Initiative fall under this definition.
- The Regulation also leaves discretion to the Commission to consider other ESI Funds programmes and priorities to be of critical importance. This is the case for programmes and priorities that support investments related to the implementation of country-specific recommendations addressed to Member States in the context of the European Semester and are aimed at structural reforms. This is also the case for investments related to priorities supporting poverty reduction or to financial instruments for the competitiveness of SMEs.
- Excluding certain ESI Funds programmes (or priorities) from the scope of the suspension will, however, not reduce the overall size of the suspension. The suspension level of the non-sheltered programmes will have to be increased accordingly.
- Excluding certain programmes from the suspension requires assessing whether the programmes meet the conditions to be considered as being of critical importance to addressing adverse economic and social conditions. The Commission has the obligation to undertake this assessment as all programmes that are of critical importance 'shall be excluded from the scope of the suspension'. It will thus require a solid justification why certain programmes that support investments related to the implementation of country-specific recommendations and are aimed at structural reforms and investments supporting poverty reduction are not considered to be programmes that are of critical importance.

Timing of the measures

• There is no deadline in the legislation by when the Commission has to adopt its suspension proposal. However, in order for the suspension of commitments to have an impact, the suspension decision has to be adopted before the end of year.

- The Commission proposal is only deemed adopted if it is not rejected by the Council by qualified majority within one month of its submission by the Commission.
- However, rest assured that the Commission will act in a spirit of loyal cooperation with the European Parliament before making its suspension proposal.

Listen to views of EP before taking such a decision

- This is why we would like to listen to the views and opinions of MEPs. And this is why VP Katainen has informed President Schulz on 14 July of the situation and expressed the COM's readiness to participate in a structured dialogue on the application of this measure, with a view to make a balanced proposal.
- We are very happy that the President Schulz invited the Commission to a structured dialogue which takes place today with MEPs of six different committees. We would like to express our thanks to the Chairs of the REGI and ECON committees for organising this meeting. We look forward to an open and frank discussion. Please rest assured that we will take your views duly into account when adopting our proposal.

Defensive points for Q&A

On the one hand, the Commission did not propose a sanction (fine) under SGP; on the other hand, it will propose an ESI Funds suspension for two countries affected heavily by the crisis. This is incoherent and risks aggravating the economic situation of Spain and Portugal.

- The suspension of ESI Funds commitment is not a sanction. Contrary to a fine under the SGP, which has an immediate impact, the suspension of commitments does not have any short-term impact on programme implementation. It does not concern payments and there are sufficient open commitments against which the Commission can make payments. It is only a temporary measure, which will be lifted again as a Member State complies with the Council recommendation under EDP.
- The objective of the suspension is to provide incentives to Spain and Portugal to address their excessive deficits. One of the lessons of the crisis is that ESI Funds can only be effective and have a lasting impact if they operate in a sound macroeconomic environment. Therefore, it is important that the two governments adopt measures restoring macroeconomic and fiscal conditions conducive to sustainable growth and employment.

Why has the Commission recommended cancelling the fine under the corrective arm of SGP? What elements did the Commission take into account?

- According to the so-called six-pack, the Commission is legally required to propose a fine of 0.2% of GDP of the preceding year. However, this amount can be reduced or cancelled if a country faces exceptional economic circumstances, or following a reasoned request from the Member State concerned.
- Spain and Portugal had submitted a reasoned request to cancel the fine, while reaffirming their commitment to comply with the rules of the SGP.
- In consideration of this, and in acknowledgment of the reform efforts of Portugal during its economic adjustment programme as well as in Spain in recent years following the financial assistance programme, the Commission proposed to the Council to cancel the fines.

Recognizing the reforms undertaken by Spain and Portugal, the Commission recommended cancelling the fine under SGP. At the same time it will propose an ESI Funds suspension. Couldn't the Commission cancel the suspension of ESI Funds as well?

Article 23(9) CPR is a "shall" provision meaning that non-effective action in EDP automatically triggers a suspension proposal by the COM. This is
contrary to the corrective arm of the SGP (SGP) where the stepping up of the EDP may result in imposing a fine, which can be reduced or cancelled.

What are the next steps in the EDP procedure?

- According to the Council decision of 8 August, Spain and Portugal have to report to the Commission and Council on the action taken to address
 their excessive deficits by 15 October 2016. The reports should include the targets for government expenditure and revenue and specify the fiscal
 policy measures on both the expenditure and the revenue side.
- I expect the Commission to present its assessment of the reports of Spain and Portugal on the action taken to address their respective deficits by ca. mid November.
- The assessment of effective action by the Commission in autumn is particularly important as it will need to conclude whether or not Spain and Portugal have taken effective action.

What if there is non-effective action due to the lack of government with full legislative power in Spain? What are the constraints to take effective action as long as there is no government with full legislative power?

• Spain has more than a month to form a new Government (until end of October) before going to a new election. It does not make any sense to speculate at this stage what may or may not happen due to the fact that there is a caretaker government in place with limited legislative power.

- In the absence of a government with full legislative power, it is important to continue applying existing provisions in domestic law to keep public spending under control, both at national and sub-national level. It is important to achieve the headline and structural targets of 2016 and to facilitate the achievement of the recommended targets for 2017. While the caretaker government may only submit a no-policy change Draft Budgetary Plan, we expect the new government to submit a full-fledged plan once in place.
- Should a government with full legislative power be in place, we expect the Draft Budgetary Plan to clearly indicate the actions to be taken in 2016 as well as those planned for 2017 to meet the recommended budgetary targets. A failure to do so could lead to stepping up the EDP procedure.

What if the Council decides that Spain and/or Portugal have not taken effective action?

• The assessment of effective action by the Commission in autumn (mid-November) is important as it will conclude whether or not there is need for stepping up of the Excessive Deficit Procedure, which could entail sanctions under the Stability and Growth Pact. It could also be considered as "significant and persistent" non-compliance according to Article 23 of Common Provisions Regulation which could give rise to a gradual increase of the size of the ESI Funds suspension. The Council would have to take a decision on that within 4 months from the adoption of the Article 126(9) notice, meaning on 8 December 2016 at the latest.

What are 'unexpected adverse economic events with major unfavourable consequences for government finances' envisaged in the EDP procedure? Is lack of government such an event?

• The notion of adverse economic events encompasses those developments outside of the government's control, which may result in the deficit target not being met, in spite of the government putting in place measures that could have been expected to correct the deficit based on the scenario underlying the recommendation. Essentially, these unexpected developments consist mainly of lower economic growth or a shortfall in revenues compared to what was expected at the time of the recommendation, as well as impact of other unexpected and unusual events.

What will be the impact of the suspension on the implementation of the ESI Funds programmes?

- There will not be any disruption in the on-going project implementation on the ground. A suspension will only concern a part of 2017 financial commitments. The COM will be able to make payments against financial commitments made in 2014-2016 plus a big part of 2017 commitment.
- This means that a possible suspension will not put in question any investment project currently being implemented with ESI funding in Spain or Portugal.
- Of course, it cannot be excluded that new investments will be delayed as it is possible that planned calls for proposals are being put on hold. This is already the case for Portugal where there is already a slowdown in investments due to the uncertainties about the possible suspension of the European Social Fund.

When should the Commission put forward a proposal of ESI Funds suspension?

- The Commission has the obligation to propose a suspension of the European Structural and Investment Funds once the Council has decided on non-effective action (i.e. has adopted a decision under Article 126(8) of the Treaty).
- The Common Provision Regulation on EU funds (EU 1303/2013) does not foresee any deadline for the Commission proposal to suspend ESI Funds.
- According to the Common Provision Regulation, the Commission has to inform the European Parliament as soon as the conditions for a suspension
 are fulfilled (i.e. after the Council had adopted the decision under Article 126(8) of the Treaty), as well as to provide details on the ESI Funds and
 programmes to be suspended.

On that basis, the European Parliament has invited the Commission to this structured dialogue.

Will the Commission propose to suspend ESI Funds immediately after the structured dialogue?

- The Commission has an obligation to act. However, the Regulation is clear on the need to involve Parliament in this process. Failure to do so could make the final suspension decision invalid.
- On 3 October, the structured dialogue will take place and the Commission will give due attention to this exchange of views before making a suspension proposal.
- The objective of these rules that link the effectiveness of the ESI Funds to sound economic governace is to provide an incentive to Member States not living up to their obligations under the Stability and Growth Pact. Against this background, the structured dialogue has to be organised in a way so as to evolve in a reasonable time frame.
- It is then up to the Commission to decide on the exact content and timing of its suspension proposal taking into account the different steps of the Excessive Deficit Procedure and the rules established by the Common Provsions Regulation when deciding on the level and the scope of the suspension, thereby excluding all programmes that are of critical importance: some programmes are already considered by the Regulation to be of critical importance (such as the programmes related to the Youth Employment Initiative). Other programmes may be considered by the Commission to be of critical importance. However, once the Commission is of the view that these programmes are indeed of critical importance (as they support the implementation of relevant CSRs or support the fight against poverty), the Commission has the obligation to exclude these programmes from the scope of the suspension.
- We hope that this dialogue will be sufficient for the Commission to prepare the final proposal.

What are the next steps in the ESI Funds suspension procedure?

- Today's structured dialogue is an important stage as the Commission has to give "due consideration to any elements arising from and opinions expressed through this dialogue". The Commission will take the views expressed by MEPs duly into account when adopting its proposal.
- There is no deadline in the legislation by when the Commission has to adopt its proposal. However, in order to have an impact, the proposal has to be adopted by the Commission by ca. mid November.
- This is due to the fact that the proposal concerns the financial commitments to be made available to Portugal and Spain as of 1 January 2017 and the Commission proposal is only deemed adopted if it is not rejected by the Council by qualified majority within one month of its submission by the Commission, i.e. by ca. mid-December.
- The Commission will transmit the proposal to the EP immediately after its adoption. The EP may invite the Commission to explain the reasons for its proposal.

What will happen in case no effective action is taken?

- Where the Commission concludes, that effective action has not been taken, it will issue a recommendation for a Council decision to step up the EDP, which could impose a fine.
- As regards the ESI Funds suspension, the legislation foresees that the level of the suspension shall increase gradually up to a maximum of 100 % of the commitments in case of persistent non-compliance. It may also cover the suspension of ESI Funds payments depending on the seriousness of non-compliance.

What will be the actual size of the ESI Funds suspension for Portugal and Spain?

• In order to determine the scope and the level of the suspension proposal, the Commission will make use of all available criteria laid down in the legislation, including socio-economic factors such as high unoyment affecting both Spain and Portugal.

What will be the scope of suspension? Which programmes and priorities will be excluded from the suspension in Portugal and Spain?

- According to the legislation, the Commission determines, in a first step, the level of the suspension. The suspension of commitments will then proportionally affect all ESI Funds programmes.
- However, the Commission has to exclude, in a second step, the ESI Funds programmes, which are of critical importance to addressing adverse economic or social conditions, from the scope of the suspension. The Regulation establishes that investments related to the Youth Employment Initiative fall under this definition.
- The Regulation also leaves discretion to the Commission to consider other ESI Funds programmes and priorities to be of critical importance. This is the case for programmes and priorities that support investments related to the implementation of country-specific recommendations addressed to Member States in the context of the European Semester and are aimed at structural reforms. This is also the case for investments related to priorities supporting poverty reduction or to financial instruments for the competitiveness of SMEs.
- Excluding certain ESI Funds programmes (or priorities) from the scope of the suspension will <u>not</u> reduce the overall size of the suspension. The suspension level of the non-sheltered programmes will have to be increased to reach the suspension level established in step one, unless the Commission would decide to establish a lower level of suspension under the first step as the Regulation only determines a maximum level of suspension.

• Excluding certain programmes from the suspension requires to establish that these programmes are of critical importance (for example: programmes supporting poverty reduction, competitiveness of SMEs programmes and programmes aiming at structural reforms;). In case the Commission does not exclude programmes qualifying to be considered as being of critical importance, it will need to have a solid justification why certain programmes - despite the fact that they can be considered to be of critical importance - are not excluded from the scope of the suspension

How would the ESI Funds be made available again to the Member States?

- The Commission will lift the suspension of commitments if the Excessive Deficit Procedure is put in abeyance (Article 9 of Regulation (EC) No 1467/1997).
- If the suspension is lifted still in 2016 or during 2017, the ESI Funds will again be made available to the Member State for commitment in the originally planned commitment year (i.e. 2017 in the present case). In case the suspension is only lifted after 2017, the suspended commitments shall be transferred to the following years (but not beyond 2020¹) and are still to be respecting the rule n+3 for using them.

What are the Council recommendations for the fiscal adjustment path for Spain?

• The Council recommended that Spain puts an end to its excessive deficit by 2018. Spain shall reduce its general government deficit to 4.6% of GDP in 2016, to 3.1% of GDP in 2017 and to 2.2% of GDP in 2018. This improvement in the general government deficit is consistent with a deterioration of the structural balance by 0.4% of GDP in 2016 and an improvement of 0.5% of GDP in both 2017 and 2018, based on the updated Commission 2016 spring forecast. Spain shall also use all windfall gains to accelerate the deficit and debt reduction.

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¹ In accordance with Article 8 of the MFF Regulation according to which suspended commitments of year n may not be re-budgeted beyond year n+3.

• In addition to the savings already included in the updated Commission 2016 spring forecast, Spain shall adopt and fully implement consolidation measures amounting to 0.5% of GDP in both 2017 and 2018. It shall also stand ready to adopt further measures should risks to the budgetary plans materialise.

What are the Council recommendations for the fiscal adjustment path for Portugal?

- The Council recommended that Portugal should put an end to the excessive deficit situation by 2016, and to reduce it to 2.5% of GDP in 2016. This improvement in the general government deficit is consistent with an unchanged structural balance compared to 2015, based on the Commission 2016 spring forecast. Portugal shall also use all windfall gains to accelerate the deficit and debt reduction.
- In addition to the savings already included in the Commission 2016 spring forecast, Portugal shall adopt and fully implement consolidation measures amounting to 0.25% of GDP in 2016, and shall stand ready to adopt further measures should risks to the budgetary plans materialise.

Background information

The 2014-2020 legal framework establishes close links between ESI Funds and the economic governance procedures (in particular the Excessive Deficit Procedure, but also the Macroeconomic Imbalance Procedure and for countries under an economic adjustment programme). This is the 'so-called' principle of macroeconomic conditionality.

This principle comprises two strands:

— In the 'first strand', the Commission may request a Member State to review its Partnership Agreements and programmes to support the implementation of relevant country-specific recommendations issued in the European Semester or to maximise the growth and competitiveness impact of the available ESI Funds in the case of programme countries.

In the 'second strand' the Commission has to propose the suspension of (part of the) commitments (and in serious cases of payments) in case of a Council Decision of non-effective action by a Member State to address an excessive deficit (or other Council decisions or recommendations set out in the CPR).

Spain and Portugal are major beneficiaries of ESI Funds: Spain will receive up to EUR 40 billion in 2014-2020, while Portugal will receive up to EUR 26 billion from the ESI Funds in the same period. ESI Funds account for a substantial and increasing share of public investment in both countries estimated to reach 78% of national public investment in Portugal and 21% in Spain in 2014-2016.

The last (and only) case of a suspension related to macroeconomic conditionality was in 2012 for Hungary. However, back then the suspension only applied to the Cohesion Fund and there was no automatic obligation for the Commission to propose a suspension in case of a non-effective action decision by the Council. Given that the Hungarian government corrected the fiscal situation quickly, the suspension was lifted before it entered into force.

Structured dialogue with EP

There is no precise deadline for the structured dialogue with EP and no indication regarding the procedure for adopting an 'opinion' of the EP, if any, and for its transmission to the Commission.

The Legal Service (LS) of the Commission is of opinion that the CPR should be interpreted taking into account the purpose of Article 23(10) CPR that is to suspend part of the commitments in time so as to exercise pressure on Member States not living up to their obligations under the macro-economic policy.

On that basis, LS takes the view that the structured dialogue has to be organised in a way so as to evolve within a reasonable time frame.

The following timetable of EDP needs to be taken into account:

- ES&PT to report to on effective action COM by 15 October;
- COM assessment by mid-November;

Structured dialogue	with the	Europ	ean	Parlian	nen
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ECOFIN deciding on non-effective action on 8 December (= 4 months after Council notice of 8 August)