REPLIES OF THE EUROPEAN COMMISSION TO THE EUROPEAN COURT OF AUDITORS SPECIAL REPORT:

"COMMISSION'S SURVEILLANCE OF MEMBER STATES EXITING A MACROECONOMIC ADJUSTMENT PROGRAMME: AN APPROPRIATE TOOL IN NEED OF STREAMLINING"

EXECUTIVE SUMMARY

I. Common Commission reply to paragraphs I and II.

The Commission welcomes the European Court of Auditors (ECA) audit on post-programme surveillance (PPS) and enhanced surveillance. Regulation (EU) 472/2013 came into force briefly before the end of the first macroeconomic adjustment programmes. It was drafted and negotiated still under the pressure of the economic crisis. Its central motivation was to prevent cases where a former programme country would again face serious financial difficulties and thus to preserve financial stability. To achieve this, the Commission was requested to provide a regular assessment of the economic, fiscal and financial situation also after the end of a programme. The regulation also sought to ensure that post-programme surveillance is fully embedded in the EU's multilateral surveillance framework established by the Treaty on the Functioning of the European Union (TFEU). The Commission's subsequent actions should be assessed against this mandate. In particular, the Commission always took into account to achieve the intended objective in its assessment without creating an undue burden for the Member State concerned. This required a certain degree of flexibility and a country-specific approach in the surveillance.

III. The arrangements for the approval and amendments of Recovery and Resilience Plans, as well as for the monitoring of implementation of plans, are set out in Regulation (EU) 2021/241. The Commission considers that the results of the ECA's work could usefully contribute to the ongoing review of economic governance arrangements in the Economic and Monetary Union (EMU).

V. The Commission is bound by the legal design and set-up of all elements of the European multilateral surveillance framework. The Commission considers that overlaps, to the extent they do exist, are thus also a reflection of the need to ensure consistency of products under different surveillance instruments, or by different institutions having different mandates and constituencies with regard to broad macroeconomic monitoring. The activities carried out by the European Stability Mechanism (ESM), for example, are in an inter-governmental context and outside the EU legal framework. The purpose of the ESM's monitoring is to assess the repayment capacity as a creditor to protect its balance sheet. The post-programme surveillance (PPS) process is about economic surveillance provided for in EU law, which feeds into the ESM Early Warning System.

VII. The motivation of the Regulation (EU) 472/2013 is to preserve economic and financial stability, and therefore, it requests a broad assessment of the economic situation and financial risks. This requires taking into consideration policy developments as they evolve over time. The assessments of repayment risks use established analytical tools of the Commission.

VIII. The Commission acknowledges that the implementation of reforms is affected by many variables and that it is hard to attribute developments directly to surveillance by the Commission. However, judged by contacts with stakeholders, including financial market actors and rating agencies as well as with other Member States, surveillance is perceived as being helpful. The Commission acknowledges that the role played by PPS is especially important in the immediate years after a programme ends.

It should be recalled that, under enhanced surveillance, the Commission monitors the implementation of specific reform commitments given by Greece to European partners in June 2018, and the reports provide a basis for the release of additional tranches of debt relief measures. To date, the Commission has issued ten quarterly enhanced surveillance reports, which has led to five tranches of debt relief measures amounting to EUR 4 billion.

IX. The Commission accepts all recommendations.

OBSERVATIONS

21. a) The Regulation (EU) 472/2013 mandates the Commission to conduct, in liaison with the European Central Bank (ECB), regular review missions and assess the economic, fiscal and financial situation of the Member State under PPS. The Commission's actions should be assessed against this regulatory mandate.

25. The Commission needs to ensure consistency with the EU legal framework, including for economic policy coordination, irrespective of whether financial assistance was provided by the EU or in an inter-governmental context. The EU legislation does not allow the ESM to conduct economic surveillance. The Commission and the ESM agreed on a Memorandum of Understanding in 2018 to clarify the working relations between both institutions. This is without prejudice to the application of any rule of EU legislation.

29. Second indent: The assessment of the economic, fiscal and financial situation is requested from the Commission by Article 14(3) of the Regulation (EU) No 472/2013.

31. The PPS does not systematically assess implementation of all Country Specific Recommendations (CSRs) but has a focus on those relevant for the assessment of the economic, fiscal and financial situation. In the early years after programme end, CSRs were meant to cover remaining challenges stemming from the programme period. However, in later years, the scope of CSRs was broadened to cover also other issues, due to the broader nature of the European Semester (including, for instance, environmental objectives). These issues are not covered in PPS.

33. The Commission points out that the legal base contains a clear mandate for the Commission to assess the economic, fiscal and financial situation. Putting the debt service capacity at the centre would thus not be in line with the current regulation, which has to guide the Commission.

36. The task allocation between the Commission's services as regards the European Semester and the Recovery and Resilience Facility on the one side and PPS and enhanced surveillance on the other, is explained by the broader nature of the former and the more specific nature of the latter.

The Commission points out that the work on the Recovery and Resilience Facility is carried out in close collaboration with all concerned Commission services with structured and consistent internal coordination mechanisms.

49. For the two Member States without formal agreement on data provision, reporting was agreed at technical level after a general letter by the responsible Commissioner to the Minister of Finance or by an informal agreement following negotiations with the government. The Commission would consider these two cases comparable to the others in substance.

52. Monitoring of reform processes in shorter intervals can be useful, as reforms are usually implemented in a gradual manner. There are steps leading to full implementation of a reform (e.g. studies undertaken, staff hired, laws prepared); these can (and should) be monitored on a frequent basis, not only at the end of the 12 to 18 months period.

53. To some degree, even where reports were repetitive, this can be considered as positive as it implies that no new (negative) developments happened. Reports would then provide necessary data updates and, more importantly, confirm stability.

58. The PPS and enhanced surveillance are not fully comparable with regard to the question how much the monitored reforms are to be specified. The latter needs to specify requested reform progress as this is linked to debt relief.

64. The Regulation (EU) 472/2013 calls for surveillance of financial stability. As problems with financial stability will have a direct impact on a country's macroeconomic and fiscal situation, which are under the direct competence of the Commission, it is very relevant that this analysis be made in the context of PPS. While PPS should focus on the stability of the system (as opposed to the viability of individual banks, which is in the focus of the Single Supervisory Mechanism (SSM)), problems of individual banks can have significant impact, for example, on the budget. This would have to be addressed under PPS.

68. The Commission is bound by the Regulation (EU) 472/2013 to provide a broader assessment with a view to preserving financial stability. Nevertheless, the specific presentation of repayment schedules can be reviewed.

70. The Commission points out that information on recent debt issuance, spreads, early repayments and ratings are core parts in assessing repayment risks.

71. The quantification of the possible impact of specific risks, like the country- or sector-specific impact of the UK's exit from the EU, of COVID-19 or of bilateral or geopolitical tensions, will always remain difficult.

Second indent: The fiscal impact of the pandemic is monitored carefully and the Commission has published a number of Communications on this. The Commission considers that an assessment of the long-term fiscal implications of COVID-19 that could have been done in PPS reports by December 2020 would have been premature since the COVID-19 crisis had started only in March 2020.

72. Whether or not a country can ensure market access depends on many factors, among them also developments in other countries (spillovers). It is thus impossible to define a specific debt level and trajectory as ensuring market access or not. However, high and/or (rapidly) increasing debt is a risk factor.

80. The reforms listed in annex II of the present ECA's report were indeed very sensitive for national authorities as they affect, for example, the degree of discretion of authorities or core elements of the structure of public revenue.

83. Regarding reform implementation in Greece, delays due to the pandemic became fully apparent at the time of drafting the 7th enhanced surveillance report in September 2020. This has been compounded by delays due to factors largely outside of the control of the Greek government (tender delays, legal challenges etc.) that already occurred prior to the pandemic. Keeping the initial deadlines in the report would unduly focus the assessment on these delays, at the cost of acknowledging important actions taken.

84. The Commission acknowledges that there have been delays in some reforms compared to the timetable agreed in June 2018. However, account should be taken of the impact of a general election of the Greek Parliament in May 2019. In addition, there was progress with many reforms, and some reforms went further than initial commitments.

87. The PPS ensures continuous, independent and rigorous country surveillance. It is thus a valuable input to other reports, e.g. from rating agencies or financial institutions.

CONCLUSIONS AND RECOMMENDATIONS

88. The Commission recalls that its activities have to be guided by the EU legislation in force, which demands a broad assessment of the economic, fiscal and financial situation with a view to preserve financial stability.

The Commission considers that a distinction should be drawn between the situation of Member States under PPS and Greece under enhanced surveillance. Successive enhanced surveillance reports have confirmed continued reform implementation, which has provided a basis for the release of tranches of debt relief. The combination of enhanced surveillance and debt relief measures do appear to have an impact on reform implementation.

89. The Regulation (EU) 472/2013 seeks to preserve financial stability. Article 14 in the same regulation provides the basis for assessing the economic, fiscal and financial situation also for the purpose of ensuring that financial assistance is repaid. According to Article 14, PPS is in place for as long as minimum 75% of financial assistance received from one of the relevant creditors has not been repaid. The vade mecum helps spelling out which tools can be helpful to meet the objectives of the above regulation.

90. The Commission is bound by the legal design and set-up of all elements of European economic policy coordination framework. The Commission considers that overlaps, to the extent that they do exist, are thus also a reflection of the need to ensure consistency of products under different surveillance instruments, or by different institutions having different mandates and constituencies with regard to broad macroeconomic monitoring. The Commission is of the opinion that there is value in having PPS reports providing comprehensive analysis, while having a distinct audience in the affected countries and externally (e.g. rating agencies).

Focusing predominantly on the repayment capacity would not do sufficient justice to the task mandated in the Regulation (EU) 472/2013 of assessing the economic, fiscal and financial situation (and concomitant risks).

92. Economic policies monitored under the European Semester and to be supported under the Recovery and Resilience Facility are much broader than the policies monitored under enhanced surveillance. The internal organisational arrangements of the Commission reflect this broader scope.

93. The Commission needs to ensure consistency with the EU legal framework, including for economic policy coordination, irrespective of whether financial assistance was provided by the EU or in an inter-governmental context. The EU legislation does not allow the ESM to conduct economic surveillance. The Commission and the ESM agreed on a Memorandum of Understanding in 2018 to clarify the working relations between both institutions.

94. It could be warranted that a euro area Member State that exits a programme still presents potential spillover risks for other Member States in the euro area even after the end of a macroeconomic adjustment programme.

Recommendation 1 – Integrate the different surveillance activities

The Commission accepts recommendation 1 (a).

The Commission is committed to streamline the PPS process, so as to make it both more efficient and effective. This is particularly true – and necessary – for more mature country cases. The Commission has already taken steps to align PPS surveillance better with the European Semester, avoiding unnecessary overlap and duplication of work, while maintaining a clear profile for each element in our overall surveillance architecture. Specific ways of how to integrate PPS and enhanced surveillance into the European Semester need careful reflection, as this could raise legal and institutional implications without producing significant efficiency gains. This reflection will feed into the economic governance review.

The Commission accepts recommendation 1 (b).

The Commission shares the view that EU legislation should clearly state its objectives. The economic governance review will provide the opportunity to increase such clarity in the Regulation (EU) 472/2013, where necessary.

The Commission accepts recommendation 1 (c).

The Commission shares the view that a robust risk-oriented approach is necessary to assess the repayment capacity. This entails the analysis of debt sustainability under different scenarios, of the development of yields and spreads and of recent debt issuances. This will be complemented by a more systematic presentation of outstanding loans, the discussion of potential new risks and their quantification as much as possible.

Recommendation 2 – Streamline procedures and add flexibility

The Commission accepts recommendation 2 (a).

The Commission accepts recommendation 2 (b).

The Commission accepts recommendation 2 (c).

98. The ECB has been given the tasks of centralised supervision in the SSM Regulation so the Single Supervisory Mechanism work is factored in. Article 3(3) of the Regulation (EU) No 472/2013 ensures consistency with the activities of these other EU bodies and crucially ensures that this input feeds into the surveillance of the Commission as it has a direct bearing on the Member State’s macroeconomic and fiscal situation.

99. For the Member States without formal agreement on data provision, reporting was agreed at technical level after a general letter by the responsible Commissioner to the Minister of Finance or by an informal agreement following negotiations with the government. The Commission would consider these two cases comparable to the others in substance.

Recommendation 3 – Improve interaction with Member States and stakeholders

The Commission accepts recommendation 3 (a).

The Commission accepts recommendation 3 (b).

In accepting recommendations 1 and 2, the Commission points out that it is not in a position to make specific commitments in relation to possible legislative proposals or to the outcome of the legislative negotiations with the co-legislators.