Portugal
and the European Challenge

Wilfried Martens Centre for European Studies

Plataforma para o CRESCIMENTO SUSTENTÁVEL

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Plataforma para o CRESCIMENTO SUSTENTÁVEL

About the PCS

The Plataforma para o Crescimento Sustentável (PCS)/Platform for Sustainable Growth (PCS) was launched in October 2011 as an independent, non-profit organisation, with no party affiliation. With active public participation and in coordination with national and international R&D centres and think tanks, the PCS contribute towards asserting a sustainable development model.

PCS has established partnerships with the following think-tanks and foundations: BRUEGEL (Belgium), Centre for European Policy Studies-CEPS (Belgium), ASTRID (Italy), REFORM (United Kingdom), RESPUBLICA (United Kingdom), Centre for European Studies - CES (Belgium), ENTORNO (Spain), Konrad Adenauer Foundation (Germany), FLAD (Portugal) and the Millennium Foundation (Portugal). The leaders of these institutions are members of PCS's Advisory Board, chaired by Francisco Pinto Balsemão.

PCS is organised in six work groups – Knowledge, Well-being, Sustainability, Competiveness, Global Challenges and Citizenship, Democracy and Freedom – and 27 sub-areas, within which about 400 members are highly active.

In addition to the work involved in producing the Report for Sustainable Growth, PCS has started working on new activities, using a more cross-sectional and less segmented approach, introducing thematic debate series, original in-house research and the production of cross-sectional documents. This publication is the first result of an in-house research project. In-house research consists of original studies produced by visiting researchers, who remain at PCS throughout the duration of each project.

Introduction

Two years ago, the Plataforma para o Crescimento Sustentável/Platform for Sustainable Growth (PCS) presented its ideas for the Post-Troika period. To this end, it mobilised all of PCS's members and produced the Report for Sustainable Growth: a post-troika strategy, outlining 27 strategic challenges and 511 recommendations, segmented into areas and sub-areas. One year later, after presenting and holding a public debate on its proposals, PCS produced the Contract for Sustainable Growth, a more targeted and strategic document, based on a shared vision and consensus about key country objectives and measures.

Of all the challenges and strategic guidelines identified, in the Report for Sustainable Growth's chapter on Global Challenges, PCS argues that Portugal should 'Participate more actively in the EU to reinforce a Political Union and fully assert the EU's position in the world'. We believe that a new growth strategy cannot be dissociated from global trends and international developments, or from the future of the European project. For this very same reason, we maintain that the strengthening of a Political Union, as well as the economic and financial deepening of the EU, is necessary to tackle the biggest crisis to affect Europe in the post-war period.

It was within this context, coinciding with the elections to the European Parliament held on 25 May 2014, that we decided to focus our work for the first half of 2014 on European affairs and the challenges facing Portugal in this regard. Our aim was to contribute to the corresponding national debate, while reflecting on matters of importance to Portugal in this context and developing PCS's chief recommendations on these topics. Thanks to the support of the European think tank, Wilfried Martens Centre for European Studies, we also hope this work may serve as a basis for future research and civic action at both national and European levels.

This publication is the product of the work carried out by our visiting researcher, Duarte Cunha de Eça Valente, under the joint guidance and coordination of the board member and coordinator for Global Challenges, Carlos Costa Neves, and board member, Jorge Vasconcelos. In addition to this research project, which ran from January to June 2014, we also held a series of debates on the theme 'Portugal and the European Challenge' in its various dimensions, bringing together many specialists on European affairs. This work is the first of a series looking to shed light on the challenges identified as being fundamental to releasing Portugal's growth potential.

With this in mind, we hope that it will add to the public debate and contribute to the emergence of new ideas on an issue that is so decisive for our collective future.

Carlos Pimenta
Chairman of the Platform for Sustainable Growth

Researcher's Note

1. Work structure

The first research project of the Platform for Sustainable Growth (Plataforma para o Crescimento Sustentável, PCS) was dedicated to European affairs and in particular, to Portugal's role in the European Union's (EU) deepening process. The present report is the final product of this independent initiative, including all documents elaborated during the project's time-period, i.e. the first half of 2014, coinciding with the European elections. Here, you will find all debate session support documents, as well as a more extensive research work on Portugal and European economic governance.

The first and second support documents fall within the framework of the first public debate organised on 18 March 2014, about **European citizenship**. The first document deals with this theme from the point of view of consolidating the European political space, while the second is wider reaching in its approach and addresses instead the political deepening of the Economic and Monetary Union (EMU). Both documents put forward proposals to be considered within the context of Portugal's participation in the EU's strengthening process. These complete in turn the element that received the most attention in this project, i. e. the more extensive research work on Portugal and European economic governance. This work looks in greater detail at the research presented during the second public debate, organised on 29 April 2014, on the issue of promoting growth and employment in Portugal within the European framework. The corresponding support document, presented at the time as a 'work in progress', is available online for consultation on the PCS's website. It is not included here; it serves only as a basis for the research carried out on Portugal and European economic governance.

Apart from the two support documents and the work on Portugal and European economic governance, the report includes a fourth document, used as support for the third and last public debate organised on June 4 2014, about the outcome of the European Parliament elections. Unlike other support documents herein included, this document does not set forth recommendations, serving only as a guide for discussion on the electoral result in the context of the PCS's research project.

For each debate held, you can find the corresponding programs and support documents, as well as the interventions of guest speakers in video, on the PCS's website.

The choice of European economic governance as a topic for detailed analysis imposed itself for several reasons:
(i) the conclusion of the Economic and Financial Assistance Programme (EFAP) and the uncertainty felt as the country returned to a new and still evolving European economic governance framework;
(ii) the importance of reviewing the European economic governance framework, both for the EMU and euro area to function correctly, and to identify an exit to the crisis on the back of sustainable growth;
(iii) the prospect of such a review occurring in the medium and long term, making it important to reflect as soon as possible on the position and interests of Portugal; and,
(iv) the existence of a debate on EMU and euro area deepening at the European level and, to a certain extent, at national level, in which it is important to take part and contribute.

The purpose of the documents included this report is precisely to contribute to the debate and civic action. The initiatives considered, both support documents and the more extensive work on Portugal and European economic governance do not intend to be exhaustive. There are certainly other angles of analysis and proposals to consider.

Acknowledgements

This research project would not have been possible without the confidence, availability and support provided by the Chairman of the Platform for Sustainable Growth, Carlos Pimenta, the board members and coordinators, Carlos Costa Neves and Jorge Vasconcelos, and the resident researcher, Marta Mucznik.

The energy invested by Chairman Carlos Pimenta in PCS has played an important role in this organisation's growth and, above all, in the undertaking of such ambitious research projects as this one. The support of the Chairman has been indispensable in the context of the PCS's growth and adaptation to new forms of work, i.e. from specific projects involving voluntary work, through crowd-thinking, to work done with the support of visiting researchers.

The collaboration of the coordinators, Carlos Costa Neves and Jorge Vasconcelos, was also important. The coordinator of the Global Challenges Working Group, Carlos Costa Neves, dedicated his time to giving advice, discussing ideas, commenting on first drafts and moderating debates. His knowledge of the issues at stake, and his long service to Portugal in dealing with European affairs, allowed him to play a key role in this research project. I owe him my gratitude, as I do to Jorge Vasconcelos, the coordinator responsible for selecting visiting researchers, to whom I thank the intellectual challenge, the availability and willingness to open doors and as well as his high working standards.

Lastly, I thank researcher Marta Mucznik for her tremendous coordination capacity, whether in organising debate sessions, or in her regular contacts with board members and PCS members in general. Her support throughout the process, despite her other responsibilities, was priceless. It insured that the research project stayed on track.

I am grateful to everyone in general, for their patience and understanding throughout the research project, as well as for the friendships forged throughout this process.

I would like to thank our guest speakers, among other academics, diplomats and staff of national and European political institutions consulted. Their advice was useful and welcomed. It facilitated my understanding and treatment of such current and complex matters as those discussed within this report.

Thank you.

Duarte Cunha de Eça Valente

Support documents for the series of debates on ‘Portugal and the European Union’

Consolidating the European political space to ensure a greater and better exercise of European citizenship

EXECUTIVE SUMMARY

The European elections in 2014 will be different from all previous elections because in the meantime the Treaty of Lisbon has come into force and the European Union (EU) is in crisis. One of the main challenges of these elections will be to help EU citizens gain a better understanding of their rights and the effect of EU policies on their daily lives, as well as the political importance of these elections. Bearing in mind the recommendations made by the EU institutions in this regard, and previous proposals made by the Platform for Sustainable Growth (PCS) on the active participation of Portugal in the EU, measures are recommended in this document with a view to consolidating the European political space and, as a result, to ensuring a greater and better exercise of European citizenship.

A. The Treaty of Lisbon

The European elections in 2014 will be the first held within the framework of the Treaty of Lisbon that, in coming into force on 1 December 2009, partially contributed towards reinforcing European democracy. The Treaty of Lisbon increased the legislative and fiscal powers of the European Parliament, as well as its influence over the selection procedure for the President of the European Commission. The European Council must now take account of the European election results when proposing a candidate for President of the European Commission to the European Parliament. This demand means that today European citizens can have an indirect influence on what is still a complex election process for the head of the European executive by voting in the elections to the European Parliament.[1]

Apart from increasing the powers of the European Parliament, the Treaty of Lisbon made clear both the right to participate in the democratic life of the EU and the objective of bringing the Union closer to its citizens. The Treaty created a European mechanism for direct political participation, the European Citizens' Initiative, and made the Charter of Fundamental Rights of the European Union binding. The fifth chapter of this Charter addresses European citizenship and the following rights in particular: the right to vote and to stand as a candidate at elections to the European Parliament and at municipal elections; the right to good administration; the right of access to the documents of the European institutions; the right to refer to the Ombudsman of the Union; the right to petition the European Parliament; freedom of movement and residence; and diplomatic and consular protection.

Despite the contribution made by the Treaty of Lisbon to the consolidation of European democracy, there is still a long road ahead. The upcoming European elections provide the opportunity to explore ways of improving European democracy as part of the debate on the future of the EU and of Portugal in the European framework, namely within the context of deepening the Economic and Monetary Union (EMU). Discussing these issues takes on a particular relevance in light of the crisis and the rise in populism. Populist groups, radicals and Eurosceptics have been querying the basic rights of European citizens, such as freedom of movement, in the context of re-nationalization of European policies.

B. The crisis of the European Union

The European elections in 2014 will take place in a context of crisis. The global economic and financial crisis of 2007-2009, and the subsequent crisis that began in 2010 and its affect on the euro, raised doubts as to the future of the EU project, in certain cases seriously affecting the trust EU citizens have in European and national institutions, and in the image and future of the EU. [2] In the case of Portugal, for example, in May 2007, 52% of the Portuguese population said they trusted the *Assembleia da República* (Portuguese Parliament), 49% trusted the Government, and 74% trusted both the European Commission and the European Parliament. Six years later, in May 2013, only 13% said they trusted the Portuguese Parliament, 10% the Government and 33% the European Commission and the European Parliament. In November 2013, only 22% said they viewed the EU favourably and only 31% said they were optimistic about the future of the EU. [3]

The crisis gave rise to a political atmosphere ripe for a protest vote, already common in European elections, which have tended to be treated like national, secondary competitions in many European countries and therefore with high levels of abstention reported. [4] The protest vote, in principle, should benefit the opposition or small parties, including the populist, radical and Eurosceptic groups in some Member States with larger populations and more seats in the European Parliament, namely Spain, France, the Netherlands, Italy and the United Kingdom. [5]

If in May there is increased support for populist, radical and eurosceptic groups at the polls this should not necessarily be interpreted as greater influence for the respective European political forces in the European Parliament and in the EU as a whole, given their ideological and other differences. Having said this, a rise in European populism could still have a negative effect over time on how power is democratically exercised in the European Parliament. It could impose forced consensus among the major European political parties, which would then have less room for manoeuvre to support different policies and visions regarding the advancement of the EU project.

Apart from the negative impact of the crisis on the EU, it is also important to look at the EU's response to the crisis. One of the main aspects of this response has been to deepen EMU, with a political union that guarantees the transparency, accountability and legitimacy of the European institutions and the European decision-making process. Developing this political union means consolidating a European political space where citizens have a better understanding of their rights, the effect of EU policies on their daily lives and the political importance of the European elections. [6]

1. Consult article 17/7 of the Treaty on European Union. See EUROPEAN UNION, "Consolidated versions of the Treaty on European Union and on the Functionaing of the European Union," in *The Official Journal of the European Union*. Série C, nº 326, 26 October 2012.
2. According to ROTH, Felix *et al.*, the trust EU citizens have in European Union and national institutions has fallen more in Cyprus, Spain, Greece, Ireland and Portugal, that is, in the countries that adopted economic and financial adjustment programmes. See ROTH, Felix; NOWAK-LEHMANN D., Felicitas; e OTTER, Thomas, "Crisis and Trust in National and European Union Institutions – Panel Evidence for the EU, 1999 to 2012," *European Union Democracy Observatory (EUDO) Working Paper Series.* Italy : European University Institute (EUI). May 2013.
3. See EUROPEAN COMMISSION Standard Eurobarometer 80: *Public Opinion in the European Union: First Results*. December 2013 See also Francisco Manuel dos Santos Foundation (FFMS), *Portal de Opinião Pública* (POP). Available on: www.pop.pt.
4. See EUROPEAN PARLIAMENT, *Turnout at the European elections (1979-2009)*. Available on: http://www.europarl.europa.eu/aboutparliament/en/000cdcd9d4/Turnout-(1979-2009).
5. See BERTONCINI, Yves e KREILINGER, Valentin, *LSE EUROPOP Blog: The European Parliament elections will see populist parties make gains, but they will remain a battle for control between mainstream parties*. 3 December 2013.
6. According to the European Commission, in November 2013, the majority of Europeans (55%) and Portuguese (58%) claimed they not knew their rights as citizens of the EU. However, in November 2012, most Europeans claimed that the rate of participation in the European elections would be higher if there were more information on the EU elections (84/85%), on the impact of the Union on the daily life of citizens (84/86%) and on the programme and objectives of the candidates of the parties in the European Parliament (84/81%). In their opinion, the same would happen if the political parties were to demonstrate their European political affiliation at home in all campaign aspects (73/70%), the elections were to take place on a common date throughout the EU (62/70%) and the political parties were to put forward a candidate for President of the European Commission (62/72%).

II. DEVELOPMENT

A. Proposals made by the European Parliament and the European Commission

The European Parliament and the European Commission have been making recommendations since 2012 to the EU Member States and to the European and national political parties with a view to consolidating the European political space. [7] Among their different recommendations, the following are particularly important:

- **To encourage and facilitate information to the electorate on the European affiliation of national political parties before and during elections to the European Parliament:** for the European Parliament and the European Commission, both the EU Member States, and the political parties participating in the European elections, should inform citizens on the relationship between the European political parties and the national political parties using the election bulletin, campaign materials and different forms of communication or political broadcasts held in the context of the European elections.
- **To support a candidate for President of the European Commission:** the Community institutions have recommended nominating candidates to President of the European Commission at European level, demonstrating political support nationally and organising European electoral campaigns centred on the candidates selected and during which the political programmes of the candidates for President of the European Commission are made known.
- **To agree on a common date for elections:** the European Commission recommended to the EU Member States that they should organise the European ballot on the same day and at the same time throughout the EU, in order to reinforce the European dimension of the European elections.
- **To adopt measures to guarantee the electoral rights of citizens throughout the EU**: the European Commission published a report in 2010 with proposals for removing the obstacles to European citizens exercising their rights, including the right of a foreign citizen resident in a Member State of the EU to vote or stand as a candidate in the European elections. To face this specific challenge, in 2013 the European Commission suggested creating a single contact authority in each Member State to facilitate the exchange of electoral information, the transfer of additional information whenever this was relevant to the electoral process and the use of safe, uniform technical means to transmit this information. The Council of the EU, in its turn, approved Directive 2013/1/EU in December 2012 to give better assurance of the right of EU citizens residing in a Member State of which they are not nationals to stand as a candidate in elections to the European Parliament.

7. See EUROPEAN PARLIAMENT, *European Parliament Resolution of 22 November 2012 on the elections to the European Parliament in 2014.* 22 November 2012; EUROPEAN PARLIAMENT, *Report on improving the organisation of the elections to the European Parliament in 2014*. 12 June 2013; and EUROPEAN COMMISSION, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Preparing for the 2014 European elections: further enhancing their democratic and efficient conduct.* 12 March 2013.

B. Proposals made by the PCS

The PCS in its 'Report for Sustainable Growth' (published in 2012) **includes recommendations on the active participation of Portugal in the EU, two of which address the European electoral process:** ***"to promote and divulge in the country, in a systematic and explanatory way, the principles, values and policies of the EU"*** **and** ***"to promote and strengthen the powers of the European Commission, as well as its democratic legitimacy."*** [8] The aim of these two recommendations is similar to that of the European institutions: to ensure adequate information for European citizens regarding the EU and to reinforce the powers, as well as the legitimacy, of the Community institutions. The difference lies essentially in the expanded scope of the second recommendation: "*in the short-term and still within the political and institutional framework, the choice of [President of the European Commission] should be the candidate presented by the political party winning most votes in the elections to the European Parliament*" and *"[in due time it should] proceed to amend the treaties to have the President of the European Commission elected by direct ballot."* [9] With this objective in mind, PCS supports the following initiatives:

1. Disclosing the European political-party affiliation of the Portuguese political parties

To make the association clear between the European political parties and the national political parties in Portugal, **the PCS urges the Portuguese political parties to display their European political-party affiliation in their respective campaign materials, in communications and political broadcasts made within the context of the European elections.** In the long-term, **the PCS encourages the Portuguese political parties to approve an electoral reform that will enable the display of their European affiliation in the election bulletin in time for its implementation during the European elections scheduled for 2019**. Underscoring the relationship between the European political parties and the national political parties will, **in the eyes of citizens, explain the contribution their vote makes in electing certain MEPs and their later participation in a European political group.** Depending on the support obtained in the polls, these MEPS will play a greater or lesser role in the life of the European Parliament, and as a result in electing the President of the European Commission.

2. Supporting a candidate for President of the European Commission

To ensure a clear connection between the European elections and election of the President of the European Commission, **the PCS encourages the Portuguese political parties that have a European political-party affiliation, to publicly and adequately announce, in advance, the candidate they support for President of the European Commission, as well as the candidate's political programme.** This measure will help Portuguese citizens better recognize the relationship between their vote in the European elections and the election of a specific candidate to President of the European Commission. With this initiative, the accountability of the President of the European Commission to the European Parliament and its elected members will be strengthened, and on the whole this will increase the legitimacy of the European decision-making process. Demonstrating national political support for certain candidates to the European Commission and their political programmes, will, moreover, help candidates and their respective political parties to organise European electoral campaigns based on European issues throughout the EU, including Portugal, thereby providing EU citizens with a clear idea of the proposed political project for the future of the EU, and in particular for the country in the EU.

3. Increasing the accountability of MEPs to the electorate

The PCS recommended in the Report 'Platform for Sustainable Growth' "*increasing the individual accountability of members to their electorate by having [...] the vote reflect not only the selection of a political party, but also the selection of specific members standing for election, regardless of the position occupied on the list submitted by the party.*" [10] In the context of the European elections, **the PCS suggests that Portuguese MEPs should be individually more accountable to their electorate by considering and adopting an electoral system of semi-open or open lists in Portugal in time for the European elections in 2019**. This reform would help bring the Portuguese closer to their EU representatives, as well as promote their interest and electoral participation, contributing towards consolidating the democratic legitimacy of the European Parliament.

4. Agreeing to hold the elections on the same day

The PCS is in favour of holding the European elections on the same day and at the same time throughout the EU in order to consolidate the European dimension of the European ballot. To this end, **the PCS recommends that Portugal continue to encourage the effort of reaching a European agreement to set the vote on the same day.**

5. Guaranteeing the electoral rights of European citizens throughout the EU

In regard to the obstacles raised by the European Commission on the electoral rights of European citizens, in Portugal the right of EU citizen eligibility is guaranteed for EU citizens living in a Member State of which they are not nationals. In this regard the PCS welcomes Directive 2013/1/EU, transposed to Portuguese law in January 2014. [11]

8. See PLATFORM FOR SUSTAINABLE GROWTH (PCS), *Report for Sustainable Growth : A post-troika strategy for Portugal*. 2012, p. 215
9. *Idem.*
10. See PCS, *op. cit.*, (2012) p. 46.
11. The Portuguese political scientist Pedro Magalhães, informally presented on his web page a proposal to reform the existing electoral lists in Portugal, using the Finnish model as a reference. See *Pedro Magalhães: A Proposta do Pedro Magalhães*. 7 January 2014. See also in this regard the comments of the Portuguese journalist Ricardo Costa in "A proposta de Pedro Magalhães que assusta os partidos," in *Expresso*. 7 January 2014.

III. RECOMMENDATIONS

The European elections in 2014 will be different to all previous elections because in the meantime the Treaty of Lisbon has come into force and the EU is in crisis. The Treaty of Lisbon made it possible for EU citizens to have an indirect influence on the election of the President of the European Commission for the first time in 2014; but the crisis had a negative effect on the confidence citizens have in the institutions of the Union and in those of their own countries. This creates a political situation likely to increase European populism in the EU as a whole, and in some Member States in particular. The economic and financial integration adopted in the meantime in response to the crisis, increasingly demands a political union that will ensure the transparency, accountability and legitimacy of the European institutions and the European decision-making process. The next step will be to consolidate a European political space in which citizens have a better understanding of their rights, the impact of EU policies on their daily life and the political importance of the European elections. Consolidating this political space will contribute to a greater and better exercise of European citizenship, including their right to vote.

Bearing in mind the recommendations of the Community institutions, as well as the previous proposals made by the Platform for Sustainable Growth (PCS) on the active participation of Portugal in the EU, the PCS recommends that:

In the short term:

- **Portuguese political parties display their European political and party affiliation** in campaign materials, and in communications and political broadcasts made within the context of the European elections.

- **The Portuguese political parties** that have a European political and party affiliation **publicly and adequately announce, in advance, the candidate and the political programme of the candidate they nominate for European Commission President.**

In the medium and long term:

- **The Portuguese political parties approve an electoral reform enabling them to indicate their European political and party affiliation in the voting bulletin in time for its implementation during the European elections in 2019.**

- **The Portuguese political parties approve an electoral reform that increases the individual accountability of the Portuguese MEPs to their electorate.** To this end, **alternatives should be considered to the closed electoral list system in Portugal,** that is, semi-open or open lists, **in time for the European elections in 2019.**

- **Portugal continues its support for holding the European elections on the same day and at the same time throughout the EU** to reinforce the European dimension of the elections.

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Taking European democracy further with political integration in the Economic and Monetary Union

EXECUTIVE SUMMARY

The euro crisis caused a considerable break down in the confidence EU citizens had in the EU itself and in its institutions, reviving the debate on the EU project and, in particular, its democratic character. With the European elections scheduled for May 2014, this discussion must be reopened and some of the main proposals of particular interest to Portugal reassessed, especially when seeking to strengthen the democratic character of European economic governance. Bearing in mind these recommendations, as well as previous proposals made by the Platform for Sustainable Growth (PCS) on Portugal's active participation in the EU, measures will be described in this paper with a view to taking European democracy further, by politically deepening the Economic and Monetary Union (EMU) in the short, medium and long-term.

A. European confidence crisis

The Euro crisis had a negative effect on the relationship between the EU and its citizens, an effect reflected today in both the image of the EU and trust in its European institutions. he image of the EU was significantly tarnished with the outbreak of the crisis in 2010. Between the autumns of 2009 and 2013, the percentage of citizens viewing the EU in a positive light fell from 48% to 31% and the percentage of citizens viewing the EU in a negative light rose from 15% to 28%.[1]
Citizen confidence in the Community institutions fell in the EU as a whole and in some EU Member States in particular. According to a study undertaken by the European University Institute (EUI) and published in 2013, the decline in citizen confidence in the European Commission and in the European Parliament was moderate in most of the EU Member States, but worse in five countries in particular – Cyprus, Spain, Greece, Ireland and Portugal.[2] According to the EUI study, the citizen confidence in these countries on the periphery of the Euro area reached critical proportions and, to a great extent, the response of these countries explains this decline in the European average of confidence levels.[3]

This decline in EU citizen confidence, according to the EUI study, **is very closely related to the increase in unemployment, which in turn helps explain the change in attitude of the Portuguese towards the EU from the start of the crisis.** According to the most recent Eurobarometer result in Portugal (autumn of 2013), Portugal today is the third EU country in line to see the EU in a negative light (39%) – at the same level as one of the more Eurosceptic EU Member States, the United Kingdom (39%), although still distanced from Cyprus (54%) and Greece (54%).[4]
The sharp decline of the EU image in Portugal, according to a European public opinion survey, coincides with the Economic and Financial Adjustment Programme (EFAP) coming into force in 2011.
The image the Portuguese had of the EU in the autumn of 2010, was in fact more positive than negative, but it declined considerably from then on. The positive image of the EU among the Portuguese fell from 40% to 22% between 2010 and 2013, while the negative image of the EU doubled, rising from 19% to 39% during the same period.[5]
In the current context of crisis and economic adjustment, only 3% of the Portuguese view the economic situation of the country positively, while 70% hold the EU responsible for austerity and 33% associate the EU with unemployment, exceeding the respective European averages of 31%, 63% and 19%. Unemployment is in fact the issue that the Portuguese most associate with the EU, followed by freedom of movement and freedom to study and work throughout the EU (32%) and the euro (32%).[6]

It is within this context of serious economic difficulty that the Portuguese have become more disillusioned with democracy. According to the most recent Eurobarometer, Portugal is the EU country with the highest level of dissatisfaction with national democracy. 85% of the Portuguese say today that they are dissatisfied with democracy, which is far higher than the European average (52%). This dissatisfaction is felt throughout Portuguese society and is the lowest since the Eurobarometers were first introduced to Portugal.[7]
In short, in Portugal, **the most recent period of crisis and economic adjustment gave rise not only to a substantial reduction in citizen confidence in the European institutions, but also in the political regime that enshrines them nationally, and that means a loss of faith in democracy.**

1. See EUROPEAN COMMISSION, *Eurobarómetro Standard 80: Public Opinion in the European Union: National Report Portugal*. Autumn 2013, p. 6.
2. See ROTH, Felix; NOWAK-LEHMANN D., Felicitas and OTTER, Thomas, "Crisis and Trust in National and European Union Institutions – Panel Evidence for the EU, 1999 to 2012," *European Union Democracy Observatory (EUDO) Working Paper Series*. Itália : European University Institute (EUI). May 2013, p. 19. In relation to Portugal in particular, according to Eurobarometer data, collected by the Institute of the Social Sciences (Instituto de Ciências Sociais – ICS) within the context of the Public Opinion Portal (POP) of the Francisco Manuel dos Santos Foundation (FFMS), 77% of citizens said they trusted both the European Commission and the Europan Parliament in the autumn of 2009, but four years later, in the Spring of 2013, only 33% said they trusted these institutions. See FFMS, *Portal de Opinião Pública*. Available at: http://www.pop.pt/pt/.
3. It was also in these countries that bail-out programmes were adopted in response to the crisis, although the programme for Spain was limited to the banking sector alone.
4. See EUROPEAN COMMISSION, *op. cit.*, p. 3.
5. *Idem.*
6. *Ibidem*, pp. 3, 4 e 7.
7. *Ibidem*, pp. 9-10.

B. A calculated assessment

The results of the Eurobarometer, explained above, illustrate how EU citizens tend to make a calculated assessment of the EU. The EU being a remote reality, EU citizens tend to focus on matters such as the economic performance of their respective countries to make their assessments of the EU.[8] It is partly for this reason that there are those today who defend the need to channel European efforts into improving the economic situation, with a view to recovering the confidence of European citizens in the actual EU project. [9]

This calculated assessment is not only economic, but political as well. *"The higher the rate of corruption and 'poor quality' governance in a country, the greater citizens appreciate the political components of European integration,"* explains the Portuguese academic Pedro Magalhães (Assistant Researcher at the Institute of Social Sciences of the University of Lisbon).[10]

The lack of confidence EU citizens have in their national institutions is usually compensated by more confidence in the European institutions, and vice versa. In the case of Portugal, **the level of confidence citizens had in the European institutions was for a long time far greater than that in their national institutions.**[11] However, **the Euro crisis has changed the dynamics.** The confidence of the Portuguese in the European institutions has fallen radically in the past decade and, although currently this level continues above that of the confidence they have in their national institutions, it is no longer as high a level as it was before.

The challenge today for the European and Portuguese leaders is to recover EU citizen confidence in the EU, the community institutions and the EU project. This means growth and employment from the economic point of view, and efficient, democratic governance from the political point of view. If promoting growth and unemployment means the economic and financial deepening of EMU, this deepening assumes the need for greater European political integration, which means reinforcing the democratic legitimacy and accountability of the European institutions.

8. See MAGALHÃES, Pedro, "Nem Portugal, nem a Europa," in *20 Anos de Opinião Pública em Portugal e na Europa*. Portugal : Francisco Manuel dos Santos Foundation (FFMS). July 2013, pp. 49-50.
9. See NEW PACT FOR EUROPE, "Strategic Options for Europe's Future," *relatório da King Baudouin Foundation, da Bertelsmann Stiftung e do European Policy Centre* (EPC). December 2013, p. 18.
10. See MAGALHÃES, Pedro, *op. cit.*, p. 51.
11. According to Magalhães, this is one of the main reasons why the combination of anti-system and Euroscepticism never thrived politically in Portugal. See MAGALHÃES, Pedro, "Cidadania, União Europeia e Globalização", paper presented at the Congress for Sustainable Growth held on 9 November 2013 in Lisbon.

II. DEVELOPMENT

The economic and financial deepening of EMU has resulted in attributing more power to the European institutions in order to reinforce coordination and economic, fiscal and financial surveillance at European level. However, **this deepening lacks the parallel, complementary political process,** which consolidates the democratic and efficient exercise of powers attributed to the European institutions. As a framework of reference, we highlight the principal proposals made by the European Commission and the European Council, as outlined in the respective guideline documents on deepening EMU, with a view to promoting greater democratic legitimacy and accountability of the EU.[12]

Having established this framework, **we will examine some of the main proposals being discussed currently at European level and of particular interest for Portugal.**

12. See EUROPEAN COMMISSION, *Communication from the Commission: A blueprint for a deep and genuine Economic and Monetary Union: Launching a European Debate.* 30 November 2012; and EUROPEAN COUNCIL, *Towards a Genuine Economic and Monetary Union.* 5 December 2012.

A. Framework of reference

Both the European Commission and the European Council defend a number of **basic principles referring to the political deepening of EMU.** Both institutions immediately point out that the **mechanisms for control and democratic accountability should be placed on the same level as the stakeholders and executive decisions concerned.** In other words, European decisions should be controlled at European level by the European Parliament, although national parliaments would still play an important role within the EMU context, namely in supervising and legitimising the actions of the EU Member States, both in the Council of the EU and in the European Council, in regard to the affairs under their jurisdiction, such as national fiscal and economic policy issues.

With regards to the proposals of the European Council and the European Commission specifically, there are two distinct approaches (see tables n.º1 e 2). The European Council, in its framework document, chose to distinguish between those aspects referring to the economic and financial dimensions of deepening EMU from those elements associated with EMU or the euro area as a whole; while the European Commission preferred to distinguish those proposals that require reforms to the EU treaties from those that could be adopted within the current European legal framework. The latter differentiation is particularly useful in that reforming the treaties of the EU of 28 seems today like a complex and time-consuming process and therefore difficult to implement in the short term, even if a debate on medium and long-term measures should not be excluded from the outset. This debate is in fact particularly opportune within the context of the 2014 European elections. The coming elections mark the end of the current European parliament (2009-2014) and, along with it, the renewal of the different EU institutions - not only the European Parliament, changing MEPs and the President, but also other leading European positions – hence opening the window to a new European political cycle in which a revision of the EU treaties might be considered.

TABLE N.º1 EUROPEAN COUNCIL PROPOSALS FOR IMPROVING THE DEMOCRATIC LEGITIMACY AND ACCOUNTABILITY OF THE EU WITHIN THE CONTEXT OF DEEPENING EMU (Source: European Council)

	IN GENERAL	INTEGRATED FINANCIAL FRAMEWORK	INTEGRATED FISCAL AND ECONOMIC FRAMEWORK
1	Transpose intergovernmental agreements, adopted in response to the crisis, to the EU legal framework.	Complement European accountability of the European Central Bank (ECB) with mechanisms for providing information, reports and transparency for the national parliaments of Member States that fall within this framework.	Involve national parliaments in both the general framework of the European Semester and in the specific context of future 'contractual arrangements', with a view to facilitating structural reform processes.
2	Strengthen external representation of the euro area.		Establish new mechanisms for cooperation between the European Parliament and national parliaments that contribute to increasing the democratic legitimacy and accountability of the EU.
3			Develop arrangements specific to guaranteeing the democratic legitimacy and accountability of a new fiscal capacity for EMU. These arrangements will depend on the characteristics of fiscal capacity.

	TABLE N.º2 EUROPEAN COMMISSION PROPOSALS FOR IMPROVING THE DEMOCRATIC LEGITIMACY AND ACCOUNTABILITY OF THE EU WITHIN THE CONTEXT OF DEEPENING EMU (Source: European Commission)
	IN THE SHORT TERM (WITHOUT REFORM TO THE EU TREATIES)
1	Promote contact between the European institutions, that is between the European Parliament, the Council of the EU, the European Commission, the European Council and the Eurogroup, within the framework of the European Semester and, in particular, in the Economic Dialogue created with the Six-Pack (2011).
2	Reinforce application of the "comply or explain principle", according to which the Council of the EU is publicly responsible for any change introduced in European Commission proposals in terms of the economic surveillance of Europe.
3	Involve the European Parliament in the selection of the EU's multi-annual priorities, as expressed in the 'Council's Integrated Guidelines', i.e. the General Guidelines for Economic Policies and Guidelines for Employment Policies.
4	Regularly inform the European Parliament on the preparation and implementation of macroeconomic adjustment programmes, as provided by the Two-Pack.
5	Create a special committee for the euro in the European Parliament.
6	Improve the way the Eurogroup functions.
7	Promote the emergence of a genuine European political space.
	MEDIUM AND LONG TERM (WITH REFORM OF THE EU TREATIES)
1	From the legal point of view, fully integrate the General Guidelines for Economic Policies and the Guidelines for Employment Policies, and so create a single instrument with which to express the EU's multi-annual priorities, and transfer its approval method to the ordinary legislative process.
2	Should it become necessary for the European Commission to eventually have the power to review national budgets in line with fiscal commitments assumed at European level, proceed with the democratic legitimacy of this by approving legislative acts by co-decision. To this end, create a special legislative procedure to guarantee a swift approval (i.e. single reading).
3	Place the European Stability Mechanism (ESM) under the legal framework of the EU, in such a way that the European Parliament can scrutinise it adequately.
4	Reinforce the powers of an eventual European Parliament Committee for the euro.
5	Reinforce the position of Vice-President of the European Commission for Economic and Monetary Affairs and the Euro, with a view to conferring more management and political accountability to a future structure for European economic governance, similar to an EMU Treasury in the European Commission.
6	Reinforce the Eurogroup, making it responsible for decisions on the euro area and the Member States that are part of it.
7	Reinforce the political accountability of the European Central Bank (ECB), as the supervisor of the European banking sector, to the European Parliament, allowing the latter to conduct regular fiscal control over this activity.
8	Grant a special status to the financial regulation agencies, with a view to consolidating their supra-national nature and democratic accountability.
9	Extend the competencies of the Court of Justice of the European Union.
10	Should there be a wish to issue euro bills, develop a model for political accountability at European level (European Parliament) and national level (national parliaments), in which an EMU Treasury is in charge of managing the debt.
11	Define a legal basis on which to create a European Redemption Fund. Once this Fund is established, the European Commission would be in charge of managing it, under the scrutiny of the European Parliament.

B. Proposals discussed at European level

Although reforms have been made to European economic governance since the start of the Euro crisis, through deepening EMU, **it is in the euro area,** of which the future of Portugal particularly depends, **that a greater effort towards economic and financial integration has been seen. This effort towards European economic and financial integration should be accompanied today by more political integration. Among the different proposals discussed on how this should be achieved at European level,** including those put forward by the European Commission and the European Council, **three** proposals are underscored that involve **reforms to the way in which the Eurogroup functions,** as well as on how **to involve the European Parliament and the national parliaments in European economic governance.**

1. Improving the way the Eurogroup functions

The Eurogroup is formed of the Council of Economy and Finance Ministers of the eurozone Member States, and it has been meeting informally since 1997 with the objective of discussing and exercising political control over the economic governance of the euro. Although the Treaty of Lisbon gave it a legal basis in 2009, the Eurogroup maintains an informal format, meeting regularly before the Economic and Financial Affairs Council (ECOFIN), the economic and financial body of the Council of the EU, to discuss and agree on positions regarding the euro area.

Increasing the visibility and accountability of the Eurogroup would help to consolidate both the democratic nature and the efficiency of European economic governance.[13] To this end, the French think tank Notre Europe, claims **it would be useful to give the Eurogroup a full-time, permanent chairman.** The Eurogroup would then be better equipped to pursue its decisions and therefore more accountable for its actions.[14] Furthermore, with the EU treaties being reformed over time, the European Parliament could have more political control over the Eurogroup, besides merging the positions of Chairman of the Eurogroup, Commissioner and Vice-President of the European Commission for Economic and Financial Affairs. The first measure would help to consolidate the democratic legitimacy and accountability of the European institutions, while the second would contribute to reinforcing the principle of equality among the eurozone Member States in questions of European economic governance.[15]

2. Creating a Sub-committee for the euro in the European Parliament

Deepening EMU assumed the establishment of **a new European structure for economic and fiscal coordination and supervision, within which today we can distinguish between rules applied to the majority, if not to all, the EU Member States and specific rules applied to the euro area. It is because this distinction exists,** a result of greater economic and fiscal integration in the euro area, **that creating a specific European parliamentary body is justified. This body will politically monitor the process of strengthening the euro area, as well as its governance.**

Creating a Sub-committee for the euro in the European Parliament may guarantee this political monitoring and require only a change in internal rules of procedure of the EP; the difficulty consists of defining its competencies and composition. The current configuration of the European Parliament, according to the French think tank Notre Europe and the Italian Institute of International Affairs (IAI), is not compatible with the appointment of MEPs based on nationality, whether as a whole, or in sub-committees of the European Parliament. MEPs are elected to represent Europe's citizens and not the Member States of the EU and the European Parliament.[16] Moreover, the same think tanks add, the EMU countries are affected as a whole by the development and decisions of the euro area, and, with the exception of whichever country has opted for a lesser degree of European integration, will eventually adopt the single currency. These arguments tend today to favour those who support creating a Sub-committee for the euro, open to all Member States of the EU and within the legal framework of the EU, that is, in line with the EU's community principles and values, as defended by the PCS.[17]

An alternative to creating a Sub-Committee for the euro would be to establish a separate European parliamentary chamber, grouping MEPs and national parliamentarians of EU Member States in a single body with decision-making capacity on matters associated with the euro area. However, despite establishing a parliamentary body specific and exclusive to the euro area, **this choice would have the disadvantage of further complicating and fragmenting the EU.**[18]

3. Involving National Parliaments more

National parliaments have an important role to play in the control, accountability and democratic legitimacy of the executive bodies and the decisions they adopt in regard to European economic governance at national and European level.[19] At national level, this role includes discussing the instruments used in the European Semester, such as Stability or Convergence Programmes, National Reform Programmes or Draft Budgetary Plans, as well as political scrutiny of government action at European level.

The political scrutiny of government action varies according to the Member States of the EU.[20] In Portugal, the Portuguese Parliament's (*Assembleia da República* – AR) control over government action in the European Council is done regularly in plenary (*ex-ante*) and in the Commission for European Affairs (CEA) (*ex-ante and ex-post*).[21] **This system of scrutiny means that Portuguese members can follow and assess the work of the national executive in the European Council, although the quality of this control in itself depends on a series of factors,** such as the information or political incentives these members have in scrutinising the government. **It is partly for this reason that the association between the electorate and those elected should be reinforced over time, as proposed by the PCS in 2012 in the Report for Sustainable Growth, which suggested reviewing the system of electoral lists in Portugal.** In reviewing this system with a view to increasing the individual accountability of parliamentary members to the electorate, gives Portuguese members more political independence and, as a result, more room for manoeuvre to scrutinise a government that might be formed or composed of their own party.[22]

Regardless of the practicality of reviewing the system of electoral lists in Portugal, **it is recognised that participation of the *Assembleia da República* (AR) in European affairs has made positive progress over recent years.** An information exchange platform between the AR and the EU, installed under Regulation n.º248/2008, encouraged this participation and keeps the national parliament better informed on European affairs. According to the current AR representative to the EU, Bruno Alexandre Dias Pinheiro, involving the AR in European affairs *"has been a learning process internally and between peers, i.e., within the actual AR and between the national parliaments of the EU"*.[23]

More specifically, within the context of European economic governance, ***"any assessment of the AR's involvement,"*** in the words of the current representative of the AR, ***"should take account of the fact that Portugal has been under an Economic and Financial Assistance Programme (EFAP) for the past 3 years,"*** in the context of which the Government was not obliged to submit Stability Programmes or National Reform Programmes.[24] Draft Budgetary Plans, introduced in the meantime, will only be submitted for the first time in October 2014. This means that once Portugal exits the EFAP and European economic governance is strengthened in response to the crisis, the role of political scrutiny of the AR in regard to the main instruments for European economic governance may increase in coming years.

According to Dias Pinheiro, ***"one of the main challenges of the next legislative period of the European Parliament** [for the AR in matters of European economic governance] **will be to see how the committees of the AR, and the AR in general, interact with the Government and how the national parliaments of the EU, and in particular of the euro area, relate to one another."*** [25] In his view it is likely that an assessment will be required on what has been done up until now under the framework of the European Semester, and what could be done to improve the involvement of the AR in European economic governance, including a comparative perspective with other national parliaments of the EU.

Although there are certainly several **ways of improving the AR's involvement in the European Semester, the current representative of the AR to the EU underscores two,** which are: (i) **the right and the capacity of the AR to address questions to the European institutions,** particularly to the European Commission, and (ii) **developing a parallel and extended system for monitoring the affairs discussed within the context of the European Semester,** i.e. a true National Semester which reflects the adoption of the European Semester in Portugal.[26]

In regard to the right and capacity of the AR to address questions to the European Commission on specific topics, such as specific recommendations per country, **the idea would be to enable the AR the possibility of being better informed by this European institution,** helping it to compare information obtained from other sources, namely from the Government. This would help reinforce the quality of the AR's political scrutiny of European affairs. To this end, it would be useful to allow **national parliaments to conduct hearings with European Commissioners, although Commissioners could delegate these tasks to high-ranking staff members of the European Commission in specific circumstances**. This delegation of competencies, however, could be a potentially sensitive matter for countries that have been recently, or still are, in a process of economic adjustment. As a result, it would be important **to ensure that the high-ranking staff members selected have a clearly defined mandate and competencies to guarantee sufficient authority to respond fully to the questions asked by the AR.**

In developing a National Semester, **the objective would be to reinforce not only the quality of the AR's political scrutiny, but also the democratic legitimacy of the Government and of the Community decision-making process.**
In the case of specific recommendations per country, for example, **it might be possible for the AR to follow each step of the process of preparing recommendations,** particularly in the different bodies of the EU Council, where these recommendations are discussed. When the time would come to approve the recommendations, the Government would find itself politically and democratically reinforced vis-a-vis its European partners and institutions.

This extended monitoring of the AR would particularly benefit the country considering the goal of adopting future instruments for European economic governance, such as the Instrument for Convergence and Competitiveness, considered by the European Commission, and the Partnerships for Growth, Employment and Competitiveness, considered by the European Council. The implementation of these instruments in Portugal would imply, *a priori*, designing and implementing a programme of structural reforms in line with the recommendations addressed to Portugal in the framework of the European Semester.

The aim would be to involve the AR in the discussion and approval of such structural reform programmes, thus guaranteeing their appropriation nationally, as well as their democratic legitimacy.

"One way of bringing the AR closer to the European institutions and therefore consolidating the involvement of the AR in issues of European economic governance", according to Dias Pinheiro, *"consists of holding meetings between national MPs, MEPs and the staff of the European institutions."* [27] According to the current representative of the AR to the EU, a video-conferencing system for this purpose was recently installed – Portugal participated in a pilot project, in which Lithuania and the Netherlands were also involved, – enabling remote meetings between the AR and the European institutions.[28] The system has not been put to much use yet, but it should be in operation from the start of the next European Parliament. Apart from remote meetings, MPs, MEPs and European staff members also meet fairly frequently during visits or meetings organised in Brussels or Lisbon. During the last legislative term of the European parliament, some Portuguese MEPs travelled several times to Lisbon to discuss areas of their competencies with members of the AR. These meetings are particularly useful because, apart from an exchange of technical and political information, they encourage inter-institutional contact. In the case of MEPs or foreign representatives, organising meetings may be more difficult. The representative of the AR to the EU says that **inter-institutional contact should be facilitated with the use of the video-conferencing system and the organisation of meetings.**[29]

On the other hand, **at European level, the work of national parliaments should rest on greater coordination between them and the European Parliament, so as to ensure more control and democratic accountability of the European institutions in matters of European economic governance. It was to this end that last year the Inter-Parliamentary Conference on Economic and Financial Governance was created** based on article 13 of the Treaty on Stability, Coordination and Governance (TSCG).

The Inter-Parliamentary Conference currently meets twice a year (in January and in October) and is a platform for national parliaments and the European Parliament to discuss and coordinate issues of economic and financial governance, particularly matters under the scope of the TSCG, such as fiscal procedures.[30] The Inter-Parliamentary Conference helps national parliaments follow more closely the matters discussed in the framework of the European Semester, particularly the results of the preceding European Semester and priorities for the European Semester in place, held in January, as well as the specific recommendations per country and the Draft Budgetary Plans, in October.

The last meeting of this Conference was held in January 2014 in Brussels. Despite the relevant content of the organised debate, **the meeting did raise criticism from some of its participants, who said that the lack of rules of procedure was a hindrance to the efficient functioning of this structure for inter-Parliamentary cooperation.**[31] This specific obstacle to inter-parliamentary cooperation in the field of European economic governance is problematic, given that interparliamentary cooperation could be perceived as a zero-sum game in which no player can win without the other losing.[32] To overcome this obstacle, the think tank Notre Europe, for example, suggests a **functional, non-exclusive division of tasks between the European Parliament and the Inter-Parliamentary Conference on Economic and Financial Governance** (see table n.º 3). This division of tasks should, in theory, help strengthen the mechanisms for control and political and democratic accountability, contributing in turn to consolidating the democratic character of European economic governance and of the euro area in particular.

To overcome this obstacle, the Inter-Parliamentary Conference on Economic and Financial Governance could set itself up as an important platform for information sharing and best practice between national parliaments in matters of European economic governance.

The Inter-parliamentary Conference will only be truly useful to national parliaments, however, if the respective institutions become involved and duly prepare the meetings.

If not, the Inter-Parliamentary Conference on Economic and Financial Governance will serve above all the European Parliament, which is currently in a position of advantage in discussing European economic governance because it enjoys more technical support to do this. However, the European Parliament has no competency to speak on behalf of national parliaments at European level, particularly on matters concerning national budgets and economic policies. This being the case, **it is up to these national parliaments to adopt the European Semester at national level in order to improve their involvement in the EU decision-making process,** thus enhancing its democratic legitimacy.

TABLE N.º3 FUNCTIONAL AND NON-EXCLUSIVE DIVISION OF TASKS BETWEEN THE SUB-COMMITTEE FOR THE EURO AND THE INTER-PARLIAMENTARY CONFERENCE ON ECONOMIC AND FINANCIAL GOVERNANCE (Source: Notre Europe)

	SUB-COMMITTEE FOR THE EURO	INTER-PARLIAMENTARY CONFERENCE ON ECONOMIC AND FINANCIAL GOVERNANCE
Monitoring Policies	▸ General, on-going monitoring of EMU guidelines and decisions. ▸ Adoption of resolutions on decisions made by the European executive authorities on EMU.	▸ Adoption of resolutions on economic strategies and national budgets.
Political Accountability	▸ Organising regular hearings with the European authorities in the euro area.	▸ Organising hearings with national or inter-governmental authorities.
Scrutiny of Financial Assistance Programmes	▸ Monitoring the use of bail-out funds resulting from the European Financial Stability Mechanism (EFSM).	▸ Monitoring the use of bail-out funds associated with the European Stability Mechanism (ESM).
Debate on Sharing Sovereign Debt	▸ Contributing to the debate on sharing sovereign debt.	

13. Ver BERTONCINI, Yves, "Zone Euro et démocratie(s): Un débat en trompe l'oeil," *Notre Europe Policy Brief.* Paris : Notre Europe. 18 July 2013, pp. 22-23.
14. See RETTMAN, Andrew, "Merkel and Hollande call for future full-time euro President." *EUObserver*. 31 May 2013; e REUTERS, *France, Italy call for full-time Eurogroup chief*, 20 November 2013.
15. A previous recommendation made by the PCS should be recalled here: "Contributing towards the consolidation of economic governance, regarding the community decision-making method centred on the European Commission. To this end, the Eurogroup, like ECOFIN, should be chaired by a Vice-President of the European Commission." See PCS, *Report for Sustainable Growth : A post-troika strategy for Portugal*, 2012, p. 216.
16. See BERTONCINI, Yves, *op. cit.*, pp. 24-25; e MAURER, Andreas "From EMU to DEMU: The Democratic Legitimacy of the EU and the European Parliament," *Istituto Affari Internazionali Working Papers*. Series 13, nº11, April 2013, p.9.
17. In the *Report Towards Sustainable Growth,* the PCS recommends: "Contributing actively towards the definitive construction (improvement) of a Political Union, insisting, in the interest of Portugal and in the general interest of the Union, on protecting the principles and values that preside in the constitution of the European Communities, [...]." See PCS, *op. cit.*, p. 215.
18. See EURACTIV, *Schäuble advocates separate eurozone parliament*. 28 January 2014.
19. Recall here a previous proposal made by the PCS that remains valid: "Aim for national parliaments to participate more and become more involved in the Community decision-making process". See PCS, *op. cit.*, p. 215.
20. On the political scrutiny of European affairs in Portugal, see the web page of the *Assembleia da República*, in particular: http://www.parlamento.pt/Legislacao/Documents/Legislacao_Anotada/AcompanhamentoApreciacaoPronunciaARProcessoConstrucaoUE_simples.pdf ou http://www.parlamento.pt/europa/Paginas/PerguntasFrequentes.aspx#3.
21. On political scrutiny of European affairs in other EU countries, see, for exemple, BERTONCINI, Yves, *op. cit.*, pp. 18-19.
22. "Increasing the individual accountability of members to their electorate, using the open party list in the context of our proportional system and being able to vote not only for the party, but also for specific members, regardless of the position on the list presented by the party." PCS, *op. cit.*, p. 46.
23. PINHEIRO, Bruno Alexandre Dias, *Interview on 19 May 2014 in the context of the research project conducted by the Platform for Sustainable Growth (PCS) on Portugal and the European Union (EU).*
24. *Idem.*
25. *Ibidem.*
26. *Ibidem.*
27. *Ibidem.*
28. *Ibidem.*
29. *Ibidem.*
30. See EUROPEAN COUNCIL, Treaty on Stability, Coordination, Coordination and Governance in the Economic and Monetary Union. 22 January 2013.
31. See NATIONAL ASSEMBLY OF THE FRENCH REPUBLIC, *Communication de la Présidente Danielle Auroi, M. Pierre Lequiller et M. Christophe Caresche sur la réunion de la Conférence sur la gouvernance économique et financière de l'UEM à Bruxelles du 20 au 22 janvier 2013.*
32. See KREILINGER, Valentin, "La nouvelle conférence interparlementaire pour la gouvernance économique et financière," *Notre Europe Policy Paper*. Paris : Notre Europe. October 2013, p.18.

III. RECOMENDATIONS

The Euro crisis seriously shook the trust EU citizens have in the EU in general, and in the European institutions in particular. The impact was greater in some Member States than in others, particularly in five countries on the periphery of the euro area, Cyprus, Spain, Greece, Ireland and Portugal, where the confidence of EU citizens in the European Commission and in the European Parliament suffered most with the crisis. This lack of trust, according to an EUI study, is associated with rising unemployment, which in part explains the change in attitude of the Portuguese towards the EU during the crisis. Today, Portugal is one of the European countries where the image of the EU is at its lowest, being relatively close to one of the most Eurosceptic Member States the EU, the United Kingdom.

If the economic and financial deepening of EMU has been until now the response of the EU to the crisis, as well as being the European vehicle to promote growth and employment in Portugal, this process of deepening can only move forward with legitimacy with a political complement which creates and consolidates the necessary mechanisms for accountable and democratic legitimacy, as the EU project continues to progress.

With this in mind this article will be used to suggest recommendations for deepening the political dimension of EMU. The recommendations that follow focus mainly on the euro area, since the future of Portugal depends on its development.

The list does not pretend to be exhaustive. There will be other recommendations to consider – covered, for example, by the European Commission and the European Council in their respective documents on the process of deepening EMU, among other entities that have participated until now in the debate on the future of EMU.

In the short term:

- **Improve the way the Eurogroup functions,** establishing a **full-time, permanent president** to ensure the work of the Eurogroup is followed up and assume, although informally, accountability for decisions adopted by this body.

- **Involve national parliaments more in the Community decision-making process.** On how to involve the *Assembleia da República* (AR) in matters of European economic governance:

    - **Examine what has been done until now, as well as what could be done in the future, to improve the AR's involvement in European economic governance,** including a comparative study on the participation of national parliaments in the European Semester.

    - **Create a Sub-committee for the Euro in the European Parliament**, to consolidate the democratic accountability of stakeholders and decisions adopted at European level regarding the euro.

    - **Support approval of rules of procedure for the Inter-Parliamentary Conference on Economic and Financial Governance**, with a view to improving the efficiency of this body for inter-parliamentary cooperation.

In the medium and long term:

- **Group the positions of President of the Eurogroup and the Commissioner and Vice--Chairman of the European Committee on Economic and Monetary Affairs**, to reinforce the principle of equality among the EU Member States.

- **Consolidate the political accountability of the Eurogroup to European citizens through the European Parliament.**

- **Promote a functional and non-exclusive division of tasks between a future Sub-committee for the Euro and the Inter-Parliamentary Conference on Economic and Financial Governance,** thus contributing to both bodies functioning efficiently, particularly in their functions of controlling and monitoring the democratic accountability of the European and national institutions within the EMU framework.

- **Promote the participation of the national parliaments in the Inter-Parliamentary Conference on Economic and Financial Governance**, in order to increase the adoption of the European Semester nationally and ensure the necessary coordination in areas under its jurisdiction, namely national budgets and national economic policies.

- **Involve national parliaments more in the Community decision-making process. In regard to the involvement of the *Assembleia da República* (AR) in European economic governance:**
  - **Promote hearings with European Commissioners by the AR**, including high ranking staff members of the European Commission fully equipped to respond to the AR's questions on European economic governance.

  - **Promote the development of a National Semester**, i.e. synchronised monitoring of the European Semester by the AR and corresponding committees, e.g. in the process of preparing specific recommendations for the country.

  - **Promote the involvement of the AR in preparing future "contractual arrangements"** com vista a facilitar a elaboração e o apoio político a programas de reformas estruturais daí resultantes.

  - **Increase the individual accountability of members to the electorate in Portugal**, by reviewing the electoral lists system, to adopt open or semi-open lists. This measure would make Portuguese members more independent, which would help reinforce the political scrutiny of government action in matters of European economic governance.

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The European Union after the elections. Now what?

I. HOW WILL THE ELECTIONS RESULTS IMPACT THE SELECTION OF THE NEXT PRESIDENT OF THE EUROPEAN COMMISSION?

The electorate directly elects members to the European Parliament, but they do not elect the President of the European Commission. Consequently **the European elections indirectly impact the process for selecting the President of the European Commission.**[1] The association between these two elements is the result of The Treaty of Lisbon (2009), according to which the European Council can nominate a candidate for President of the European Commission to the European Parliament *"taking into consideration the elections to the European Parliament and after going through the appropriate consultations."*[2] **The members of the European Parliament –** also known as MEPs – **will therefore have a say in the choice of the next President of the European Commission, albeit with limited influence over the selection process.**

The influence of MEPs is partly a result of a political reality that they helped create, in which candidates are nominated and political programmes presented to the presidency of the European Commission by the European political parties. The language used in the Treaty of Lisbon to describe this is ambiguous: the Treaty associates the result of the European elections with the process of selecting the President of the European Commission, but does not refer in detail to its nature, nor far less to the nomination, or even the election, of candidates previously nominated during the election campaign to the European Parliament. The European election campaign this year was a new reality, resulting from recommendations made by the European institutions to the European political parties, namely by the European Commission and the European Parliament.[3]
The aim of these recommendations, made in preparation for the European elections, was to consolidate the European political space, improving the visibility of the elections and the participation of the electorate, as well as connecting citizens and European decision-makers.[4]

Once the preliminary results of the elections to the European Parliament were published on 25 May 2014, **the question now is understanding to what extent, and with what impact for the democratic credibility of the European political system, these results are taken into consideration at the time of selecting the President of the European Commission.**
Here we should recall that selecting the President of the European Commission depends on several factors, which are:

- **(i)** negotiation between the European Parliament and the European Council,
- **(ii)** negotiation within each one of these institutions and, eventually,
- **(iii)** negotiation between the heads of Government and State of the European Union (EU) with a view to distributing several leading European positions, that is, the Presidents of the European Commission, the European Council, the Eurogroup, the European Parliament and the High Representative of the Union for Foreign Affairs and Security Policy.

The main impact of the election results on the process of selecting the President of the European Commission will probably be to define the order of candidates to be considered in each one of these negotiations. If none of the candidates nominated by the European political parties gets sufficient support, that is, neither a qualified majority from the European Council, nor a majority of MEPs, it will be for the European Council to present alternatives.[5] Whatever the case, selection of the next President of the European Commission will depend on the support of these two European institutions.[6]
Once the provisional results of the elections have been published, it is likely that the candidate with most votes, namely Jean-Claude Juncker of the European People's Party (PPE), will be allowed to conduct negotiations with a view to getting the necessary support for his election.[7] Should this not happen, the situation could be one of inter-institutional disagreement and consequently halt the selection process for President of the European Commission.[8]
In these complex and possibly long drawn out negotiations, it is likely that a number of factors will come into play, including the distribution of leading European jobs and the content of the agenda of the next European Commission, in which the promotion of growth and employment must certainly be underscored.

The democratic credibility of the selection process for President of the European Commission will depend on the consideration given to the result of the European elections by the players involved in this process. The Treaty of Lisbon does not oblige any of the European institutions to back the candidate with the largest number of votes, or even any of the candidates presented by the European political parties. However, if the selection of the President of the European Commission is not duly explained and justified to the public – particularly if the candidate selected is different to the candidates presented during the electoral campaign – European citizens may lose even more interest and faith in the EU, hence triggering an opposite effect to that desired when organising a European electoral campaign.

On the other hand, if one of the candidates to the presidency of the European Commission were to be appointed and elected, this would have contributed, although indirectly, to strengthening the bond between Europe's citizens and its decision-makers, consolidating the EU's democratic legitimacy.

In short, **the impact of the election results on the selection of the next President of the European Commission will be indirect, limited and uncertain.** It will be **indirect**, because the electorate elects members to the European Parliament directly, and they in turn have an influence on the process of selecting the President of the European Commission. It is **limited**, because selecting the President of the European Commission depends on favourable majorities, i.e., a majority of MEPs and a qualified majority of Member States in the European Council. And it will be **uncertain**, because, confronted with the provisional election results, there is no certainty that the next President of the European Commission will be one of the candidates presented by the European political parties.

With no clear majority backing any one of the candidates presented by the European political parties, the selection of the President of the European Commission will depend on negotiations conducted over coming weeks or months among parliamentary groups, in the European Parliament, and between Member States, in the European Council.

1. See attachment nº 1 on the procedure to select the President of the European Commission.

2. According to article 17/7 of the Treaty of European Union: "*Taking into consideration the elections to the European Parliament and after the necessary consultations, the European Council, adopting a decision with a qualified majority, suggests a candidate to the European Parliament for the position of President of the Commission. The candidate is elected by the European Parliament by a majority of its members. Should the candidate not obtain a majority, the European Council, with a qualified majority, will suggest within one month a new candidate, who is elected by the European Parliament using the same process.*" See EUROPEAN UNION,"Consolidated versions of the Treaty of European Union and the Treaty on the Functioning of the European Union," in *Official Journal of the European Union*. Series C, nº326, 26 October 2012.

3 See EUROPEAN PARLIAMENT, *Resolution of the European Parliament of 22 November 2012 on elections to the European Parliament in 2014*. 22 November 2012; EUROPEAN PARLIAMENT, *Report on improving the organisation of lections to the European Parliament in 2014*. 12 June 2013; and EUROPEAN COMMISSION, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Preparing for the 2014 European elections: further enhancing their democratic and efficient conduct.* 12 March 2013.

4. See attachment nº 2 on participation in the elections to the European Parliament.

5. A qualified majority of votes in favour in the European Council assumes that the majority of EU Member States, i.e. 15 of 28, supports the candidate nominated and that this candidate gets 260 of the 352 possible votes, and it is also required, should some Member State request verification of demographic representation, that the vote represents 62% of the population of the EU. If not, the decision of the European Council will not be adopted. In the European Parliament, a majority of elected members is the equivalent of 376 out of 751 members. Information is available online: http://www.consilium.europa.eu/council/voting-system-at-the-council?lang=en and http://www.elections2014.eu/en/new-commission.

6. See on possible post-election scenarios, for example: BERTONCINI, Yves e KREILINGER, Valentin, "What political balance of power in the next European Parliament?," *Notre Europe Policy Paper*. Paris : Notre Europe. nº102, 24 November 2013; BERTONCINI, Yves e KREILINGER, Valentin, *LSE EUROPOP Blog*: *The European Parliament elections will see populist parties make gains, but they will remain a battle for control between mainstream parties.* 3 December 2013; FEUSTEL, Christian, "400 is the magic number: scenarios for electing the next European Commission president," *Europe Decides Viewpoint.* 6 February 2014; e TORREBLANCA, José Ignacio e LEONARD, Mark, "The Eurosceptic surge and how to respond to it," *European Council on Foreign Relations (ECFR) Policy Brief*. 9 April 2014.

7. See the provisional results of the elections to the European Parliament in attachment nº 2, as well as the current political balance of the European Council in attachments nº 3 and 4. See also FONTANELLA-KHAN, James, "Socialists back Jean-Claude Juncker for top EU job," in *Financial Times*. 27 May 2014; NIELSEN, Nikolaj, "Right-wing MEPs to form new constellations in EU parliament," in *EUObserver*. 27 May 2014; e *THE GUARDIAN*, "David Cameron tries to stop Jean-Claude Juncker getting EU top job." 27 May 2014.

8. The Conference of Presidents of the Parliamentary Groups of the European Parliament gave its support last Tuesday, 27 May 2014, to the candidate of the European People's Party (PPE) to the presidency of the European Commission, in allowing him to be the first candidate to try and gather support. The Member States of the EU refused, however, to automatically accept this possibility. The heads of State and Government followed the European treaties to the letter, and last Tuesday night gave the President of the European Council, Herman Van Rompuy, a mandate to consult first the European Parliament and the EU Member States, and only after to present conclusions to the European Council at the next meeting on 26-27 June 2014. According to Toby Vogel, journalist of European Voice, four Member States opposed the nomination of Juncker, and they were the Netherlands, Sweden, Hungary and the United Kingdom. See VOGEL, Toby, "National leaders give mixed responses to European Parliament elections," in *European Voice.* 28 May 2014 e POP, Valentina, "EU leaders decline to endorse Juncker," in *EUObserver.* 28 May 2014.

II. WILL THERE BE AN INCREASE IN POPULIST FORCES IN THE EUROPEAN PARLIAMENT? IF SO, WHAT WILL THE CONSEQUENCES BE FOR THE POLITICAL AND DEMOCRATIC BALANCE IN THIS INSTITUTION?

The increase in support for populist forces was already a certainty before the European elections, and was confirmed at the time the provisional results of the elections were published on 25 May 2014.

According to the director of the French think tank Notre Europe, Yves Bertoncini, populist forces are currently scattered throughout four different political groups in the European Parliament, namely Europe of Freedom and Democracy (EFD), which includes the parties of the "autonomist right", the parliamentary group for non-attached members, including representatives of the extreme right, the Confederation Group of the European United left and the Green Nordic Left (GUE-NGL), that includes radical left wing parties, and the group of European Conservatives and Reformists (ECR), that includes Eurosceptic or anti-European right wing parties.[9]

However, the European think tank, the European Council on Foreign Relations (ECFR), warns that **the configuration of the outgoing European Parliament may change if a new European Parliamentary group is created, that is, the European Alliance for Freedom** (EAF). This parliamentary group will include a series of populist parties such as the National Front (France), the Party for Freedom (Netherlands), the Freedom Party (Austria) and the Flemish Interest (Belgium). [10]

The creation of new parliamentary groups may, then, assume a change in existing groups. The Northern League (Italy), for example, is currently part of the EFD, but has already expressed its intention to leave this group to join the future EAF. [11]

On the other hand, apart from possible changes of this type, it should be noted that 60 of the recently elected MEPs are not yet affiliated in the political groups of the outgoing parliament. [12]

These members who might possibly join the existing European parliamentary groups, or new groups, will change the current configuration of the European Parliament. When the members of the SD join the EAF, this will immediately contribute to creating this populist parliamentary group in the European Parliament.

The populist forces have today, as a whole, around 140 MEPs, that is approximately 20% of the seats available in the European Parliament.

Before the elections, several estimates suggested a significant increase in political representation, with more or less 200 MEPs in the next parliament, which is a quarter of elected European representatives. [13]

This trend, already verified in some EU Member States, is due to several factors, such as the secondary and national nature of the European elections, which, besides having low turn-out, is used as a way of expressing the electorate's discontent with national governments without, however, penalising them directly.

This tends to benefit the political parties in opposition, or the small parties, including the populist groups, which most mobilise the protest vote in this context.

Apart from this already traditional facet of the European elections, it is important to bring the lack of trust EU citizens have in the EU into the picture, reflected both in the declining image of the EU, and the lack of confidence in the European institutions. [14]

The impact of the European economic and financial crisis, particularly high unemployment rates and, above all, youth unemployment in some EU member states, also impacts on citizen confidence in the EU. [15] It was in this specific electoral and economic context that electoral support rose for the populist forces, both to the left and to the right of the European political spectrum.

The populist forces had their best results in the United Kingdom (27,5%), **Denmark** (26,6%), **Greece** (26,6%) **and France** (24,9%). The United Kingdom Independence Party (UKIP), the Danish People's Party, the Radical Left Coalition and the National Front came first in the polls in their respective countries. In other countries, Italy, Austria, Finland, Hungary, the Netherlands, Greece and Germany, the populist forces also gained significant results. The Five Star Movement (MSS) came second with 21.1% of the vote, the Freedom Party (FPO) came third with 19.7%, the Party of the Finnish (PS) came third with 12.9%, the Jobbik came second with 14.7%, the Party for Freedom (PVV) came third with 13.2% and the Alternative for Germany (AFD) came fifth with 7%. [16]

Electoral support for the populist forces was high in several EU Member States, but should not automatically reflect greater political influence for the respective elected members.

The influence any political force has within the European Parliament, explains Yves Bertoncini and Valentin Kreilinger, respectively director and researcher of Notre Europe, depends on three factors. Apart from the number of seats obtained, the internal cohesion of political forces is taken into account and the capacity to form majority coalitions with other parties, two dimensions in which the populist forces have proved to be structurally weak because of their ideological differences. [17] The influence of populist forces in the European Parliament will, for a start, not be as high as the number of elected members.

This does not mean that an increase in populist forces in the European Parliament will not affect the political and democratic balance of this institution, particularly if there is less support for political groups that usually support the centre-left and centre-right of the European Parliament, i.e. the Greens-European Free Alliance (Greens/EFA) and the Alliance of Democrats and Liberals for Europe (ALDE). [18]

Should this be the case, the increase in populist forces and the consequent political polarisation of the European Parliament could have a negative effect on the democratic exercise of power in this European institution. Without sufficient alliances to the left or to the right to help them promote their own vision of the EU project and its widely varying areas of integration and cooperation, the main European political groups of the centre-left and centre-right, i.e. the S&D and the PPE, would be forced to opt for a forced consensus to assure the required absolute majority to fully exercise their powers within the European legislative framework, namely in the co-decision process. [19]

Bearing in mind that parliamentary participation in the European Parliament is around 65%, an absolute majority is in reality a three-quarter majority, which forces the S&D and the PPE to work together. [20]

This, in turn, would tend to reinforce the idea that there are no substantial differences between the main European political groups, exacerbating the gap between the pro-Europeans, the Eurosceptics and the anti-Europeans. Bearing in mind the current distribution of MEPs across the European parliamentary groups, the centre coalitions (PPE and S&D or PPE, S&D and ALDE) are the only plausible combinations to achieve an absolute majority of members (405 or 469 of 751). A centre-left coalition (S&D, Greens/EFA and GUE/NGL) would get 288 members, or 352 if they were to join the ALDE, while a centre-right coalition would get 298 members, or 362 with the ALDE.

9. See BERTONCINI, Yves,"European elections: less abstention, more 'populism'?," *Notre Europe Tribune*. Paris : Notre Europe. 14 November 2013, pp. 5-6.

10. Creating a new European parliamentary group requires a minimum of 25 MEPs from 7 different Member States. If the FN (24 elected MEPs), PVV (4), FPO (4), VB (1), LN (5), and SD (2) were to join one another, all they need is one representative from another EU Member State to join their group to create a new parliamentary group in the European Parliament. According to Sonia Piedrafita and Vilde Renman, the benefits of creating a new parliamentary group are essentially added power and funds. Parliamentary groups of the European Parliament are granted funds, broadcasting time, the chance to head meetings and committees and the capacity to prepare and amend committee reports. See EURACTIV "Wilders-Le Pen alliance: what makes it, what breaks it?". 16 May 2014; MARTINS, Catarina Fernandes, "Marine Le Pen reúne com líderes de extrema- direita para criar novo bloco," in *Observador*. 28 May 2014; e PIEDRAFITA, Sonia e RENMAN, Vilde, "Euroscepticism in the next European Parliament: a reason to worry?," in *Intereconomics: Review of European Economic Policy*. Hamburgo : ZBW – Leibniz Information Centre for Economics. Vol. 49, nº1, January-February 2014, p. 26.

11. See NIELSEN, Nikolaj, *op. cit*.

12. See annexes nº 2.2.

13. See TORREBLANCA, José Ignacio e LEONARD, Mark, *op. cit.*, p. 6.

14. See BORJA-SANTOS, Romana, "Portugal é o segundo país da UE onde mais gente acha que a situação está pior.", in *Público*. 12 May 2014; EUROPEAN COMMISSION, *Special Eurobarometer 415: Europeans in 2014*. March 2014; EUROPEAN COMMISSION, *Standard Eurobarometer 80: Public Opinion in the European Union: First Results*. December 2013; and TORREBLANCA, José Ignacio e LEONARD, Mark, *op. cit.*,p. 3.

15. See ROTH, Felix, NOWAK-LEHMANN D., Felicitas e OTTER, Thomas, "Crisis and Trust in National and European Union Institutions – Panel Evidence for the EU, 1999 to 2012", *European Union Democracy Observatory* (EUDO) *Working Paper Series*. Italy : European University Institute (EUI). May 2013. The EUI study identifies a strong link between the confidence crisis in the European Union and the European economic crisis, more specifically the unemployment rates in the EU Member States. See also, by way of example, on the composition of the electorate of the National front (FN), PINCHA, João Pedro, "Eleitor de Le Pen é jovem, desempregado e tem menos do que o ensino secundário," in *Observador*. 26 May 2014.

16. See the European Parliament web page for the results of European elections: http://www.resultados-eleicoes2014.eu/pt/election-results-2014.html. See also FALCÃO, Catarina; MARTINS, Catarina Fernandes e COSTA, Andreia Reisinho, "Começou o terramoto eurocético", in *Observador*. May 2014.

17. See VOTEWATCH EUROPE, "How often have Euro-sceptic/far-right parties voted together in 2009-2014?", *VoteWatch Europe special policy brief*. May 2014; BERTONCINI, Yves and KREILINGER, Valentin, "What political balance of power in the next European Parliament?", *Notre Europe Policy Paper*. Paris : Notre Europe. Nº102, 24 November 2013; and FRANTESCU, Doru, *LSE EUROPOP Blog: The balance of power in the European Parliament is crucial for understanding what is at stake in the 2014 European elections*. 24 October 2013.

18. Both the Greens-European Free Alliance (Greens/EFA), and the Alliance of Democrats and Liberals for Europe (ALDE), saw votes in support of them fall in 2014. The Greens/EFA in principle will have lost 5 members, while the ALDE will have lost 19. The composition of these two parliamentary groups, as well as the others, will depend on new members eventually joining them, coming from both non-attached members and those who have no European political affiliation. See on the views of HIX, Simon; FRANTESCU, Doru; LEFRANCO PARI, Joan Manuel and VAN HULTEN, Michel, "What Groups Will Form In The New EP?," in *Votewatch Europe*. 20 May 2014.

19. See TORREBLANCA, José Ignacio and LEONARD, Mark, op.cit., p.6.

20. See BERTONCINI, Yves and KREILINGER, Valentin, "The Balance of Power in the Next European Parliament," in *Intereconomics: Review of European Economic Policy*. Hamburgo : ZBW – Leibniz Information Centre for Economics. Vol. 49, nº1, January-February 2014, p. 11.

III. WHAT IS THE IMPACT OF THE ELECTION RESULTS ON STRENGTHENING THE EU PROJECT?

The impact of the election results on strengthening the EU project will depend on several factors, including the process for selecting the President of the European Commission and the political representation of populist forces in Europe. Apart from aiming to strengthen the democratic legitimacy of the EU and the European Commission in particular, **the European election campaign conducted around the association between the elections to the European Parliament and the selection of the President of the European Commission, did present risks from the point of view of the political and institutional balance of the EU**, raising doubts regarding its impact on strengthening the EU project.

According to the director of the British think tank, the Centre for European Reform (CER), Heather Grabbe, and the researcher of the European think tank, Carnegie Europe, Stefan Lehne, **the nomination of candidates to the presidency of the European Commission presented by the European political parties would be detrimental to the EU**, because it would discredit the European executive as the guarantor of the EU treaties and the impartial promoter of common interests. [21] Grabbe and Lehne present valid points on the possibility of the EU Member States querying the authority of a partisan European Commission and, moreover, one excessively dependent on the European Parliament, in various areas under its jurisdiction, particularly the recently reinforced European economic governance.

However it should be underscored that **the main candidates likely to be elected** – namely Jean-Claude Juncker (PPE) and Martin Schulz (S&D) – **were chosen by European political parties within which we find represented today political parties that are leaders in the Member States of the EU.**

Furthermore, as long as the selection of the President of the European Commission and its different commissioners continues to depend on the result of negotiations between the European Parliament and the European Council, **it is highly unlikely that a European executive will come to light under one single political colour**, and disproportionately dependent on the European Parliament. **The question is to what extent the European political parties assume greater political protagonism with a view to developing alternative visions for the EU project**, thus contributing to strengthening the democratic nature of the European political arena.

On the other hand, **if reinforcing the political and democratic accountability of the European Commission seems to make sense for the Member States of the euro area** that have transferred more powers to Brussels, **the same cannot be said of those who opt out of an expanded process of European integration**, for example by not sharing the single currency.

In this context **the question is what political integration will help strengthen the EU project.** This will without a doubt be one of the major institutional issues to be discussed during the next European Parliament in the context of deepening Economic and Monetary Union (EMU), either because the Treaty on Stability, Coordination and Governments (TSCG) provides for its incorporation in the European legal framework by 2018 – which means in turn amending the EU treaties – or because the United Kingdom is planning a referendum on its membership of the EU for 2017, the result of which could be followed by a mandate to renegotiate the membership of the United Kingdom and also the powers of the European institutions.

In addition to the process of selecting the President of the European Commission, **the increase in populist forces in Europe could also affect the effort to further strengthening the EU project.** This could result from the impact this increase will have on the political balance of the European Parliament, and, in particular, the capacity of the major parliamentary groups to approve legislation in a context of growing political polarisation, as well as from the capacity of the populist forces to determine the political agenda at the European level (and also nationally, namely in the EU Member States whose main political parties today see their electoral support threatened because of growing support for populist forces). [22]

Raised through the ballot in legitimate opposition to the major European and national political parties, **the populist forces not only feed on, but represent to a certain extent today, the discontent of EU citizens with the difficulty the EU and its Member States face with certain issues, or their incapacity to deal with them.** Among these issues are the effective and timely resolution of the European economic and financial crisis; developing a consistent, efficient immigration policy, as well as the coordinated management of the opportunities and challenges that globalisation presents currently, including, among other factors, trade and foreign investment and climate change.

In this context of cross-border challenges, some populist forces claim a return to the national approach in order to solve complex problems which require, however, a common, European approach. Growing populist forces, according to José Ignacio Torreblanca and Mark Leonard, will hinder progress with the European project on several fronts, beginning with the more heated issues, such as immigration. **As a result, it could possibly become more difficult to reach a central compromise on issues sensitive to the left or to the right, such as developing governance in the euro area or the freedom of movement for workers.** [23]

The increase in political representation of the populist forces in the European Parliament may not directly and automatically influence the European legislative process, but will continue to affect the agenda of the main political parties of the EU Member States.

In seeing their electoral support threatened nationally, **they may prefer to adopt populist political positions instead of confronting the positions defended by the respective political forces.** [24]

Statements made by the former President of France, Nicolas Sarkozy, on the Schengen area and the possible need to review it on the eve of the European elections, can be read in the light of these electoral dynamics. [25]

In other words, the influence of populist forces on the agenda of the major political parties at national level may affect the dialogue and, possibly, the political support of these players for specific aspects of EU and euro area governance. This debate is expected to take place in the next legislative term of the European parliament given the need to revise EU treaties and give continuity to deepening EMU in response to the crisis in the euro area.

Less appetite for European solutions may hold back the EU project, consequently harming the EU Member States that most depend on its progress.

21. See GRABBE, Heather and LEHNE, Stefan, "The 2014 European elections: Why a partisan Commission president would be bad for the EU," *CER Publications*. Reino Unido : Centre for European Reform (CER). October 2013.
22. It is worth remembering here that four populist parties — the United Kingdom Independence Party (UKIP), the Danish People's Party, the Radical Left Coalition and the National Front — came first in the European elections in their respective countries, and as many others gained considerable electoral victories.
23. See TORREBLANCA, José Ignacio and LEONARD, Mark, *op. cit.*, p. 8.
24. See Torreblanca, Jose Ignacio and Leonard, Mark (9 April 2014), p. 5.
25. See ANDRADE, Diogo Queiroz de, and CASTANHO, Ana, "Sarkozy defende suspensão imediata do espaço Schengen," in *Observador*. 22 May 2014.

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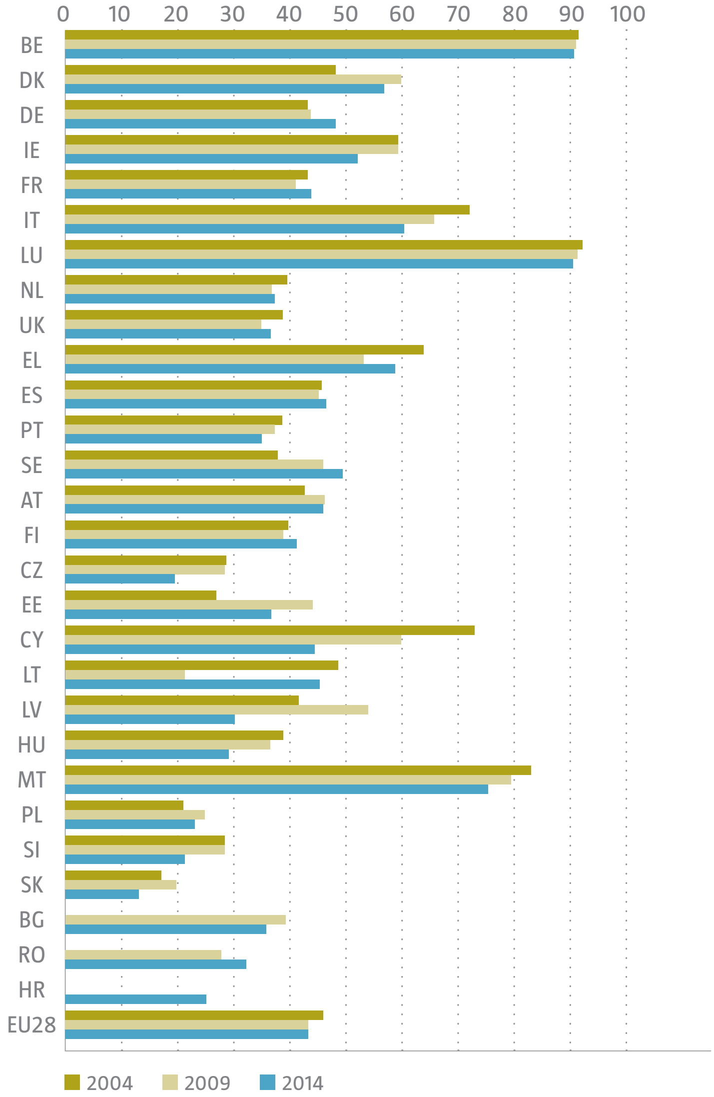
1. Timetable for the selection process for the President of the European Commission [Source: European Parliament (2014)]

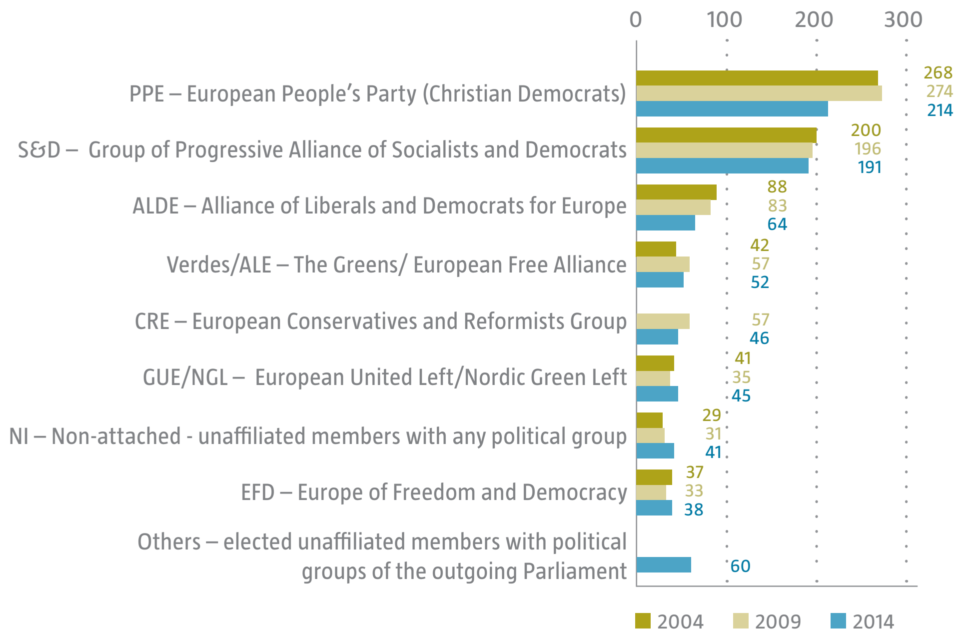
- **22-25 May:** Elections to the European Parliament.
- **June:** The President of the European Council consults the European Parliament on a possible candidate for the presidency of the European Commission, taking into consideration the results of the European elections. The consultation completed, the President of the European Council nominates a candidate to the European Council. The European Council takes a decision on this candidate by qualified majority
- **July:** The European Parliament elects the President of the European Commission by a majority vote of MEPs (at least 376).
- **August-September:** The EU Member States nominate candidates for Commissioner, in cooperation with the President of the European Commission. The respective committees of the European Parliament conduct hearings with candidates for Commissioner.
- **October-November:** The European Parliament approves the new European Commission by majority vote. The new European Commission is sworn in before the European Parliament..

2. Voter participation in the elections to the European Parliament [Source: European Parliament (2004)]



3. Provisional results of the elections to the European Parliament

3.1. *Number of members per parliamentary group (revised 28 May 2014)* [Sources: European Parliament (2014) and European Parliament (2004)]

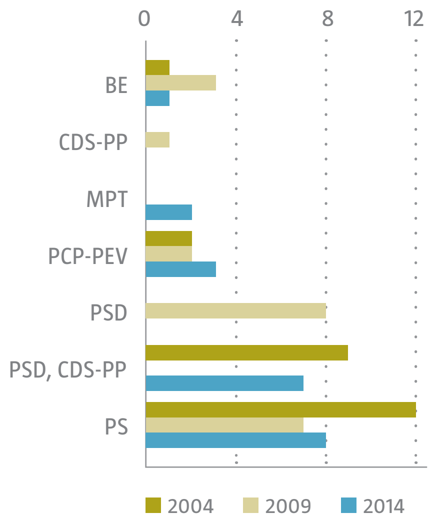


It is worth recalling that the European Conservative and Reformist Group (ECR) was created in 2009. Some parties that joined it belonged to the Europe of Nations Group (ENG), which in 2004 had 27 members from mainly eurosceptic and nationalist political parties. Important also is the fact that the number of MEPs has been growing with successive enlargements and European elections, rising from 732 in 2004 to 785 in 2007, 736 in 2009, 754 in 2011, 766 in 2013 and 751 in 2014.

3.2. *Number of members in the category "other", per country and political party* [Source: European Parliament (2014)]

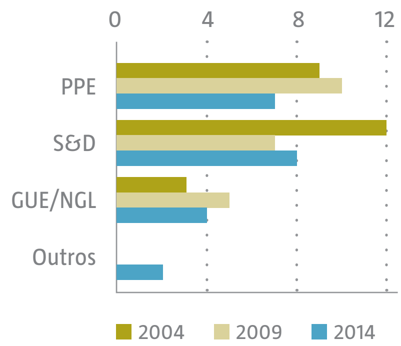
MEMBER STATE	POLITICAL PARTIES	NUMBER OF DEPUTIES ELECTED TO EUROPEAN PARLIAMENT
Italy	Five Star Movement (M5S)	17
Germany	German Alternative (AFD) + Animal Protection Party (Tierschutzpartei) + National Democratic Party (NPD) + Family Party (Familie) + Greens and Democratic Party (ODP) + The Party (Die Partei)	7 + 1 + 1 + 1 + 1 + 1 (12)
Spain	We Can + Citizenship Party (C'S)	5 + 2 (7)
Greece	Golden Dawn + Independent Greeks	3 + 1 (4)
Poland	New Right Congress (KNP)	4
Bulgaria	Coalition ББЦ+ВМРО-БНД *et al.* + Coalition of Reformist Block	2 + 1 (3)
Sweden	Swedish Democrats (SD) + Feminist Initiative (FI)	2 + 1 (3)
Ireland	Independents	2
Portugal	Land Party (MPT)	2
Slovakia	Ordinary People and Independent Personalities (OL'aNO)	1
Slovenia	I believe (Verjanem)	1
Netherlands	Animal Party (PvdD)	1
Lithuania	Lithuanian Peasent and Green Union (LVZS)	1
Czech Republic	Free Citizens Party (Svobodní)	1
Romania	Independent Mircea Diaconu	1

3.3. *Number of Portuguese MEPs* [Source: Pordata: Bases de dados Portugal Contemporâneo (Francisco Manuel dos Santos Foundation, FFMS)]



Note that the PSD and the CDS-PP presented separate candidates to the European elections in 2009 and in electoral coalition in 2004, and again in 2014

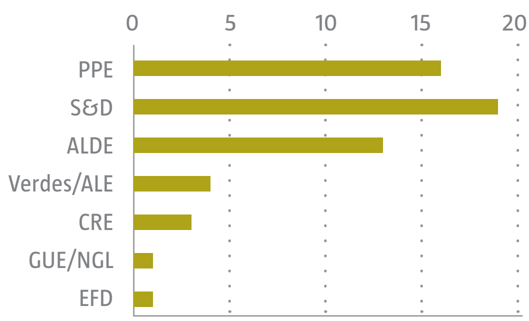
3.4. *Number of Portuguese MEPs per parliamentary group* [Sources: European Parliament (2014) and Pordata: Bases de dados Portugal Contemporâneo (Francisco Manuel dos Santos Foundation, FFMS)]



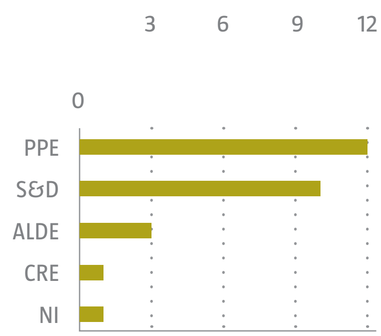
Note that the number of Portuguese MEPs has been decreasing because of the different changes made over time to the effective total number of MEPs, dropping from 24 in 2004 to 22 in 2009 and 21 in 2014

4. Composition of European Council per political family

4.1. *The number of political parties that play roles in national governance, individually or in coalition, and who are part of European parliamentary groups* [Source: Euractiv (2014)]



4.2 *The number of political parties that head executives of EU Member States and that have joined European parliamentary groups* (Source: Data compiled from several source)



Note that of the 28 EU Member States, only the political party in power in Slovenia is not currently a member of any of the categories identified above.

5. Composition of European Council per European political group and votes
(Source: Data compiled from several sources)

5. COMPOSITION OF EUROPEAN COUNCIL PER EUROPEAN POLITICAL GROUP AND VOTES		
MEMBER STATE	EUROPEAN POLITICAL PARTY TO WHICH HEAD OF EXECUTIVE BELONGS	NUMBER OF VOTES
Germany	PPE	29
France	PES	29
United Kingdom	CRE	29
Italy	PES	29
Spain	PPE	27
Poland	PPE	27
Romania	PPE	14
Netherlands	ALDE	13
Greece	PPE	12
Belgium	PES	12
Portugal	PPE	12
Czech Republic	PES	12
Hungary	PPE	12
Sweden	PPE	10
Austria	PES	10
Bulgaria	PES	10
Croatia	PES	7
Denmark	PES	7
Slovakia	PES	7
Finland	PPE	7
Ireland	PPE	7
Lithuania	NI	7
Latvia	PPE	4
Slovenia	-	4
Estonia	ALDE	4
Cyprus	PPE	4
Luxemburg	ALDE	4
Malta	PES	3

CICLO DE DEBATES
'PORTUGAL E A UNIÃO EUROPEIA'
1ª SESSÃO : 18 Março 2014

ISCSP | UTL
Campus do Alto da Ajuda

Plataforma para o **CRESCIMENTO SUSTENTÁVEL**

Há uma Cidadania Europeia?

O que é ser cidadão europeu? Quais os seus direitos e deveres?
É mesmo possível viver e trabalhar em qualquer estado da UE?
Que mecanismos e instrumentos de participação cívica têm os cidadãos à sua disposição a nível europeu?
Qual o papel e capacidade de influência da opinião pública, dos partidos políticos e dos parlamentos nacionais no processo de decisão da UE?
Como reforçar a legitimidade democrática das instituições europeias?

17h30 **Recepção dos participantes**

18h00 **Abertura:** Carlos Pimenta
Presidente da Plataforma para o Crescimento Sustentável

José Tavares
Professor da Faculdade de Economia da Universidade Nova de Lisboa

Maria Manuel Leitão Marques
Professora da Faculdade de Economia da Universidade de Coimbra

Manuel Meirinho
Presidente do Instituto Superior de Ciências Sociais e Políticas

Moderador: Carlos Costa Neves
Coordenador da área dos Desafios Globais, PCS

Confirme a sua presença em: www.crescimentosustentavel.org

COM O PATROCÍNIO: dstgroup

A Plataforma para o Crescimento Sustentável (PCS) é um think tank que visa, num quadro de ampla participação pública e de parceria com centros de I&D e outros think tanks nacionais e internacionais, contribuir para a afirmação de um modelo de desenvolvimento sustentável. Nesse sentido, a PCS estabeleceu uma relação de parceria com os seguintes think tanks e Fundações: BRUEGEL (Bélgica), CENTRE FOR EUROPEAN POLICY STUDIES – CEPS (Bélgica), ASTRID (Itália), REFORM (Reino Unido), RESPUBLICA (Reino Unido), CENTRE FOR EUROPEAN STUDIES – CES (Bélgica), FUNDAÇÃO ENTORNO (Espanha), FUNDAÇÃO KONRAD ADENAUER (Alemanha), FUNDAÇÃO MILLENNIUM (Portugal), FUNDAÇÃO LUSO AMERICANA PARA O DESENVOLVIMENTO (Portugal).

CICLO DE DEBATES
'PORTUGAL E A UNIÃO EUROPEIA'
2ª SESSÃO : 29 Abril 2014

ISCSP | UTL
Campus do Alto da Ajuda

Plataforma para o CRESCIMENTO SUSTENTÁVEL

Como promover o Crescimento e Emprego no quadro europeu?

Como deve evoluir o sistema de Governação Económica da UE? Quais os mecanismos e instrumentos que permitem dar resposta à crise da zona euro, gerar crescimento, combater o desemprego jovem e corrigir desequilíbrios? Que cenários económicos pós-troika se adivinham a curto prazo para o País? Qual deve ser a posição de Portugal em relação a temas como a união bancária, fiscal, económica e política? Dever-se-á reforçar o papel da Comissão Europeia em matéria de governação económica ou será preferível o método intergovernamental?

17h30 **Recepção dos participantes**

18h00 **Abertura:** Carlos Pimenta
Presidente da Plataforma para o Crescimento Sustentável

Francesco Franco
Professor da Nova School of Business and Economics da Universidade Nova de Lisboa

Maria da Graça Carvalho
Deputada ao Parlamento Europeu

Elisa Ferreira
Deputada ao Parlamento Europeu

Moderador: Carlos Costa Neves
Coordenador da área dos Desafios Globais, PCS

19h30 **Debate**

20h00 **Conclusões**

Confirme a sua presença em: http://crescimentosustentavelcicloue2.eventbrite.pt

COM O PATROCÍNIO:
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A Plataforma para o Crescimento Sustentável (PCS) é um think tank que visa, num quadro de ampla participação pública e de parceria com centros de I&D e outros think tanks nacionais e internacionais, contribuir para a afirmação de um modelo de desenvolvimento sustentável. Nesse sentido, a PCS estabeleceu uma relação de parceria com os seguintes think tanks e Fundações: BRUEGEL (Bélgica), CENTRE FOR EUROPEAN POLICY STUDIES – CEPS (Bélgica), ASTRID (Itália), REFORM (Reino Unido), RESPUBLICA (Reino Unido), CENTRE FOR EUROPEAN STUDIES – CES (Bélgica), FUNDAÇÃO ENTORNO (Espanha), FUNDAÇÃO KONRAD ADENAUER (Alemanha), FUNDAÇÃO MILLENNIUM (Portugal), FUNDAÇÃO LUSO AMERICANA PARA O DESENVOLVIMENTO (Portugal).

CICLO DE DEBATES
'PORTUGAL E A UNIÃO EUROPEIA'
3ª SESSÃO : 4 Junho 2014

ISCSP | UTL
Campus do Alto da Ajuda

Plataforma para o CRESCIMENTO SUSTENTÁVEL

A União Europeia no pós-eleições. E agora?

Qual o impacto do resultado eleitoral para a selecção do próximo Presidente da Comissão Europeia? Verificar-se-á um crescimento das forças populistas no Parlamento Europeu? Se for o caso, quais as possíveis consequências para o equilíbrio político e democrático dentro desta instituição? Qual o impacto do resultado eleitoral para o aprofundamento do projecto de construção europeia?

18h30 **Abertura:** Carlos Pimenta
Presidente da Plataforma para o Crescimento Sustentável

Apresentação: Duarte Valente
Investigador Convidado, PCS

19h00 Marcelo Rebelo de Sousa
Professor Catedrático da Faculdade de Direito, Universidade de Lisboa

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20h30 **Conclusões**

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Portugal and European economic governance: improving the European framework to help exit the crisis on the back of sustainable growth

I. INTRODUCTION

The 2007-2009 international economic and financial crisis and the subsequent euro crisis, initiated in 2010, revealed several weaknesses in the Economic and Monetary Union (EMU), affecting both the prevention and the resolution of serious economic and financial instability situations at the European level. The European Union (EU) immediately corrected some of the chief EMU failings in response to this situation, without, at the same time, coming up with definitive solutions to the challenges that its deficient institutional architecture presented, and continues to present, to both the EMU and the Eurozone, preventing them from functioning correctly, and from finding an exit to the crisis on the back of on sustainable growth. The framework for European economic governance, consolidated since 2010 via the introduction of a number of institutional reforms, thus took on an imperfect, incomplete and complex form, which now merits revision in light of the ongoing debate on the future of the EU, particularly with regard to the institutional development of EMU and Eurozone countries in the medium and long term.

Having recently concluded an Economic and Financial Assistance Programme (EFAP), Portugal faces the challenge of adapting to a still changing framework of European economic governance. As a result, we need to ask ourselves to what extent the existing European economic governance framework affects Portugal and what the country can do in the context of an active participation in the EU to improve the way it works, and thus help find an exit to the crisis on the back of sustainable growth.

To respond to these questions, this document will be divided into two parts.

The **first** part explains what the current European framework means for Portugal, both from the point of view of its implementation and limitations; whereas the **second** part presents the principal proposals set forth to date at the European level in order to improve the institutional architecture of the EMU.

In this context, proposals for which approval entails a revision of EU treaties are distinguished from proposals that can be approved within the current European legal framework. Special attention is paid to identifying initiatives that may interest Portugal in that they look at the best way for EMU and the Eurozone to function correctly, and at finding an exit from the crisis based on sustainable growth.

Once these initiatives have been identified, an attempt will be made to determine the position of the major Portuguese political parties in this regard in order to facilitate future consensus.

II. PORTUGAL AND THE CURRENT EUROPEAN ECONOMIC GOVERNANCE FRAMEWORK

With the closure of the Economic and Financial Assistance Programme (EFAP), agreed about three years ago with the troika of international and European institutions, i.e. the European Central Bank (ECB), the European Commission and the International Monetary Fund (IMF), Portugal became subject to different conditions within the European economic governance framework gradually established in response to the euro crisis. From a fiscal and economic point of view, the country enjoyed a greater degree of freedom. This European framework, however, remains complex, imperfect and incomplete today, raising doubts as to how well the Economic and Monetary Union (EMU) and the Eurozone function, as well as their capacity to help find an exit from the crisis based on sustainable growth.

Dispelling such doubts once and for all requires improving the European framework itself, thus ensuring not only that the EMU and the Eurozone will work well, but also that a common, sustainable, balanced solution will be found to the euro crisis, without which the burden of economic adjustment will continue to have a heavy impact on deficit countries, including Portugal. This will tend to widen existing gaps between Eurozone countries, which, in time, may jeopardise their membership of the single currency.

A. Conclusion of the Economic and Financial Assistance Programme

1. An originally unforeseen delay

The Government of Portugal (hereinafter referred to as the "Government") had planned to officially wrap up the Economic and Financial Assistance Programme (EFAP) on 17 May 2014, a few weeks before the troika concluded its 12th regular programme evaluation and released the last instalment of the country loan amounting to a total of €2.6 of 78 thousand million. However, when the Constitutional Court shot down three of four fiscal measures included in the State Budget submitted on 30 May 2014, the government's plans were foiled.[1] Bearing in mind that that 12th evaluation of the programme depended on alternative and yet to be presented State Budget measures, which in turn hinged on Constitutional Court approval, the Government decided to dispense with the remaining €2.6 thousand million of the planned loan, thus avoiding the uncertainty that a possible request to extend the EFAP could cause on the capital markets in relation to Portugal.

Portugal ultimately closed the EFAP on 30 June 2014, overcaming in this manner the last in a series of Constitutional Court rejections on State Budgets submitted by the Government under the EFAP. To be sure, one should note that in matters of fiscal policy, the content of the budget must always reflect both the measures agreed with the troika and commitments assumed at the European level.[2]

The originally unforeseen delay caused by the negative ruling of the Constitutional Court underscored, once again, the difficulty of achieving a balance between national and European legal frameworks within the context of European economic governance and in particular under an EFAP. The struggle arises specifically between two elements, i.e. respect for the Constitution and, in particular, interpretations of the Fundamental Law by the Constitutional Court when scrutinising laws on fiscal and economic issues, and complying with corresponding Community or common regulations, as applied by policies presented and pursued by the Government over the past three years.

The purpose of this document is not to analyse the roles of the Government and the Constitutional Court in this context, but **to point out that the tension observed during the EFAP did not end with the closure of the troika sponsored adjustment programme, as did not the commitments of the Portuguese State to matters of European economic governance**.

The closure of the EFAP meant a return to a regular framework of European economic governance, gradually reformed since the start of the euro crisis, whose implementation in Portugal entails similar fiscal and economic commitments and as a result a certain potential for renewed inter-institutional tensions. Faced with this scenario, **we must try to understand the application of the European framework to Portugal,** even if only **to identify possible improvements.** To do this, we should begin by noting that **the external surveillance of Portugal did not end with the EFAP.**

1. While the Economic and Financial Assistance Programme (FAP) was in force, the Government had to negotiate with the troika and adopt a variety of measures, in order to meet the EFAP objectives. The regular EFAP evaluation therefore tried to assess the progress being made by the national authorities in dealing with this, releasing instalments of the planned loan in parts after, anddepending on, the results of each assessment.

2. For more information on the Constitutional Court's rejection of measures relevant to compliance with the EFAP, covering measures included in the State Budgets, see: PEREIRA, Helena, "Explicador: O que deve saber sobre o Tribunal Constitucional e as leis da troika," in *Observador*. 19 May 2014. With regard to the debate on how the Constitutional Court acted during the EFAP, see, for example: FERREIRA, Casimiro António and PUREZA, José Manuel, "Estado de Direito ou Estado de Exceção: A justiça constitucional face ao questionamento do Estado Social," in *A Anatomia da Crise: Identificar os problemas para construir as alternativas*. Centro de Estudos Sociais da Universidade de Coimbra e Observatório sobre Crises e Alternativas. December 2013. pp. 250-272; or RIBEIRO, Gonçalo de Almeida and COUTINHO, Luís Pereira. *O Tribunal Constitucional e a Crise: Ensaios Críticos*. Almedina. 2014.

2. Post-programme surveillance

Apart from current surveillance of the regular framework of European economic governance, particularly in fiscal, economic and financial matters –, **Portugal continues to be monitored within the context of post-programme surveillance,** although less regularly than under the EFAP, within which assessment missions took place every quarter.

Four different entities currently monitor Portugal within the context of post-programme surveillance:

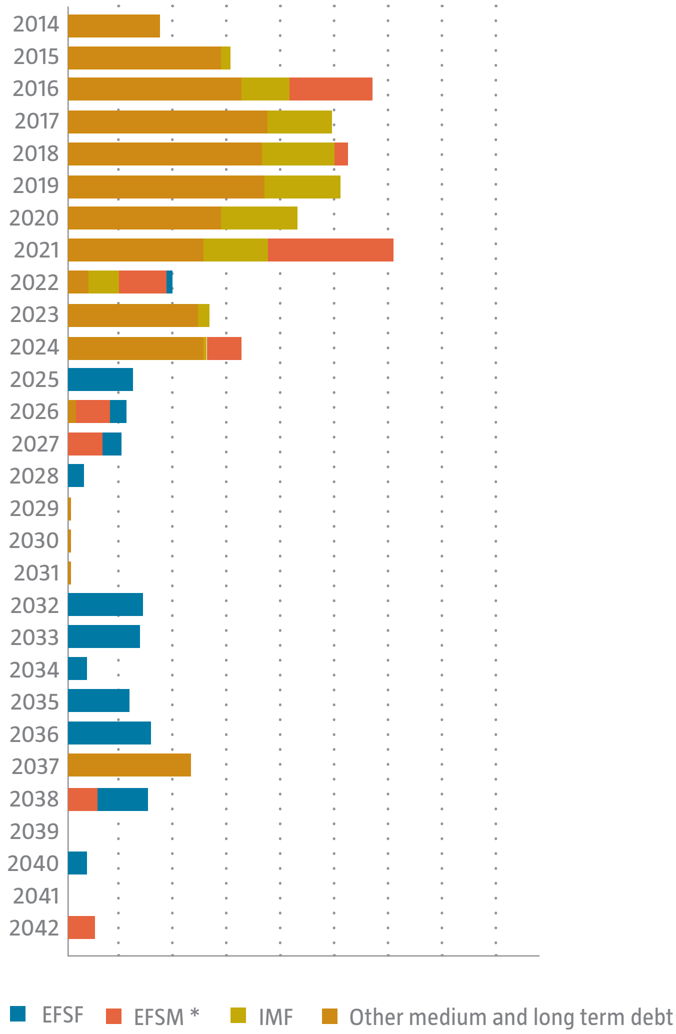
- **The IMF monitors Portugal within the framework of 'post-programme monitoring',** with biannual missions and reports until such time as the country has only less than 200% of its share to pay to this institution.[3] Portugal has a share of around €1.15 thousand million, so that the IMF's post-programme surveillance should continue until Portuguese debt to the IMF is approximately less than €2.3 thousand million. According to the medium and long-term debt repayment schedule prepared by the Agência de Gestão da Tesouraria (IGCP), Portugal's public debt agency, this will take until 2021 (see Graph nº1).[4]

- **The European Commission and the European Central Bank (ECB),** acting in coordination in this, **observe Portugal within the context of 'post-programme surveillance',** with biannual missions and reports until the Portuguese State repays at least 75% of European Union (EU) loans contracted under the EFAP, that is €38.42 of €51.23 thousand million.[5] According to the IGCP schedule, this post-programme surveillance should remain in force for more than two decades, with no reimbursements being planned prior to 2026 and 75% of reimbursements made prior to 2035.
- Lastly, the **European Stability Mechanism (ESM),** a new European body responsible for delivering loans to Eurozone countries, **also monitors Portugal.** The ESM verifies the country's capacity to meet financial commitments agreed within the context of the EFAP, under European instruments for financial assistance that pre-date the ESM, but are now under its responsibility, i.e. the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF).[6] ESM surveillance should last until EU loans have been fully repaid, which, according to the IGCP schedule, will happen only in 2042.

Having said this, it is worth noting that **the post-programme surveillance applied to Portugal could have been different. It could have been stricter and more difficult for the State to endure,** as it depended on the outcome of the EFAP, that is, it depended on whether the government opted for a clean exit or a precautionary financial assistance programme. The Government opted for a clean exit, a decision announced formally on 5 May 2014, following a discussion of this issue at the European level, in the Eurogroup. In making this choice, the Government rejected a precautionary programme, whose access would have entailed asking for an ESM credit line, its negotiation and eventual activation of a Memorandum of Understanding with the ECB, the European Commission and, if possible, the IMF, as well as accepting the reinforced surveillance resulting thereof. [7]

Having regained access to capital markets at reasonable interest rates and therefore ensured the financial needs of the Portuguese State up to 2015, the Government decided to avoid any added restraints to the economic governance of the country, preferring to recover greater room for manoeuvre under the framework for European economic governance, which had been in the meantime revised under the EFAP period.

GRAPH Nº1 Medium and long term schedule for debt repayment in thousand million euro (Source: IGCP)



* The maturity of EFSM loans will be extended for a 7-year period on average. The extension of each loan will come into operation close to the respective pay-back date, and it is not expected that Portugal will have to refund any EFSM loan before 2026.

3. See INTERNATIONAL MONETARY FUND. *Post-Program Monitoring*. 14 March 2005.
4. See AGÊNCIA DE GESTÃO DA TESOURARIA E DA DÍVIDA PÚBLICA (IGCP). *Calendário de amortizações de dívida de médio e longo prazo*. 18 July 2014.
5. See EUROPEAN UNION "Regulamento (UE) nº472/2013 do Parlamento Europeu e do Conselho, de 21 de maio de 2013, relativo ao reforço da supervisão económica e orçamental dos Estados-Membros da área do euro afetados ou ameaçados por graves dificuldades no que diz respeito à sua estabilidade financeira," in *Oficial Journal of the European Union*. 27 May 2013 (A).
6. See EUROPEAN STABILITY MECHANISM. *Frequently Asked Questions on the ESM Early Warning System*. 2 April 2014.
7. The advantage of opting for a cautious EFAP was essentially to ensure greater security against eventual adverse shocks during the period of return to the capital markets, offset by the fact that accepting the corresponding line of credit would presumably bring similar, if not the same, conditions as the previous EFAP. See the EUROPEAN STABILITY MECHANISM; and the, EUROPEAN FINANCIAL STABILITY FACILITY, *Frequently asked questions on the EFSF financial assistance programme for Portugal (concluded on 18 May 2014)*. 18 May 2014.

B. A new European economic governance framework

1. A gradual response to the crisis

1.1. *A four-phase crisis*

The new European economic governance framework, which gave rise to the previously mentioned European post-programme surveillance, **is the product of a gradual EU response to the euro crisis**. To date, the crisis has seen several phases.

Looking at the outlines employed by three international researchers, Stephen Pickford (Senior Researcher at Chatham House), Federico Steinberg (Researcher at Real Instituto Elcano) and Miguel Otero-Iglesias (Senior Analyst at Real Instituto Elcano), and two Portuguese researchers, Ana Costa (Researcher at Centro de Estudos Sociais da Universidade de Coimbra) and José Castro Caldas (Researcher at Universidade de Coimbra), **four distinct phases can be distinguished:** [8]

- A financial crisis originating in the United States of America (USA) (2007-2008): **The first phase extends from 2007 to 2008** and precedes the outbreak of the sovereign debt crisis in the Eurozone. During this period, **the crisis, still rather financial in nature, is seen as a phenomenon originating in the USA, to which EU Member States respond mostly with individual measures and some coordination at the European level,** to ensure the stability of the financial system as well as the solvency and liquidity of their financial institutions. **The Portuguese Government in the last quarter of 2008 approved the Initiative to Reinforce Financial Stability (IREF)**, in order to strengthen the duties of financial institutions to provide information and transparency, guarantee deposits, grant public guarantees to banks and ensure financial solidity.
- A crisis of fiscal discipline (2009-2010): **The crisis clearly took on economic features in Europe at the end of 2008. For this reason, EU Member States adopted a Relaunch Plan in November 2008**, with a view to stimulating the economy. Bearing in mind the importance of fiscal consolidation, EU Member States started to pay more attention to this element as the crisis unfolded in the EU, namely with the worsening of the situation in Greece starting 2010, where the unexpected revelation of fiscal excesses ended up giving way to **a sovereign debt crisis in the Eurozone. Contagion gradually spread to other countries,** albeit for different reasons and with varying degree of intensity, affecting **many on the periphery of the Eurozone,** including Ireland, Portugal, Spain and Cyprus, who as a last resort asked for economic and/or financial assistance from the European institutions and the IMF. [9] During a second phase, **the idea or perception that the crisis was essentially due to a lack of fiscal discipline in the peripheral countries prevailed.** The EU response to the crisis thus centred essentially on creating financial support instruments, to whose access was conditioned on the adoption of fiscal consolidation measures and structural reforms. In 2009, **Portugal began by approving the Initiative for Investment and Employment,** within the framework of EU endorsed fiscal stimulation initiatives, **to later adopt fiscal consolidation measures within the context of three successive Programmes for Stability and Growth (Pactos de Estabilidade e Crescimento, PEC),** namely PEC I (March 2010), PEC II (April 2010) and PEC III (September 2010). **PEC IV was rejected in March 2011, forcing the Government to resign and the country to request economic and financial assistance.**
- The banking crisis (2011-2012): Despite EU efforts, the crisis worsened, with growing speculation in capital markets about a Greek euro-exit and a Spanish sovereign debt crisis, even though the latter's challenges were essentially conscribed to the banking sector. **The worsening economic and financial situation caused uncertainty about the solvency of sovereign states and banking sectors in the more vulnerable Member States,** which led to a flight of capital from southern to northern Eurozone countries, thus **exacerbating the breakup of the European financial market. It was only after this third phase that northern EU countries themselves started to accept that the accumulation of macroeconomic imbalances throughout the preceding decade also explained economic and financial instability in the Eurozone. As a result, reforms adopted during this period aimed at strengthening Member State accountability for fiscal excesses and macroeconomic imbalances.** The goal of such reforms consisted in making room for later movement towards European solidarity initiatives that would be more effective and above all more likely to lead towards a better balance between fiscal discipline, economic growth and social wellbeing, including similar interventions by the ECB in capital markets, i.e. via sovereign bond purchases.
- From crisis management to EMU reform (2012-present day): **The fourth and current phase of the crisis came soon after EU institutions and Member States agreed to major reforms on European economic governance. The July 2012 statement of ECB Chairman, Mario Draghi, defending the euro, marks its start.** This statement, together with the subsequent announcement of the programme for Outright Monetary Transactions (OMT), in September

2012, had a positive impact on capital markets, which, given expectations of ECB intervention, began to reduce pressure on interest rates charged over the sovereign debt of the peripheral countries. [10] In these circumstances, **the EU, its institutions and Member States gained room for manoeuvre to reflect and present plans for deepening Economic and Monetary Union (EMU) in the short, medium and long-term.**[11]

1.2. *The crisis and the institutional weaknesses of Economic and Monetary Union*

Plans to deepen EMU, presented in 2012 and discussed since then at the European level, **aim at responding to EMU institutional weaknesses revealed with the euro crisis,** some of which were already identified in the 1989 *Delors Report* as essential dimensions for the EMU to work well.[12]

At the fiscal level, for example, **the inefficiency of European structures to supervise and coordinate the fiscal policies of EU Member States became evident.** The European framework did not ensure the national discipline required for countries to avoid unacceptable levels of budget deficit and public debt in situations of crisis. This increased the possibility of sovereign default, which had in turn a destabilising impact in the Eurozone. The institutional architecture of EMU was in fact not prepared for this; it excluded such a scenario right from the start, i.e. the approval of the Maastricht Treaty in 1992.

Economically, **it was hardly possible to prevent and duly correct macroeconomic imbalances accumulated at the national and European levels**.

The compartmentalised supervision of macroeconomic imbalances made it difficult to both detect and recognise the risk associated with the excessive imbalance accumulation, which made it in turn difficult to prevent their impact on national fiscal situations and on the Eurozone as a whole.

In addition to this, surveillance instruments and the coordination of economic and fiscal policies did not sufficiently encourage the adoption of structural reforms at the national level. According to the theory of optimum monetary areas, structural reforms are essential for European economic convergence, over which depends the capacity of EMU and the Eurozone to adjust to adverse asymmetrical shocks.

In absence of sufficient economic convergence, and considering the effort adopted towards fiscal consolidation in several Member States, greater EU, or Eurozone, existing fiscal capacity was felt to be insufficient to support the absorption of adverse asymmetric shocks in EU Member States and in the Eurozone in general.[13]

Lastly, at the financial level, **it became clear that there were no European instruments to guarantee the financial stability of EMU and the Eurozone in situations of crisis**. Both the lack of instruments with which to respond to the crisis, and in particular a mixed bag of last-minute tools, such as the initially shaky EU approach to creating common crisis instruments, led to uncertainty in capital markets. This increased sovereign debt risk in more vulnerable Member States and led instead to financial instability in the Eurozone.

The architecture of the European financial system not only made it difficult to adopt a coordinated, common, effective response to the crisis, but it also gave way to financial instability in Eurozone periphery countries.

The sovereign debt crisis emerged thus in a context of dependence between banking sectors and national sovereign powers, without any adequate, common institutional structure to help them break, or at least weaken, this dependence, and consequently avoid the contagion resulting thereof in crisis situations. The subsequent breach in trust led paved the way to capital flight within the Eurozone, which encouraged in turn banking sector re-nationalisation and fragmented the European financial market. Apart from exacerbating the existing dependence between sovereign states and banking sectors, the fragmentation of the European financial market caused significant gaps between Eurozone countries, and in particular between their companies, in gaining access to bank credit. These gaps prejudiced not only the capacity of the peripheral countries to compete in the common market, but also affected negatively the efficiency of the mechanism for transferring European monetary policy.

1.3. *A three-dimensional response*

Faced with the failures of EMU institutional architecture and its impact on the crisis, **the EU focused its response in three aspects:**

- **developing financial support instruments for Member States in difficulties,** namely the EFSM (2010), the EFSF (2010) and the ESM (2012), in order to avoid sovereign defaults;
- **improving mechanisms for the surveillance and coordination of the fiscal and economic policies of Member States,** so as to prevent further fiscal excesses and macro economic imbalances; **and,**
- **creating a banking union**, with a view to lessening dependence between banking sectors and governments, thus counter-acting the fragmentation of the European financial market.

Financial assistance instruments aside, the EU developed an integrated system, including to a certain extent differentiated aspects, **to supervise and coordinate the fiscal and economic policies of Member States,** known as **the European Semester** (see Box n° 1). It also established **the principal pillars of the European Banking Union (EBU)**.

The European Semester was introduced in 2010 and gradually consolidated through a series of inter-governmental regulations, directives and inter-governmental agreements, namely the Euro Plus Pact (2011), the Six-Pack (2011), the Two-Pack (2013) and the Treaty on Stability, Coordination and Governance (TSCG) (2012), that incorporates the Fiscal Compact (commonly known as the 'Fiscal Treaty').

The main pillars of the EBU were established gradually over time, via Community and inter-governmental channels. Currently, the EBU includes a Single Supervisory Mechanism (SSM), approved in 2013; the Single Resolution Mechanism (SRM), approved in 2014; and, the Harmonisation of Deposit Guarantee Schemes (DGS), established in 2014.

BOX Nº1: THE EUROPEAN SEMESTER

EUROPEAN COMMISSION, *The EU's economic governance explained*. 28 May 2014. Available at: europa.eu/rapid/press-release_MEMO-13-979_en.htm

The European Semester operates according to a precise schedule, so that the EU Member States can discuss in a timely manner their respective fiscal and economic policies among themselves and also receive guidance from the European Commission, prior to adopting decisions on such policies at the national level. The schedule begins each year in November and ends in the following year in July.

- November: The European Commission publishes the Annual Growth Survey (AGS) and the Alert Mechanism Report (AMR). With this, begins the European Semester. The AGS announces the EU's main economic priorities for the following year, while the AMR seeks to verify, in general, whether there are any macroeconomic imbalances in EU Member States. The European Commission shares reports on Draft Budgetary Plans (DBP) (submitted by the Eurozone countries) and Economic Partnership Programmes (submitted by the Eurozone countries with excessive deficits). The Finance Ministers of the Eurozone discuss DBPs later within the Eurogroup.
- December: Eurozone Member States adopt their respective DBPs, taking into account the reports of the European Commission as well as the opinions of Eurozone Finance Ministers.
- February/March: The European Parliament and relevant EU Ministers (employment, economy and finance and competitiveness) discuss the AGS in the Council within the context of the Economic Dialogue. The European Commission publishes the *Winter Economic Bulletin*. The European Council adopts the EU's economic priorities based on the AGS, and the European Commission publishes the detailed assessments of countries with macroeconomic imbalances identified in the context of the AMR.
- April: EU Member States submit Stability Programmes or Convergence Programmes (plans for medium-term fiscal strategy) and National Reform Programmes (structural reform plans), taking into account previous EU recommendations. Programmes should be preferably submitted by 15 April, even though they may be delivered up to the end of the month. In the meantime, Eurostat publishes data on debt and deficit levels for the previous year, which the European Commission uses to verify if Member States have met the corresponding fiscal goals.
- May: The European Commission makes Country Specific Recommendations (CSR), i.e. political guidelines elaborated in light of the situation of each country, based on the priorities laid down in the AGS, as well as the programmes submitted to the European Commission in April. The European Commission in the meantime also publishes the *Spring Economic Bulletin*.
- June/July: The European Council approves CSRs. EU Ministers discuss them and EU Finance Ministers adopt them in the Council in July.
- October: Eurozone countries submit their respective DBPs for the following year, by 15 October. Should they not conform to agreed upon medium-term objectives, the European Commission may request a revision, without, however, having the power to veto in this regard.

8. See COSTA, Carlos da Silva, "A criação da União Bancária Europeia e o sistema bancário português," paper prepared for the presentatiojm of the Governor of the Bank of Portugal, Carlos da Silva Costa, in São Paulo on 28 April 2014.
9. Ireland asked for financial support in November 2010, Portugal in April 2011 and Spain in June 2012. Both Ireland and Portugal adopted economic and financial assistance programmes, while Spain implemented only a financial assistance programme. Cyprus asked for assistance in June 2012 and gained access to an economic and financial assistance programme.
10. See EUROPEAN CENTRAL BANK (ECB), *Speech by Mario Draghi, President of the European Central Bank at the Global Investment Conference in London*. 26 July 2012; and EUROPEAN CENTRAL BANK (ECB), *Technical features of Outright Monetary Transactions*. 6 September 2012.
11. See EUROPEAN COUNCIL, *Towards a Genuine Economic and Monetary Union* (5 December 2012); EUROPEAN COMMISSION, *Communication from the Commission: A blueprint for a deep and genuine Economic and Monetary Union: Launching a European Debate.* 30 November 2012; EUROPEAN PARLIAMENT, *European Parliament resolution of 20 November 2012 with recommendations to the Commission on the report of the Presidents of the European Council, the European Commission, the European Central Bank and the Eurogroup 'Towards a genuine Economic and Monetary Union.'* 20 November 2012; and, FOREIGN AFFAIRS MINISTERS OF GERMANY, AUSTRIA, BELGIUM, DENMARK, SPAIN, FRANCE, NETHERLANDS, ITALY, LUXEMBURG, POLAND AND PORTUGAL, *Final Report of the Future of Europe Group*. 17 September 2012.
12. See ENDERLEIN, Henrik and EULALIA, Rubio "25 Years After the Delors Report: Which Lessons for Economic and Monetary Union?," *Notre Europe Policy Paper.* Paris: Notre Europe. 30 April 2014.
13. On the theory of optimum monetary areas and Economic and Monetary Union, see for example PICKFORD, Stephen, STEINBERG, Federico and OTERO-IGLESIAS, Miguel "How to Fix the Euro: Strengthening Economic Governance in Europe," *A Joint Chatham House, Elcano and AREL Report.* March 2014, pp. 13-17.

2. Two European economic governance regimes

In accepting an EFAP in 2011, Portugal became part of a separate framework for European economic governance, the purpose of which was to ensure compliance with the Memoranda of Understanding agreed with the troika members. Having exited the EFAP in June 2014, **Portugal returned to the regular European framework, in which context it is now subject to two specific regimes of European economic governance. One regime deals with the prevention and correction of fiscal excesses and macroeconomic imbalances, and the other is dedicated to the surveillance and coordination of economic policies,** which differ, above all, from the point of view of incentives used to guarantee compliance with the respective European regulations (see Box nº 2).[14]

BOX Nº2 PORTUGAL'S PRINCIPAL COMMITMENTS WITHIN THE FRAMEWORK OF EUROPEAN ECONOMIC GOVERNANCE FOLLOWING THE ECONOMIC AND FINANCIAL ASSISTANCE PROGRAMME.

Source: EUROPEAN COMMISSION. 28 May 2014.

Portugal's principal commitments within the framework of European economic governance following the conclusion of the Economic and Financial Assistance Programme can be classified into three categories: those associated with the prevention and correction of fiscal excesses and macroeconomic imbalances, those related to the surveillance and coordination of economic policies, and those that apply in general to both.

Prevention and correction of fiscal excesses and macroeconomic imbalances:

- Comply with the fiscal criteria detailed in the Stability and Growth Pact (SGP), as revised by the Six-Pack, the Two-Pack and the Treaty for Stability, Coordination and Governance (TSCG), including in particular the Fiscal Compact. To this end:
  - maintain a budget deficit below 3% of GDP, reaching 2,5% of GDP in 2015.
  - maintain a public debt below 60% of GDP, reducing excessive deficits at an average annual rate of one twentieth, and begin, at the latest, three years after meeting the correction goal for the deficit defined under the Excessive Deficit Procedure (EDP).
  - define a medium-term fiscal goal, revising it every three years, with a view to improving the structural balance by 0,5% of GDP per year.
  - maintain a structural deficit below 0,5% of GDP as long as the debt ratio is above 60% of GDP, or less than 1% of GDP if the debt ratio were far lower than 60% of GDP.
  - Avoid public spending growing more rapidly than the potential growth of GDP in the medium-term, unless the increase in public spending is compensated by returns.
- Submit a Stability Programme (medium-term fiscal plan, or its annually revised version, by 15 April.
- Submit a Draft Budgetary Plan (DBP) for the following year by 15 October.
- Adopt the DBPs submitted for the following year by 31 December.
- Within the context of EDP, submit regular reports on developments in the process for budget deficit correction, as well as an Economic Partnership Programme.
- Inform the Eurogroup and the European Commission in advance of public debt issue plans.
- Participate in the Macroeconomic Imbalances Procedure (MIP).

Surveillance and coordination of economic policies:

- Submit a National Reform Programme (medium-term economic plan), or its annual revised version, by 15 April.
- Discuss in February/March the Annual Growth Survey (AGS) with the European Parliament within the context of Economic Dialogue, and adopted it in the following European Council.

In general:

- Contribute in the European Council and discuss in Council the Country-Specific Recommendations (CSR), with a view to their adoption in July.
- Take into consideration the CSR received.
- Collaborate with the European institutions within the context of post-programme surveillance until at least 75% of the financial assistance granted by the European Union (EU) during the Economic and Financial Assistance Programme has been repaid.

2.1. *Prevention and correction of fiscal excesses and macroeconomic imbalances*

The prevention and correction of fiscal excesses and macroeconomic imbalances in the EU Member States is based on different European legal bases, regulations and procedures. The rules regarding fiscal excesses are laid out in two plans:

- **the Stability and Growth Pact (SGP)**, adopted in 1997 and revised on several occasions, with significant reforms introduced in 2005, 2011 and 2013; and
- **the Fiscal Compact**, adopted through the TSCG in 2012 and transposed into national legal frameworks in 2013 (see Box nº 3).[15]

The rules on macroeconomic imbalances, their identification, prevention and correction, are organised according to the **Macroeconomic Imbalances Procedure (MIP)**, that the Six-Pack introduced in 2011.[16]

The Portuguese State undertook to give its support in the prevention and correction of fiscal excesses and macroeconomic imbalances, in regard to several specific criteria:

- budget deficit;
- structural deficit;
- public debt; and
- the table of eleven macroeconomic indicators used within the context of the MIP.

Reducing the budget deficit and public debt

Portugal does not comply currently with the regulations for budget deficit and public debt, so that temporarily the country is subject to the Excessive Deficit Procedure (EDP), i.e. the corrective arm of the SGP. Within this context, the government adopts measures to guarantee it complies with the commitments it has assumed at the European level and in this way ensures both the sustainability of public finance, as well as European economic convergence, particularly in fiscal terms.

The budget deficit rules stipulate the deficit should be reduced and maintained below 3% of GDP. [17]

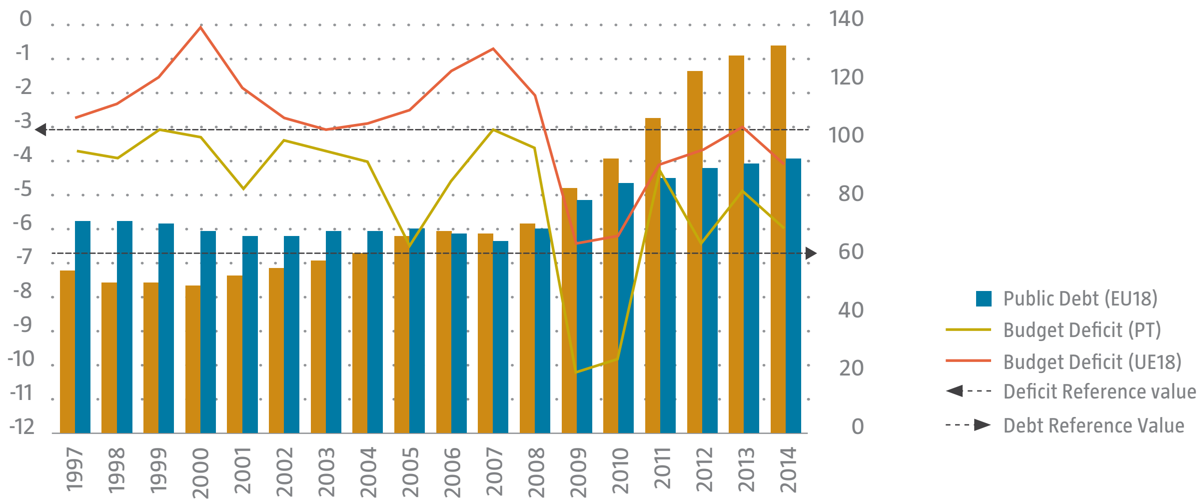
To reduce the budget deficit within the context of EDP, the Government undertook in 2009 to achieve specific goals, since revised following re-negotiation with European partners in 2012, with budget deficit targets of 4% of GDP in 2014 and 2,5% of GDP in 2015.[18]

To get public debt under control, the government committed to measures that sustain an average reduction of excess public debt, i.e. a public debt above 60% of GDP, **by one twentieth per year of the difference compared to the reference value.**

Portugal, along with the other EU Member States under the EDP in 2011 (when criteria referring to the rate of reduction of excessive public debt were introduced) **had a transition period of three years after the close of the Portuguese EDP to begin complying with this specific rule.** In other words, in complying with the goal agreed with the European partners to reduce the budget deficit in 2015, the reduction in public debt should be achieved at the rate demanded at the latest in 2018.

It is important to remember that, according to Eurostat data, **the budget deficit and Portuguese public debt rose respectively to 6% and 132,9% of GDP in the first quarter of 2014,** when averages in the Eurozone were respectively at 4,1% and 93,9% of GDP (see Graph nº2). In both cases, **the figures recorded in Portugal in the first quarter of 2014 were worse than those for the previous quarter** by 3.4 percentage points for the budget deficit (2,6%) and 3,9 percentage points for the public debt (129%).

GRAPH Nº2 PORTUGUESE FISCAL DEFICIT AND PUBLIC DEBT IN PERCENTAGE OF GDP COMPARED TO AVERAGES IN THE EUROZONE SINCE ADOPTING THE STABILITY AND GROWTH PACT (SGP) IN 1997 (Source: Eurostat)



Keeping public spending close to balance

Currently Portugal does not comply with the structural deficit rule on either (i.e. the budget deficit corrected for cyclical variations and net of extraordinary and temporary measures). **Complying with commitments assumed at the European level in terms of structural deficit normally dictates keeping this indicator below 0,5% of GDP or 1% of GDP if public debt is well below the reference value.**

According to the Conselho das Finanças Públicas (CFP), an independent national institution created in 2012 by virtue of the TSCG to ensure compliance with this fiscal criterion, **the structural deficit amounted to 2,8% of GDP in 2013.**[19]

To meet this fiscal criterion, Portugal, like other EU Member States, **adopted not only a medium-term budgetary objective (MTO),** measured in terms of structural balance, **but also a series of rules to guarantee that the trajectory of public finances would be corrected if a deviation from the MTO occured.**[20] The government undertook to converge at a minimum rate of 0,5% of GDP a year towards the MTO, whenever there was a significant deviation from the MTO, or in the planned adjustment curve.[21]

Portugal also agreed to ensure that during adjustment periods the growth rate of public spending, net of extraordinary, temporary or discretionary measures in revenue, would not rise above the medium-term reference rate for potential GDP growth.[22] The purpose of these commitments was to guarantee that any budget deficit recorded in Portugal in this context arises from the economic cycle and is therefore temporary. In other words, **the aim of the MTO is to ensure that public finances,** in structural terms, **have reached, or are on their way to reaching, a point close to balance or**, even **surplus,** reducing budget deficits and public debt growth. **Compliance with the MTO constitutes** therefore **the preventative arm of the EDP.**

The Document on Fiscal Strategy 2014-2018, initially presented by the Government on 30 April 2014, **predicted that the country would achieve its MTO in 2017, exceeding it soon afterwards, in 2018.**[23] [24] But **the Constitutional Court sentence of 30 May 2014, announcing a rejection of a number of fiscal consolidation measures, raised doubts about the government's ability to carry out the aforementioned fiscal strategy and in particular the commitments assumed at the European level to correct fiscal excesses and service Portuguese public debt under its current terms.** Although it is not the aim of this document to analyse the Government's fiscal strategy, the main arguments put forward on compliance with the fiscal criteria agreed at the European level, and specifically the sustainability of Portuguese public debt, should be identified, because any sustainable solution for this issue within the framework of EMU means, to a greater or lesser degree, the involvement of the European Union.

BOX Nº3 THE ADDED VALUE OF THE FISCAL COMPACT

The Fiscal Compact has featured prominently in Portuguese public debate on European economic governance, with positions that are strictly in favour, against and some which favour revising the corresponding treaty, so as to create a more balanced European framework, i.e. one that is more tilted in favour of growth and employment.

Although there is no doubt that greater institutional balance is desirable, it should be noted that the Fiscal Compact did not change the essence of the European framework in this respect, because its rules reflect the content of the existing Stability and Growth Pact (SGP) which EU Member States are already supposed to comply with this. **In practice, rejecting the Fiscal Compact would not change the essential nature of the commitments the Member States have already assumed in terms of European economic governance.**

So what is the added value of the Fiscal Compact?

In comparison with other reforms adopted to strengthen European economic governance, the Fiscal Compact **requires Eurozone Member States transpose the principal European economic governance rules into their national legal frameworks,** preferably at constitutional or an equivalent level.

These include the definition of the Medium Term Budgetary Objective (MTO) and the creation of an automatic mechanism to correct deviations from the MTO or from the adjustment path adopted, at the risk of having to pay a fixed percentage amount or a compulsory cash fine in the case of non-compliance, as adjudged by the EU's Court of Justice.

To encourage Member States to transpose these rules, **the Fiscal Compact helps European economic governance to be introduced nationally,** which could increase the **efficiency of structures that monitor compliance with the rules transposed.** Although it is the European Commission's role to suggest the convergence path with the MTO, with due regard for "the risks to sustainability specific to the country," it is for independent national institutions to control compliance with the rules transposed.

The Fiscal Compact establishes that both **compliance with the MTO,** and **progress made to achieve this, should be** ***"assessed based on a global assessment taking the structural*** *balance as a reference, including an analysis of the net cost of discretionary measures on returns."*

Although undoubtedly useful, as it takes into account the cyclical effects of national economies, **the structural balance is a controversial indicator** because, as pointed out by the Irish think tank Nevin Economic Research Institute (NERI), there is a lack of consensus on the best way to calculate it. In fact, the European Commission recently changed the corresponding calculation in response to repeated criticism, reducing the fiscal consolidation demanded of the EU's Member States, including Portugal.

In addition to ensuring the incorporation of European economic governance to the national level, **the Fiscal Compact also helps to consolidate trust among the EU Member States and those of the Eurozone in particular.**

A greater degree of accountability to the European level, as foreseen by the Fiscal Compact's incorporation into national legislation, reinforces trust among Member States, thereby improving European solidarity. This is particularly true of the new instruments for European economic governance, such as the instruments used for structural reforms or the instruments for public debt management.

The Fiscal Compact helps therefore to encourage adoption of the new instruments for European solidarity, because it responds to one of the main anxieties associated with this, that is moral hazard, i.e. the possibility that some countries might opt to enjoy the benefits which flow from these instruments of solidarity without assuming the corresponding accountability and costs.

Reinforcing fiscal discipline through the Fiscal Compact is an important step towards a better balance between European accountability and solidarity, namely in the context of deepening Economic and Monetary Union (EMU). To achieve this balance, and also to ensure that the fiscal criteria underlying the Stability and Growth Pact and the Fiscal Compact are met, now is the time, according to the French think tank Notre Europe, to promote the adoption of European solidarity measures to support growth and employment.

Sources: COHEN-SETTON, Jérémie, "The structural balance controversy" in *Bruegel Blogs review*. 22 October 2013; COHEN-SETTON, Jérémie and VALLÉE, Shahin, "The fiscal compact" in *Bruegel Blogs Review*. 16 March 2012; COUNCIL OF THE EUROPEAN UNION, *Treaty on Stability, Copordination and Governance in Economic and Monetary Union*. 2 March 2012; NEVIN ECONOMIC RESEARCH INSTITUTE, "EU Fiscal Compact Treaty," *Information Note*. May 2012; GASPAR, Eva, "Europa acorda novo método de cálculo que pode reduzir dose de austeridade em Portugal" in *Jornal de Negócios*. 20 March 2014; VITORINO, António, "The European 'Fiscal Compact': a goal or a starting point?," *Notre Europe Viewpoint*. Paris : Notre Europe. 7 June 2012; and DELORS, Jacques and VITORINO, António *et al.*, "Stability and growth: perfecting the new European pact," *Notre Europe Viewpoint*. Paris : Notre Europe. 16 May 2012.

The debate on the sustainability of Portuguese public debt

Special attention has been given to the level of Portuguese public debt nationally, both to the way it has evolved and to the cost that its reduction will have on the current European framework, including from the point of view of Portugal's capacity to promote sustainable growth in the country.

Portugal's public debt **is** indeed **high** and, despite adjustments made since 2011 to balance public finances, **it has risen steadily in relative terms since the International crisis 2007-2009.** According to Eurostat, Portugal's public debt **rose from 68,4 to 94% of GDP between 2007 and 2010, reaching 132,9% of GDP in the first quarter of 2014** (see Graph nº3).[25]

Reducing the public debt involves close consideration of three factors: the primary budgetary balance, the interest rate on the debt stock, and the rate of nominal GDP. The correct combination of all three, in the medium and long term, ensures sustainability of public debt.

The 2013-2017 FSD, for example, **forecasts that,** with a primary budgetary balance of 3,5%, a variation rate in nominal GDP of around 3,5% and an implicit interest rate of 4,3%, **Portugal's public debt would start to fall from 2015, reaching 60% of GDP in 2037 in line with the EDP and the Fiscal Compact.**[26]

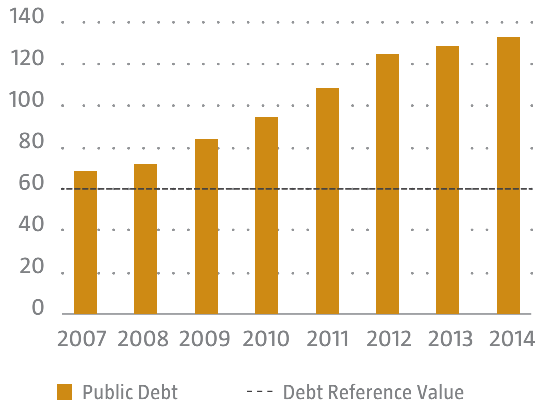
The **2014-2018 FSD dispensed with a similar analysis on the medium and long term sustainability of public debt, putting forward only data on the five-year period in question.** That is: a positive and growing primary budgetary balance, increasing from 0,4 to 4,2% of GDP between 2014 and 2018; nominal GDP growth equally positive and growing, rising from 1,9 to 3,6% between 2014 and 2018; and a relatively stable implicit interest rate, at around 4% between 2014 and 2018 (see Table nº1).[27]

If these estimates are confirmed over the five-year period in question, as well as structural deficit at MTO levels after 2018, **the 2014-2018 FSD forecasts that Portugal's public debt**

TABLE Nº1 FISCAL STRATEGY DOCUMENT 2014-2018 FORECASTS FOR MACROECONOMIC AND PUBLIC FINANCE FRAMEWORK (Source: Ministry of Finance)

	2014	2015	2016	2017	2018
Primary budget balance	0,4%	1,8%	2,7%	3,4%	4,2%
Real growth in GDP	1,2%	1,5%	1,7%	1,8%	1,8%
GDP deflator	0,7%	0,9%	1,7%	1,8%	1,8%
Nominal growth in GDP	1,9%	2,4%	3,4%	3,6%	3,6%

GRAPH Nº3 PORTUGESE PUBLIC DEBT IN PERCENTAGE OF GDP BETWEEN 2007 AND 2013 (Source: Eurostat)



will start declining as of 2015, dropping after 2018 in line with the rate demanded by the EDP and the Fiscal Compact.

Keeping the structural deficit at MTO levels after 2018 would, however, imply according to the CFP, **making a considerable fiscal consolidation effort**, to generate the necessary primary budgetary balances and in this manner reduce public debt in line with European commitments.

In accordance with CFP estimates, with a nominal interest rate of 4,5%, a nominal growth rate of 3,5% after 2017 and, a primary budgetary balance over 4% of GDP between 2018 and 2020, declining gradually until it reaches 2% of GDP at the end of the projected period (2050), that is an average of 3% of GDP per year, **Portugal's public debt would fall to 60% of GDP in 2042, in line with the EDP and the Fiscal Compact**.

Having said this, **one should bear in mind that compliance with these estimates** – as in fact the FSD itself and the CFP's corresponding analysis indicate – **depends on a range of factors,** from how the economic situation will evolve and the effective enforcement of fiscal strategy, to possible changes in statistics and regulations. These factors explain, for example, the difference that exists between estimates presented by the Government in the 2013-2017 and 2014-2018 FSDs.

Considering that the FSD forecasts are unrealistic and the underlying strategy not only is inefficient, but also constitutes an excessive threat to Portuguese society and the economy, **several academics and members of Portuguese civil society have criticised the Government's fiscal strategy and in particular the plan to ensure public debt sustainability.** They have instead put forward alternative solutions, particularly since the presentation of the 74 Manifesto.[28]

Ricardo Cabral (Vice-Rector of the University of Madeira), **Ricardo Paes Mamede** (Assistant Professor of the ISCTE), **Paulo Trigo Pereira** (Full Professor of the Instituto Superior de Economia e Gestão and President of the Institute of Public Policy Thomas Jefferson-Correia da Serra) and **Emanuel Santos** (former Secretary of State for the Budget), for example, **question the realism of Portugal's fiscal strategy in comparison to the economic and fiscal experience of the 28 EU Member States**, including Portugal, **between 1996 and 2013.**[29] The four Portuguese economists analyse the number of instances in which the conditions described in the 2014-2018 FSD have been observed with a view to ensuring that Portugal's public debt is compatible with the Fiscal Compact, and they conclude that these were verified in only 2% of cases observed (see Table nº2).[30]

With this evidence, **Cabral *et al.* estimate that: *"in the current and foreseeable conditions of the Portuguese economy, and with no structural change to fiscal policy within the euro framework, payment of the public debt in the current terms is not compatible with meeting the terms of the Fiscal Compact. If public debt is not significantly restructured, the effort to meet budgetary goals will mean prolonging austerity until 2018, with high costs*** *for the sustainability of public health, education and social protection systems, social cohesion, the regulatory role of the State, economic development and job creation."* [31] [32]

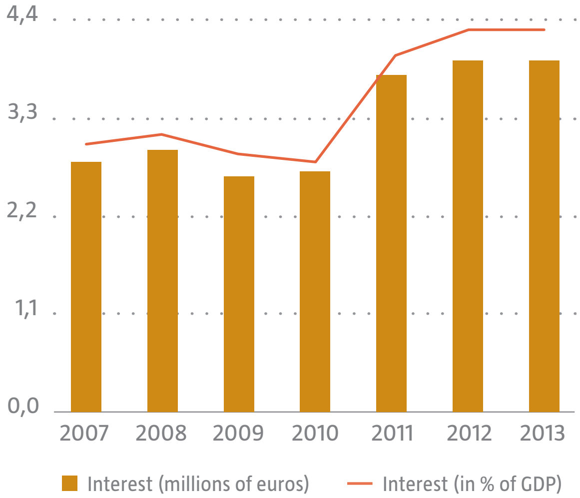
According to the four Portuguese economists, **the growth in interest payments**, as a component of public spending, **partly explains the high social and economic costs incurred in the context of the current fiscal consolidation policy**, given that it has forced the Government to redirect the financial resources necessary for the economic and social development of the country so that it can meet the current terms of its financial commitments. Measures to cut civil service salaries and pensions, as well as to raise taxes, adopted in recent State Budgets, illustrate this. According to the National Statistics Institute, Portugal paid €7.183 billion in interest payments in 2013, the equivalent of 4,3% of GDP or 8,9% of public spending, i.e. €2.287 billion more than in 2010, when interest payments amounted to 2,8% of GDP and accounted for 5,5% of public spending (see Graphs nºs 4 and 5).

In this context, **the need to pay off medium and long term debt must also be considered**, as it represents an important part of public spending. According to the debt repayment schedule of the IGCP, Portugal's debt agency, the Portuguese State must repay a debt of €66.49 billion by 2018 or €112.82 billion by 2021 (see Graph nº1).
If the State's debt continues to rise and economic growth does not in the meantime accelerate, interest payments will continue to grow and weigh increasingly on GDP and public spending in particular, thus constraining the country's fiscal room for manoeuvre and the capacity of the Portuguese State to promote growth and employment over time.[33]

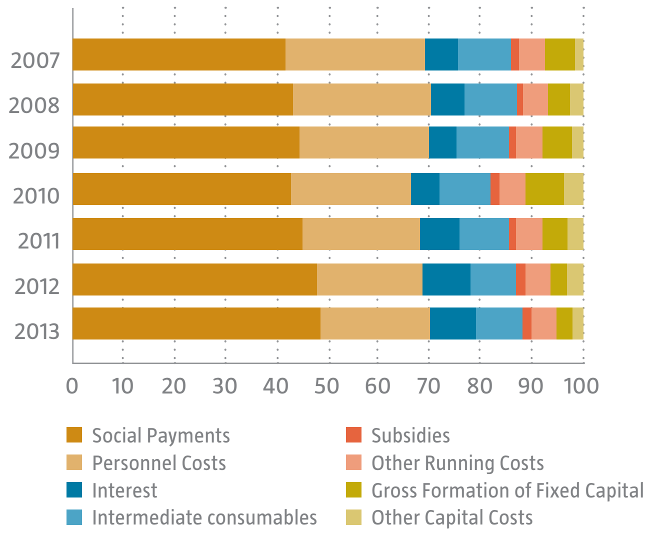
TABLE Nº2 VERIFYING MACROECONOMIC CONDITIONS OUTLINED IN THE 2014-2018 FSD IN THE EU

	NUMBER OF TIMES CONDITIONS WERE VERIFIED IN THE COUNTRY IN ANY YEAR BETWEEN 1996 AND 2013, ASSUMING:	
COUNTRY	NOMINAL GROWTH ≤ 3,6% GDP DEFLATOR ≤ 1,8% PRIMARY BUDGET BALANCE ≥ 1,8%	PREVIOUS CONDITIONS + GROWTH IN PRIVATE CONSUMPTION ≤ 0,8% (YEAR IN WHICH VERIFIED)
Germany	3	2 (2008, 2012)
Hungary	3	3 (2011, 2012, 2013)
Italy	2	2 (2012, 2013)
Luxemburg	3	1 (2008)
Sweden	5	2 (2001, 2008)
Other	14	0
Total	30	10
Percentage of total (491 observations)	6%	2%

GRAPH Nº4 INTEREST RATE COSTS IN MILLIONS OF EURO AND IN PERCENTAGE OF GDP BETWEEN 2007 AND 2013 (Source: Eurostat)



GRAPH Nº5 TOTAL PUBLIC ADMINISTRATION SPENDING IN PERCENT OF GDP PER COMPONENT BETWEEN 2007 AND 2013 (Source: INE)



In short, Cabral *et al.* criticised the fiscal strategy outlined in the 2014-2018 FSD, because they considered it unrealistic in view of the economic and fiscal experience of the EU member states, including Portugal's experience. **And because carrying it out implies excessively high social and economic costs** in light of rising interest payments or repayment of medium and long term debt, without taking into consideration possible additional charges that could arise from accrued deficits or recapitalisations of public enterprises or the assumption of their liabilities.

In their opinion, **the challenges of the sustainability and compatibility of public debt with the Fiscal Compact are not strictly Portuguese challenges. They affect the Eurozone as a whole and particularly countries on the periphery of the Eurozone**, where increases in public debt were particularly pronounced from the onset of the Euro crisis.

As the four economists explain, *"n the absence of mechanisms to offset external shocks, the peripheral euro economies suffer more from the negative effects of a single exchange rate and, consequently, the impact on their public finances is also greater."* [34]

Cabral *et al.* are not the only ones to emphasise the European dimension of these challenges. The Portuguese economist Vitor Bento addresses the issue of public debt specifically from the point of view of the Eurozone. In *Strong euro, weak euro, two cultures, one currency: an (im)possible relationship?*, Bento argues that until the outbreak of the crisis two monetary cultures lived side-by-side in Europe: one was an inflationary monetary regime, leading to a weak currency; the second a monetary regime targeting price stability and a strong currency from the start. At the same time, the actual institutional architecture of Monetary Union, as well as the behaviour of its central institution, the ECB, have been geared from the start to a strong currency regime.[35]

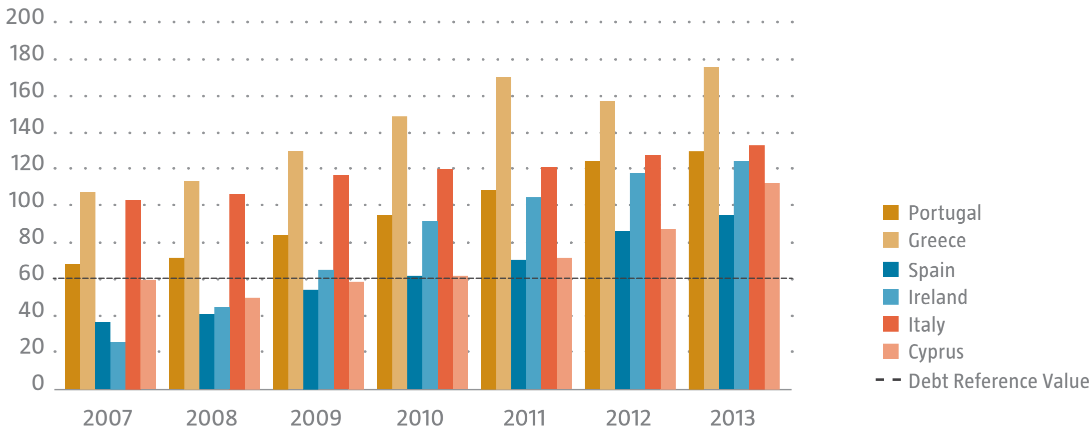
In Bento's opinion, the crisis revealed and accentuated the differences between these two cultures, **the central challenge of the Eurozone** now being ***"to create the conditions for all its members to be able to share in a common monetary regime and with it to meet the aspirations of the social wellbeing of their respective populations, realising and developing their economic potential."*** [36]

Since a reconfiguration of the European monetary regime in itself seems improbable – at least in the short term – **the adjustment required has fallen to economies and societies with differing behaviours.** Yet **the adjustment of differing behaviours alone is insufficient in itself, and is far from easy.** Indeed, *"without monetary instruments,"* Bento points out, *"to fully ensure that debts are serviced will require a considerable economic and social effort which, without solid economic growth, could become politically unsustainable and unleash serious tensions as to whether countries (the 'weak euro' or the Greek-Latin group) remain in the euro."* [37] (see Graph nº6).

In his opinion, ***"it will be extremely difficult to find a solution to the debts of the 'weak euro' countries, and for their return to sustained economic growth, without debt relief** — at least in the near future, during which time the adjustment is socially and economically more demanding."* For the Portuguese economist, *"the only viable solution will be by using some form of mutualisation that implies significantly reducing the debt service paid by these countries, at least during the time required for economic recovery"*

As he sees it, debt mutualisation does not necessarily require joint debt issuing, but could also include, as in fact has been the case until now in the EU's economic and/or financial assistance programmes, *"eplacing private creditors by official creditors"* and *"making the ECB a lender of states in difficulties".* To be fully effective and practical in adjustment processes, debt mutualisation should be *"accompanied by significant restructuring of debt payment plans, involving effective relief during the macroeconomic adjustment period in 'weak euro' economies.'"* [38]

GRAPH Nº6 PUBLIC DEBT DEVELOPMENT IN THE 'WEAK EURO' COUNTRIES AND 'GRECO-LATIN' GROUP IN PERCENTAGE OF GDP BETWEEN 2007 AND 2013 (Source: Eurostat).



Bento, who contributed to the preparation of a report on creating a debt repayment and euro-bills fund at the request of the European Commission, **recognises, all the same, that there are significant obstacles, starting with the need to reduce moral risk associated with debt mutualisation.**[39] Debt mutualisation, according to the Portuguese economist, *"would be difficult to consider seriously without the processes of financial stabilisation being concluded and without the 'weak euro' group implementing the institutional reforms required to prevent a repetition of the situation in which currently its Member States find themselves."* [40]
Furthermore, the Portuguese economist adds, "*for an eventual debt mutualisation to become politically acceptable to the 'hard-core' (i.e. Germany, or Austria, the Netherlands, Luxembourg and Finland) the benefits of what is known as the social model will first have to be harmonised within the Eurozone (at the risk of) it being difficult for societies in "contributing" countries, and where social benefits are less generous, to accept sharing financial responsibilities with countries where the social benefits are more generous."* [41]

In other words, **debt mutualisation will depend on both the conclusion of the adjustment process currently underway in the Eurozone, and on greater European integration, the implementation of which** – given the obstacles mentioned, and depending on the planned objective (joint issuing of debt or not) – **will unfold more in the medium and long term than in the short term. Debt mutualisation will therefore imply a greater or lesser degree of EMU deepening.** The second part of this document will address the proposals put forward in this regard at the European level in the context of the debate on EMU deepening.

Preventing and correcting macroeconomic imbalances

The European Commission has not assessed Portugal for macroeconomic imbalances under the MIP because monitoring and subsequent adoption of corrective measures was carried out between 2011 and 2014 within the context of the EFAP. The EFAP having been concluded, **Portugal will now be assessed under the MIP as of the next European Semester onwards** (from 2015). **It is therefore useful to describe the main characteristics of this European procedure, as well as the importance of preventing and correcting imbalances for Portugal.**

The MIP has two components:

- **a preventative component**, responsible for the timely identification and observance of macroeconomic imbalances in the context of an Alert Mechanism; and,
- **a corrective component**, known as the Excessive Deficit Procedure, that requires the EU Member States to adopt corrective measures after identifying excessive imbalances.

The Alert Mechanism, including the preparation and annual publication of an Alert Mechanism Report (AMR), integrates the European Semester and operates on two occasions: first as a general, wide reaching evaluation, to identify imbalances at the European level, followed by a more detailed, selective approach, with thorough analyses per country, aimed at determining the relevance of identified imbalances.[42]

The identification of imbalances in themselvesis carried out with the support of a scoreboard of eleven principal indicators, to which the European Commission adds relevant supplementary information, including taking into consideration the surrounding economic context (see Table nº 3). This makes the assessments of European institutions somewhat subjective in nature and therefore gives them a certain room for manoeuvre when making decisions in this regard. [43]

A failure to comply with one or more basic MIP indicators does not automatically subject EU Member States to a detailed analysis, or even to an Excessive Imbalances Procedure, the activation of which depends on a proposal submitted by the European Commission to the Council in this sense and its subsequent approval by qualified majority.

Both the subjective nature of the analyses, and the process for opening an Excessive Debt Procedure, make the use of the corrective arm of the MIP more difficult, particularly as compared with the EDP and in relation to the countries of the Eurozone that ratified the TSCG. [44]

This does not mean that the MIP loses its value as an instrument of surveillance and support in coordinating EU Member State fiscal and economic policies. The results of the aforementioned detailed analyses are in fact meant to inform country specific recommendations within the context of the European Semester. Having said this, **when all is said and done, the efficiency of the corrective arm of the MIP depends on the will of EU Member States,** given that, with the exception of macroeconomic adjustment programmes, in which government room for manoeuvre is limited, the adoption of corrective measures, including structural reforms, requires the political support of the respective Member States at the national level.

The importance of preventing and correcting imbalances for Portugal

The creation of an instrument for preventing and correcting macroeconomic imbalances in 2011 assumed particularly relevance for the EMU, the Eurozone and, in particular, countries that – like Portugal, Greece, Spain and Ireland – **had accumulated significant imbalances within the European context and had as a result run into situations of serious economic and financial instability as of 2010**, when the Euro crisis broke out.

This accumulation of imbalances was due to several factors, including the defective architecture of EMU, which, apart from encouraging imbalances between EU Member States, did not initially consider adequate mechanisms for the prevention and correction of imbalances, despite the weaknesses detected at the time of the debate on creating the EMU in preparation for the institutional revision provided by the Treaty of Maastricht. [45]

In this context, national academics and economists **frequently present the way in which the European framework evolved, including Portugal's participation in the integration of Europe, as one of the principal factors responsible for developing imbalances that today explain the weak performance of the Portuguese economy**, among other factors, such as the persistent structural weaknesses of the economy or the adverse shocks suffered since the EMU was created. [47]

Fernando Alexandre (Associate Professor of the University of Minho) and **Pedro Bação** (Professor of the University of Coimbra), two Portuguese academics who wrote recently on the history of national economic imbalances, **identify four factors, which combined, helped imbalances develop in Portugal.** These are:

TABLE Nº3: SCOREBOARD OF 11 INDICATORS USED UNDER THE MIP (SOURCE: EUROPEAN COMMISSION) [46]			
EXTERNAL IMBALANCES AND COMPETITIVENESS			
INDICATOR	UNIT OF MEASUREMENT	THRESHOLDS	PORTUGAL: MOST RECENT DATA FROM 2014 AMR (2012)
Current Account (% of GDP)	3-year average	-4% of GDP and +6% of GDP	-6.5%
Net Position of Foreign Investment (% of GDP)	–	-35% of GDP	-115%
Share of Exports Market	5-year variation	-6%	-16%
Unit Labour Cost (Nominal)	3-year variation	+9% in the Eurozone +12% in other Member States	-5,3%
Real Effective Exchange Rate	3-year variation compared to 41 industrialised countries	+/-5% in Eurozone +/- 11% in other Member States	-4%
INTERNAL IMBALANCES			
INDICATOR	UNIT OF MEASUREMENT	THRESHOLDS	PORTUGAL: MOST RECENT DATA FROM 2014 AMR (2012)
Private Sector Debt (% of GDP)	–	133% of GDP	224%
Credit Flows from Private Sector	–	+14%	-5,4%
Housing Prices (Deflated)	Annual variation	+6%	-8,6%
Public Administration sector debt (% of GDP)	–	+60%	124%
Unemployment rate	3-year average	+10%	13,6%
Financial Sector Liabilities	Annual variation	16,5%	-3,6%

- **the nominal stabilisation of the EMU framework** (with interest rates falling during the nineties to levels similar to those of Germany);
- **development of the financial sector and the consequent rise in credit availability in Portugal,** to which the process of nominal stabilisation, privatisations and legislative reform of the financial sector within the context of the European financial integration all contributed;
- **the increase in public spending**, associated to the process of development and democratisation of the Portuguese economy and society, reflected in the growth of several public sectors, such as health and education, as well as construction, and in the redistribution of wealth through the State Budget, which benefited in particular from the Community funds attributed to Portugal within the EU framework; and
- **the international insertion of the Portuguese economy**, particularly the rise in the exchange rate in real terms in the EMU context and the Eurozone, the rise in oil prices and the process of globalisation, including growing competition from China and the East European countries as a result of increasing global trade. [48]

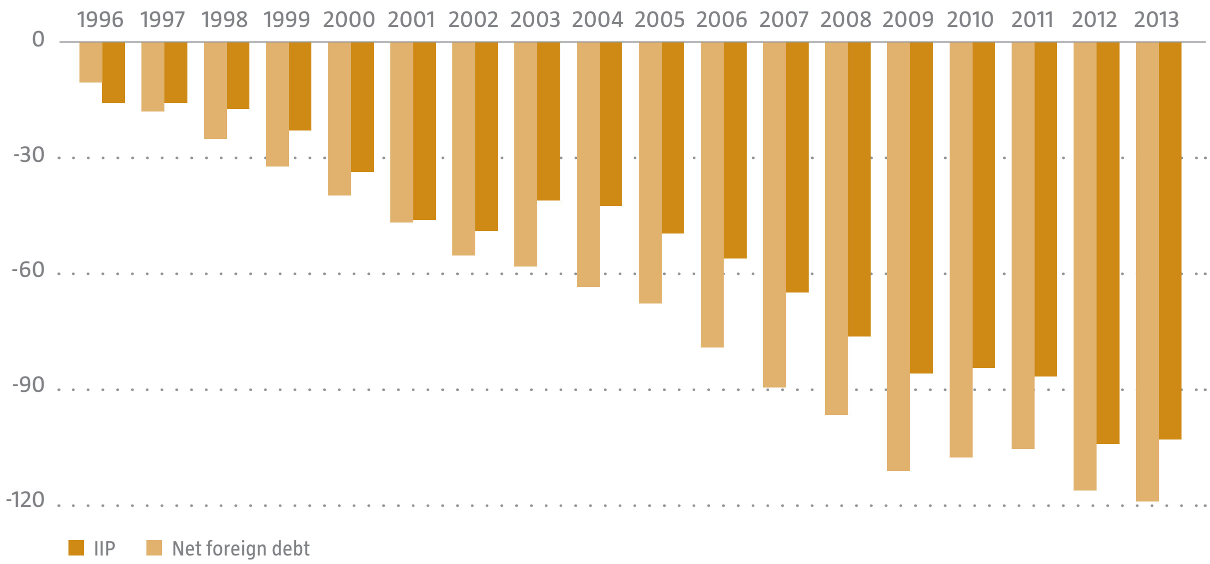
According to Alexandre and Bação, **the combination of these factors contributed to developing two specific imbalances:**

- **growth in the non-tradable sector to the detriment of the tradable sector,** after Portugal joined the euro in 1999; and,
- **the increase in public and private indebtedness, and particularly foreign indebtedness**, as illustrated by the rise in net foreign debt and Portugal's International Investment Position (IIP), from the mid-nineties onwards, following the EMU being created (see Graph nº7).[49]

According to Bank of Portugal data, the net foreign debt and the net foreign liability of the country increased respectively from 15,1 to 102,9% and from 10,1 to 118,7% between the last quarter of 1996 and the last quarter of 2013.

Expansion of the non-tradable sector elicited a structural change in the Portuguese economy, paving the way for the economic stagnation evident since the start of the twenty first century — with the non-tradable sector seen as contributing less to the productivity of the economy and thus to the country's long term growth —, **and foreign deficits accumulation.**

GRAPH Nº7 PORTUGAL'S NET FOREIGN DEBT AND INTERNATIONAL INVESTMENT POSITION (IIP) IN PERCENTAGE OF GDP BETWEEN 1996 AND 2013
(Sources: Banco de Portugal and Eurostat)



In the opinion of the two aforementioned Portuguese academics, **it was a combination of these two dynamics –** a stagnant economy and the accumulation of foreign deficits – **that drove Portugal into a sovereign debt crisis, the final push being given by increases in public spending and the subsequent deficits contracted with a view to overcoming the effects of the international financial crisis of 2007-2008.** [50]

The international financial crisis therefore aggravated an already unbalanced and fragile economy. The crisis not only increased the country's foreign indebtedness, but also exposed the structural weaknesses and accumulated imbalances within the context of the EMU and the Eurozone. Confronted by an initially shaky European response to the sovereign debt crisis started in 2010 in the Eurozone, the capital markets began to question the capacity of the more vulnerable Member States, including Portugal, to promote sustainable growth and, subsequently, to guarantee their financial commitments, which, as the situation worsened, ended in causing an abrupt cut in foreign funding to the national economy.

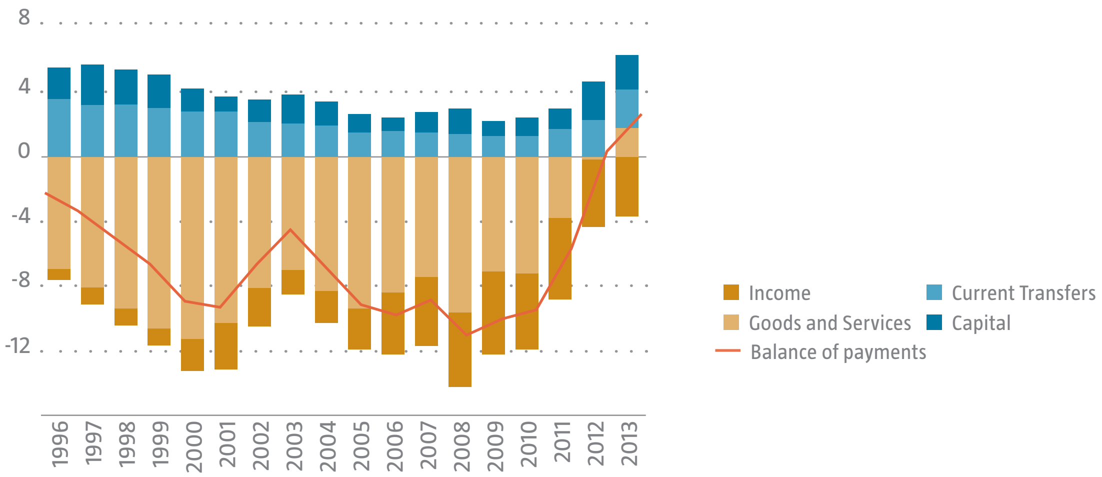
The request for a bailout in April 2011 came in the wake, and as a result of, inadequate dynamics and decisions, both at the national and European levels.

In this context, **correcting the external imbalance is fundamental for Portugal**, particularly because the capacity to fund the national economy depends on it.

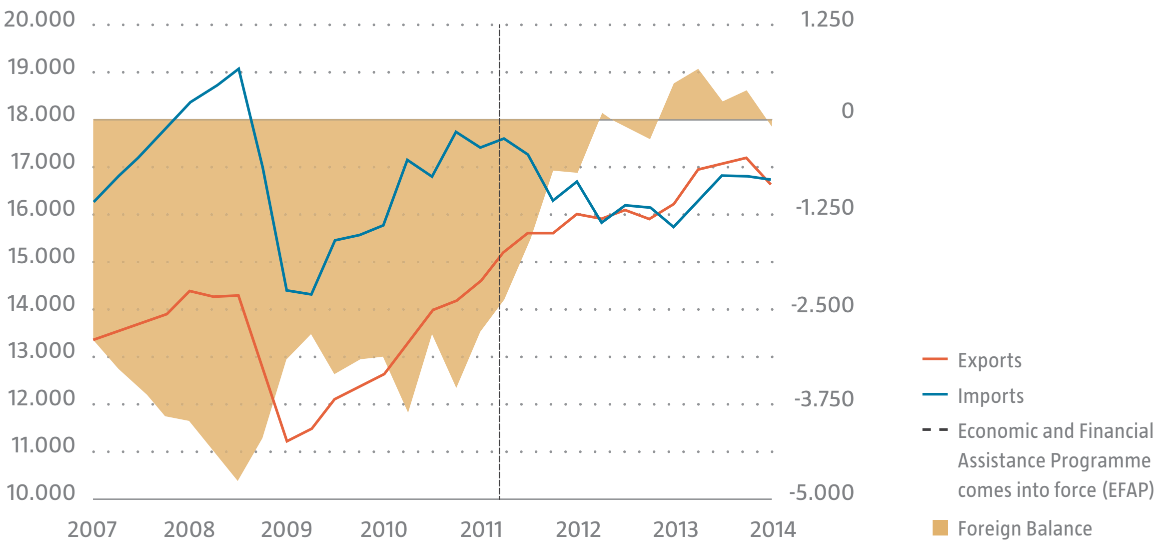
Correcting the external imbalance means reducing foreign deficits, particularly trade deficits, which until recently accounted for a substantial part of deficits systematically accumulated in the context of the EMU and the eEurozone – **and the balance of income deficits,** which, resulting mainly from interest payments on gross foreign debt and dividend payment, have been growing since the start of the millennium, and today represent a considerable part of the Portuguese balance of payments deficit (see Graphs nºs 8 and 9). [51]

This adjustment is particularly difficult compared to previous ones, because it must be carried out within the context

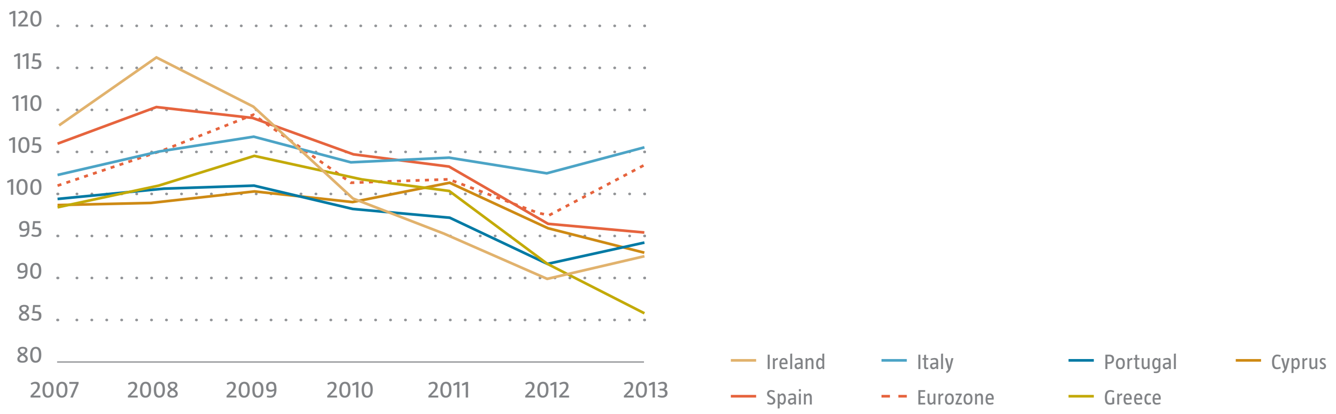
GRAPH Nº8 PORTUGUESE BALANCE OF PAYMENT CHANGES IN PERCENT OF GDP BETWEEN 1996 AND 2013 (Source: Pordata)



GRAPH Nº9 QUARTERLY VALUE OF EXPORTS, IMPORTS AND FOREIGN TRADE BALANCE IN GOODS AND SERVICES (CURRENT PRICES IN MILLIONS OF EURO) BETWEEN THE FIRST QUARTER OF 2007 AND THE FIRST QUARTER OF 2014 (Source: INE)



GRAPH Nº10 REAL EXCHANGE RATE BASED ON UNIT LABOUR COSTS, BETWEEN 2007 AND 2013 IN PORTUGAL, COMPARED TO THE AVERAGE IN THE EUROZONE AND THE DEFICIT COUNTRIES, OF THE 'WEAK EURO' OR THE 'GRECO-LATIN' GROUP (REFERENCE INDEX: 2005) (Source: AMECO)



of EMU and the Eurozone, that is, **it must be done without using exchange rate and monetary policy instruments and with a real overvalued exchange rate** (see Graph nº10).
While external deficits, accumulated in the context of the EMU and the Eurozone, represent one of the main causes of foreign indebtedness, the reduction of which is essential to ensuring economic growth, it bears mentioning that the **external balance alone will not allow a return to full employment.** According to Bento, without being able to adjust the respective real exchange rates, *"the economies (of the 'weak euro' countries in the process of adjustment) may return to growth and keep external accounts in balance, but growth alone will for long not be enough to set back the GDP of these economies at a full employment level."* [52] In this situation, the Portuguese economist suggests that **a return to full employment requires a combination of three measures,** including:

- **a slow process of relative deflation,** with salaries and prices in the non-tradable sector frozen or growing below levels in other economies;
- **a programme of structural reforms that will help increase productivity faster than competitors;** and
- **emigration** that, in 'exporting' the 'surplus supply of labour gradually eliminates unemployment' (see Box nº4).

This combination of measures, he author warns nonetheless is *"whatever the case, **a slow adjustment,** unless (the structural forms manage) to accelerate their effects (and apart from the outcome of this) is always **a process of relative impoverishment.**"* [53] [54]

Bento concludes **that the 'weak euro' countries are therefore faced with two situations highly adverse to growth in the coming years: a debt/GDP ratio that is far too high and an over-valued real exchange rate, without any instruments to provide rapid correction.** To these elements, one must also **add the peripheral nature of the 'weak euro' countries within the EU, as well as the risk of an eventual recession at the European level, as a result of the asymmetric, simultaneous adjustment being made in the Eurozone.** [55]

The asymmetrical, simultaneous adjustment of imbalances in the Eurozone, an adjustment to a great extent operated through fiscal consolidation policies in the peripheral, and deficit, countries of the Eurozone, **is a difficult challenge** in that it constrains the growth of domestic demand, limits the possibility of export-driven growth and hightens deflation risk throughout Europe.

According to the Belgian economist, Paul de Grauwe, **the asymmetrical adjustment of imbalances in the Eurozone explains the deflationary pressures observed today at the European level** (see Graph nº11).
These pressures represent a serious risk to Portugal, as well as to any Eurozone country with a high public debt, because they promote an increase in the real value of the debt and reduce real economy returns, worsening the debt crisis and generating a risk of prolonged economic stagnation.

BOX Nº4 THE ECONOMIC AND SOCIAL CONSEQUENCES OF PORTUGUESE ADJUSTMENT

Sources: ABREU, Alexandre *et al.* (October 2013); BENTO, Vitor (March 2013); INTERNATIONAL MONETARY FUND (IMF), *Portugal: Request for a Three-Year Arrangement Under the Extended Fund Facility*. June 2011; ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), "Portugal: Deepening Structural Reform to Support Growth and Competitiveness" in *'Better Policies' Series*. July 2014; INTERNATIONAL LABOUR ORGANISATION (ILO), "Enfrentar a Crise do Emprego em Portugal", report prepared by the Inter-Departmental Action Group of the ILO on countries in crisis for the High Level Conference 'Enfrentar a Crise do Emprego em Portugal: que caminhos para o future?' organized in Lisbon on 4 November 2013.

The adjustment made in Portugal since 2011 within the context of the Economic and Financial Assistance Programme (EFAP) has reflected a combination of measures previously referred to by Vitor Bento, with significant , and to a certain extent unexpected, social and economic consequences, and to a certain extent unexpected, which, despite the positive results obtained up to the present, raise doubts as to the likely success of the adjustment over time.

The EFAP agreed with the troika on 17 May identified as the major challenges to the Portuguese economy:

- **the loss of competitiveness and high deficits in the current account;**
- **unsustainable budget deficits; and**
- **high debts of the financial sector and the private sector.**

In this context, the EFAP associated a series of structural factors with the problems of competitiveness and growth in the Portuguese economy, which are:

- excessive protection of the non-tradable sector;
- the inflexibility of the labour market (mainly in terms of wage policy, social contributions for unemployment and redundancy compensation) and a large, poorly qualified labour force; as well as,
- an inefficient judicial system.

To confront these challenges, the EFAP established the following objectives:

- **promoting competitiveness and growth with internal devaluation, implemented through structural reforms;**
- **recovering confidence in markets and ensuring fiscal sustainability with a policy for fiscal consolidation; and,**
- **safeguarding financial stability with a series of measures to support the banking sector.**

While it is not the aim of this document to analyse the measures adopted over the past three years under the EFAP, **it is still important to point out their economic and social impact in that they give one an idea of the consequences of the adjustment currently underway in Portugal.** To this end, it bears mentioning that the **Portuguese socio-economic situation worsened following the adoption of the EFAP,** structural reforms and fiscal consolidation, which, together with limited access to bank credit, due in part to the process of financial stabilisation, ended encouraging, more than expected, the recessive effect of the Euro crisis in Portugal.

At the economic level, declines in consumption and investment are evident, as is an increase in unemployment, in particular youth unemployment and long-term unemployment, an increase in the number of companies and families in debt, and a growth in company insolvency. According to the INE (National Statistics Institute), public and private consumption fell respectively by 7,8 and 5,3% between 2011 and 2013, while investment dropped by 19%. Moreover, unemployment increased substantially during this period, rising from 12,7 to 16,2%. This was particularly felt among young people, whose unemployment rate rose from 30,3% to 38,1%, and long-term unemployed people, whose rate rose from 6,7 to 10%. The percentage of companies and families in debt also increased between 2011 and 2013. According to the Bank of Portugal, the percentage of Small and Medium Companies (SMC's) in debt, for example, rose from 21,5 to 29,5% during this period. Lastly, according to Ministry of Justice data, the number of bankruptcy, insolvency and company recovery cases sentenced in first instance district courts rose by 68,9% between the first quarters of 2011 and 2014. To be specific, the closure of insolvency cases increased by 90,9% during the same period.

At the social level, and apart from an increase in unemployment, **there is a growing lack of protection for the unemployed and other more vulnerable sectors of the population, as well as growing income inequality and an increase in emigration.** According to Pordata, the percentage of beneficiaries of unemployment benefits out of the total number of unemployed registered with job centres and vocational training centres in Portugal went from 62 to 58,2% (including the unemployment social subsidy and unemployment subsidy itself) between 2011 and 2013. The erosion of social protection coverage herein illustrated is also visible in other social benefits, whether wide reaching benefits, such as the family benefit, or benefits targeting specific age or social

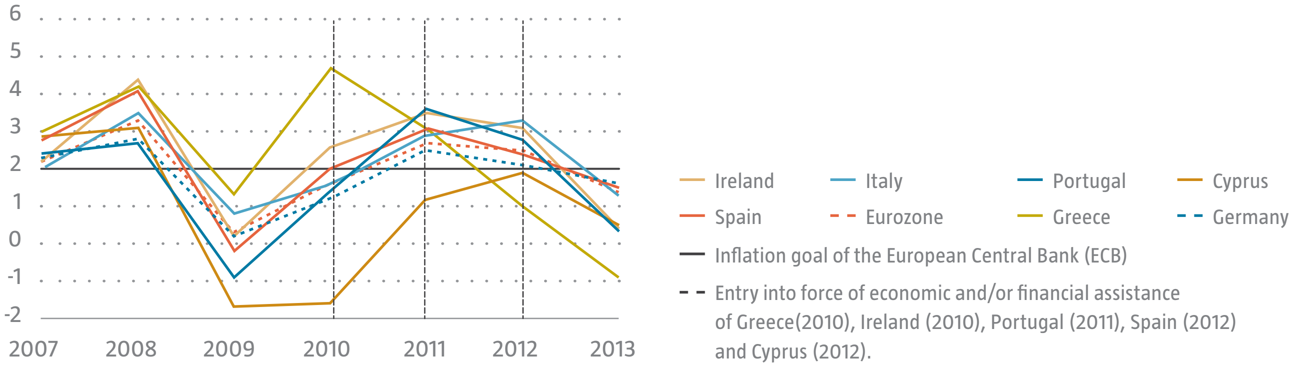
BOX Nº4 THE ECONOMIC AND SOCIAL CONSEQUENCES OF PORTUGUESE ADJUSTMENT (CONTINUATION)

groups or even monetary poverty, such as the complimentary allowance for the aged and the social insertion benefit. The number of people benefiting from the family allowance fell by 9% between 2011 and 2013 and old-age benefits fell by 4%, whereas the social insertion benefit declined by 20% during the same period. In terms of income inequality, as measured by the Gini index, increased in the first two years of the EFAP, and according to Eurostat, the coefficient rose from 33,7 in 2010 to 34,5 in 2012, breaking the declining trend observed since 2005. Lastly, according to the INE, having Portugal become once again a country of emigrants in 2010 and the number of permanent emigrants doubled in the following year, emigration has continued to rise, with a growth of 18% between 2011 and 2012.

Despite the positive results obtained with the Economic and Financial Assistance Programme (EFAP), namely a return to capital market funding at accessible interest rates, the initial rebalancing of the current account and the apparently positve impact of structural reforms on the productivity of the national economy, as indicated in a recent OECD report, **the way in which the national economic and social situation has evolved since the EFAP was adopted raises doubts about the success of Portuguese adjustment.** Both the decline in investment and the increase in long-term unemployment, observed during the period in which the EFAP was in force, raise doubts in this regard They negatively affect the capacity of the Portuguese economy to regenerate over time, which in turn raises doubts about sustainable growth in the country. The continued increase in public debt, as well as the difficulty in reducing budget deficits and the still fragile external balance tends to add weight to these concerns.

Faced with this situation, **a question springs to mind: at what cost and for how long will the country continue to carry out the present economic adjustment to correct the imbalances identified at national and European levels? The debate on EMU deepening and the Eurozone,** including the prevention and resolution of imbalances, **highlights the need of promoting a European response to this situation. Considering the origins of these imbalances are European and national, a common coordinated approach should be devised and deployed to correct them.** Having said this, it remains to be seen whether this approach will develop in time to reduce social and economic costs incurred as a result of the asymmetric adjustment adopted by deficit Member States, including Portugal, and support the actual adjustment process, namely the structural reforms to be adopted in this context.

GRAPH Nº11 FLUCTUATIONS IN INFLATION (AVERAGE ANNUAL FLUCTUATING RATE) IN THE DEFICIT COUNTRIES, OF THE 'WEAK EURO' OR THE 'GRECO-LATIN' GROUP SINCE 2007, COMPARED TO THE EURO AVERAGE AND GERMANY (Source: Eurostat)

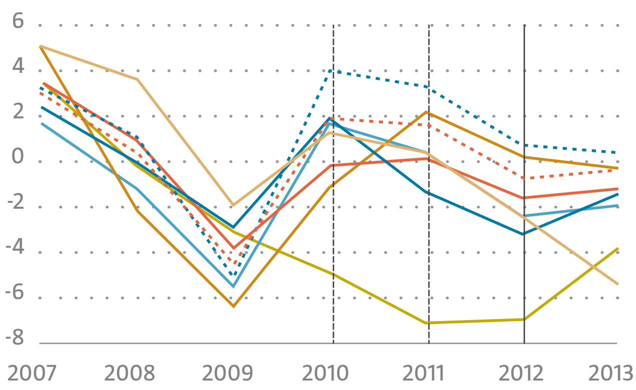


Faced with a risk of deflation at the European level, it is imperative that inflation in the Eurozone be realigned with the goal established by the ECB – an approved inflation rate measured by the Harmonised Consumer Price Index (HCPI) at a level inferior, but close, to 2% in the medium-term. To this end, the ECB announced in June 2014 a series of measures to combat risks of deflation and economic stagnation, combining, among other aspects, a reduction in reference and deposit rates with a new programme for granting long-term credit to banks in the Eurozone and an end to the sterilisation of debt bonds acquired in 2011 and 2012. [56]
It remains to be seen whether these measures will be sufficient.

Another important risk that bears mentioning in this context is the possibility of prolonging the relative impoverishment resulting from the adjustment underway at the European level and, therefore, aggravating economic differences between the Eurozone countries.
For Bento, depending on the social and political costs they entail, economic differences in the Eurozone may *"sooner or later put at risk once more the social and political sustainability (of 'weak euro' or Greco-Latin group countries) in the Eurozone."* [57]
Faced with this prospect, the various economic differences between the EU Member States and the Eurozone in particular, should be borne in mind. Maria João Rodrigues (Professor at the Free University of Brussels and MEP for the Portuguese Socialist Party), distinguishes structural differences of competitiveness and cyclical character, to which must also be added fiscal and financial differences.[58]

Structural differences are the result of different economic specialisation standards, which expose Member States to adverse asymmetric shocks. The Eurozone countries in particular are exposed to these differences, evident in the different rates of economic growth and unemployment observed at the European level (see Graphs nºs 12 and 13).
Outside the Eurozone, these differences can be reduced through exchange, monetary or fiscal policies, while inside the Eurozone only fiscal policies can be used, whose room for manoeuvre, moreover, apart from varying according to the case, has on the whole been reduced with the adoption of a fiscal consolidation policy in response to the crisis.

GRAPH Nº12 ANNUAL GROWTH RATE OF REAL GDP IN THE DEFICIT COUNTRIES, OF THE 'WEAK EURO' OR THE 'GRECO-LATIN' GROUP, SINCE 2007, BY COMPARING THE EURO AVERAGE AND GERMANY (Source: Eurostat)

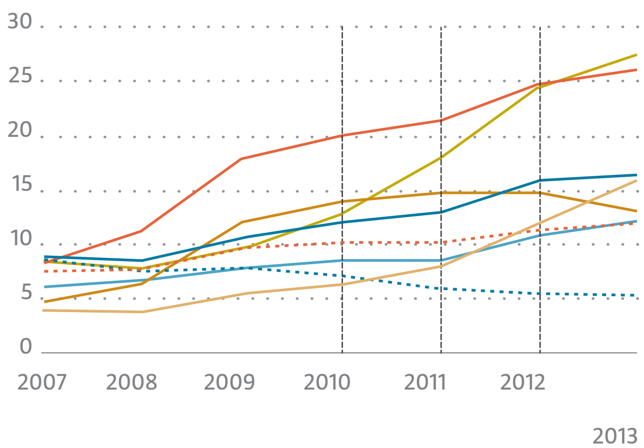


Ireland — Italy — Portugal — Cyprus
Spain — Eurozone — Greece — Germany

- - Entry into force of Economic and/or Financial Assistance Programmes for Greece(2010), Ireland (2010), Portugal (2011), Spain (2012) and Cyprus (2012)

— Partial restructuring Greece's public debt (2012) and statement from the President of the European Central Bank (ECB) Mario Draghi in defence of the euro (2012)

GRÁFICO Nº13 ANNUAL UNEMPLOYMENT RATE IN THE DEFICIT COUNTRIES OF THE 'WEAK EURO' OR THE 'GRECO-LATIN' GROUP SINCE 2007, BY COMPARING THE EURO AND GERMANY AVERAGE (Source: Eurostat)



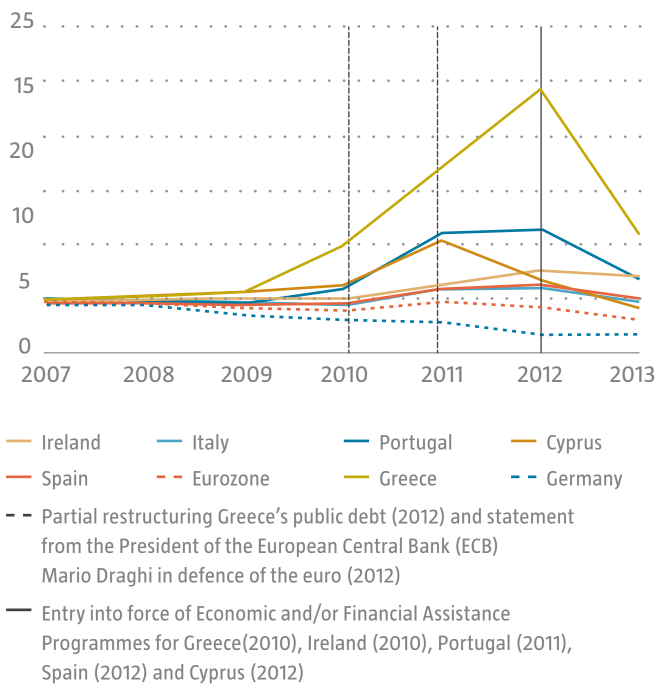
Ireland — Italy — Portugal — Cyprus
Spain — Eurozone — Greece — Germany

- - Entry into force of Economic and/or Financial Assistance Programmes for Greece (2010), Ireland (2010), Portugal (2011), Spain (2012) and Cyprus (2012)

In this context, **Eurozone countries remain exposed to asymmetrical adverse shocks and have limited – in certain cases insufficient – room for fiscal manoeuvre to avoid high economic and social impacts when macroeconomic adjustments are adopted.** It is in this sense that proposals have been put forward at the European level, in the context of debate on EMU deepening, to improve the coordination of fiscal policies of the Member States and/or create common instruments for macroeconomic stabilisation.

Differences in competitiveness are associated with a multiplicity of factors, such as the business environment, the labour market, social protection, education and the innovation systems of countries. **To reduce these differences and adopt a sustainable growth model, able to confront the challenges of the global economy, Member States must adopt structural reforms and attract investment.** However, it so happens that **the differences in competitiveness have been increasing for some time**, either due to a lack of investment, or to a lack of coordination in adopting reforms among Member States or, more recently, as a result of growing financial differences (arising from the serious situation of financial instability in the Eurozone, namely in terms of the cost of access to credit) (see Graphs nºs 13 and 14).

GRAPH Nº14: ANNUAL CHANGES TO RETURNS ON THE EURO BONDS OF DEFICIT COUNTRIES, IN THE "WEAK EURO" OR "GREEK-LATIN" GROUP FROM 2007, COMPARED WITH THE EURO AND GERMAN AVERAGES



The crisis worsened this situation. It constrained the fiscal capacity of the EU Member States and, in particular, those having adopted adjustment programmes in the Eurozone, **giving rise to a discussion on what measures should be adopted to help reduce these differences.** For example: developing the fiscal capacity of the EU and/or the Eurozone with a view to supporting structural reforms and investment; increasing coordination of fiscal and economic policies, including coordination in adopting structural reforms; and, creating a banking union, in order to halt the breakup of the European financial market and therefore re-establishing conditions of equality in credit access.

Cyclical differences, specific to the Eurozone, **arise from the combination of different labour costs and inflation rates with a common monetary policy**, resulting in turn in multiple interest rates at the national level. **The ECB has been managing these differences, but, in principle, this could be improved through better coordination of the Eurozone country economic policies** and wage policies in particular.

Faced with these challenges, **many academics, economists and even the EU institutions themselves**, including the EU Member States, **have recognised the importance of further developing the institutional architecture of EMU**, providing it with institutions and instruments adequate at political, fiscal, economic, financial and also social levels, as illustrated by the aforementioned proposals.
According to the Portuguese academic and MEP, Rodrigues, **if the deficiencies of the EMU are not resolved, the following sequence of events could take place:** [59]

- **In the more vulnerable Eurozone countries:** a considerable reduction in wages, beginning with social benefits, followed by a significant loss of jobs, leading to a recessive spiral, an increase in emigration and losses of human capital, diminished potential for GDP growth and an increase in the debt/GDP ratio and the erosion of democratic regimes.
- **In the remaining Eurozone countries:** an increase in pressure on social norms; risk of social dumping; and a reduction in export opportunities.
- **In the EU as a whole:** the erosion of existing social instruments; a reduction of domestic demand; a reduction of the internal market; systemic pressure in the sense of a lower growth level or a recession; and the loss of political legitimacy.

In this context, the multiple measures considered currently within the context of the debate on EMU deepening should be given careful thought, so as to avoid such occurances.

Whatever the case, Rodrigues argues **that Member States should decide on what type of project they want to build:** [60]

- **A Eurozone of internal divergences**, including sharp contrasts in terms of wages, welfare payments, unemployment rates and emigration; or,
- **A Eurozone of internal convergences**, with more coordination of reforms and investments, and upward trends in growth, employment, inclusion and social sustainability.

Commitments and sanctions concerning fiscal excesses and macroeconomic imbalances supervision and correction

To ensure that assumed EU commitments are met at the European level in terms of fiscal excesses and macro economic imbalances supervision and correction, the Government must:

- **Within the EDP framework**, submit regular reports on the process of reducing budget deficit, as well as a programme for economic partnership with specific measures to correct this.
- **Within the MIP**, submit a plan of corrective measures, should the Council approve the opening of an Excessive Debt Procedure.
- **Within the framework of the European Semester**, submit annually a Stability Programme (medium-term budgetary plan), or its revision, as well as Draft Budgetary Plan for the following year (short-term fiscal plan), accompanied with the corresponding macroeconomic framework.
- **Within the framework of the TSCG**, inform the Eurogroup and the European Commission in advance of plans to issue public debt.

By regularly submitting these documents to the European institutions, the Government is demonstrating to the EU how it intends to achieve its objectives in line with the supervision and correction of fiscal excesses and macroeconomic imbalances – common structures to which it adhered.

If the Government neither submits, nor pursues, plans to correct the defects identified within the framework of the EDP and the Procedure for Excessive Imbalance, the Portuguese State runs the risk of being sanctioned by the EU, under a system that is today quite strong and differentiated, with strict rules and a gradual application in the case of the Eurozone.[61]

Said system of sanctions still foresees situations of exception, in which deviating from the objectives agreed under the preventative and corrective arms of the SGP and the Fiscal Compact is allowed:

- **On the preventative side**, the European framework accepts three situations of exception:
  - a major economic recession in Portugal, in the Eurozone or throughout the EU;
  - natural disasters or other exceptional situations with a considerable fiscal impact; and
  - structural reforms that have a positive impact on long-term economic activity.[62]
- **On the corrective side**, the European framework contemplates timeline extensions to correct excessive deficits in two instances:
  - if the Council determines that unforeseen economic events have occurred with a significant negative impact on the forecasts that justified the respective EDP; and,
  - in the case of a serious economic recession affecting the Eurozone and the whole of the EU.[63]

It remains to be seen to what extent the new rules for European economic governance will be applied, particularly bearing in mind that no Member State of the EU has yet been the target of sanctions under the SGP or the MIP.

At the end of the day, the efficiency of the system for supervising and correcting fiscal excesses and macroeconomic imbalances, of which the EU sanctions system is a part, **depends on how well the European Semester functions**, including the supervision and coordination of fiscal and economic policies, the efficiency of which will depend, in turn, on the extent to which Member States accept and adhere to the European Semester at the national level.

2.2. *Supervision and coordination of economic policies*

The economic policies of the EU Member States are assumed as a question of common interest in article 121 of the Treaty on the Functioning of the European Union (TFEU), the coordination of which, indicated in the Treaty itself, should be conducted at the Council level. [64]

The coordination of EU Member State economic policies is not only an important element for the EMU and the Eurozone to function well – in that it contributes towards European economic convergence –, **but it is also an indispensable instrument for promoting European economic growth and the relationship of the EU with globalisation.**

Adopted in June 2010, **the Europe 2020 strategy for intelligent, sustainable and inclusive growth** informs the coordination of EU Member State economic policies up to 2020. **The Portuguese State** – as other EU Member States – **has undertook to support the objectives of this strategy at the national level through National Reform Programmes** (structural reform plans), renewed annually, in line with the General Guidelines of the EU's Economic Policy, and with the economic priorities of the EU outlined at the start of each European Semester in an Annual Growth Survey (AGS) (see Table nº4). [65]

The objectives adopted within the context of the Europe 2020 strategy are varied and their implementation – unlike what happens within the framework for preventing and correcting fiscal excesses and macroeconomic imbalances in the EU Member States – **depends essentially on political incentives** (recommendations, control and mutual pressures).

Portugal receives specific recommendations from the European institutions on the reforms it needs to adopt to achieve its objectives, and it is then up to Portugal to decide whether, and how, it will adopt them, with greater or lesser control and political pressure from the institutions and the EU Member States. [66]

The European Structural and Investment Funds (ESIF) attributed to Portugal for the period 2014-2020, provide financial support to the country under strict conditions, in line with the Europe 2020 objectives. The distribution of this support is currently defined in the Partnership Agreement established between the Government and the European Commission in July 2014 (see Box nº5).

TABLE Nº4: PORTUGAL AND EUROPA 2020 STRATEGY GOALS (Source: European Commission)

OBJECTIVE	INDICATORS	2013	GOAL PT 2020
STEPPING UP R&D AND INNOVATION	Investment in R&D in % of GDP	1,5%	Between 2,7 and 3,3%
MORE AND BETTER EDUCATION	Early drop-out rate from education and training in the 18-24 year old population	19,2%	10%
	% of qualified school leavers between 30 and 34 years of age who have completed Higher Education or the equivalent	29,2%	40%
CLIMATE/ENERGY	Energy Efficiency (% gain in primary energy consumption compared to 2005)	24,6%	20%
	% renewable energies in final energy consumption	24,6%	31%
	Green House Gas Emissions (% variation compared to 2005 in non-EU ETS emissions)	-12%	1%
INCREASING EMPLOYMENT	Employment rate (population 20-64 years old)	65,6%	75%
OVERCOMING POVERTY AND SOCIAL INEQUALITY	Persons at risk of poverty/social exclusion (difference compared to 2008)	-92mil	-200mil

BOX Nº5 PORTUGAL AND EUROPEAN STRUCTURAL AND INVESTMENT FUNDS (ESIF)

Source: GOVERNMENT OF PORTUGAL, *Partnership Agreement 2014-2020*. July 2014.

In July 2014 Portugal concluded negotiations for a Partnership Agreement with the European Commission for the application of 25.6 thousand million euro, attributed under European Structural and Investment Funds (ESIF) for the period 2014-2020. The Partnership Agreement sets out a path to economic growth and employment in Portugal, in which 7 conditioning factors are identified:

- external imbalances;
- restrictions to funding the economy;
- restrictions arising from the consolidation of public accounts;
- unemployment and social exclusion;
- the challenge of demographic change;
- territorial imbalances and potentials; and
- commitments assumed under the National Reforms Programme for Portugal and the Europa 2020 Strategy.

The Partnership Agreement is implemented according to four thematic areas and two transversal dimensions:

- competitiveness and globalisation of the economy;
- investment in human capital;
- social inclusion and employment; and
- sustainability and efficiency in the use of resources

As well as:

- the reduction of regional imbalances, taking into consideration specific regional potentials, and
- promoting a more effective and efficient public administration, the first four themed areas coordinating with the last two transversal fields.

The Euro Plus Pact and the TSCG – adopted respectively in 2011 and 2012 – **brought new impetus to the system of coordination and surveillance of EU Member State economic policies in response to the Euro crisis**, and identified specific objectives to help the EMU and the Eurozone function well. **Neither the Pact nor the TSCG changed the essence of the way the system functions**, including incentive structures. Today, such limitations still make it difficult for the EU to promote the adoption of structural reforms necessary for European economic convergence and the correct functioning of EMU and the Eurozone.

In this context, **the Government is responsible for:**

- **Within the framework of the European Semester**, submitting annually to the Council and to the European Commission a National Reforms Programme, or its annually revised version.
- **Within the framework of the Euro Plus Pact**, submitting annually to the highest political level specific measures to be implemented using national competencies, with a view to achieving the objectives agreed in this inter-governmental context:
  - to promote competitiveness,
  - create employment incentives,
  - contribute towards the sustainability of public finances and
  - reinforce financial stability. Measures contemplated in this context should fall within the framework of the National Reform Programmes and the Stability Programmes, guaranteeing thus their coordination and regular surveillance under the European Semester.
- **Within the framework of the TSCG**, apart from adopting measures to guarantee that the EMU and Eurozone function well, including the objectives covered in the Euro Plus Pact, ensuring the debate and, when appropriate, coordination of the significant economic policy reforms it intends to pursue.

The greater room for manoeuvre that EU Member States enjoy in the context of the surveillance and coordination of economic policies, as compared to the surveillance and coordination of fiscal policies, illustrates the asymmetrical nature of the current framework for European economic governance. The institutional balance corresponding to this framework makes it difficult to promote EU objectives on convergence and economic growth, in part because it does not consider incentives aimed at ensuring the adequate coordination of national economic policies, nor does it sufficiently integrate dimensions essential for achieving sustainable and qualitative growth, such as, the environment, employment, poverty and social exclusion, health and the living conditions of citizens. [67]

To even out the composition of the European economic governance framework and ensure it functions correctly, **many proposals have been made**, including initiatives such as reinforcing the powers of the European Commission, creating instruments to support the adoption and coordination of structural reforms, increasing the EU's fiscal capacity and/or that of the Eurozone, and revising the instruments used for the surveillance and coordination of economic policies with a view to reflecting a growth strategy that is wider reaching and more solid in key areas such as the environment and social cohesion.

In the current context of crisis and fiscal consolidation wherein the more vulnerable Member States have a limited margin to fund the implementation of programmes and projects aimed at helping one meet the Europe 2020 strategy objectives, **increasing the EU's fiscal capacity, and the development of alternative solutions, have gained particular relevance. Similarly, the social impact of the crisis and the asymmetrical, simultaneous adjustment in progress at the European level has increased attention over the importance of developing the social dimension of EMU.** Taking into account the limitations of the current framework for European economic governance, these initiatives will be examined in the second part of this document.

14. See for example BERTONCINI, Yves "Zone Euro et démocratie(s): Un débat en trompe l'oeil," *Notre Europe Policy Brief*. Paris : Notre Europe. 18 July 2013; and FERNANDES, Sofia, "Who calls the shots in the euro area: "Brussels" or the Member States?," *Notre Europe Policy Paper*. Paris : Notre Europe. 15 May 2014.
15. In transposing the Budget Pact at European level, as at national level, see the study done by the German Council of Economic Experts, as well as the reports of the Conselho de Finanças Públicas on the seventh and eighth amendments to the Framework Law on the Budget and amendments to that same law, see: BURRET, Heiko T. and SCHNELLENBACH, Jan, *Implementation of the Fiscal Compact in the Euro Area Member States: Expertise on behalf of the German Council of Economic Experts*. November 2013; CONSELHO DAS FINANÇAS PÚBLICAS, "Sétima alteração à Lei de Enquadramento Orçamental: Proposta de Lei nº124/XII," *Parecer do Conselho das Finanças Públicas*. nº1/2013. 22 February 2013; CONSELHO DAS FINANÇAS PÚBLICAS, "Oitava alteração à Lei de Enquadramento Orçamental (LEO): Draft Bill nº550/XII," *Parecer do CFP*. nº1/2014. April 2014; ASSEMBLEIA DA REPÚBLICA, "Lei nº37/2013 de 14 de junho: Procede à sétima alteração à lei de enquadramento orçamental, aprovada pela Lei nº91/2001, de 20 de agosto, e transpõe para a ordem jurídica interna a Diretiva nº2011/85/UE, do Conselho, de 8 de novembro, que estabelece requisitos aplicáveis aos quadros orçamentais dos Estados membros," in *Diário da República*. 1ª Série, nº113, 14 June 2013; and AR, "Lei nº41/2014 de 10 de julho: Oitava alteração à Lei nº91/2011, de 20 de agosto (lei de enquadramento orçamental)," in *Diário da República*. 1ª Série, nº131, 10 July 2014.
16. See EUROPEAN UNION, "EU Regulation nº 1176/2011 of the European Parliament and the Council, of 16 November 2011, on preventing and correcting macroeconomic imbalances," in the *Official Journal of the European Union*. 23 November 2011 (D).
17. Apart from Greece, Portugal is the only country in the Eurozone that has never had a budget deficit below 3% of GDP since the adoption of the Growth and Stability Pact (GSP) in 1997. Portugal was already under an Excessive Deficit Procedure (EDP) between 2005 and 2008, the current EDP having begun in 2009.
18. See COUNCIL OF THE EUROPEAN UNION, *Council Recommendation with a view to bringing an end to the situation of an excessive government deficit in Portugal*. 18 June 2013.
19. See CFP, "Análise do Documento de Estratégia Orçamental 2014-2018," *Relatório do Conselho das Finanças Públicas*. nº3/2014. May 2014, p. 3.
20. For more information on applying the rule of structural deficit, or structural fiscal balance, consult article 12.º-C of Fiscal Framework Law, namely the seventh and eighth amendments to it. Alternatively, consult the summary in the analysis of the Conselho das Finanças Públicas to the same law 2014-2018.
21. The medium term budgetary objective for Portugal is currently set at -0,5% of GDP.
22. For more information on growth rates for public spending and medium term reference to potential GDP growth, see for example: CONSELHO DAS FINANÇAS PÚBLICAS. May 2014, p. 12.
23. The Fiscal Strategy Document replaced the Stability Programme as a medium term budgetary plan during the time the EFAP was in foce at the Government's choice, despite delivery of Stability Programmes, or their annual revision, not being obligatory in the context of economic and financial assistance programmes due to the added coordination and surveillance these programmes assume.
24. According to the Conselho das Finanças Públicas, in confirming the forecasts of the 2014-2018 Fiscal Strategy Document, the substantial reduction planned for the fiscal deficit should lead to a rapid fall in public debt over the 5-year period in question, in this way complying with the transitional rule of reducing public debt in the first three years after the close of the EDP. Maintaining the structural deficit of the MTO after 2008 will then be sufficient to reduce the public debt in excess of 60% of GDP at the rate demanded by European commitments. See CFP. May 2014, p. iii.
25. Despite progress made with the fiscal balance, the public debt ration rose continuously from 2007. According to the Bank of Portugal, the following factors explain this development: deficit-debt adjustments; the impact of issuing contingency capital instruments in the context of the capitalization processes of several national banks; interests costs; and the effects of the primary deficit and the variation in nominal GDP. See BANCO DE PORTUGAL, *Relatório do Conselho de Administração: A Economia Portuguesa*. 2014, pp. 87-88.
26. See CFP. May 2013, p. 15.
27. See MINISTRY OF FINANCE, *Documento de Estratégia Orçamental 2014-2018*. April 2014.
28. *Manifesto dos 74* movement projected the debate on the sustainability of the public debt to the streets and can be consulted online at: http://www.manifesto74.com/.
29. See CABRAL, Ricardo; MAMEDE, Ricardo Paes; PEREIRA, Paulo Trigo and SANTOS, Emanuel, *Um contributo para o Debate Público em torno da Dívida da Pública*. Institute of Public Policy Thomas Jefferson-Correia da Serra (IPP TJ-CS). 5 June 2014.
30. These observations reflect the probability that the conditions provided in the FSD will be in place within a single year, whereas the FSD itself for casts that these conditions will be met within a period of more than a decade.
31. See CABRAL, Ricardo; MAMEDE, Ricardo Paes; PEREIRA, Paulo Trigo and SANTOS, Emanuel. 5 June 2014, p. 11.
32. Referring specifically to debt restructuring, consult, for example: CABRAL, Ricardo; MAMEDE, Ricardo Paes; PEREIRA, Paulo Trigo and SANTOS, Emanuel. 5 June 2014; or CABRAL, Ricardo, LOUÇÃ, Francisco, PIRES, Eugénia and SANTOS, Pedro Nuno, "Um programa sustentável para a reestruturação da dívida portuguesa," *IPP TJ-CS Report*. Institute of Public Policy Thomas Jefferson-Correia da Serra (IPP TJ-CS). Nº1/2014. July 2014.
33. Paulo Trigo Pereira, Ricardo Cabral and Luís Teles Morais clearly illustrate what the burden of interest payments means for the Portuguese State in the medium term in analyzing in another study the 2014-2018 FSD: *"all estimated savings on salaries and intermediate consumption [during the period 2014-2018] (€735.4 million) are consumed with the increased spending on interest (€798.5 milhões) [...] all cuts predicted for this period are consumed by an increase in interest that, if nothing changes in the meantime, will amount to €8 thousand million in 2018."* See PEREIRA, Paulo Trigo; CABRAL, Ricardo and MORAIS, Luís Teles, "Estratégias Orçamentais para Portugal 2014-2020," *IPP TJ-JCS Policy Paper*. Institute of Public Policy Thomas Jefferson-Correia da Serra (IPP TJ-CS). May 2014, p. 18.
34. See CABRAL, Ricardo; MAMEDE, Ricardo Paes; PEREIRA, Paulo Trigo and SANTOS, Emanuel. 5 June 2014, p. 8.

35. Vitor Bento classifies the following EU Member States into 'weak euro' countries: Greece, Portugal, Spain, Ireland and Italy. According to Bento, these are the same countries, with the exception of Italy, that accumulated considerable foreign imbalances during the period the euro has been inforce. Adjusting these countries to the European monetary regime, in the meantime led the Portuguese economist to a second classification, that of the 'weak euro' and 'strong euro', i.e. the 'hard core' and the 'Greco-Latin' group, the latter incorporating the following countries: Greece, Portugal, Spain, Italy and Cyprus. See BENTO, Vitor, "Euro forte, Euro fraco, duas culturas, uma moeda: um convívio (im)possível?", *Bnomics*. March 2013, p. 38 and pp. 58-59.
36. *Idem*, p.162
37. *Ibidem*, pp. 146-147.
38. *Ibidem*, pp. 146-149.
39. See EUROPEAN COMMISSION, *Final Report submitted on 31 March 2014: Conclusions. Report prepared by the group0 of experts on the Debt Repayment Fund and Eurobills, at the request of the European Commission.* 31 March 2014.
40. See BENTO, Vitor. March 2013, p. 148.
41. *Idem*.
42. An in-depth analysis is done to identify the origins of imbalances, including the economic and financial inter-connection between the EU Member States and the impact of the respective economic policies among themselves, to verify whether the imbalances are excessive, and to analyse any relevant developments in the EU's growth and employment strategy, and in economic events in the EU and in the Eurozone.
43. See EUROPEAN UNION. 23 November 2011 (D); MATOS, João Cadetede and OLIVEIRA, Pedro, "Procedimento relativo aos Desequilíbrios Macroeconómicos", presentations prepared for the 11th. Meeting of the Permanent Section for Economic Statistics of the Conselho Superior das Estatísticas, for the interventions of the Director of the Statistics Department of the Bank of Portugal, João Cadete de Matos and the Director of the Department for National Accounts of the National Statistics Institute (INE), Pedro Oliveira on 18 November 2013) and the EUROPEAN COMMISSION, *Statistical Annex of the Alert Mechanism Report 2014*. November 2013.
44. The EDP is activated on a proposal made by the European Commission to the Council when there is a fall in the reference values corresponding to budget deficit and public debt. The Council approves the proposal by inverse qualified majority, i.e. opening an EDP for a particular country in the Eurozone that has ratified the TSCG is considered approved, unless opposed by a qualified majority of Eurozone countries.
45. There are many reasons that led EU Member States to adopt a macroeconomic management architecture that was initially incomplete and they have been repeatedly mentioned in literature on the institutional framework of Economic and Monetary Union. For a European perspective on this, see for exemple: ENDERLEIN, Henrik and RUBIO, Eulalia. 30 April 2014. For a Portuguese perspective on this see, for exemple: MAMEDE, Ricardo Paes; RODRIGUES, João; TELES, Nuno and CABRAL, Ricardo, "Portugal no Contexto Europeu," article prepared for the conference "Economia Portuguesa: Propostas com Futuro" organised by the Calouste Gulbenkian Foundation in LIsbon on 16 February 2013. For other factors that helped develop macroeconomic imbalances in the Eurozone, see for example: TRESSEL, Thierry; WANG, Shengzu; KANG, Joong Shik and SHAMBAUGH, Jay, "Adjustment in Euro Area Deficit Countries: Progress, Challenges and Policies." *IMF Staff Discussion Note*. July 2014.
46. This table is taken from the Alert Mechanism Report 2014, which, although not examining Portugal in detail, includes in attachments data on Portugal, as well as on the remaining 27 EU Member States. The table can be consulted on-line at: http://ec.europa.eu/europe2020/pdf/2014/amr2014_en.pdf. Items identified in red correspond to the categories in which Portugal shows imbalances according to MIP criteria.
47. See for example: SANTOS, Fernando Teixeira dos, "Convergence and Imbalances in the EMU: The case of Portugal," in *Structural Change, Competitiveness and Industrial Policy: Painful Lessons from the European Periphery*. London and New York. 17 June 2014; ALEXANDRE, Fernando *et al., A Economia Portuguesa na União Europeia: 1986-2010*. Coimbra : Conjuntura Actual Editora. March 2014; ABREU, Alexandre *et al., A Crise, A Troika e as Alternativas Urgentes*. Lisboa : Tinta-da-China. October 2013; and, MAMEDE, Ricardo Paes, RODRIGUES, João, TELES, Nuno and CABRAL, Ricardo. 16 February 2013.
48. See ALEXANDRE, Fernando and BAÇÃO, Pedro, "A história de uma economia desequilibrada," in *A Economia Portuguesa na União Europeia: 1986-2010*. Coimbra : Conjuntura Actual Editora. March 2014, pp. 84-94.
49. *Idem*, p. 84.
50. *Ibidem*, pp. 77-79 and 98-101.
51. See CABRAL, Ricardo, LOUÇÃ, Francisco, PIRES, Eugénia and SANTOS, Pedro Nuno. July 2014, p.14.
52. See BENTO, Vitor. March 2013, p. 150.
53. *Idem*, p.150.
54. A recent discussion paper from the International Monetary Fund on the adjustment underway in the deficit countries in the Eurozone, i.e. Portugal, Greece, Spain and Ireland, seems to corroborate this opinion in analysing the projections of the World Economic Outlook for the development of the potential for product and unemployment in several countries. The projections for the deficit countries in the Eurozone in terms of potential for product suggests weak growth in all cases, with the exception of Ireland. The unemployment rate, on the other hand, despite improvements will take some time to fall. In fact, although a reduction in unemployment is foreseen in the case of Portugal, in the medium term the improvement is not likely to be substantial. See TRESSEL, Thierry; WANG, Shengzu; KANG, Joong Shik and SHAMBAUGH, Jay. July 2014, pp. 21-22.
55. See BENTO, Vitor. March 2013, p. 151.
56. See EUROPEAN CENTRAL BANK. 5 June 2014.
57. See BENTO, Vitor. March 2013, p. 146.
58. See RODRIGUES, Maria João, "Youth Unemployment, Socio-Economic Divergences and Fiscal Capacity in the Euro Area," *Notre Europe Policy Paper.* Paris : Notre Europe. November 2013, pp. 3-4.
59. See RODRIGUES, Maria João. November 2013, p. 4.
60. *Idem*, p.6.
61. The Council's regime for voting on sanctions was one of the main aspects of the EU sanctions system consolidated with the reform to European economic governance introduced at the start of the crisis. In the case of the Eurozone countries, sanctions may now only be rejected under the preventative arm of the SGP with an inverse qualified majority. The same voting regime is applied to all EU Member States under the corrective arm of the SGP, as well as to all Eurozone countries in the context of an MIP. Furthermore, due to the TSCG, opening an EDP in the Eurozone is now also by inverse qualified majority, contrary to the MIP, which continues to be activated by a qualified majority. For sanctions attributed under the SGP and the MIP, consult respectively: EUROPEAN UNION, "EU Regulation Nº 1173/2011 of the European Parliament and the Council, 16 November 2011, on the effective implmentation of fical supervision in the euro área," in the *Official Journal of the European Union.* 23 November 2011 (B); and, EUROPEAN UNION (23 November 2011) (D). Alternatively, consult for a wider approach, FERNANDES, Sofia. 15 May 2014.
62. Should any of the situations identified occur, the convergence curve should be corrected, at a maximum, in the four subsequent fiscal years. See article 72.º-D of Fiscal Framework Law available for consultation at ASSEMBLEIA DA REPÚBLICA. 14 June 2013.
63. See nº5 of article 3º of EC Regulation nº 1467/97, amended by EU Regulation n° 1177/2011, in European Union, "EU Regulation nº1177/2011 of Council, 8 November 2011, that amends EC Regulation nº1467/97 on the acceleration and clarification procedure for excessive devices," in *Official Journal of the European Union.* 23 November 2011 (E).
64. See EUROPEAN UNION. 26 October 2012.
65. The EU's economic priorities identified within the context of the AGS remain unchanged since 2012, including: (i) pursuing country-specific fiscal consolidation to promote growth; (ii) restore credit facility to the economy; (iii) promote growth and competitiveness in the present and in the future; (iv) avoid poverty and the soial consequences of the crisis; and (v) modernize public administration.
66. Should it be found that the country-specific recommendations proposed for Portugal are not duly adopted, the European Commission may issue a warning, in this way bringing pressure to bear on the Government, although sanctions may also be proposed to the Council.
67. See SABATO, Sebastiano; NATALI, David and BARBIER, Cécile, "A Model for Implementing Sustainable and Qualitative Growth in the EU", *Wilfred Martens Centre for European Studies and European Social Observatory Collaborative Research Paper.* February 2014.

3. Creating a European Banking Union

Promoting financial stability has been seen from the start as an essential component of the EU's response to the crisis, which, as the situation worsened, brought about the decision in June 2012 to create a banking union.

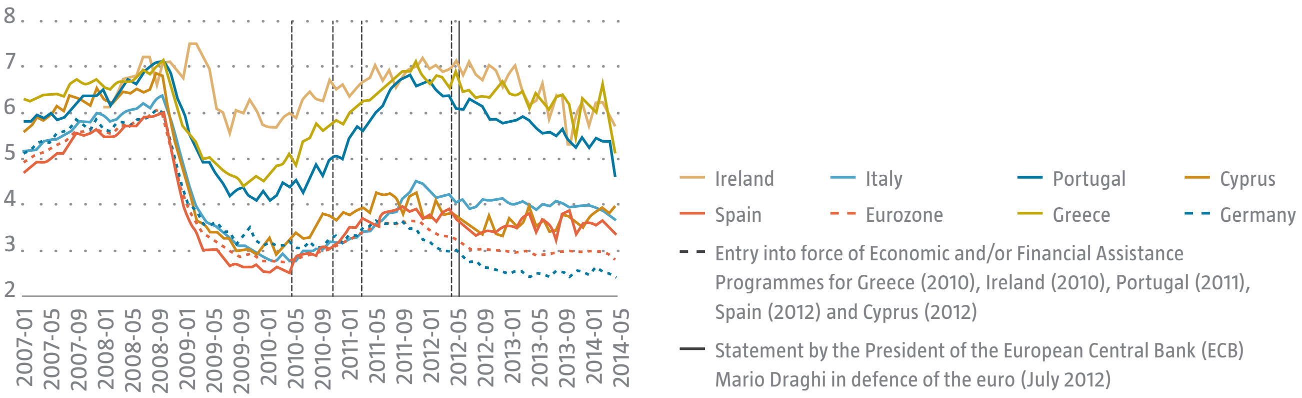
The European Banking Union (EBU), currently under development, aims at establishing a common institutional framework that will lead to a consistent, coherent and effective response to serious situations of financial instability that threaten the Eurozone. EBU will therefore contribute towards reverting the break up of the European financial markets and the consequent reduction in financial gaps, whether in rates of return on the euro bonds of the Eurozone countries, or the interest rates applied by financial monetary institutions (credit and other institutions) to deposits and loans to individuals and non-financial companies since 2007 (Graphs nºs 14 and 15).

Currently, the EBU is in the form of a hybrid system and its functions are shared between the competent European and national authorities based on a Single Rulebook prepared by the European Banking Authority (EBA). [68]

EBU development is based on three pillars:

- *Single Supervisory Mechanism,* SSM;
- *Single Resolution Mechanism,* SRM; and
- *Single Deposit Guarantee Scheme,* SDGS.

GRAPH Nº15: CHANGES IN INTEREST RATES APPLIED BY THE FINANCIAL MONETARY INSTITUTIONS IN THE EUROZONE TO INDIVIDUAL AND NON-FINANCIAL COMPANY DEPOSITS AND LOANS, BETWEEN 2007 AND 2014 (Source: BCE)



3.1. *Single Supervisory Mechanism*

The Single Supervisory Mechanism, SSM, adopted in October 2013, gives the European Central Bank (ECB) responsibility for the prudential supervision of credit institutions and investment companies in the Eurozone, as well as other EU Member States that have joined the EBU. Its tasks are nonetheless between European and national supervisory authorities. [69] With the SSM, the ECB becomes directly responsible for supervising institutions classified as being significant, that is close to 130 of the approximately 6.000 banks covered by the EBU, whereas national supervisory authorities become directly responsible for the remaining institutions, under a common framework and in line with general instructions defined by the ECB. [70] The ECB may, furthermore, take up the supervision of any bank that falls under the EBU, creating thus a mixed system, in which the European and national authorities are called upon to act in coordination.

The ECB only fully assumes its supervisory duties in November 2014, by which time the results of the comprehensive assessment, carried out by the ECB itself, in collaboration with the national authorities, to credit institutions and investment companies, should be known.

If the assessment exercise begun in November 2013 is successful, the results should help to improve the quality of information on the state of the institutions assessed, identify and implement corrective measures when and where necessary and assure all relevant parties that the institutions assessed are solid and reliable. **The results of the assessment will be determining in the short term** for resolution operations in situations of financial instability that threaten the Eurozone, **in that they will serve as the basis for operations to be implemented at the national level. In the medium and long term, both the success, and limitations revealed in this assessment exercise, will cement the reputation of the ECB as a supervisor and the SSM as a European instrument for preventing serious situations of financial instability**, with a likely impact on the confidence of economic and financial agents in the banking sectors that make up the EBU.

According to the Bank of Portugal, four national banks are being subjected to this supervisory exercise – Banco BPI, Banco Comercial Português (BCP), Banco Espírito Santo (BES) and the Caixa Geral de Depósitos (CGD).[71] [72]

An efficient SSM would lead to closer and more impartial supervision of credit institutions and investment companies. This would help limit the ability of sovereign states and banks to mutually influence one another. Credit institutions and investment companies in the EBU would be assessed more for their own financial position than on the financial stability of the sovereign state in which hey reside.

By weakening thus the link between banks and sovereign states, **the SSM would help to re-establish a certain equality of conditions between credit institutions and investment companies within the EBU**, contributing in turn to reverting the breakup of European financial markets and recovering financial stability in the Eurozone.

Harmonising regulatory practices and promoting better co-ordination between the supervisory authorities of Member States, would be of particular assistance, and would also have positive effects on credit institutions acting across borders.

3.2. *Single Resolution Mechanism*

The Single Resolution Mechanism (SRM), agreed provisionally between the European Parliament and the Council in March 2014, **is composed of three elements: a common legal framework; a mixed institutional system; and, a common resolution fund.**

The **common legal framework** is based on the Bank Recovery and Resolution Directive, BRRD, the content of which should be developed by the European Parliament and Council Regulation on SRM in order to ensure that EBU rules are harmonised.[73] The **mixed institutional system** involves two components, the functions of which should work in coordination:

- at the European level, there is a plan to establish a centralised decision-making process to deal with resolution, which will have a Single Resolution Board, SRB, in which the European Commission and the Council will participate in exceptional situations;
- while at the national level the competent authorities in the EBU Member States will intervene.

In this context, the SRB will become responsible for managing resolution operations organised within the context of EBU.

The SRB will conduct this task directly with the institutions under the direct supervision of the ECB or involved in cross-border trading, including those for which the ECB claimed the right of supervision; while the national authorities will deal directly with other institutions or cross-border groups, whenever the resolution plan does not foresee the use of the common resolution fund, known as the Single Resolution Fund, SRF.

The SRF, the funding instrument used to carry out resolution measures, the gradual establishment of which was defined in an inter-governmental agreement on the transfer and sharing of contributions to the actual fund, will begin completing this framework from January 2016. In the meantime, a yet to be defined credit line must be made available to ensure the SRM's resolution capacity.[74]

Some aspects of the SRM – refering to the creaton of SRB and how it will function and cooperate with the national authorities in preparing resolution plans – **will come into force from January 2015. Others aspects will only come into operation in January 2016.**

As a result, and although the European resolution scheme comes into force at the start of 2015 at the same time as the BRRD, **resolution operations begun in the meantime will be conducted only at the national level.**[75] **Another central dimension of the SRM that will only take effect from January 2016, is the bail-in process**, considered for the first time within the framework of the SRM as an integral part of resolution operations.[76]

Once in operation, the SRM will function as the EBU's crisis management mechanism. **Once the SRM and associated legislation are in force, resolution rules and practices will be harmonised, contributing gradually to levelling the conditions for credit institutions and investment companies existing within the context of the EBU**, including cross-border groups.

Creating and running the SRB and the SRF should contribute towards this effect, providing that in the meantime no entities require a bail-out, whose funding requirementes exceed funds made available by the credit institutions themselves and by the SRF, and therefore requiring the intervention of the corresponding sovereign states.

In this case, the contribution made by the SRM towards financial stability in the Eurozone and above all to weakening the association between banking sectors and sovereign states will be less effective. Such a resolution could even have a negative impact on the public finances and even the taxpayers of the sovereign states called on to support the institutions in question.

Bearing in mind the operational schedules of both the SRM, and the SRF, and setting aside the arguably limited funding allocated to the SRF, **only in the long term will the SRM be able to perform its functions fully**, i.e. help to maintain better financial stability, at the lowest possible cost to taxpayers, whenever it becomes necessary to guide a credit institution or investment company with serious financial imbalances towards a resolution process. [77]

3.3. *Single Deposit Guarantee Scheme*

The third and last pillar planned for the EBU is the Single Deposit Guarantee Scheme, SDGS.

The EU, its institutions and Member States have not yet reached an agreement on this issue, but they have already taken the first step towards it in adopting an initiative to harmonise the rules on the deposit guarantee provided at the national level, the Directive on deposit guarantee schemes.[78] The European framework established for this provides that:

- up to €100,000 guaranteed per depositor and per bank;
- there should be faster payment of deposits (to be done within 7 working days instead of 20);
- and deposit guarantee schemes are assured by setting up a deposit guarantee fund, composed of contributions from the banks, the total of which should amount to 0,8% of deposits covered over a period of ten years.
- should these funds prove to be insufficient in the resolution of a credit institution, additional contributions will be collected from the banking sector.
- in the last instance, the deposit guarantee scheme will have access to alternative methods of funding, such as public and private loans or loans between deposit guarantee schemes.

Harmonisation of the deposit guarantee schemes will contribute, together with the SSM and the SRM, **to equalising existing conditions for credit institutions and investment companies and, also, to reversing the breakup of the European financial market.**

But as long as there are substantial differences between the Member States of the EBU – whether in terms of standards, or level of practices, that lead to the life or death of credit institutions and investment companies, or even in relation to the financial capacity of resolution funds and deposit guarantees – **the potential for contagion among sovereign states and the corresponding banking sectors will persist, eluding the correction of one of the principal sources of financial instability seen during the crisis in the Eurozone.**

68. The European Banking Authority (EBA) was given the task of preparing a Single Rulebook whose compliance reflects the consistent application of the Capital Requirements Directive and Regulation at the European level (Capital Requirements Directive, CRD IV, and Capital Requirements Regulation, CRR). See EU, "Directive 2013/36/EU of the European Parliament and the Council, of 26 June 2013, on access to the work of credit institutions and cautious supervision of credit institutions and investment companies, that amends Directive 2002/87/EC and revokes Directives 2006/48/EC and 2006/49/EC," in the *Official Journal of the European Union*. 27 June 2013 (A); and EU, "EU Regulation nº 575/2013 of the European Parliament and the Council, of 26 June 2013, on prudential requirements for credit institutions and investment companies that amends EU Regulation nº 648/2012," in *Official Journal of the European Union*. 27 June 2013 (B).

69. See EUROPEAN UNION, "EU Regulation nº 1024/2013 of the Council, 15 October 2013, that gives the ECB specific attributions in regard to policies on the prudential supervision of credit institutions," in *Official Journal of the European Union.* 29 October 2013.

70. The EBU banks considered significant are those with a balance exceeding €30 thousand million, account for 20 % of the country's GDP or benefit from European assistance.

71. See COSTA, Carlos da Silva, "A criação da União Bancária Europeia e o sistema bancário português," paper prepared for the presentation of the Governor of the Bank of Portugal, Carlos da Silva Costa, in São Paulo on 28 April 2014, p. 20.

72. The Banco Espírito Santo (BES) was recently the target of national intervention, and was divided into two parts, the Novo Banco and BES.

73. See EUROPEAN PARLIAMENT, *Parliament negotiators rescue seriously damaged bank resolution system*. 20 March 2014.

74. The Single Resolution Fund will be composed initially of national compartments, the contents of which will consist of contributions paid regularly by credit institutions authorised in each Member State. The mutualisation of national compartments, with a view to creating an authentic common resolution fund, should be done over an eight-year period, beginning on 1 January 2016, to reach a total of 55.000 million in 2024. According to the intergovernmental agreements that governs the establishment Single Resolution Fund, SRF, the rate of fund neutralisation will be the following: 40% of funds contributed should be shared after the 1st year in which the SRF is in operation, and 60% of funds contributed should be shared after the 3rd year. See COUNCIL OF THE EUROPEAN UNION, *Agreement on the transfer and sharing of contributions to the Single Resolution Fund*. 14 May 2014.

75. According to João Freitas, a resolution regime has been in force in Portugal since February 2012 that gives the Bank of Portugal powers to apply resolution measures when a credit institution or investment company covered by the same regime does not meet, or is at serious risk of not meeting, the requirements to maintain authorisation to trade in its business, if the application of such measures were considered indispensable to ensure the continuity of the provision of essential financial services, safeguard against systemic risk, safeguard the interests of taxpayers or maintain the trust of depositors. See FREITAS, João, "Um mecanismo de resolução para a União Bancária: fundamentos e configuração" in *Relatório de Estabilidade Financeira.* Bank of Portugal. May 2014, p. 82.

76. The process of internal recapitalization consists of the obligation to proceed with a prior absorption of losses, as well as having shareholders and creditors participate in the effort to recapitalize, to a sum corresponding to 8% of the total liabilities of the institution, besides limiting use to 5% of total liability, that may only be exceeded in exceptional circumstances. The aim of this process is to protect tax-payers from the costs of resolution operations and also to weaken the association between sovereign powers and banking sectors.

77. See FREITAS, João. May 2014, p. 110.

78. See EUROPEAN UNION, "EU Directive 2014/49/ of the European Parliament and the Council, of 16 April 2014, on deposit guarantee schemes," in the *Official Journal of the European Union.* 12 June 2014.

III. PORTUGAL AND THE IMPROVEMENT OF THE EUROPEAN ECONOMIC GOVERNANCE FRAMEWORK

Faced with the urgency of the crisis, the EU initially corrected some of the principal failings of the EMU, leaving the adoption of more substantial economic, fiscal, financial, social and political reforms to a later date. A well-functiong EMU and Eurozone, and sustainable growth in the EU, including in Portugal, depend on the adoption of substantial reforms, considered and discussed here within the context of the debate on deepening EMU. It therefore bears examining which measures gain most consensus nationally, particularly among the principal Portuguese political parties.

A. Deepening Economic and Monetary Union

1. Framework of reference

Deepening the Economic and Monetary Union (EMU) is pivotal to the European response to the crisis. This issue has been the object of several studies and guidance documents over the past two years, with special reference to the documents of the European Council (December 2012), the European Commission (November 2012), the European Parliament (November 2012) and some EU Member States, including Portugal, within the Group for the Future of Europe (September 2012).[79]

The reports of both the European Commission and the European Council, put forward a series of proposals for consideration in the short, medium and long-term (see Tables nºs 5 e 6). [80] Bearing in mind that these overlap in many aspects, and that the framework presented by the European Commission helps distinguish initiatives that require European treaty reform from those that could be put into practice with secondary legislation, **the scheme proposed by the European Commission will be hereafter employed by way of reference.**

This does not mean that the set of initiatives considered below are fully representative of the debate on EMU deepening, although the wide range of proposals and approaches available for analysis does make it difficult for one to reproduce each and every one in this space.

TABLE Nº5 EUROPEAN COMMISSION PLAN TO STRENGTHEN EMU (Source: European Commission)

	PLAN FOR AN EFFECTIVE, DEEPER EMU	SECONDARY LEGISLATION	CHANGE TO TREATY
SHORT TERM (2013-2014)	1. 1. Full application of the European Semester and the Six-Pack and rapid agreement on the Two-Pack and its application.	■	
	2. Banking Union: rapid agreement on proposals for a single set of rules (*Single Rulebook*) and create the Single Supervisory Mechanism.	■	
	3. Banking Union: create a Single Resolution Mechanism.	■	
	4. Approve the next multi-annual financial framework.	■	
	5. Establish an ex ante coordination framework of the principal economic reforms of Member States and create a Convergence and Competitiveness Instrument (CCI).	■	
	6. Promote investment in the Eurozone in line with the Stability and Growth Pact (SGP).	■	
	7. Consolidate external representation of the Eurozone.	■	
MEDIUM TERM (2014-2017)	1. Reinforce fiscal and economic integration.	■	
	2. Develop adequate fiscal capacity for the Eurozone based on CCI.	■	■
	3. Create a redemption fund to help reduce the public debt surpluses of Member States under strict conditions of supervision and European coordination.		■
	4. Make the issue of debt possible at the European level with short term maturities (euro-bills).		■
LONG TERM (POST-2017)	1. Finalise banking union.		■
	2. Conclude fiscal and economic union.		■
	3. Develop fiscal capacity built on own resources and managed by a central fiscal authority, i.e. a European Treasury, so as to fund an instrument for macroeconomic stabilisation at the European level.		■
	Political Union: Measure progress in legitimacy and democratic accountability.		■

TABLE Nº6 EUROPEAN COUNCIL PLAN TO DEEPEN EMU (Source: European Council)

	PLAN FOR AN EFFECTIVE, DEEPER EMU
PHASE I (2012-2013)	1. Conclude and implement a strengthened framework for fiscal governance (Six-Pack, Stability Treaty, Coordination and Governance (TSCG) and Two-Pack).
	2. Create a framework for the systematic coordination of structural reforms.
	3. Establish a Single Supervision Mechanism.
	4. Agree to harmonise national resolution and deposit guarantee frameworks.
	5. Make the direct recapitalisation of banks through EEM operational.
PHASE II (2013-2014)	1. Conclude the integrated financial framework with authority for common resolution and an adequate back-stop.
	2. Establish a European mechanism to improve the coordination, convergence and execution of structural policies including 'contractual arrangements' between Member States and the European institutions with financial support from the EU.
PHASE III (POST-2014)	1. Establish a defined, limited fiscal capacity with a view to absorbing macroeconomic shocks better.
	2. Increase the level of common decisions on national budgets and coordinate economic policies better, particularly in fiscal and employment matters.

79. See EUROPEAN COUNCIL. 5 December 2012; EUROPEAN COMMISSION. 30 November 2012; EUROPEAN PARLIAMENT. 20 November 2012; and FOREIGN MINISTRIES OF GERMANY, AUSTRIA, BELGIUM, DENMARK, SPAIN, FRANCE, THE NETHERLANDS, ITALY, LUXEMBOURG, POLAND AND PORTUGAL. 17 September 2012.
80. The items in bold in the squares are proposals yet to be approved.

2. Proposals

2.1. *EMU in the short term (2013-2014)*

The priority of EU Member States until now has been to deepen the EMU without recourse to reforming European treaties. Initiatives so far adopted have aimed essentially at resolving the main failings of the EMU, which the crisis revealed at fiscal, economic and financial levels. It was only with the improvement in the European situation from 2012 onwards, that Member States began to look beyond their initial, immediate, responses to the challenges of the crisis. Proposals considered by the European institutions in the short term do not require amendments to EU treaties.

Establishing a framework for the ex-ante coordination of the major economic reforms

The current framework of supervision and coordination of Member States' economic policies, although reinforced in response to the crisis, **does not yet support the systematic coordination of major Member State economic reforms, as provided by article nº 11 of the TSCG.** Establishing an ex-ante framework to coordinate these reforms is therefore necessary, particularly to ensure that EU Member States consider the collateral effects of any significant economic reforms they adopt, on other Member States, the EU and/or the Eurozone as a whole.

The debate on the systematic coordination of major EU Member State economic reforms is in progress at the European level. The European Commission submitted a proposal in March 2013 to launch an institutional discussion in the EU. [81]

The coordination system devised by the European Commission would be limited to a number of policy areas where reforms may produce either positive or negative collateral effects, such as competitiveness, employment, market performance for products and services and network industries, fiscal systems, financial stability and fiscal sustainability.
The system would also take into account the social dimension of all reforms considered, and if required complementary measures would be suggested to reduce any negative social impact.
It would be mandatory for Eurozone member states to participate in this system, as a result of their growing inter-dependence. Other EU Member States would be free to join, in line with the spirit of article nº 121 (1) of the Treaty on the Functioning of the European Union (TFEU).

The coordination itself of structural reforms would integrate the European Semester and, in this context, could be carried out through the Eurogroup and ECOFIN. The relationship of these two bodies with the European Commission would be, in this sense, strengthened to ensure the effectiveness of coordination; whereas political and democratic supervision mechanisms at the national and European levels would be consolidated to guarantee the democratic legitimacy of functions carried out in this framework.

Adopting such an initiative would be welcome from the point of view of the Eurozone and in particular of countries which, like Portugal, **have fallen foul of EU stipulations on economic policy over the past decade**, in part due to the absence of an adequate mechanism for coordinating economic reforms.

An *ex-ante* framework for coordinating major EU Member State reforms would not only consolidate the European dimension of national economic policies, supporting thus the effectiveness of the EMU and/or the Eurozone, but would also help Member States in preparing efficient economic reforms via technical support and shared learning at the European level.

Creating a fund to support structural reforms would also facilitate the approval of initiatives that are more difficult to adopt.

Creating a fund to support structural reforms

The initiative to support structural reforms – currently under discussion at the European level within the context of the debate on EMU deepening – is known as "Partnerships for Growth, Employment and Competitiveness", as recorded in the conclusions of the European Council, 20 December 2013, or Instrument for Convergence and Competitiveness (ICC), in the version submitted by the European Commission in March 2013. [82]

The initiative's aim is to support the adoption of structural reforms in areas important for growth, employment and competitiveness.
From the viewpoint of the European Council and the European Commission, the Partnerships would be established based on 'contractual arrangements' defined jointly by the EU Member states targeted, the European Commission and the European Council, with funding for implementation provided by solidarity mechanisms yet to be defined. [83]

The Partnerships system would integrate the European Semester and would target Eurozone countries, although it would remain open to all Member States. Countries receiving support under existing assistance programmes would not be eligible for support within this context.

The identification of structural reforms to be adopted at the national level would be done in the context of the MIP, thereby taking into account the potential impact of such reforms on all other Member States, the EMU and the Eurozone as a whole.

The creation of a support fund for structural reforms, together with the establishment of a framework for the *ex-ante* coordination of major economic reforms, **would reinforce the supervision and coordination structures of EU Member State and/or Eurozone economic policies, substantially altering the existing incentives scheme**, which would then cease to be predominantly political and become more economic.

The support fund would help EU Member States and/or Eurozone countries to reduce imbalances accumulated over the past decade, to the benefit of the EMU and/or the Eurozone. It would also help Member States exit the crisis on the back of sustainable growth. **The adoption of these funds would be particularly useful for EMU and/or Eurozone countries in the process of adjustment**, because it would help moderate the social impacts of the required structural reforms.

In addition, **it would help increase the rate of adoption of structural reforms recommended to the Member States within the framework of the European Semester, and the MIP in particular.**

Having said this, **the impact of this initiative would depend to a large degree on its final characteristics.**

The framework below indicates the main characteristics of the proposals made by the European Commission and the European Council, as well as the alternative proposal put forward by the researcher of the French think tank Notre Europe, Eulalia Rubio (Table nº7). [84]

TABLE Nº7 PROPOSALS FOR THE FUND TO SUPPORT STRUCTURAL REFORMS
(Sources: European Commission, European Council and Notre Europe)

	COMPETITIVENESS AND CONVERGENCE INSTRUMENT (CCI) (EUROPEAN COMMISSION)	PARTNERSHIPS FOR GROWTH, EMPLOYMENT AND COMPETITIVENESS (EUROPEAN COUNCIL)	TEMPORARY COHESION MECHANISM FOR EMU (NOTRE EUROPE)
OBJECTIVE	Help those Member States whose economic difficulties may affect the Eurozone to adopt the necessary reforms.	Support convergence processes in EMU and achieve higher levels of sustainable growth.	Guarantee (economic, social and political) acceptance of internal devaluation processes in EMU and support the convergence process within the Eurozone.
BENEFICIARIES	Eurozone countries, except those under an assistance programme. Open to the remaining EU Member States.	Eurozone countries, except those under an assistance programme. Open to the remaining EU Member States.	Eurozone countries in the process of internal devaluation and with no room for fiscal manoeuvre to make high cost reforms.
MEASURES CONSIDERED	In the case of voluntary membership: Member States approved submit a reform plan based on the corresponding recommendations specific to the country. If applied to Member States under the corrective arm of the EDP, should include measures related to competitiveness, financial stability, functioning markets for goods, products and services and also capacity to adjust the economy.	Policies and measures in support of growth, employment and competitiveness, including: performance of labour and products markets; efficiency of public sector; research and innovation; education and vocational training; employment and social inclusion.	High cost structural reforms with a view to lessening the social impact of internal devaluation processes or improve productivity of national economies in the long term, e.g. (through support for reforming active policies for employment, social protection systems, education and research systems).
CONDITIONING FACTORS	Associated with the adoption of reforms considered and not with a specific economic result.	Yet to be defined.	Prior and theme-based: payments associated with the adoption of certain reforms or the introduction of other measures considered necessary for the effective use of funds attributed.
FINANCIAL SUPPORT	National contributions or new own resources. Consistent, coherent and complementary support from other instruments, e.g. Structural Funds.	Yet to be defined.	National contributions or, preferably, new own resources, to avoid possible conflict between beneficiaries and tax payers.

Promoting investment in the Eurozone

The European Commission argues that **the EU fiscal framework provides the means for one to balance the need for productive public investment with the objectives of fiscal discipline**, specifically within the context of the preventative arm of the SGP.

While it is true that the EU fiscal framework does provide for the possibility of temporary deviations in the Medium Term Budget if adopted structural reforms have a positive impact on long-term economic activity, **it is also true that the crisis and subsequent fiscal consolidation efforts carried out in countries experiencing economic adjustment, restricts the possibility of public investment support at the national level. The fall in public spending in Portugal between 2007 and 2013 illustrates this situation** (see Graph nº5). Public spending corresponding to Gross Formation of Fixed Capital (GFFC) accounted for about 6% of GDP in 2007, while in 2013 it amounted only to 3,1% of GDP. In absolute terms, public spending in GFFC fell from €4.5 billion in 2007 to €2.5 billion in 2013, lower than 1995 levels, when the National Statistics Institute began recording these figures.

In this light, and on top of support already provided by the ESIF to Portugal and other Member States, **the European Commission has made several proposals aimed at relaunching and increasing investment in the European economy, including long-term investment, whose communication channels, i.e. banks,** the crisis has distorted. [85]

It was with this in mind that the European Commission published a statement in March 2014 on long-term funding for the European economy, proposing:

- mobilising long-term private sources of funding;
- improving the use of public funds;
- developing European capital markets;
- improving access to funding for SMEs;
- attracting private investment with a view to meeting the objectives of the 2020 Europe strategy;
- and improving the regulatory framework to promote sustainable finances.

In view of the severe fiscal consolidation efforts carried out in some Eurozone countries, as Portugal, **these initiatives have an important role to play, i.e. promoting much-needed investment,** which is why it is vital that they are supported at the European level.

Consolidating external representation of the Eurozone

The importance attributed to consolidating the external representation of the Eurozone in the European Commission road map for EMU deepening, **is linked to the recent development of European economic governance.**

It is in this context that the Eurozone has been gaining ground, and developing economic governance structures that to a certain extent differ from those applicable to other EU Member States. [86]

The consolidation of the Eurozone's external representation is a response to these institutional developments as competences have shifted across such policy areas from Member States to the EU, namely in the coordination of fiscal and economic policies, macroeconomic supervision, exchange rate policy and financial stability.

To pursue this reform, possibly, after having consolidated the institutional architecture of the euro, **an agreement must be reached on a plan to achieve unified Eurozone external representation in international and economic organisations and forums**, such as the IMF.

Although this measure does not require any change to European treaties, the position of the non-Eurozone EU Member States must be borne in mind in preparing it, with a view to a differentiated integration that is consistent with the remaining structures of European economic governance.

81. See EUROPEAN COMISSION, *Communication from the Commission to the European Parliament and Council: Towards a deep and genuine Economic and Monetary Union: Ex-ante coordination of plans for major economic policy reforms*. 20 March 2013 (A).
82. See EUROPEAN COUNCIL, *European Council 19/20 December 2013 Conclusions*. 20 de dezembro de 2013; e COMISSÃO EUROPEIA, *Communication from the Commission to the European Parliament and Council: Towards a Deep and Genuine Economic and Monetary Union: The introduction of a Convergence and Competitiveness Instrument.* 20 March 2013.
83. The President of the European Council was to reflect on the preparation of this instrument together with the President of the European Commission and the EU Member States, with a view to presenting the results to the European Council in October 2014. The President of the European Investment Bank (EIB), was, however, to be responsible for reflecting on solidarity mechanisms. See European Council. 20 DECEMBER 2013.
84. See RUBIO, Eulalia, "Quel Instrument Financier Pour Faciliter Les Réformes Structurelles Dans la Zone Euro?," *Notre Europe Policy Paper.* Paris : Notre Europe. December 2013.
85. See EUROPEAN COMMISSION, *Commission roadmap to meet the long-term financing needs of the European economy.* 27 March 2014.
86. See EUROPEAN COMMISSION. 20 November 2012.

2.2. *EMU in the medium term (2014-2017)*

European Commission medium-term initiatives aim at reinforcing the EU fiscal and economic integration framework, developing an adequate fiscal capacity for the Eurozone and the joint management and issue of euro bills. The adoption of short-term initiatives, i.e. the framework for the ex-ante coordination of major Member State economic reforms and the structural reform fund - paves the way for both the development of an adequate Eurozone fiscal capacity and the joint management and issue of euro bills at the European level, in that it reduces their inherent moral risk. [87]

Depending on their format, the approval of these initiatives may require changes to the EU treaties.

Reinforcing fiscal and economic integration

On the fiscal side the European Commission suggests strengthened coordination of Eurozone Member State policies, specifically their draft budgetary plans. The European Commission proposes that, in certain serious cases - to be defined - the Commission should be given the right to review specific fiscal implementation decisions, insofar as these lead to a significant deviation from the adjustment path agreed at the European level, and also given the ability to issue binding recommendations. Currently it has only the right to request a review and issue a non-binding opinion.

Apart from requesting stronger oversight on draft budgetary plans, the European Commission suggests that clear competencies be given to the EU in order to harmonise national budgetary legislation, in line with the TSCG, and appeal to the European Court of Justice in cases of non-compliance.

To carry out these changes, reforms would have to be made to the European treaties, in part to allow for the corresponding development of political integration, thus ensuring the democratic legitimacy of EU fiscal coordination exercises. **In this context of treaty changes, the European Commission is also considering closer coordination of Eurozone Member State economic policies in such different areas**, as taxation, labour market and in particular labour mobility. It also suggests **reinforcing the coordination and supervision of social and employment policies and, specifically, merging the General Guidelines for Employment Policies with Employment Guidelines.**

Improving the coordination of Eurozone Member State policies in areas as varied as social, labour, fiscal and also environmental legislation – according to the four Portuguese academics: **Ricardo Paes Mamede** (Assistant Professor of ISCTE), **João Rodrigues** (Visiting Assistant Professor of the University of Coimbra) **Nuno Teles** (Researcher at the Centre for Social Studies of the University of Coimbra) and **Ricardo Cabral** (Vice-Rector of the University of Madeira) – **merits special attention in light of the imbalanced nature of the European economic governance framework.** The common market and the single currency coexist with fragmented national fiscal schemes, labour legislation, social policy and, to a lesser extent, environmental policy, where, according to the same academics, harmonisation is limited or non--existent. [88]

The resulting effect, as these four academics point out, is that this *"**asymmetrical regulation** – which imposes common rules in some fields and decentralises political accountability in others - perversely guides national public policies towards the erosion of social, environmental and labour rights, as well as justice in fiscal systems."* [89] Bearing in mind that *"the social, environmental, labour and fiscal legislation of each Member State is reflected in the cost structure of domestic companies and, consequently, in their capacity to compete with foreign competitors,"* this group of academics draws attention to the risk of European economic coordination that is either insufficient or non-existent.[90] In their opinion *"in the absence of politically driven harmonisation, a lesser harmonisation is likely to emerge,"* mposed by competitive pressures, and with a negative impact on the social development standards of Member States.[91] Confronted with this risk, it is important to consider ways of improving coordination of the economic policies of Eurozone Member States, both in line with the Euro Plus Pact and with the TSCG, as well as measures already adopted within the current European legal framework.

Reinforcing fiscal and economic integration

Developing an adequate fiscal capacity for the Eurozone has been considered with various outcomes in mind, within the context of the debate on EMU deepening, including:

- **promoting structural reforms to support growth, employment and competitiveness;** and
- **reducing the impact of macroeconomic shocks, and in particular adverse asymmetrical shocks.** [92]

Both the European Council and the European Commission consider a gradual approach in this respect, beginning with the creation of a fund to support structural reforms in the Eurozone. To this end, the European Commission recommends developing a fiscal capacity whose elaboration be built based on previous experience.

In associating the development of a fiscal capacity for the Eurozone with the fund to support structural reforms and adoption of structural reforms at the national level, the European institutions at first seek to promote European economic convergence, reducing in this sense the moral risk associated with developing a fiscal capacity for the Eurozone.

According to the European Commission, developing an adequate fiscal capacity for the Eurozone based on the ICC could be done via secondary legislation, although EU treaty reform will be required in order to provide specific legal grounds and grant it the capacity to apply for loans.

The fiscal capacity of the Eurozone would ultimately become separate from that of the EU's overall budget at this stage, having its own financial resources including, eventually, the possibility of applying for loans to support adoption of structural reforms in those Member States facing major economic difficulties.

Creating a public debt redemption fund and providing for the joint issue of euro bills

The debate on creating instruments for managing public debt, including the joint issue of euro bonds has seen a number of proposals over recent years, aimed at strengthening fiscal accountability and the European economy.

The European Commission proposed the creation of two instruments in 2012, i.e. a Debt Redemption Fund and Pact (DRF/P) and the joint issuing of euro bills, and tasked a group of experts with their study, following an agreement with the European Parliament to ensure ratification of the Two-Pack. [93] The Group of Experts' Report, published in March 2014, confirms the merits of the suggested instruments in terms of stabilising public debt markets, supporting the transfer of monetary policy and promoting financial stability and integration, without overlooking the economic, financial and moral risks associated with the two concepts. **Still, the authors of the report recommend caution for the time being**, as more evidence is needed on how the recently-created framework of European economic governance functions, particularly the European Semester.

This does not mean that the different forms, advantages and disadvantages of creating such instruments should not be considered in the meantime, taking due account of the respective risks of each format.

The current treaties do not give sufficient competencies to the EU to create solid, lasting DRF/P or euro-bill schemes within the current European legal framework, so **a gradual approach might be adopted**, considering they might be created, where possible, within the current European legal framework, on a *pro rata* basis.

This approach might fit into the context of further reflection on instruments for the joint issue of euro-bills, including the issue of euro-bonds to fund European investment, **and creating an institution for issuing and managing European debt**, such as an Agency for European Debt or a European Treasury.

Whatever the case, protection mechanisms will be indispensable to guard the EU and Members States against moral hazard, avoiding a situation whereby less pressure from bond markets sees governments waver in their commitment to structural reforms at the national level, and to reforming the financial sector at the European level.

87. *Idem*.
88. See MAMEDE, Ricardo Paes; RODRIGUES, João; TELES, Nuno and CABRAL, Ricardo. 16 February 2013, p. 16.
89. *Idem*.
90. *Ibidem*.
91. *Ibidem*.
92. See for example: EUROPEAN PARLIAMENTARY RESEARCH SERVICE (EPRS), *Rationale behind a euro area 'fiscal capacity': Possible instruments including a dedicated budget*. 26 July 2013; RODRIGUES, Maria João. November 2013; RUBIO, Eulalia.December 2013; and VANDEN BOSCH, Xavier, "Contractual Arrangements: the overlooked step towards a fiscal union," *Egmont European Policy Brief*. December 2013.
93. See EUROPEAN COMMISSION. 20 March 2013 (A).

Concluding banking union

Despite progress made to date, building the EBU will only be completed in the medium and long term, because its various components will take time to come into force and take effect. Furthermore, creating a complete and sustainable banking union depends on further developing of EMU itself – including fiscal, economic, financial and political dimensions, which in turn depend partly on changes to the EU treaties. [94]

Completing fiscal and economic union

According to the European Commission, completing fiscal and economic union will be the last stage in EMU deepening. It would imply a political union with an adequate degree of sovereign power sharing, a common budget with its own fiscal capacity and the means to impose fiscal and economic decisions on its members in specific and well-defined circumstances.

The fiscal dimension to be developed in this sense would depend on the level of European integration that EU Member States are ready to support and their readiness to undertake the corresponding political changes.

Developing a fiscal capacity to fund an instrument for macroeconomic stabilisation

Better coordination of Eurozone Member State budget policies would facilitate, in theory, the adjustment of imbalances accumulated over the last decade at the European level which were exacerbated by the outbreak of the crisis.
This coordination would help the Eurozone to balance the costs of adjustment currently in progress in the majority of deficit Member States, including in Portugal.
The imbalances would then cease to be dealt with as a problem solely of deficit countries, and would be faced as joint challenges for the Eurozone as a whole.

The optimum coordination of 18 Member State budgetary policies is, nevertheless, difficult in the current situation. [95]
Despite a recent improvement in budget coordination among Eurozone Member States, which must now submit draft budgetary plans annually to the European institutions, the budgetary policies of these countries are still essentially perceived from a national point of view. They respect in this way the sovereignty of the Member States and in particular the policy prerogatives of national parliaments. In the absence of sufficient European economic convergence, and confronted by the current crisis context and fiscal consolidation, the capacity for each to confront asymmetrical shocks, or common shocks with asymmetrical effects, is limited. It requires complementary support at the European level.

Creating an instrument for macroeconomic stabilisation at the European level is an appealing option for a common currency area. Discussions on developing an adequate fiscal capacity for the Eurozone have in fact already addressed this issue. Apart from financing a support fund for structural reforms, a Eurozone fiscal capacity could sustain the creation and use of an instrument for macroeconomic stabilisation at the European level.
This instrument would help Member States to confront imbalances arising from asymmetrical shocks, or common shocks with asymmetrical effects, thereby fostering greater equilibrium between fiscal consolidation and economic growth, particularly in countries that, like Portugal, have limited room for budget manoeuvre, due to ongoing adjustment processes.

Both the European Commission and the European Council, in the context of their respective road maps on EMU deepening, **have proposed creating a common instrument for macroeconomic stabilisation, the funding of which would come from a Eurozone fiscal capacity.** Their proposals coincide in many ways: in objectives, scope and the eventual format of the macroeconomic stabilisation instrument.
The objectives consist of supporting Eurozone Member States to adjust to asymmetrical shocks and prevent contagion in Europe.
The scope is restricted to the Eurozone.
The format, in theory, will be a subsidy scheme, with two possible approaches: a macroeconomic approach, in which contributions and payments are determined depending on income and cyclical spending, or depending on economic activity; or a microeconomic approach, as a measure associated with a specific public function, sensitive to the economic cycle, such as an unemployment subsidy which would see contributions fluctuate according to the labour market.

In the long term, both the fund to support structural reforms and the instrument for macroeconomic stabilisation

would be part of a central budget, the funding sources of which could be, in principle, a combination of own resources with national contributions, and possibly the capacity to take out loans and issue eurobonds.

It is also important to note that **the choice of funding sources for the central budget is integral to the scheme's functioning.**

To a certain extent this discussion is at the centre of the debate on EMU deepening and the project for European integration that is to be promoted over time.

Take the case of national contributions. In using national contributions, one would have to ensured that this method of funding the central budget would not result in uni-directional, permanent transfers, undermining a sense of solidarity in the European Union.

Concerns in avoiding this type of transfer should be seen today in light of the friction that the perception of unequal benefit has caused among EU Member States, particularly between the countries of the North and those of the South.

To avoid this perception and its negative impact on European cohesion, **alternatives to the current composition of the EU budget and a future fiscal capacity for the Eurozone, would have to be explored, including those of a new own resources** (e.g. a European financial transaction tax) **or the alignment of national contributions with Member States' economic cycles** (the output potential of Member States). [96]

Faced with the need to reflect further on the composition of the EU's fiscal capacity, **the European Parliament reached a compromise in 2013 with the other European institutions on the composition of the EU budget for 2014-2020. As a result, the EU budget will have to be fully revised as of 2016.**

According to the MEP and Chairman of the Budget Committee of the European Parliament, Alain Lamassoure, the working group responsible for examining this issue should submit its preliminary conclusions at a mini budgetary conference – an inter-institutional conference with the national parliaments – towards the close of 2014, even before the new European Commission takes office. [97]

The final conclusions should be published in 2016, so that the European Commission can make a new general proposal in 2017.

Developing alternative sources of funding will demand, whatever the case, **changes to EU treaties.**

According to the European Commission, both the capacity to collect new taxes and the ability to tap debt markets depend on changes to EU treaties.

Developing a specific legal basis for macroeconomic stabilisation, creating the corresponding, specific budget, based on own resources, instituting a European Treasury and extending the Eurozone fiscal capacity to Member States currently preparing to join the euro, would also require these changes.

94. See EUROPEAN COMMISSION, *Final Report submitted on 31 March 2014: Conclusions. Report prepared by the experts group on the Debt Amortization Fund and Euro-bills at the request of the European Commission.* 31 March 2014; and VÉRON, Nicolas, "A Realistic Bridge Towards European Banking Union," *Bruegel Policy Contribution*. June 2013.

95. See DARVAS, Zsolt and VIHRIÄLÄ, Erkki, "Does the European Semester deliver the right policy advice?," *Bruegel Policy Contribution*. 20 September 2013.

96. For example, the Professor of Law and current Deputy Minister for Regional Development, Miguel Poiares Maduro, claims that the EU's own resources should come from economic activities made possible by the internal market, economic activities that, although taking place in a specific Member State, have important external attractions in other Member States, or economic activities that Member States may no longer regulate and tax for themselves. See MADURO, Miguel Poiares, "Intervenção do Ministro Adjunto e do Desenvolvimento Regional na conferência 'O reforço da participação democrática nas eleições europeias,' under the European Year of Citizens 2013. 20 June 2013.

97. See LAMASSOURE, Alain, "Budget Européen: Les Citoyens Trancheront," in *Interface – Bulletin Mensuel de Confrontations Europe.* June 2013.

2.4. *Towards a Political Union?*

EU initiatives adopted in response to the crisis, in order, to reinforce the European economic governance framework, **have entailed a greater transfer of powers to Brussels**, namely those of a budgetary and economic nature. **This transfer of powers has been accompanied politically by an increase in the involvement of the European Parliament, national parliaments and civil society in the context of economic and budgetary policy coordination**, namely in the European Semester. **However, there is still wide room for improvent in the mechanisms for political accountability and democratic legitimacy of institutions and decisions adopted on such matters at the European level.**

This is particularly the case in the Eurozone, as shown by proposals put forward by the European Commission and the European Council, outlined in the first and second documents of this report.

The political dimension of EMU must be improved, both in view of reforms already adopted, and of the road to economic, budgetary, financial and social integration proposed by the European institutions, supported by several Member States, and discussed in Europe to complete EMU and therefore ensure an exit from the crisis on the back of sustainable growth.

This improvement is an on-going task and one that faces many challenges, the solutions to which depend on the political willingness of the EU Member States and the support they are ready to give to European integration. **There are at least three principal challenges:**

- **The first challenge comes from the balance of power existing between EU Member States** and in particular the capacity that countries as Germany currently have to protect their interests in the EU and, therefore, their view of EMU deepening. For Portugal, a smaller country, with less influence and certainly with a monetary culture that is manifestly different – placing it, according to the Portuguese economist Bento, in the group of countries of the 'weak euro' or the 'Greco-Latin' group – **developing a policy of alliances within the EU is of the utmost importance in order to ensure that EMU development also reflects its interests,** in line with the objectives of economic convergence and social cohesion. In other words, the first challenge requires promoting the development of an EMU and Eurozone that will encourage sustainable growth, based on more balance between European accountability and solidarity.

- **The second challenge comes from a reluctance to reform EU treaties, especially if this entails organising national referenda.** Experience to date, including in particular the rejection of a referendum on a European Constitution in some countries in 2005, **recommends caution**, namely in the current context of crisis, economic stagnation and weak growth, as all of this has shown itself to be the fuel of euroscepticism. **Promoting growth and employment policies in Europe** – including support for investment – **could in time create comparatively better conditions in which to revise EU treaties.** However, without any notable economic recovery, it will probably be difficult to convince public opinion of this approach. If increased growth and employment depend on adopting reforms to European economic governance, even if without treaty changes, **the project for European integration will have to be defended in public to ensure citizen support, and then the ground prepared for future EU treaty reforms.** This will be particularly the case if national referenda are employed as instruments of democratic legitimation.

- **The third challenge is linked to the growing use that Member States make of the inter-governmental method.** While there is no doubt that inter-governmental agreements, such as the TSCG, serve to advance the European integration project in the short term, when initiatives lack consensus, **their use in the medium and long-term raises doubts as to the EU's democratic nature,** particularly with the EU's lack of mechanisms for political accountability and democratic legitimacy.
  Integrating these structures into the European legal framework in the medium and long-term, although necessary, raises doubts as to the development of a differentiated integration and the coherence and coordination of structures created in the Eurozone with the other structures of European governance.
  To the extent that differentiated integration, with more political, economic, budgetary, financial and social depth in the Eurozone, **is indispensable to guarantee the sustainability of the actual Eurozone, a way of ensuring the coherence and coordination of institutional structures that govern economic governance in the EU and the Eurozone will have to be found.**
  In this sense, deepening EMU should take account of the differentiation currently in effect in the process of European integration in matters of economic governance — distinguishing Member States of the Eurozone, Member States of countries aiming to join the Eurozone and Member States that do not wish to become part of the Eurozone.
  The current crisis, and the consequent reluctance to reform treaties, aside, **this differentiation may push EU Member States towards reforming EU treaties in the medium-term**, particularly in the run up to any national referendum in the United Kingdom (potentially for 2017) to determine whether this country will remain in the EU.

2.5. *Developing EMU's social dimension*

The social dimension of EMU is not covered in the roadmaps of the European Commission and the European Council for deepening EMU. Yet, **this issue is hardly new.** It was in fact underscored in the European Parliament's report published for the debate on deepening EMU.

Arguments put forward today in favour of developing the social dimension of EMU and the Eurozone are multiple and varied, but the three most important bear mentioning: [98]

- **The first argument claims growing social differences between EU Member States** threaten the stability of EMU and the Eurozone and therefore demand a common response. There are those who argue that social differences should be seen as 'excessive differences,' similar to fiscal excesses and excessive macroeconomic imbalances, therefore requiring more supervision.

- **The second argument is functional.** Having dispensed nationally with their instruments for monetary and exchange rate policy, and having limited budget room for manoeuvre, Member States under financial pressure and in the process of economic adjustment in the Eurozone cannot devalue their currency, but must instead make the effort of internal devaluation, with often high social costs, at least in the short term. This effort contributes to growing social differences, and hence the need to find common responses that compensate for the absence of national instruments and help the EU confront this situation.

- **The third argument is political.** In this case, there is a chance that the single currency might come to be seen as a threat to the Social State. This could jeopardise EU citizen support for the euro, if not the whole project of European integration. This risk would be particularly high in EU Member States that, like Portugal, have been implementing budget reforms to meet the objectives agreed under the framework of their respective adjustment programmes.

In this context, the European Commission has been working to develop the EMU's social dimension. The European executive issued a statement in October 2013, in which several aspects for further development of the EMU's social dimension were identified: [99]

- *Reinforcing supervision of social and employment challenges, and coordinating the policies of Member States:*
  - by increasing monitoring of social and labour developments as an integral part of the EU's macroeconomics supervision, adding social and employment indicators to the analysis of imbalances applied within the context of the MIP;
  - by creating a score-board of social and employment indicators to be integrated into the Joint Report on Employment, published annually as part of the AGS; and,
  - by consolidating coordination of social and employment policies of Member States within the context of the European Semester, via the reinforcement of existing instruments, such as benchmarking and an exchange of best practices.

- *Increase solidarity and measures for employment and labour mobility:*
  - by channelling European funds to social issues and developing initiatives such as the Youth Employment Initiative and the Programme for Employment and Social nnovation, during the 2014-2020 cycle;
  - by adopting legislation that will facilitate labour mobility; and,
  - by developing new instruments for European economic governance: that is, establishing a support fund for structural reforms, as well as a fiscal capacity for the Eurozone, with a view to funding the creation and running of a macroeconomic stabilisation instrument.

- *Strengthen social dialogue:*
  - by improving the use of forums for existing dialogue (biannual Macroeconomic Dialogue and the Tripartite Social Summit); and,
  - by encouraging social partners to become more involved in European economic governance, particularly in the European Semester.

There has been progress in certain areas.

One element in particular is that two tables of social and employment indicators within the context of the MIP and the other in assessing budgetary and macroeconomic policies in the European Semester. [100]

The Council has been encouraging the use of such instruments since 2014, with the intention of acquiring a better understanding of social dynamics in EU Member States. [101]

If this understanding goes on to be used in country specific recommendations, it could have an important impact on the design of adjustment policies and their resulting social costs. This would in turn be beneficial for countries undergoing adjustment processes, such as Portugal.

Another aspect that merits mention is the Youth Employment Initiative. Portugal, a country where youth unemployment in the first quarter of 2014 rose to 37,5% of the working population, is set to receive €160.8 million in this context, over the 2014-2020 cycle. [102]

Other EMU social dimension issues have also been discussed at the European level, including notably: **labour mobility; and the creation of new instruments for European economic governance, such as economic stabilisers in times of crisis.** Encouraging labour mobility in the EU has been addressed recently among EU Member States.

For example, Germany and France issued a joint statement in May 2013, demonstrating their readiness to consider implementing a national minimum wage, as well as several measures designed to facilitate labour mobility, removing obstacles, improving cooperation between employment services and facilitating the portability of rights. [103]

As for the creation of new European economic governance instruments, the debate has looked into how structural reform fund support would unfold, and in particular whether the funds made available to EU Member States should be distributed – much like with adjustment programmes, in which loans are released depending on progress made –, or whether a different logic should be adopted, closer to the structural fund model and therefore entailing more solidarity. [104]

98. See FERNANDES, Sofia and GYGER, Emanuel, "Quelle Europe Sociale Après la Crise?," summary of a seminar organised by the French think tank Notre Europe together with the Calouste Gulbenkian Foundation on 3 December 2013. 4 February 2014.
99. See EUROPEAN COMMISSION, *Communication from the Commission to the European Parliament and Council: Strengthening the Social Dimension of the Economic and Monetary Union*. 2 October 2013.
100. See VANDENBROUCKE, Frank, "The Case for a European Social Union," *Egmont Institute European Policy Brief.* March 2014.
101. See EUROPEAN COUNCIL. 20 December 2013.
102. See web page of the European Commission delegation in Portugal: "Fundos e Programas Europeus: solidariedade ao serviço da economia portuguesa."
103. According to the former Belgian Minister for Social Affairs and Employment, Frank Vandenbroucke, in writing for the Belgian think tank, Egmont Institute, this statement strengthened the idea that European labour mobility can be positive, if it develops in line with existing social regulation, namely minimum wages. See Vandenbroucke, Frank, March 2014.
104. See FERNANDES, Sofia and GYGER, Emanuel. 4 February 2014.

1. Portugal and key proposals for enhancing the European framework

Despite the positive economic results emerging with the adjustment, notwithstanding high social costs –, **the Portuguese economy continues to face major challenges.** These include imbalances accumulated over the past decade within the context of the EMU and the Eurozone, a subsequent increase in external debt, and persistent structural weaknesses, which represent today obstacles to sustainable growth.

Resolving these challenges, as illustrated by European and national strategies for encouraging sustainable growth, **is forecast to be a long-term project and seems difficult in the current European economic governance framework, without improvements to the EMU.**

In fact, **Portugal**, like other Eurozone deficit countries, **faces many difficulties.** To start with, in contrast to previous adjustments, **the current adjustment must be undertaken without mechanisms for the rapid correction of external imbalances**, i.e. without any control over exchange rates and monetary policy instruments at the national level.

This means that the burden of adjustment falls on national budgetary, economic and social policies in a context of high foreign debt, low growth and an over-valued exchange rate. Furthermore the policy for fiscal consolidation adopted at the national level, within this framework, limits the capacity of the Portuguese State to promote investment and sustain mechanisms for macroeconomic stabilisation, with a view to moderating the negative impact of the adjustment underway, including the domestic devaluation process and the structural reforms adopted to promote the competitiveness of the Portuguese economy. In these circumstances, **it becomes difficult to contain the economic and social costs associated with the adjustment adopted, which if prolonged**, in the absence of significant economic and social improvements in the near future, **may represent a threat to Portugal's continued position in the Eurozone.**

Moreover, **adopting fiscal consolidation policies simultaneously in several deficit Eurozone countries raises serious doubts as to the adjustment undertaken at the European level**, in that this generates deflation within the Eurozone, restricts European internal demand and, therefore, compromises the success of an export-based growth strategy.

Deflation increases the real value of the debt and gives rise to the risk of economic stagnation, which in turn reduces the capacity to lower the debt of the Portuguese State.

Already a fragmented European financial market restricts the effectiveness of transmitting European monetary policy and creates differences in access to credit within the common market, making it difficult to relaunch national and European investment.

In short, despite efforts made to date, **the strategies adopted for European and national growth, and in particular the asymmetrical and simultaneous adjustment resulting from this, seem to have increased economic, social and financial gaps between the Eurozone countries**, including levels of growth, employment and access to credit, **which makes it difficult for the EMU and/or the Eurozone to function well and support an exit from the crisis on the back of sustainable growth.**

The initiatives considered by the European institutions within the context of the debate on deepening EMU address these challenges. Their timeframe – as illustrated in the guidance plans of the European Commission and the European Council – **respects the gradual development of European integration**, in terms of European accountability and solidarity, as a function of the commitment EU and/or Eurozone countries are prepared to make at a given time.

In the current context of crisis, the time needed for European integration – in this case, the slow development of the European economic governance framework – **comes up against the urgent needs of those Eurozone countries in the process of adjustment, and in particular of their citizens, who want to improve their economic and social situation.**

This tension has a knock-on effect in European and national political stages, where the struggle of EU Member States to adapt to a still new European economic governance framework is confronted with the need to develop this framework further, based on the prevailing political, economic and social context.

Bearing in mind these dynamics, and aware that deepening EMU may help respond to the country's challenges, **it would be in Portugal's interests to consider a series of short, medium and long-term initiatives**:

- In the short term (2013-2014): **initiatives to encourage the coordination and adoption of structural reforms would be of interest to Portugal in that they seek to reinforce the efficiency of the European approach to growth promotion**, with due consideration for the impact of structural reforms on the other Members States, as well as on EMU and /or the Eurozone as a whole.

These initiatives would be particularly useful if they were to lead to a significant improvement in the incentive structures underlying the coordination of economic policies and correction of macroeconomic imbalances, as it would help Portugal accelerate the ongoing process of structural reforms, while also moderating the economic and social impact of adjustment.

Adopting structural reforms would furthermore gradually push the country towards greater economic convergence with the rest of the Eurozone.

On the other hand, bearing in mind the effort of fiscal consolidation and the difficulties evidenced at the national level in gaining access to credit, **it would also be in the country's interest to promote alternatives to investment,** including long-term investment, **at the European level.**

A European approach to growth, including developing European public policies to encourage growth, **requires European investment, which may imply, for example, developing the fiscal capacity of the EU and/or the Eurozone in the medium and long term.**

Lastly, while useful, **the consolidation of Eurozone external representation may take on greater importance in the medium and long term**, once the current Eurozone governance structures are consolidated.

- In the medium term (2014-2017): **additional reinforcement of European budgetary and economic integration**, even though this would require changes to the EU treaties, **would be in Portugal's interest in that it would sustain the development of a common budgetary policy**, with a view to developing a central fiscal capacity in the long term.

This additional reinforcement would also be of interest to Portugal from the point of view of rebalancing the European economic governance framework. It would complement the common market and the single currency with an economic union that is more solid and which features better social, labour, budget and environmental coordination.

Such an institutional rebalance would help reduce the moral hazard arising from shared sovereignty and risk-sharing resulting from the creation of such medium and long-term solidarity instruments, as a fiscal capacity for the Eurozone and the management and issuing of public debt.

Risk-sharing would, in principle, give Portugal greater room for manoeuvre to promote sustainable growth at the national level.

While this is certainly an appealing scenario, one should not forget that risk-sharing implies a greater degree of budget, economic and political integration, which depends on the political support that Member States provide to European integration. **At the end of the day, this is a political choice: agreeing to develop a Eurozone characterised by differing domestic situations or supporting the construction of a Eurozone characterised by internal convergence,** the latter case would require more European integration and coordination.

Bearing in mind the risks that limited or non-existent European economic coordination present to sustainable growth, as well as the importance of this coordination to reduce the moral risk associated with developing solidarity instruments, **it would be in Portugal's interest to encourage the development of a Eurozone characterised by internal convergence.**

- In the long term (post-2017): **the conclusion of EBU in the long term would be of interest to Portugal, since it aims to halt and correct the fragmentation of the European financial market**, making the conditions of access to credit in the Eurozone more equal by creating a common institutional and regulatory framework. In promoting more financial integration, EBU would help improve both access to credit in the Eurozone, and transmit European monetary policy, thus encouraging the relaunch of investment and, consequently, of European economic activity.

If successful, **this initiative would be of a particular advantage to countries that, like Portugal, have suffered a major loss of confidence in their banking sectors** as a result of the association between these sectors and local sovereign powers.

Lastly, concluding a budgetary and economic union would provide better grounds for sharing risks associated with adopting solidarity initiatives, such as developing a central fiscal capacity with additional functions, namely the capacity to fund a common macroeconomic stabilisation instrument.

It is nonetheless important to note that developing this fiscal capacity, apart from creating an important instrument to help reduce the exposure of Member States to adverse shocks, **is associated with the essential question of the European integration project: what type of community do Member States want to create?**

Portugal will have to define its position in terms of fiscal capacity funding sources, in that these affect the sense of a European political community. Greater use of own resources, for example, would help increase the visibility of the benefits of European integration in the eyes of European citizens, which would possibly help strengthen the sense of community and European cohesion.

Apart from short, medium and long term proposals considered by the European institutions, **it would be in Portugal's interests to support both the process of political integration and the development of an EMU social dimension.**
Further political integration would help reinforce the political accountability and democratic legitimacy of agents, institutions and decisions adopted at the European level within the framework of European economic governance. The initiatives outlined in the first two documents of this report are worth considering by way of example.
These initiatives would help to draw citizens closer to European political leaders, as well as cement the democratic legitimacy of European economic governance structures developed and considered over time.

Lastly, they would increase the role of the European Commission and the European Parliament within the framework of European economic governance, enshrining them as the representatives of European interests and, to a certain extent, as the guarantors of the balance between the interests of the EU Member States.

Developing the social dimension of EMU, apart from helping to reduce social differences in Europe, **would help to reconcile fiscal consolidation efforts with sustainable growth and social wellbeing.** To this end, one could consider for instance, **the use of social indicators in analysing imbalances and effectively taking them into account in country specific recommendations. These initiatives would be particularly important for countries that,** like Portugal, **are dealing with slow, painful adjustment processes with high social and economic costs.**

2. The main Portuguese political parties and the improvement of the European framework

Having pointed out above some of the main initiatives of interest to Portugal within the context of deepening EMU, **the support they receive from the respective major Portuguese political parties bears examining.**
When all is said and done, it will be for these political agents to promote and defend these initiatives at the national level in order to ensure citizen support for the European integration project, particularly if a national referendum is held within the context of substantial changes to the EU treaties.

The tables below identify the positions of major Portuguese political parties with seats in parliament, i.e. the *Assembleia da República,* and European Parliament, **based on the content of their respective political programmes presented during the 2014 European elections** (see Tables nºs 9 e 10).
Particular attention is paid to the following political parties: the Socialist Party (PS), the Social Democratic Party (PSD) and the People's Party (PP), that ran together under the Portugal Alliance (AP); the Left Wing Bloc (BE) and the Portuguese Communist Party (PCP), that ran together with the Green Party (PEV) under the United Democratic Coalition (CDU).
The first table identifies five types of position in relation to the initiatives presented by the European institutions. These are:

- support for initiatives considered individually;
- likely to support as compared to the position expressed for similar initiatives;
- the lack of an explicit or relative position;
- rejection; and,
- possible rejection as compared to the position expressed for similar initiatives.

The content of the political programmes presented during the 2014 European elections indicate that the political parties with the most similar positions are the parties of the centre-left, centre-right and right (PS, PSD and CDS-PP under the AP). It could be that emphasis on one or other initiatives in particular during the campaign, such as partial public debt mutualisation initiatives, differ temporarily for political reasons, but support to such concepts, namely the creation of solidarity and risk-sharing instruments, appears to exist in general.
Overall, this set of parties supports the European integration process, in the sense of more economic, fiscal, financial, social and political integration. **The parties to the left and extreme left, i.e. the BE and the PCP (that ran together with the PEV), on the other hand, share a less integrationist position**, either because they do not see themselves as part of the status quo, or because they identify with a more inter-

governmental view of the European integration project and, consequently, more rooted in strict coordination of national policies at the European level, without ceding any power to supra-national entities.

The areas that appear to garner consensus from all political groups are:

- **promoting investment at the European level, by increasing the EU's fiscal capacity;**
- **coordination** (although not necessarily integration) **em matéria de políticas económicas e sociais, in matters of economic and social policy, including in particular wage and tax policies;** and,
- **developing certain aspects of a political union**, such as the involvement of national parliaments in the European decision-making process and the increase of political scrutiny at the European level (for example scrutiny of the ECB).

In conclusion, **the view put forward by the European institutions in the debate on EMU deepening** – which most initiatives are crucial for Portugal if it is to balance fiscal discipline with sustainable growth and social wellbeing – **get support principally from those political parties most likely to ever be called to form a government** (PS, PSD and CDS-PP). **There is far less support from more fringe parties. There is partial support from the BE and only very sporadic support in the PCP and in the PEV.**

Bearing in mind the changes required for this view to apply, as well as the importance of ensuring citizen support, these parties should consider, discuss and eventually support or reject, both at the national and at the European level, the initiatives considered within this context.

TABLE Nº9 AREAS OF POSSIBLE CONSENSUS AMONG THE PRINCIPAL PORTUGUESE POLITICAL PARTIES ON DEEPENING EMU
(Sources: Political programmes presented for the 2014 European elections)

		Socialist Party (PS)	Aliança Portugal (PSD and CDS-PP)	Left Bloc (BE)	United Democratic Coalition (PCP-PEV)
1	Ex ante coordination of the main economical reforms	No specific mention, but probably supports	No specific mention, but probably supports	No mention	No specific mention, but probably does not support
2	Convergence and Competitiveness Instrument (CCI)	No specific mention, but probably supports	Support	No mention	No specific mention, but probably does not support
3	Promoting Investment in the Eurozone	Support	No specific mention, but probably supports	No specific mention, but probably supports	No specific mention, but probably supports
4	Consolidating the external representation of the Eurozone	No mention	No mention	No mention	No specific mention, but probably does not support
5	Reinforcing fiscal and economic integration	Support	Support	No mention	No support
6	Developing a fiscal capacity adequate for the Eurozone based on the CCI	Support	Support	No mention	No specific mention, but probably does not support
7	Creating a redemption fund	Support	No specific mention, but probably supports	No specific mention, but probably supports	No specific mention, but probably does not support
8	Making the issue of euro-bills possible at European level	No specific mention, but probably supports	No specific mention, but probably supports	No mention	No specific mention, but probably does not support
9	Concluding the Banking Union	Support	Support	No mention	No support
10	Concluding fiscal and Economic Union	No specific mention, but probably supports	No specific mention, but probably supports	No mention	No support
11	Developing fiscal capacity with a macroeconomic stabilisation instrument	Support	Support	No mention	No specific mention, but probably does not support
12	Political Union	Support	Support	No specific mention, but probably supports	No support
13	Social Union	Support	Support	No specific mention, but probably supports	No support

No specific mention, but probably supports · No specific mention, but probably does not support · No mention · Support · No support

TABLE Nº10 POSITION OF THE PRINCIPAL PORTUGUESE POLITICAL PARTIES ON DEEPENING EMU
(Source: Political programmes for the 2014 European elections)

		PS	AP (PSD AND CDS-PP)	BE	CDU (PCP-PEV)
1	EX-ANTE COORDINATION OF MAIN ECONOMIC REFORMS	**No specific mention**, although supports the guarantee of true coordination of economic and social policies of the Eurozone countries.	**No mention**, although supports reinforced economic governance, with coordination of economic policies.	**No mention.**	**No mention**, although probably not supported, in that this implies more integration.
2	CONVERGENCE AND COMPETITIVENESS INSTRUMENT (CCI)	**No specific mention**, although refers to the need to complement national budgets with a specific fiscal capacity for the Eurozone to support reforms.	**Supports** (e.g. the EU should promote structural reform in Member States through a system of 'contractual arrangements' and 'associated solidarity mechanisms', mutually agreed by the Member States).	**No mention.**	**No mention**, although probably not supported, in that this implies more integration.
3	PROMOTING INVESTMENT IN THE EUROZONE	**Supports** (e.g. complement national budgets with a fiscal capacity specific to the Eurozone to support investment and reforms, and to protect against economic shocks).	**Supports**, although not specifically in the Eurozone.	**Supports,** although not specifically in the Eurozone. Defends investment spending being excluded from calculating the deficit.	**Supports**, although not specifically in the Eurozone. Defends the increase in the EU budget to reinforce public investment.
4	CONSOLIDATING EXTERNAL REPRESENTATION OF THE EUROZONE	**No mention.**	**No mention.**	**No mention.**	**No mention**, although probably not supported, in that this implies more integration.
5	REINFORCING FISCAL AND ECONOMIC INTEGRATION	**Supports** (e.g. greater share of fiscal powers between the Member States and the EU; proceed with fiscal convergence).	**Supports** (e.g. well functioning EMU implies (...) reinforcing economic governance, with coordinated economic, fiscal and budgetary policies between European institutions and governments and the national parliaments).	**No specific mention,** although supports revision of current structures for coordination with organisation of a referendum on a Budgetary Pact. Defends fiscal coordination with a view to harmonising tax on income from capital, as well as an active European wage policy to combat economic imbalances between Member States, including a wage increase at the centre of the EU and a fixed minimum wage that accompanies average wages.	**Does not support.** Defends the reversibility of agreements and treaties that govern current integration, beginning with the Treaty of Lisbon, the Fiscal Compact and legislation on economic governance, an end to the Stability Pact and the dissolution of EMU.

TABLE Nº10 POSITION OF THE PRINCIPAL PORTUGUESE POLITICAL PARTIES ON DEEPENING EMU
(Source: Political programmes for the 2014 European elections)

		PS	AP (PSD AND CDS-PP)	BE	CDU (PCP-PEV)
6	DEVELOPING FISCAL CAPACITY ADEQUATE FOR THE EUROZONE BASED ON CCI	**Supports** (e.g. complement national budgets with a fiscal capacity specific to the Eurozone to support investments and reforms and to protect against economic shocks).	**Supports** (e.g. within the framework of 'contractual arrangements', Member States involved in fiscal consolidation and in structural reforms should have facilitated access to a funds system for specific areas).	**No specific mention**, although supports an increase in the EU's budget, redistributive in nature and with a view to developing a European development strategy.	**No mention, although probably does not support**, as this implies more integration. Defends more the reinforcement of the Community budget by revising the current Multi-Annual Financial Framework, leading to a budget funded on national contributions, measured according to Gross National Income (GNI), and with the aim of ensuring its redistributive function.
7	CREATING A REDEMPTION FUND	**Supports** (e.g. defends partial sharing of management of public debt of Member States).	**Não menciona em específico**, although supports future development of solidarity mechanisms and risk sharing.	**No specific mention**, although supports creating debt management instruments for the EU.	**No mention,** although probably not supported, in that this implies more integration.
8	MAKING EURO-BILL ISSUE POSSIBLE AT THE EUROPEAN LEVEL	**Não menciona em específico**, although supports the issue of euro bonds.	**Não menciona em específico**, although supports future development of solidarity mechanisms and risk sharing.	**No mention.**	**No mention, although probably not supported,** in that this implies more integration.
9	CONCLUDING BANKING UNION	**Supports** (e.g. full implementation of Banking Union).	**Supports**, in that it considers Banking Union is a priority for Portugal.	**No mention.**	**Does not support.** Defends rejection of the Banking Union.
10	CONCLUDING FISCAL AND ECONOMIC UNION	**No mention**, but supports initiatives that require more fiscal and economic integration.	**No mention**,but supports initiatives that require more fiscal and economic integration.	**No mention.**	**Does not support.** Defends the end of the Stability Pact, dissolution of EMU and creation of a support programme for countries whose continuation in the euro has been revealed to be unsustainable, that provides for due compensation for damages caused and that includes a negotiated exit for these Eurozone countries, apart from recovering instruments for monetary, exchange, budgetary and fiscal sovereignty.

TABLE Nº10 POSITION OF THE PRINCIPAL PORTUGUESE POLITICAL PARTIES ON DEEPENING EMU
(Source: Political programmes for the 2014 European elections)

		PS	AP (PSD AND CDS-PP)	BE	CDU (PCP-PEV)
11	DEVELOPING FISCAL CAPACITY WITH A MACROECONOMIC STABILISATION INSTRUMENT	**Supports** (e.g. to give the Eurozone the fiscal capacity to complement national budgets in order to protect them from economic shocks; fiscal capacity for the Eurozone with own revenue by creating a tax on cross-border financial transactions, to be paid by the banks).	**Supports** (e.g. progress with EMU means reinforcing the EU's fiscal capacity; application of fiscal resources should leave a European mark, dissociating it from granting resources to some on behalf of others, facilitating the introduction of effective anti-crisis measures and ironing out imbalances that affect the smooth running of EMU).	**No mention.**	**No mention, although probably not supported**, in that this implies more integration.
12	POLITICAL UNION	**Supports** (e.g. directly elect the President of the European Commission and the political programme of the same; reinforce the role of the European Parliament and coordinate it better with national parliaments; reinforce transparency in decisions and the accountability of political players; reinforce participative democracy and access to information).	**Supports** (e.g. deepening European construction implies defending and reinforcing the Community method to the detriment of inter-governmental logic; safeguarding the Community method demands a strong Commission; the importance of the European Parliament should be encouraged; boosting national parliaments is indispensable; the special nature of the Eurozone should be recognised in the institutional plan, which makes it legitimate to create decision-making bodies specific to the Eurozone) órgãos de decisão próprios para a área do euro).	**No specific mention**, although defends that the European institutions, including the European Central Bank (ECB), and governments of Member States are directly accountable to citizens through effective democratic control. Also defends, among other things, introducing the capacity of legislative initiative to the European Parliament, as well as changing the statutes of the ECB in order to increase political scrutiny of the Bank.	**Does not support, in that it implies more integration**. Defends safeguarding democracy and national sovereignty and defends the effective participation of peoples in determining their destiny, as well as reinforcing the decision-making capacity of national parliaments on EU policies.
13	SOCIAL UNION	**Supports** (e.g. definition of social objectives that rebalance European macro-economic supervision).	**Supports** (e.g. promote at the European level the harmonisation of national provisions such as the way to correct 'social fractures' resulting from the imbalances between Member States and encourage a true internal market: weigh up the possibility of introducing European social payments, whenever this is justified to correct the effects of asymmetrical shocks in the context of EMU).	**No specific mention**, although supports reinforced political cohesion.	**Does not support, in that it implies more integration**. Defends coordination with a view to convergence of progress for labour and social norms and legislation, higher wages and rejection of the Europa 2020 strategy, as well as its replacement by a Social Progress and Employment Pact.

IV. CONCLUSION

In concluding the Economic and Financial Assistance Programme (EFAP) in June 2014 with a clean exit, Portugal gained more government room for manoeuvre in fiscal and economic terms, and from now on is free to determine its own fiscal and economic policies providing it complies with agreed EU limits. However, the country exceeded the reference figures agreed for deficit and public debt during the crisis, so currently it must reduce both indicators under the Excessive Debt Procedure (EDP), in line with the Stability and Growth Pact (SGP) and the Fiscal compact.

Government estimates presented in the Fiscal Strategy Document (FSD) for 2014-2018, indicate that the targets for the deficit in 2015 and for public debt in 2042 will be met. However, will these goals really be achieved? And if they are, at what cost?

Government estimates have been the subject of debate in Portugal for several reasons. The two main concerns are the possibility that:

- the economic adjustment process implemented in Portugal, to make the economy more competitive, encourage growth and ensure the sustainability of public debt, impoverishes the country to the point of jeopardising Portugal's social and political sustainability in the Eurozone; and
- the recessive effect of the adjustment adopted at the same time in several deficit Eurozone Member States spreads contagion throughout the Eurozone, and so aggravates the crisis. Both the social and economic costs revealed during the period in which the EFAP was in force, as well as current deflation, and the consequent threat of a long period of weak growth or economic stagnation in Europe, sustain these concerns.

Meeting these challenges means adopting a more symmetrical, balanced adjustment, but one for which the current European framework does not have the necessary instruments. The route forward is already mapped out in general terms, in several documents prepared by the European institutions on deepening EMU. Having strengthened the pillars of European accountability – the structures for supervising and coordinating the fiscal and economic policies of the EU Member States -, done initially in response to the crisis, it is now time to consider developing the instruments for European solidarity required for EMU and the Eurozone to function well, and to seek an exit from the crisis based on sustainable growth.

However, deepening EMU is not without obstacles. Reforming the EU treaties, required to adopt certain initiatives, is immediately one of the major challenges to be overcome, because not all EU Member States are currently open to this scenario. Furthermore, not all share the same view of these initiatives.

To be successful, Portugal will have an interest in forming alliances on those initiatives that respond most to its needs. Its approach will have to take into account the timeframe and institutional alignment, as well as the format of the desired European integration process, so that it initially adopts the European framework at the national level in order to then defend reinforcing the framework for European economic governance, including pushing for changes to the EU treaties, if necessary.

The prospect of substantial reform to the EU treaties may justify holding a national referendum to consolidate the democratic legitimacy of the choice made for the European integration project.

Should this happen, it will be for the Portuguese political parties to play a pivotal role in convincing citizens and gaining their support.

It will be for Portugal to consider a series of short, medium and long term initiatives with a view to improving the framework for European economic governance in order to ensure that both the EMU and the Eurozone function smoothly, as well as to seek an exit from the crisis based on sustainable growth.

The table below includes proposals put forward to date for these initiatives, with the exception of those presented in the two previous documents on the political deepening of EMU.

In the short term (2013-2014):

- Establish an *ex-ante* coordination framework for the principal economic reforms (p. 36).
- Create a fund to support structural reforms (p. 37).
- Promote investment in the Eurozone (p. 39).

In the medium term (2014-2017):

- Reinforce fiscal and economic integration (p. 39).
- Develop an adequate fiscal capacity for the Eurozone based on a fund to support structural reforms (p. 42).
- Develop the social dimension for EMU in its different aspects, ensuring that recently created scoreboards of social and employment indicators contribute to an analysis of the social dynamics of the EU Member States and use these for the specific recommendations made to each country (p. 45).

In the long term (pós-2017):

- Create a public debt redemption fund and allow the joint issue of euro-bills (p.41).
- Conclude banking union (p.42).
- Conclude fiscal and economic union (p. 42).
- Develop the fiscal capacity to fund a macroeconomic stabilisation instrumenta (p. 42).

On-going:

- Promote a network of stable alliances with countries of a similar dimension that share the same interests in relation to the process of European integration (p. 44).

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Final Conclusion

This chapter offers a summary of the research project carried out during the first semester of 2014 by the Platform for Sustainable Growth (Plataforma para o Crescimento Sustentável, PCS) on Portugal and the European Union, the purpose of which is to allow for an easier understanding of the work's general conclusions. To this end, it adopts the following structure: first, it recalls the objectives of the research project conducted within the context of PCS' work and development; then, it explains the process adopted in response to the objectives defined; and, finally, it highlights the general conclusions resulting from the research undertaken.

The objectives of the research project

PCS published the *Report for Sustainable Growth: a post-troika strategy* in December 2012, including one chapter dedicated to the global challenges that Portugal faces today. In this chapter, the organisation identified in particular the challenge of "fully assuming the European, Atlantic and Universalist vocation" of Portugal, and proposed three strategic guidelines, one of which is directly linked to Portugal's participation in the EU, i.e., "participating more actively in the EU with a view to strengthening Political Union and fully asserting the EU's position in the world." PCS reaffirmed the importance of this strategic guideline in November 2013 with the launch of a *Contract for Sustainable Growth*, a second more targeted and strategic document. In it, PCS stated that Portugal should "be an active agent in improving the European Union in order to increase its legitimacy, efficiency and cohesion, protecting the principles and values that prevailed in the constitution of the European Communities, with respect to the balance between the Member States, within a framework of solidarity associated with the economic, social and territorial cohesion of the Union and strengthened European citizenship".

One year after the first PCS report was published, Portugal had come closer to exiting the Economic and Financial Assistance Programme (EFAP), with only about six months left to go. The troika's departure was gradually getting in sight and, as a result, so was the time to carry out the country's strategy devised by PCS. The troika was then expected to leave Portugal towards the end of May, shortly after the celebration of the carnation revolution's 40th anniversary on 25 April and just before the European Parliament elections, scheduled for 25 May 2014, in Portugal.

In this context, PCS thought it would be both useful and important **to support a research project on Portugal and its role in deepening the EU, thus contributing to the corresponding national debate.**

The preliminary stage

Taking advantage of the expected electoral context, PCS initially sought to address to two questions:

- **What are the issues of importance to Portugal within the context of the European Parliament elections?**
- **What are the chief PCS recommendations on these issues?**

To respond to these two questions, a preliminary research proposal was prepared and presented in an internal meeting. Having looked at the debate already in progress on European Parliament elections, including within and between European institutions, think tanks and the media, the proposal identified the following issues as being important to Portugal:

- **Strengthening the democratic legitimacy of the EU**, promoting greater participation of European citizens, as well as greater involvement of national parliaments in the European decision-making process.
- **Ensuring Portugal's capacity for sustainable growth in a post-troika period**, in light of European economic governance reforms and with a balance between fiscal discipline, an increase of competitiveness via structural reforms, and social wellbeing.
- **Contributing to the EU's and, in this manner, Portuguese world projection, as a way of dealing with globalisation**, taking into account the EU's own institutional architecture and global strategy, exploiting EU trade and investment opportunities and investment opportunities and developing synergies between the different international spaces in which Portugal participates, such as the EU and the Community of Portuguese Speaking Countries (Comunidade de Países de Língua Portuguesa, CPLP).

To guide the ensuing research, each topic was eventually re-phrased as a question:

- **How to ensure the democratic character of European governance**, in the face of growing sovereign power transfers to Brussels?
- **How to ensure sustainable growth in a post-troika period,** including a balance between fiscal discipline, increased competitiveness via structural reforms and social wellbeing?
- **How to contribute to EU, and in this manner Portuguese world projection**, making the most of global opportunities, while also facing global challenges posed to the country?

Bearing in mind this set of proposals and without overlooking the importance of the third topic, PCS decided to develop its research project around the first two questions, in order to better deal with the issues selected within the proposed timeframe.

Debates, support documents and extensive work

The debates, including the support documents prepared, speaker presentations and subsequent discussions, **were initially conceived to provide room for discussing the issues identified as being important to Portugal, the guiding questions arising from these issues and the proposals submitted by PCS in this context.** The support documents prepared for the first debate were therefore designed in response to the first leading question in the PCS's research project; while the support document for the second debate came to serve as a basis for more extensive research work on Portugal and European economic governance, through which an attempt was made to respond to the second leading question.

The support document for the third debate was the exception to the rule, in that it was not initially conceived as a direct contribution to the research work. In this case, it was more of a discussion and response to the three questions directly related to the election results:

- What was the impact of the election results in the selection of the next President of the European Commission?
- Was there an increase in populist forces in the European Parliament? If so, what would the consequences be on the political and democratic balance within this institution?
- What was the impact of the electoral results on the strengthening of the European integration project?

Once the debates had been concluded, our goal was **to deepen some of the issues addressed until then**, in light of comments received on the support documents. As such, the support documents for the first and third debates were edited, and the document for the second session was used as a basis for more extensive work on Portugal and European economic governance.

General conclusions

The first leading question of the PCS's research project enquired how to **consolidate the democratic character of European governance**, given the growing transfer of sovereign powers to Brussels, promoted in response to the Euro crisis and particularly in view of the EU citizen's loss of trust, not only in European and national political institutions but also, in the case of Portugal, in its own political regime, democracy.

The research work done in response to this first question suggested **two different approaches**, among several other possible ones. First, **consolidating the European political space was considered as a way of improving the exercise of European citizenship**, including the right to vote. Reforms were suggested on the way political parties and Portuguese Members of Parliament acted, as well as on the organisation of the elections in the EU. Then, consideration was given to the **political deepening of Economic and Monetary Union (EMU), to create and consolidate the mechanisms necessary for the democratic accountability and legitimacy of European and national political institutions**. In this case, two general fields of action were distinguished, the national field, where national parliaments act, and the European field, where the national parliaments and the European Parliament act and interact.

For Portugal, in particular, it was important to bear in mind the conclusion of the EFAP and a return to the context of European economic governance strengthened during the crisis. This **specific context** today advises **a study on the role that the *Assembleia da República* (AR) can and should play in the European decision-making process, particularly in fiscal and economic matters.** In not necessarily depending on other countries, reforms adopted nationally on the role of the national parliament in European economic governance, such as developing a National Semester, could help promote the adoption of the European framework, its political scrutiny and, as a result, its democratic character.

The second leading question looked to **sustainable growth in the post-troika context**, as a balance between fiscal discipline, competitiveness with structural reforms and social wellbeing. In fact this issue took on special importance in Portugal in light of the association between growing unemployment and a lack of EU citizen trust in the EU itself, described in the second support document for the first debate. If, initially, the approach used for analysis, also reflected in the support document for the second debate, led to a diverse set of approaches (e.g. from institutional reforms to specific initiatives, addressing areas such as support for more energy and digital market integration, or promoting trade and investment agreements); later, it became necessary, also for reasons of time and resources, to select one issue in particular and to deal with it thoroughly. This is why it was decided to examine the issue of **sustainable growth from the point of view of European economic governance**, selected for several reasons (cf. Researcher's Note).

The second leading question in PCS's research project therefore became: **how to improve the European framework to support an exit from the crisis based on sustainable growth?** To respond to this, PCS's research project looked into the question of Portugal and European economic governance, looking particularly at the current framework of European economic governance, its impact on the country and ways of improving it over time. Having taken the recommendations made by the European institutions, and in particular by the European Commission and the European Council as a reference, the work concluded that **although essential to sustainable growth, reforms to the framework of European economic governance presented and discussed currently at European and national level are not without obstacles**. Changes are required to the European treaties to improve many of the reforms associated with improving the framework of European economic governance. Furthermore, some of the reforms suggested will tend to exacerbate the distinction between the countries of the Eurozone and the remaining EU Member States, and may also aggravate existing tensions between these groups if their fears are not taken into consideration.

For Portugal, **improving the framework of European economic governance** and, as a result, **changing the European treaties, seems essential in that they address the challenges the country is currently facing and look to ensure the good functioning of the EMU, as well as support an exit from the crisis based on sustainable growth**. This is why the country should **begin to think of generating political consensus** at the national level on the reforms to European economic governance most associated with its interests, so that, late **alliances can be formed with EU Member States that share similar, if not identical, positions**.