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Rethinking EU economic governance: The European Semester

Frederico Mollet
Policy Analyst
European Policy Centre

In the debates over the future of the EU's economic governance, the reform of the Stability and Growth Pact (SGP) occupies centre stage. But the European Semester – the framework governing economic policy coordination and country surveillance – is also critical. Reforming and strengthening it is vital given the multiple challenges the EU faces, from the twin green and digital transitions to implementing the Recovery and Resilience Facility (RRF) and tackling the macroeconomic and structural scars left by COVID-19.

This Policy Brief, the second in a series of EPC papers, sets out a set of proposals for reforming the European Semester. It draws on the insights of the EPC's Task Force on Rethinking EU Economic Governance, which has gathered experts, academics and policymakers. However, the contents of this paper and views expressed are entirely the work of the author and should not be interpreted as representing the views of any Task Force member.

BACKGROUND

The European Semester

Member states must treat their economic policies as a matter of 'common concern' and coordinate between themselves (TFEU Art.5, 119, 121). The European Semester was introduced in 2010 to streamline and deepen this process of economic coordination. It brought together and synchronised several procedures into an integrated annual framework to surveil and coordinate fiscal, macroeconomic and structural policies across the Economic and Monetary Union (EMU).

The Semester sought to achieve three main objectives:[1]

- strengthen the oversight of individual member states' policies by having a continuous and integrated cycle of surveillance;
- link the surveillance of fiscal risks with that of macroeconomic and structural risks; and
- provide a cross-cutting assessment of the outlook and risks faced by the EMU and euro area as a whole.

The Semester's components can be broadly divided into the SGP, broader economic and structural policies, and the Macroeconomic Imbalances Procedure (MIP). It also incorporates social and sustainability concerns, such as the UN's Sustainable Development Goals. The binding force of the Semester's different components varies drastically. The SGP created a set of prescriptive and enforceable obligations, but otherwise, EU bodies do not have substantive powers to guide national economic policy.

The yearly timeline of the Semester is as follows:

October: Euro area member states present their draft budgetary plans (DBPs) for the following year.

November: The European Commission publishes the Annual Sustainable Growth Survey, the Alert Mechanism Report (AMR; see below), a draft Joint Employment Report, recommendations for the euro area, Opinions on the DBPs, and an overall assessment of the budgetary situation and prospects of the euro area as a whole.

February: The Council adopts the euro area recommendations. The Commission publishes a country report for each member state, analysing its economic situation and progress in implementing their respective country-specific recommendations (CSRs) issued during the previous cycle.

April: Member states present their three-years-ahead budgetary plans called Stability (for euro area members) and Convergence (for non-euro area members) Programmes (SCPs), and National Reform Programmes (NRPs), which cover their economic and structural policies.

May: The Commission assesses the SCPs and proposes CSRs on fiscal, macroeconomic and structural issues.

June-July: CSRs are endorsed by the European Council and adopted by the Council.

The Macroeconomic Imbalances Procedure

The MIP was introduced as part of the 2011 eurozone crisis reforms to serve as an early warning mechanism that identifies non-fiscal macroeconomic risks, such as rising private debt, potentially damaging asset price dynamics or current account imbalances. The AMR, which screens member states based on a scoreboard of indicators, kicks it off at the beginning of the Semester. Risks of serious imbalances can trigger an in-depth investigation by the Commission into a country's potential macroeconomic imbalances. Any specific recommendations that emerge henceforth are incorporated into member states' CSRs. The MIP's Excessive Imbalance Procedure mirrors the SGP's Excessive Deficit Procedure but has never been activated.

The pre-COVID-19 European Semester

The Semester introduced a more coherent and integrated framework of economic surveillance, but its impact beyond the SGP is often viewed as weak. CSR implementation is poor and has been declining since the European debt crisis,[2] and a common criticism is that there is little prioritisation to guide member states and that the yearly cycle is unsuited for long-term reforms.

Many in the EPC Task Force argued that the Semester should be judged less on CSR implementation and more on the extent to which it fosters dialogue and debate on economic policy, given the Commission's lack of substantive enforcement powers beyond fiscal policy. On this criterion, opinion is divided. On the one hand, the Semester process has led to in-depth engagement between the Commission and member states' civil services, as well as with a wide range of social partners and non-governmental stakeholders. On the other, the impact on wider national debates has been criticised as being relatively shallow, with little national ownership at political levels. Both the European and national parliaments play limited roles, if any. For the MIP specifically, even among experts, the process is apparently not well-known or the basis for substantive policy discussions.[3]

The Semester has also been criticised for becoming a bilateral exercise between the Commission and individual member states, with limited multilateral engagement.[4]

STATE OF PLAY

The Recovery and Resilience Facility, on paper

The creation of the RRF was a significant innovation in the EU's economic governance framework. To summarise its structure, the funds borrowed at the EU level will be distributed to member states following their National Recovery and Resilience Plans (NRRPs). These plans cover both investments and reforms and contain multiple targets and milestones which must be met to receive funds. Member states designed these plans, which therefore reflect national priorities and political objectives. However, they must also address their pre-existing CSRs, follow overarching Commission guidance, and involve close engagement with the Commission. The Semester has been amended to integrate the NRRPs. Member states will report on their milestones twice a year, alongside the NRPs and DBPs, with the reports incorporated into the respective NRPs. The Commission will update an implementation scoreboard in parallel, and present an annual report to the European Parliament and Council in July.

The Recovery and Resilience Facility, in practice

The assessment of the RRF to date has been very positive among observers and policymakers. In contrast to the Semester's top-down, 'teacher to student' process, the bottom-up nature of the NRRPs has been praised. It is judged to have increased the level of national ownership and allowed for country-specific prioritisation between competing objectives.[5] Likewise, its concrete, multiannual plans and milestones are viewed as shifting the focus to actionable long-term outcomes rather than annual processes. Of course, the large sums of funding attached are a key reason for the levels of national engagement. Nevertheless, the EPC Task Force members considered it a source of inspiration for revamping the Semester process more widely.

One area of criticism was the lack of participation by social partners, the European and national parliaments, and other stakeholders. Cross-border, pan-European projects were also limited.[6] This has been justified by the extraordinary circumstances of the pandemic and the short timeframe to set up a new instrument.

PROSPECTS

Implementing the RRF is one of the EU's critical governance challenges. If successful, it could serve as a template for deeper reforms to the EU's economic governance architecture. Beyond the RRF, the need for effective EU economic policy coordination is growing. In addition to new macroeconomic imbalances and structural scars that may arise from the pandemic, the EU must manage just green and digital transitions whose challenges and implications cut across member states.

The challenges of reform can be split into three strands: (i) integrating the RRF into the Semester; (ii) drawing on the positive lessons of the RRF process; and (iii) improving the effectiveness of cross-cutting policy coordination and the MIP.

Integrating the Recovery and Resilience Facility into the European Semester

Three main considerations must be accounted for when implementing the RRF, besides ensuring that bureaucratic processes are streamlined.

The first is that effective economic coordination remains an important objective outside the implementation of the NRRPs. Given the sums and political capital at stake, it is appropriate that the Commission allocates its resources proportionately and monitors countries receiving large RRF funds more closely than others. However, there must be safeguards to ensure that the other countries' economic challenges and structural imbalances also receive appropriate attention. Surveillance could focus on a selected number of key priorities, with high spillovers to the rest of the EU.

Second, as a default, CSRs should remain fixed for countries with substantive plans. Delivering the plans already constitutes an important challenge without having to introduce additional policy priorities. The bar for introducing new CSRs should be high.

The third is the question of political accountability. The Commission has gained greater leverage to guide national economic policy and enforce reform commitments. This makes the Commission politically responsible for engaging with a broad range of stakeholders, particularly those who could not be consulted in the design of NRRPs. Existing Commission engagement will have to be re-emphasised and stepped up. It is, fundamentally, national governments that hold the power to involve stakeholders and national parliaments. Nevertheless, **the Commission should still use its influence to carve out a wider role for stakeholders where feasible**. The European Parliament should also exercise its powers under the RRF Regulation 2021/241 to provide additional democratic scrutiny.

Lessons from the Recovery and Resilience Facility

The RRF introduces two major innovations into EU economic governance:

- Concrete, long-term investment and reform plans to address CSRs and pan-European priorities. In particular, clear milestones and targets for a transparent and structured assessment of national measures to tackle complex economic policy challenges.
- National administrations lead on the design of their own plans (with appropriate guidance from the Commission), creating stronger national and political ownership and allowing greater country-specificity.

This approach has the potential to improve economic policy coordination significantly by requiring member states to be explicit about how they plan to operationalise their CSRs, with milestones to which they can be held accountable. Such plans also encourage addressing fiscal, macroeconomic, social and structural issues (including green and digital transition) as a comprehensive package.

One option would be for **national reform and investment plans** (NRIPs), designed to address CSRs and EU-wide priorities, **to become a standard feature of the Semester**, even if the RRF is not replaced with another instrument. These could replace the NRRPs and be designed on a multiannual cycle of three or four years, with milestones monitored in the intervening period. CSRs would be fixed over this period. It would also make sense to adapt the SCPs to focus more on the composition of public investments within budgetary plans and create an explicit link between forward-looking budget plans and the public investment objectives in NRIPs. Overall, this would be a step forward in placing greater focus on the composition and quality of public finance, something that is increasingly called for.[7]

Of course, funding is a key driver for national engagement and political ownership of the NRRPs. Without such funds, the Commission would only be able to monitor and publicly hold member states accountable, so expectations should be realistic. Nevertheless, this approach could still be an improvement over the status quo. Explicit milestones would increase high-level political ownership and facilitate engagement by social partners, civil society and national parliaments. This could bolster the Semester's visibility and impact on national economic policy debates – a key objective identified by the EPC Task Force.

The impact of such NRIPs could be increased, however, if they were linked to the exercise of the SGP's flexibility clauses. The application of the clauses in practice is complex and opaque. Flexibility has also not always been used for high-quality public spending, creating mistrust and opposition to greater flexibility. Case in point, before COVID-19, public expenditure higher than forecast under the SCPs went to current expenditure rather than investment.[8] **The exercise of flexibility could instead be linked to NRIPs signed off by the Council and dependent on the regular meeting of intermediate annual milestones and targets.**

In the debates over SGP reform, additional flexibilities have been proposed, for example, for green investment or country-specific debt reduction paths. However, the use of flexibility creates a potential trade-off with faster debt consolidation, and with potential spillovers to other member states. Therefore, one of the key political obstacles to generating consent for such flexibility is ensuring that it is used for high-quality, pro-growth public spending. The link to pro-growth reforms is also important since these are essential for long-term fiscal sustainability. The NRIP/NRRP model could provide a strong governance framework, with substantial national ownership that ensures that flexibility is not being abused.

There would be a clear danger of overburdening the SGP within the Semester process, and the focus on the composition of domestic fiscal and economic policy raises legitimacy questions. However, for reforms and investments with a clear link to long-term fiscal sustainability, or EU-wide investment priorities which have clear and widespread political support, like the green transition, the case for legitimacy is much stronger. This could be bolstered further by giving the European and national parliaments a greater role.

Improving cross-cutting policy coordination and the Macroeconomic Imbalances Procedure

The proposals above pertain primarily to country-specific surveillance. But prior studies tend to find that cross-cutting policy matters are neglected and that the Semester has little impact on macroeconomic imbalances. These weaknesses must also be addressed.

On the former, the EMU's decentralised economic policymaking limits what can be achieved. Addressing pan-European issues with high spillovers by coordinating the policy of autonomous member states is extremely challenging. Council debates on Semester outputs tend to defend country-specific perspectives. Political fora outside the formal Semester, like the Eurogroup and the informal Economic and Financial Affairs Council (ECOFIN) meetings, allow such cross-cutting issues to be discussed in more depth, but their direct impact on national policy is limited.

There may be scope to create more multilateral dialogues at a civil service level, within the Semester, outside of formal decision-taking bodies. Emulating informal political formats, they could familiarise national civil services with pan-European issues and perspectives. Such dialogues could also bring in external stakeholders to increase their impact on national policy discussions.

Nevertheless, **providing a cross-cutting European perspective is fundamentally the Commission's role**. Its CSRs and guidance to specific countries should reflect these issues and be consistent with a pan-European perspective.

Regarding the MIP, the EPC Task Force agreed that given the nature of the risks addressed, one had to be realistic about what could be achieved. Using sanctions was seen as both politically and practically undesirable. The Task Force emphasised that the MIP should strengthen dialogue and debate among the relevant policymakers and that it should be better integrated into the overall Semester process.

Given the poor awareness of the MIP, one step forward could be to introduce multilateral policy dialogues, as described above. The AMR could serve as the basis for discussion. More use should be made of fora like the Eurogroup or informal ECOFIN to discuss the MIP's findings at a political level.

The MIP's country-by-country approach has also been criticised, as has the disconnect between the SGP and MIP processes. These facets could be ameliorated by introducing a separate opinion on the aggregate impact of the submitted SCPs on the EU's imbalances into the MIP process. The NRIPs proposed above should also address MIP CSRs, potentially strengthening their impact.

Finally, the Commission has indicated that expanding the scope of the MIP to include climate-related and environmental pressures is under consideration.[9] This risks overburdening the MIP, and it is not clear whether such pressures could be well-articulated in macroeconomic terms. It would be preferable to address such critical risks in a separate procedure, and ensure that the findings were reflected in a coherent set of CSRs and operationalised in comprehensive NRIPs, linking to the fiscal impact of such risks in the SCPs.

CONCLUSION

The European Semester must be realistic about what can be achieved with the EU's current competencies. The RRF could lead to more fundamental structural change but will depend on its successful implementation. One option to increase the impact of the Semester within the EU's existing competencies would be to link the exercise of SGP flexibilities to NRIPs modelled on the RRF. In the absence of such incentives for member states, the Semester can only try to promote meaningful policy debates. This can be advanced by drawing on the RRF's innovations to get member states to engage with the process and the EU's recommendations more substantively.

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3 *Ibid.*

4 Wieser, Thomas (2020), What Role for the European Semester in the recovery plan?, PE 651.368, Brussels: European Parliament.

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6 *Ibid.*

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8 Thygesen, Niels; Roel Beetsma; Massimo Bordignon; Xavier Debrun; Mateusz Szczurek; Martin Larch; Matthias Busse; Mateja Gabrijelcic; Eloïse Orseau; and Stefano Santacroce, "Reforming the EU fiscal framework: Now is the time", *VoxEU*, 26 October 2020.

9 European Commission (2021), Communication on the EU economy after COVID-19: implications for economic governance, COM(2021) 662 final, Strasbourg.

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