BRIEFING

What role for the European Semester in steering the economic recovery?

On 20 May 2020, the European Commission is expected to propose its 2020 Country Specific Recommendations (CSRs) and the Council is expected to discuss and finally adopt the 2020 CSRs in July. The competent Committees of the European Parliament will organise a hearing with the Commission on the CSRs in late May. This note presents an overview on how the European Semester framework could provide an useful tool to steer an economic recovery by coordinating national and EU policies, in view of the medium and long term objectives related to sustainable and inclusive growth.

Adjusting the European Semester Cycle to the Pandemic

Due to the pandemic crisis, the current cycle of the European Semester for economic policy coordination will need to take into account the new economic reality and focus on short term policies that can support Member States in mitigating the direct and indirect negative effects of the outbreak and support recovery. However, the medium and long term policy objectives of the Semester related to sustainable and inclusive growth remain valid and can provide a compass for the short term measures.

Tools that were never tested before - but were already agreed in the Semester framework - have been used for the first time or adjusted to deal with the effects of the corona crisis.

On 23 March 2020, the Council, based on a proposal by the Commission, activated the general escape clause under the Stability and Growth Pact (SGP) in order to provide leeway for Member States to adopt emergency measures with major budgetary consequences. Hence, the fiscal recommendations adopted by the Council in July 2019 are currently not applicable. Moreover, many Member States have also triggered national escape clauses to suspend national budgetary restrictions.

On 6 April 2020, the Commission provided guidelines on how the format and content of the 2020 Stability or Convergence Programmes (SCP) could be streamlined in light of the exceptional circumstances, and on 16 April 2020, the Finance Ministers of the EU agreed on the simplification of information requirements for this year's cycle of the European Semester:

> *Given the high degree of uncertainty as a result of the socio-economic fallout of the COVID-19 pandemic, the Commission has put forward a simplified process for this year's European Semester exercise. This is intended to preserve the European Semester's main milestones, while taking into account the challenging times member states are facing. In particular, there would be a streamlined approach for the submission of national reform and stability or convergence programmes (NRPs and SCPs) by member states.*

Following this guidance, the SCPs submitted by Member States focus on the short term budgetary measures taken to mitigate the economic impact of the pandemic. Compared to previous years, the programmes include fewer forecast figures, notably for 2021 (see separate EGOV note).

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In order to enhance the reliability of the underlying forecast figures of the SCPs, the EU requires that the macroeconomic forecasts used by the Governments are produced or endorsed by EU Independent Fiscal Institutions (IFIs). However, due to the extraordinary circumstances and in order to free up resources to estimate the budgetary and economic impacts of the crisis and government measures, many national IFIs decided not to fulfill this function in spring 2020.

These adjustments to the Semester demonstrate that the framework can be adjusted and used to cater for unexepected and dramatic situations. It has built-in features allowing flexibility.

The European Semester and economic recovery?

The European Commission is expected to publish its proposals for the 2020 Country Specific Recommendations (CSRs) on 20 May 2020. Due to the extraordinary uncertainty and the effects of the pandemic on the Member States' economic situation, the 2020 CSRs may be used to coordinate short term challenges that Member States are facing in mitigating the economic, financial and social consequences of the pandemic and preparing for the recovery.

However, the medium and longer terms objectives of the Semester related to environmental sustainability, productivity gains, fairness and macroeconomic stability[1] can provide guidance to steer the work.

Furthermore, as the President of the European Commission underlined in her speech to the European Parliament on 13 May 2020, the level playing field in the Single Market is being challenged. Therefore the Commission President suggested a response focused on:

- supporting those that need the most,

- pushing for investment and reform,

- strengthening economies by focusing on common priorities like the European Green Deal, digitalisation and Resilience.

The multilateral surveillance undertaken in the Council and in the Eurogroup may provide a useful platform to steer and discuss national and EU polices and their interlinkages.

Box 1: Daft Conclusions of the ECOFIN-Council (19 May 2020):

The Council calls for swift and targeted coordinated policy action for rapidly overcoming the economic crisis and building a basis for sustainable and inclusive growth.

The Council underlines that next to immediate measures for minimising the loss of life and reducing economic damages, it remains crucial to address structural challenges and vulnerabilities, in order to sustain the recovery from the crisis. Reform efforts and high-quality investment are key to this end, in particular to strengthen the economic resilience and facilitate the transition to a sustainable, digitalised and carbon neutral economy and respond to the challenges of population ageing.

The Council considers that the European Semester provides the framework for continued economic policy coordination in the EU, as well as for identification of new emerging challenges.

Furthermore, as part of the established Semester framework, national parliaments would be fully involved, notably in scrutinising their government commitments and actions. The European Parliament would scrutinise actions taken by the EU executives, notably by the Commission.

While the pandemic is clearly an exogenous and a common shock, it may have uneven effects on the economic situation of the Member States and thereby increase divergence between Member States due to their different economic structures and capacities to mitigate the negative effects. The Semester may therefore provide a framework to support demand and supply policies.

The recent economic developments (see box 2) imply that the assessment undertaken by the Commission as part of the 2020 Country Reports, notably under the macroeconomic imbalances procedure, will not

[1] The 2020 Annual Sustainable Growth Strategy presented by the Commission in December 2019 proposed a new economic agenda focussing of four dimensions: environmental sustainability, productivity gains, fairness and macroeconomic stability. In its Communication on the 2020 Country Reports, as presented by the Commission in late February 2020, the Commission stressed that this new economic agenda needed to be turned into concrete policies, such as investment strategies, responsible fiscal policies and structural reforms that advance competitive sustainability in all its dimensions.

anymore reflect the post-pandemic situation. This is also recognised in the draft conclusions for the ECOFIN Council of 19 May 2020[2], which stresses that the evolution of these imbalances should be monitored against the background of the pandemic.

The pandemic has and will further increase the budget deficit and public debt levels of all Member States (see box 2 and a separate EGOV briefing on public finance indicators). Once the uncertainty related to the economic effects of the pandemic is less severe and the escape clause of the SGP is not anymore active[3], the Commission and the Council will need to assess the new fiscal position of all Member States and provide the corresponding policy recommendations under the SGP[4].

To sum up, the European Semester, notably the CSRs, can provide a useful tool to support the coordination and surveillance of recovery policies, avoid policies with major negative spill-over effects among Member States and support a coordinated exit from temporary measures, such as state aid and tax benefit decisions. In assessing and implementing short term measures, the broader objectives of the Semester, such as policies relating to the sustainability of public finances, correcting macroeconomic imbalances, combating climate change, enhancing the digitalisation of public administration and social inclusiveness, can provide the frame for such actions.

In addition, the Member States of the Euro Area need specific attention and common tools to improve their resilience and capacity to absorb economic shocks. Progress on completing the Banking Union, and on a revamped Capital Markets Union, are good tools in this respect.

Box 2: Some takeaways from Commission 2020 Spring forecast

According to the Commission spring 2020 forecast the aggregate government budget deficit is expected to surge from 0.6% of GDP in 2019 to 8½% of GDP in both the euro area and the EU this year. This sharp increase largely reflects the work of automatic stabilisers and the sizeable discretionary fiscal measures. In 2021, the headline deficit is forecast to decrease to 3½% of GDP in both areas due to the expected rebound in economic activity and the unwinding of most of the temporary measures adopted in response to the COVID-19 crisis.

The Commission emphasises that some of the Member States which were hit the hardest by the virus are also the ones with the least policy space to respond. Divergences across Member States could become entrenched if national policy responses are not sufficiently coordinated or if there is no strong common response at the EU level.

Overall, the Commission stresses that the pandemic's economic impact is likely to be highly complex and widely varied. The economic effects differ with respect to demand and supply factors and with respect to the time horizon of their impact. The duration of the effects depends on the duration of the pandemic, but also on whether changes to trade policies and globalisation attitudes, consumer behaviour, working methods and production chains become permanent.

European Semester and possible new budgetary support from the EU

In order to mitigate the unprecedented economic and social effects of the pandemic, EU leaders have decided to strengthen (and create new) common tools to support the recovery in all Member States and to protect both the functioning of the internal market and the stability of the euro.

On 23 April 2020, the EU heads of state or government agreed on three safety nets for workers, businesses and sovereigns respectively, amounting to a liquidity package worth EUR 540 billion, and called for their operationalisation by the 1 June 2020. The Leaders also agreed to work towards establishing a Recovery

[2] The draft conclusions are expected to be adopted in written procedure, without discussion, at the 19 May Ecofin (see draft Ecofin agenda here).

[3] The activated general escape clause implies, according to the Commission, that the deviation from the SGP requirements will be temporary, while the Commission will apply the full flexibility provided for in the EU fiscal framework for as long as is necessary to allow Member States to implement measures to contain the coronavirus outbreak and mitigate its negative socio-economic effects.

[4] Pending the effects of the pandemic on public deficit and debt levels of the Member States, new medium term objectives for balanced budget policies, including appropriate adjustment paths, will need to be set in order to apply the provisions of the preventive arm of the SGP. For some Member States an assessment may be needed whether an opening of an Excessive Deficit Procedure would be warranted on the basis of the nominal deficit limit or the debt reduction path, while taking into account the flexibility included in the rules.

Fund and tasked the Commission to analyse the exact needs and to urgently come up with a proposal commensurate with the challenge.

On 13 May 2020, in a speech before the Parliament, the Commission President outlined her plan for the EU recovery. The Commission plan would build on two elements: the "*European budget – the MFF that you know well. Secondly – and on top of the budget - (...) a recovery instrument funded through a larger headroom*." She also pointed out on how to spend the EU money by referring to three specific pillars:

(i) Supporting Member States "*to recover, repair and come out stronger from the crisis*". This will be based on a "*new Recovery and Resilience tool - created to fund key public investment and reforms aligned with our European priorities: the twin transition to a climate-neutral and a digitalised and resilient Europe*" to be done "*within the European Semester*". This pillar will cover all Member States, however focus primarily on the ones most in need and build on top of the cohesion envelope within the MFF to be allocated based on the severity of the economic and social impacts of the crisis;

(ii) "*Kick-starting the economy and helping private investment to get moving again*" by strengthening InvestEU, creating a new Strategic Investment Facility[5] and proposing a new Solvency Instrument[6];

(iii) Learning from the crisis by strengthening programmes that have proven their value, such as RescEU or Horizon Europe, by creating a new Health Programme and by strengthening EU instruments for Neighbourhood, Development and International Cooperation and for pre-accession assistance.

On 15 May 2020, the European Parliament adopted its resolution on the new multiannual financial framework, own resources as well as the recovery plan, and notably called for an "*ambitious MFF that meets EU citizens' expectations and matches the political commitments and ambitions of the EU with the necessary financial means*" together with for "*bold decisions regarding the reform of the EU own resources system, including (...) a common consolidated corporate tax base, digital services taxation, a financial transaction tax, income from the emissions trading scheme, a plastics contribution and a carbon border adjustment mechanism*". Parliament Resolution also calls for a "*massive recovery package in line with Parliament's resolution of 17 April 2020*" with a "*Recovery and Transformation Fund (...) linked to the current and upcoming MFF and be aligned with its structure and objectives; (...) to transform our economies and strengthen their resilience through the pooling of strategic investments to support SMEs, and to increase job opportunities and skills to mitigate the impact of the crisis on workers, consumers and families; calls therefore for investments to be prioritised into the Green Deal, the digital agenda and achieving European sovereignty in strategic sectors, with a consistent industrial strategy and while shortening and diversifying supply chains and reorienting trade policies; calls for the creation of a new standalone European health programme*".

In addition, there are a number of proposals currently being discussed that have a relevant bearing for tackling the corona crisis and may play a role in the recovery phase. This is particularly the case of two instruments: the budgetary instrument for convergence and competitiveness (BICC) and the instrument for temporary support to mitigate unemployment risks in an emergency (SURE). One additional instrument - but outside the "EU community method" - the new ESM Pandemic Crisis Support (PCS), will also provide financial support for tackling possible liquidity problems of Euro Area Meember States related to the corona crisis.

BICC would allow financial assistance from the Union budget for implementing structural reforms and investments[7]. BICC has a clear link to the Semester as the priorities for reform and investment would be set

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[5] The Commission President said that the facility would aim to help invest in key value chains crucial for the EU future resilience and strategic autonomy, such as the pharmaceutical sector.

[6] The Facility would help matching the recapitalisation needs of healthy companies who have been put at risk as a result of the lockdown, as detailed by the Commission President.

[7] The BICC was proposed as budgetary tool aimed at financing structural reforms and public investments in euro area Member States, strengthening potential growth of their economies and the resilience of the single currency against economic shocks. According to currently available information, the BICC will be part of the EU budget and will be integrated into the Commission proposals for a Reform Support Programme. It is to be seen how the BICC would fit with a "new Recovery and Resilience tool" as mentioned by the Commission President (see above). For additional information on BICC, see EGOV specific briefing.

in the context of the European Semester. BICC would be complemented by the Convergence and Reform Instrument (CRI), a similar instrument addressed to non-euro area Member States.

SURE[8], on the other hand, is one of the Commission proposals to tackle the corona crisis. It would allow the Union to borrow on financial markets to provide loans to Member States for financing short term employment schemes, thus responding to the growing levels of unemployment. The Commission has made clear that it considers SURE to be "*an emergency operationalisation of a European Unemployment Reinsurance Scheme (...) without prejudice to the possible subsequent establishment of a permanent instrument under a different legal basis in the TFEU*." . A political agreement on SURE was reached last 15 May and final adoption in Council is expected by 19 May.

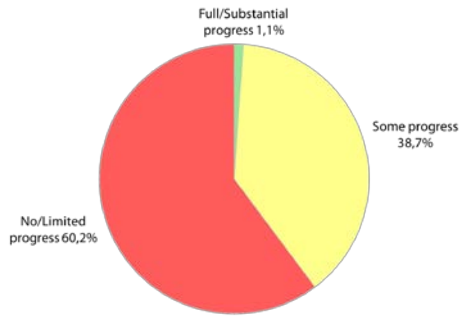
The Eurogroup also decided on 9 April 2020 to make available a specific COVID 19 precautionary credit line by the European Stability Mechanism[9]. The Eurogroup decided to attach no conditionality to the credit line besides using the funds to cater for domestic financing of direct and indirect healthcare, cure and prevention related costs due to the COVID 19 crisis and ensuring that the recipient Euro Area Member State remains committed "*to strengthen economic and financial fundamentals, consistent with the EU economic and fiscal coordination and surveillance frameworks, including any flexibility applied by the competent EU institutions*". The link to the EU economig governance framework (and the Semester) is, thus, clearly spelled out in the features of ESM pandemic support.

Implementation of CSRs - pre-pandemic

During pre-pandemic times, Member States showed a mixed track record in implementing the Country Specific Recommendations (CSRs) as adopted annually by the Council. During the years before the pandemic outbreak, the trend in implementing rate has been going downwards albeit improvements in the economic situation.

Member States made at least some progress on almost 40% (37 out of 93) of recommendations under the 2019 European Semester cycle (Figure 1 below), similar to the 2018 Semester cycle, when the corresponding number was 39%. The euro area Member States have had, taken together, a better implementation record than non-euro area Member States (this conclusion does not necessarily hold at individual country level). For more details, please see separate EGOV briefing Implementation of the 2019 CSRs.

Figure 1: Implementation of the 2019 Country Specific Recommendations



Source: EGOV based on the Commission Country Reports (February 2020).

Notes: (1) Based on Commission's assessment of actions taken (rather than outcomes that may materialise with a time lag), assigning identical weights to all CSRs (i.e. irrespective of their institutional and political sensitivities). (2) Calculations abstract from CSRs

[8] On 2 April 2020, the Commission presented a proposal for a regulation on the establishment of a European instrument for temporary support to mitigate unemployment risks in an emergency (SURE), following the COVID-19 outbreak. The regulation aims to assist in reducing unemployment and loss of income due to the coronavirus outbreak and would allow providing up to 100 billion euro in financial support to all Member States. For additional information see EGOV specific briefing.

[9] The Pandemic Crisis Support (PCS). Assistance under the credit line is available to any Euro Area Member State and is to be used for covering costs related to direct and indirect healthcare, cure and prevention due to the COVID 19 crisis. The PCS is based on the current ESM Enhanced Conditions Credit Line (ECCL) and will allow granting precautionary financial assistance of up to 2% of the requesting Member State GDP (in 2019).

entirely related to the compliance with the SGP (to be assessed by Commission separately during spring 2020). Consequently, the total number of CSRs covered in this assessment amounts to 93 rather than 97.

Similarly to the 2019 Country reports, the 2020 Country reports include for each country the overall multiannual implementation of 2011-2019 CSRs (excluding progress on compliance with the SGP). However, the COM has neither published the methodology underlying its multi-annual assessment, nor the country-specific multi-annual assessments at the level of CSRs (for more information see separate EGOV briefing).

The draft Ecofin Council conclusions, to be adopted on 19 May 2020, also recall that the multiannual assessment by the Commission illustrates that a number of CSRs relate to long-term structural issues that take time to be addressed and that tangible results take time to materialise. Nevertheless, the Council notes that the overall implementation rate of the 2019 CSRs remained low, despite a rather favourable economic environment over the last years. Reform implementation continued to vary across policy areas and countries and has been strong in financial services and active labour market policies. Progress has remained slow in addressing competition in services and with regard to the long-term sustainability of public finances.

Going forward, and if one intends to ensure that the European Semester plays an effective role in fostering recovery and monitoring the crisis response, both the design and the implementation of the CSRs will have to play a crucial part.

The on-going review of the European Semester

On 5 February 2002, the Commission presented its review of the effectiveness of the EU economic governance framework and launched a public debate on its future. The review seeks to assess how effective the economic surveillance framework has been in achieving three key objectives:

- *ensuring sustainable government finances and economic growth, as well as avoiding macroeconomic imbalances;*
- *enabling closer coordination of economic policies; and*
- *promoting convergence in Member States' economic performance.*

In order to allow for a broad consultation, the Commission launched a dedicated on-line platform on which interested parties are able to express their opinions on the matter until 30 June 2020. Lessons of the current corona crisis will surely feed into the Commission reflexion.

The ECON Committee has requested external expertise on certain elements of the economic governance framework in order to support work of its members. Until today, 3 papers on the experiences on the macro-economic imbalances procedure have been published:

- *Macroeconomic Imbalances Procedure: has it worked in practice to improve the resilience of the euro area? by Lorenzo Codogno , February 2020;*
- *How has the macroeconomic imbalances procedure worked in practice to improve the resilience of the euro area by A. Bénassy-Quéré G. Wolff, March 2020; and*
- *How has the macroeconomic imbalances procedure worked in practice to improve the resilience of the euro area by Alexander Kriwoluzky Malte Rieth, April 2020.*

The forthcoming expert papers related to the review will be ready by June-July 2020 and will cover the following 3 topics:

- *Benefits and drawbacks of an "expenditure rule", as well as of a "golden rule", in the EU fiscal framework*
- *The role of fiscal rules in relation with the green economy; and*
- *How to make the European Semester more effective and legitimate?*

Box 3: Some conclusions of a reflection paper on the European Semester (October 2019):

- *Trying to better distinguish each EU surveillance instrument according to its respective core objective (e.g. 'try to prevent certain policies' versus 'try to promote certain policies');*
- *Clarifying the policies to be covered in the European Semester coordination framework, if it is to remain the core coordination framework, to allow targeting common EU longer-term objectives (and, in so doing, replacing and upgrading the Europe 2020 strategy). That could require reframing, and possibly redesigning, the European Semester as a standalone legal instrument, and to including indicators to measure progress, along with annual or multiannual policy recommendations covering the full breath of policy objectives (e.g. green investments, social inclusion, education system, public administration, labour productivity, etc.) in a 'renewed Semester';*
- *Without prejudice to general policy recommendations addressed to all Member States of the EU and covering all the objectives of the renewed Semester, focusing the policy recommendations under the SGP and the MIP on those national developments and policies of the euro area Member States that may need specific attention due to the fact of belonging to a common currency area (or planning to join it);*
- *Rendering the EU policy recommendations more operational, namely by introducing elements that yield better results in terms of defining targets, measuring progress and setting timeframes for implementation, whenever possible coupled with financial instruments allowing Member States to further pursue jointly agreed policies;*
- *Clarifying the politically shared ownership of the EU rules-based surveillance framework, and better linking commonly agreed policies at EU level with national policy debates and implementation. In fact, the surveillance system may only be effective if all parties concerned take political ownership of the common rules and, in addition, Member State governments themselves do their utmost to integrate their EU-level commitments into national policymaking;*
- *Making better use of the Commission Country Reports, as an instrument for early and targeted political debate, including at the level of the Eurogroup and the European Parliament. Specific reports could be addressed to euro area Member States that are at risk of significantly breaching their SGP commitments or are identified as being at risk of excessive macroeconomic imbalances, in order to better frame the discussions and underpin possible recommendations for correction.*

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