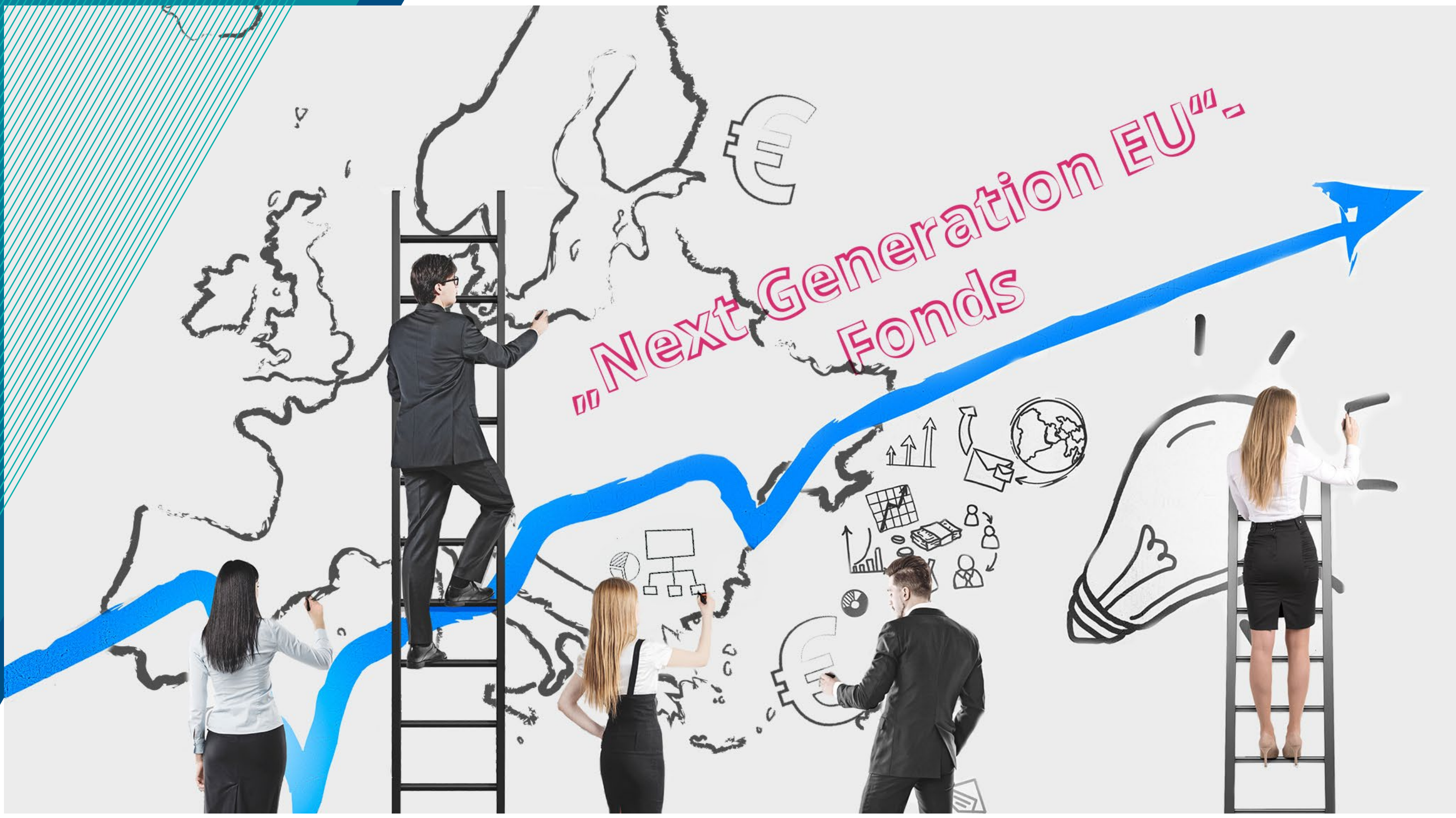
No 410 / October 2020

Facts & Findings

KONRAD ADENAUER STIFTUNG




# Is the European Semester waking from its long slumber?

## A call for increased convergence and competitiveness

*Oliver Morwinsky*

- The coronavirus crisis and its economic repercussions have further undermined economic harmonisation within the EU and revealed its inadequacies. The large support programmes launched by the EU and its Member States have compounded this.
- Using the European Semester to distribute the majority of the funds from the Next Generation EU package is sensible but still in need of some clarification.
- Conditionality will be necessary here, coupled with the greater involvement of the European Parliament.
- Germany currently holds the presidency of the Council of the European Union and thus an important role within the EU, which it should use to promote greater convergence and competitiveness.

## Contents



## Introduction

The last extraordinary European Union summit held between 17 and 21 July 2020 was described as 'historic' by some participants. After the summit, German Federal Chancellor Angela Merkel said: 'New circumstances also call for extraordinary new approaches.' This refers in particular to the agreement on a special recovery fund. Entitled Next Generation EU (NGEU), it is an 'exceptional response to those temporary but extreme circumstances'.[1] Within this special fund, the existing European Semester instrument takes on a new role. The way the EU manages these extreme circumstances will also be a key factor in determining the extent to which it is capable of action and fit for the future.

## Europe at a time of crisis – the economic dilemma

The EU is undergoing the biggest crisis in its history.

The extreme circumstances in which Europe finds itself are evident from the economic growth forecasts, with the European Commission and the European Central Bank both projecting negative figures for 2020 of −8.3 per cent and −8.7 per cent respectively.[2] These figures alone are a clear indication that the EU is going through the greatest economic crisis since its foundation.[3] There have not been as many nations where the economic output per head of population has contracted since 1870.[4] The eurozone is, of course, also affected. In comparison with the fourth quarter of 2019, the GDP of the eurozone fell by 3.8 per cent and workforce productivity[5] decreased by 3.6 per cent.[6] All this has led the EU and its Member States to launch major support packages and instruments. In addition to the European-level support packages, the individual states have put together their own packages, which differ fundamentally in scope.[7] These differences pose a threat to convergence – economic alignment through competition between the economic systems – particularly since inequalities already exist within the Economic and Monetary Union (EMU).

## Asymmetry in the eurozone

The euro area is too one-sided.

Although convergence is the aim of the EMU, it has moved away from this objective in recent years. Since 2008, economic alignment in the eurozone has come to a standstill, as reflected in the strength of European competitiveness. This can be attributed to several factors, including wage policy. In some respects, the euro area is too one-sided: analysis from a macroeconomic perspective reveals the existence of an extremely expansive monetary policy and excessively restrictive fiscal and wage policies. A massive divergence in wage and inflationary trends has been apparent since the establishment of the EMU and has had an impact on domestic demand and national competitiveness. These differences have not been addressed through structural means; instead, solutions have been sought primarily via transfers and by issuing guarantees. In southern Europe, the ECB's inflation target was regularly exceeded, whereas in the north the opposite occurred. So as long as no one looked beyond the average figure, the problems would remain hidden. This changed with the economic and financial crisis – a fact that became apparent when the balance of trade of the individual eurozone countries was examined. In the years before the financial crisis of 2007/2008, the trade deficits of the Member States in southern Europe – which are primarily explained by the region's lack of competitiveness – led to an outflow of capital to the more competitive Member States in northern Europe.[8] The limited capital in the southern countries of Europe was provided by banks and financial institutions in the form of loans. Conversely, the states with more stable economies exported goods and services to the economically weaker states, with the result that the positive balance of trade for the exporting countries rose sharply.[9] The imports were bought on credit due to the lack of capital, leading to these states becoming systematically indebted to Europe's core countries over a period of many years. It is a situation that is hampering a number of countries in their efforts to manage the coronavirus crisis because many of these national support schemes are being provided through measures financed by debt. As a result, the level of government debt is set to rise by an average of 20 per cent in all Member States.[10]

The ability of individual countries to cope with the consequences of the crisis is thus largely dependent on the national economic policies pursued in recent years. On the one hand, the different approaches, both consolidation-orientated and expenditure-based, do certainly point to the benefits of the heterogeneity in the EU's economic system, which is necessary for the Community's effective functioning. On the other, however, this heterogeneity must not be allowed to spread too widely or this will result in irregularities in convergence, especially in a Community with a single monetary policy.[11]

## Could the European Semester be a solution?

The aim of the European Semester is to promote convergence within the EU Member States.

In 2011 – in the context of the Europe 2020 strategy and the impact of the financial crisis – the EU introduced the European Semester with the aim of better managing and, ideally, harmonising such developments. It is designed to ensure economic convergence within the European Union – not just within the EMU. In the light of the enormous scale of the current crisis and the different circumstances in which the Member States seek to overcome it, the instrument has gained increased importance. With the agreement of the heads of state and government on 21 July 2020, the European Semester became a core element within the NGEU fund package. It will be used to examine national recovery and resilience plans and to disburse the resources. Although this instrument has existed for some years, it has never been free of criticism. The lack of Community-level coordination, the lack of national commitment and the failure to apply sanctions combine to make the growing national differences on the economic front appear even more threatening to European financial stability – and thus to Europe's overall stability, too.

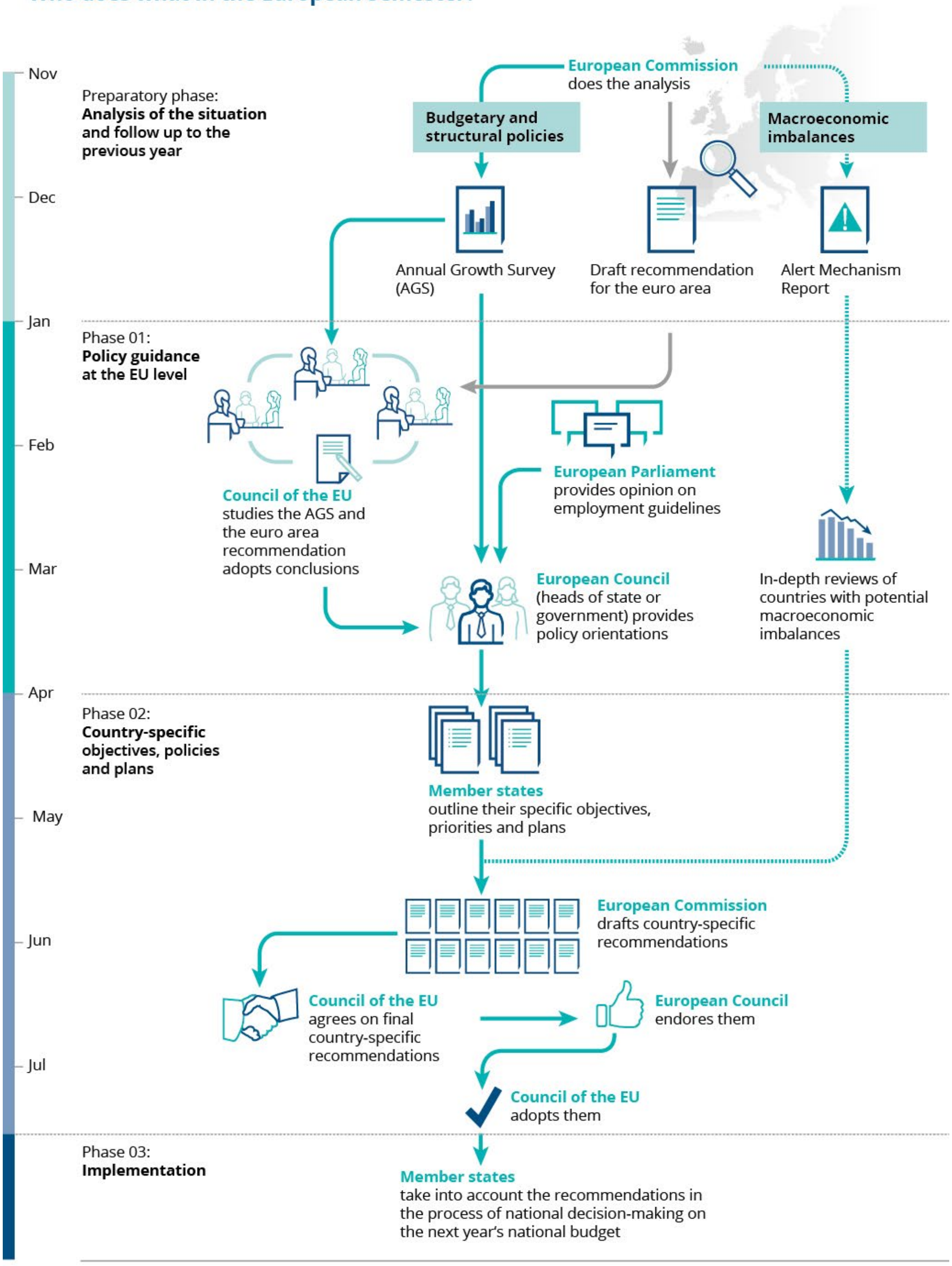
## A sensible idea with design defects

The introduction of the European Semester highlighted the need to link common monetary policy with national economic and fiscal policies.

The European Semester instrument introduced by the European Commission supports timely monitoring of national draft budgets and reforms. Following an analysis of the current economic situation by the Commission, political guidelines are defined by the European Parliament, the respective EU Council of Ministers and the European heads of state and government. Member States then present their plans for budgetary and structural policies. These are then adopted as country-specific recommendations by the Commission by means of the Council of the European Union, before going through the national parliaments. The main aim of this process is to ensure national budgetary discipline and a stronger economy. Countries with potential macroeconomic imbalances are also subjected to an in-depth analysis. The introduction of the European Semester has highlighted the need to link common monetary policy with national economic and fiscal policies.

The fundamental problem in this well-thought-out construct is the lack of obligation. At best, the individual Member States take note of the European Commission's country-specific recommendations. In a similar way to the European Fiscal Compact, the recommended implementation is neither followed up nor sanctioned in the event of non-compliance. The consequence is that the goal of a common European economic policy is pushed into the background. The enormous financial clout that is now being 'transferred' to the European Semester via the NGEU makes this instrument all the more important.

### Who does what in the European Semester?




A new cycle starts again towards the end of the year, when the Commission gives an overview of the economic situation in its Annual Growth Survey for the coming year.

**Council of the European Union**
General Secretariat

Source: Council of the European Union

## Looking to Europe's future: the Next Generation needs more conditionality

The current efforts[12] to link the NGEU fund to the European Semester could be the kiss of life for this instrument, awakening it from its apparent deep slumber by reforming its processes.

The NGEU fund has a total value of €750 billion. The largest share of the package – €672.5 billion (89.66 per cent of the total) will be bound up in the Recovery and Resilience Facility (RRF). The RRF is designed to play a key role in stabilising the economies of the EU Member States. The resources from the fund allocated to stabilisation will be distributed through the European Semester: 'in response to challenges identified in the European Semester … with a view to having a lasting impact on the productivity and resilience of the economy of the Member States.'[13]

Almost 90 per cent of the NGEU fund is held in the Recovery and Resilience Facility.

### Planned procedure within the NGEU instrument

The Recovery and Resilience Facility, like the whole of the NGEU fund, is intended to run for three years (2021–2023). Seventy per cent of the fund's resources will be paid out in 2021 and 2022. In accordance with the European Commission's proposals, this will be based on the population, the inverse of the per capita gross domestic product (GDP) and the relative unemployment rate of each Member State.[14] The remaining 30 per cent will be disbursed in 2023 on the basis of the decrease in national GDP in the years 2021 and 2022. Payments will consist of a mix of rapid support and fair allocation.

**Preparation and presentation of the plans**

In the first step, the Member States must draw up national recovery and resilience plans (RRP) in which they will set out their national investment and reform agendas for the relevant time frame. The disbursement of the financial support will be based on these plans and will take place in instalments. In each case, the payments will be geared towards achieving the objectives outlined below. In 2022, the plans will be adjusted again, where necessary, to satisfy the conditions for the award of funds in 2023.

Each EU Member State will draw up its own national recovery and resilience plan (RRP).

**Review of the plans**

As things currently stand, the European Commission aims to assess the plans within two months of submission on the basis of three conditionalities:

1. Compatibility with the country-specific recommendations made by the European Commission for the beneficiary country in question
2. Strengthening competitiveness (growth potential, job creation and economic and social resilience)
3. Making an 'effective' contribution to the digital and green transitions.

To formulate its assessment, the Commission will consult with the Economic and Financial Committee[15] and seek its opinion. Although the Committee will strive to reach a consensus, this is not set in stone. Quite the opposite. If a Member State has serious doubts as to the fulfilment of the envisaged milestones and targets of a national plan, it may ask the president of the European Council to bring the matter to the attention of the European Council at its next sitting. This is referred to as a 'super veto'. If the European Council deals with the matter, the Commission will suspend its decision-making process.

As things currently stand, the European Commission will review these plans.

**Approval of the plans**
The Commission will then submit the plans it has assessed to the Council for approval. The Council will then aim to give its approval within four weeks of the plans being submitted by way of an implementing decision on the basis of a qualified majority.

The European Commission will approve the plans and monitor the disbursement of the financial support.

**Disbursement of the financial support**
The Commission shall adopt a decision on the assessment concerning the satisfactory fulfilment of the milestones and targets. It is not yet clear whether the Commission will give the final approval and take the final decision. Some differences of opinion still remain among the Member States. The first payments are planned for the middle of 2021.[16] However, it has been stressed that funds to fight the pandemic that were spent from February 2020 onwards and meet the objectives outlined above may be disbursed in advance via the RRF or the REACT-EU programme, which is also part of the NGEU package (€47.5 billion).[17]

## Old wine in new bottles?

The European Parliament has a minor role to play.

This newly conceived construct within the framework of the NGEU places the democratic legitimacy of the decision-making process in the spotlight, in addition to the question of its legal basis (Art. 122 TFEU for the fund and Art. 311 TFEU for its financing),[18] which is usually the subject of legal discussion. The role of the European Parliament (EP), Europe's synonym for democratic legitimacy, has already been relatively small in the proceedings of the European Semester thus far. In addition to its right to express an opinion, it can invite representatives of the EU institutions or the Eurogroup to participate in the dialogue on economic policy and discuss issues together. However, none of this bears any relation to the decision-making or approval rights of the European Commission or those of the Council (of Ministers) and the European Council. The role of the EP must therefore be strengthened.

There is an opportunity to strengthen the importance of the 'European added value' by enhancing the role of the European Parliament.

This demand is not only based on the fact that the Parliament has a stronger link to the electorate or that budgetary law is its prerogative. It also underlines once again the importance of this sustainable and long-term decision. One way of strengthening the EP could be based on the confirmation of each round of newly appointed EU Commissioners and their hearings before the EP. At present, although it evaluates the candidate commissioners individually, the EP cannot approve or reject individual candidates – only the full Commission. A similar approach is conceivable when it comes to the national recovery and resilience plans. To avoid leaving the Parliament or individual political groups open to accusations of having made narrow assessments, the EP could be given the right to approve all plans. Once again, taking this step could clearly underline the importance of the 'European added value' that is meant to emerge from the reform and investment plans. The danger of giving the European Commission an excessively powerful role lies in a cautious approach to defining conditions. This impression has been reinforced in view of the decisions made at the extraordinary EU summit and the agreement to the Commission's proposals.

The chosen conditionality is not sufficient.

The greatest criticism of the chosen method is its soft conditionality. What is meant by connecting the disbursement of funds to the country-specific recommendations and by making an 'effective' contribution to the green and digital transitions appears to be wide open to interpretation. Effective should mean that other objectives are not compromised or blocked. The danger of simply taking a 'green labelling' approach thus continues to exist, in that supposedly climate-friendly projects are recognised as such and other objectives are not compromised. The issue of planning certainty for large-scale projects (especially in the field of sustainability) also appears questionable in view of the short-term provision of funding. Conditionality was already a subject of discussion when the initial support measures were to be provided through the European Stability Mechanism. Here too, a soft definition of conditions prevailed. As a result of the insufficient implementation and monitoring of the country-specific recommendations, the goal of stimulating competition between the economic policies of the Member States will not be reached. This necessary competition is a means of disciplining the Member States for their own benefit while simultaneously taking account of their membership of a single currency with a common monetary policy.

Competition between the economic policies of the Member States is needed.

## Conclusion: Routes open to Germany in the context of its presidency of the Council of the EU

The fact that the majority of the NGEU package – 89.6 per cent – will be processed by the European Semester serves to underline its importance. At the same time, it is now all the more urgent to improve the existing shortcomings, such as weak conditionality, expandable involvement of the European Parliament and clarification of the European added value in the context of the national plans. As the most powerful EU Member State from an economic and political perspective, Germany must now boldly lead the debate and push the Member States to make a stronger commitment to the goal of achieving convergence. The European Semester is a useful instrument with which to spur on the necessary competition between European economic systems. That is precisely what is needed. It is not a question of which system is better, rather one of ensuring that this competition has the effect of increasing overall convergence. This would bring about a sustainable stabilisation of the European Union. Long-term stability is more important than short-term pacification. Within the context of its EU Council Presidency, Germany has the opportunity to act as a wise but firm moderator to strengthen Europe's economic power on an enduring basis. It should seize this opportunity.

1 Conclusions by the EU Heads of State or Government (21 July 2020), p. 3, https://www.consilium.europa.eu/media/45109/210720-euco-final-conclusions-en.pdf (accessed on 28 August 2020).

2 European Commission (August 2020), https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-performance-country/eu_en; European Central Bank, 'Eurosystem staff macroeconomic projections for the euro area' (June 2020), https://www.ecb.europa.eu/pub/projections/html/ecb.projections202006_eurosystemstaff~7628a8cf43.en.html (both accessed on 28 August 2020).

3 In the second quarter of 2020, Germany's GDP fell by an historic 10.1 per cent in comparison with the previous year. Frank Specht, '"Jahrhundertrezession": Steigende Inflationszahlen gefährden den Aufschwung' ['Recession of the century': rising inflation puts recovery at risk], Handelsblatt (28 August 2020).

4 World Bank, Global Economic Prospects, June 2020 (Washington, DC: World Bank, 2020), available to download from https://openknowledge.worldbank.org/handle/10986/33748 (accessed on 28 August 2020).

5 Value added per person employed.

6 Eurostat, euroindicators (15 May 2020), available to download from https://ec.europa.eu/eurostat/documents/2995521/10294864/2-15052020-AP-EN.pdf/5a7ea909-e708-f3d3-8375-e2510298e1b8 (accessed on 28 August 2020).

7 Oliver Morwinsky, 'Wirtschaftliche Ungleichgewichte in der Eurozone – Gefahr für deren Stabilität' [Economic disparities in the eurozone – a threat to its stability] (2 June 2020), available to download from https://www.kas.de/de/kurzum/detail/-/content/wirtschaftliche-ungleichgewichte-in-der-eurozone-gefahr-fuer-deren-stabilitaet (accessed on 28 August 2020).

8 One such example is the development of unit labour costs, which were clearly too high in the southern European countries compared with Germany as the reference country. Cf. Bertram Schefold, 'Wettbewerb zwischen wirtschaftspolitischen Modellen in Europa' [Competition among economic policy regimes in Europe], Wirtschaftsdienst, 12 (2013), 807–809.

9 Hans-Werner Sinn, 'Deutschlands Kapitalexporte unter dem Euro' [Germany's capital exports under the euro], Akademie Aktuell, 3 (2011), Wirtschaft und Finanzen, 12 ff.

10 Cf. European Commission, European Economic Forecast: Spring 2020, https://ec.europa.eu/info/sites/info/files/economy-finance/ip125_en.pdf (accessed on 28 August 2020).

11 https://www.wirtschaftsdienst.eu/inhalt/jahr/2016/heft/3/beitrag/geldpolitik-im-heterogenen-waehrungsraum-und-die-offene-frage-der-konvergenz.html (accessed on 28 August 2020).

12 The resolutions agreed at the extraordinary EU summit have yet to be confirmed by the European Parliament and by each national parliament.

13 Recital no. 7 in: European Commission, COM(2020) 408, https://ec.europa.eu/info/sites/info/files/com_2020_408_en_act_part1_v9.pdf (accessed on 28 August 2020).

14 Ibid., Article 10.

15 The Committee is composed of senior representatives from national administrations and central banks, the European Central Bank and the Commission. It meets in two different configurations, that is to say, with or without representatives of the national central banks. It also meets in the 'Eurogroup' format with only the 19 euro area countries.

16 Paola Tamma, 'Commission aims for approval of national recovery plans by April', Politico Pro Intelligence, (24 July 2020).

17 Ibid.

18 Cf., for example: Anja Hoffmann, Lukas Harta and Martina Anzini, 'Das Aufbauinstrument "Next Generation EU"' [The 'Next Generation EU' recovery tool], cepAdhoc, 7 (2020), https://www.cep.eu/fileadmin/user_upload/cep.eu/Studien/cepAdhoc_Aufbau/cepAdhoc_Das_Aufbauinstrument__Next_Generation_EU__01.pdf (accessed on 28 August 2020).

# Imprint

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Publisher: Konrad-Adenauer-Stiftung e. V., 2020, Berlin
Design and typesetting: yellow too, Pasiek Horntrich GbR / Janine Höhle, Konrad-Adenauer-Stiftung e. V.

Produced with financial support from the German Federal Government.

ISBN 978-3-95721-788-2