IN-DEPTH ANALYSIS

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What role for the European Semester in the recovery plan?

External author:

Jacob Funk KIRKEGAARD

Economic Governance Support Unit (EGOV)
Directorate-General for Internal Policies
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What Role for the European Semester in the Recovery Plan?

Abstract

This briefing paper argues that the political imperative to ensure that the economic stimulus from the EU's new commonly funded facilities is provided expeditiously will prevail against desires to create a robust governance framework for these funds within the European Semester process. The pandemic-related suspension of the Stability and Growth Pact creates a need to reform the Pact ahead of its future reintroduction. This presents an opportunity to incorporate more of the Semester's reform implementation agenda directly into the Pact's policy prescriptions.

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AUTHORS

KIRKEGAARD, Jacob Funk; Senior Fellow Peterson Institute for International Economics, and Senior Fellow German Marshall Fund of the United States

ADMINISTRATOR RESPONSIBLE

Alice ZOPPÈ
Cristina DIAS

EDITORIAL ASSISTANT

Donella BOLDI

LINGUISTIC VERSIONS

Original: EN

ABOUT THE EDITOR

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To contact Economic Governance Support Unit or to subscribe to its newsletter please write to:
Economic Governance Support Unit
European Parliament
B-1047 Brussels
E-mail: egov@ep.europa.eu

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CONTENTS

LIST OF ABBREVIATIONS

AMR	Alert Mechanism Report
BICC	Budgetary Instrument for Convergence and Competitiveness
GEC	General Escape Clause
CAP	Common Agricultural Policy
CSR	Country Specific Recommendation
TOR	Traditional Own Resources
EFC	Economic and Financial Committee
OMT	Outright Monetary Transactions
EDP	Excessive Deficit Procedure
RoL	Rule of Law
TFEU	Treaty on the Functioning of the European Union
EFSM	European Financial Stability Mechanism
ESM	European Stability Mechanism
PCS	Pandemic Crisis Support
SURE	Support to mitigate Unemployment Risks in an Emergency
PEPP	Pandemic Emergency Purchase Program
MIP	Macroeconomic Imbalance Procedure
RFF	Recovery and Resilience Fund
MFF	Multiannual Financial Framework
NGEU	NextGenerationEU
SGP	Stability and Growth Pact
RRP	Recovery and Resilience Plans

LIST OF FIGURES

LIST OF TABLES

EXECUTIVE SUMMARY

The European Covid19 policy response has created the largest commonly funded European crisis fighting tools in EU history. The creation of this tool at the EU level marks the end of attempts to establish a fiscal capacity in the euro area for the foreseeable future. A political urgency exists to ensure that funds are disbursed quickly enough to effectively assist in economic recovery, but clashes with legitimate bids to implement robust oversight of new EU fiscal instruments and embed them within the European Semester process. The short-term imperative to help secure residents' health and livelihoods invariably decides in favour of the former. This political reality implies that were the European Parliament to attempt to strengthen the role of the European Semester in the oversight and governance of NextGenerationEU (NGEU) and 2021-2027 MFF recovery linked resources, it would likely fail.

As part of the broader EU pandemic policy response, the Commission in late March - with Council approval - suspended the Stability and Growth Pact (SGP) fiscal rules until further notice. Given the dramatic development in all member states' fiscal balances during the pandemic, a rapid reintroduction of an unreformed Pact would lead to significant short-term fiscal consolidation in many countries. This would run directly counter to the goals of the EU's new pandemic recovery instruments, and a reintroduction of an unreformed SGP - before especially the grant-based Recovery and Resiliency Facility is planned to be fully disbursed in 2023 - appears implausible. At the same time, the suspension of the SGP and the difficulty in reintroducing it offer a tempting opportunity to reform it, and include the part of the European Semester's framework for EU economic policy coordination that concerns domestic economic reform implementation – the so-called country-specific-recommendations (CSRs) - in the Pact's policy prescriptions.

Given how the EU and euro area economies today face a post-pandemic economic outlook characterized by historically low potential growth rates, low inflationary expectations and hence extremely low interest rates for the foreseeable future, deemphasizing the SGP's numerical debt and deficit targets fixed in the early 1990s is sound economic policy. In these macroeconomic circumstances, the debt burden that member states can sustainably carry has grown and the current reference values hold less relevance.

Amending the Pact to include alternative policy options for member states to explicitly ease fiscal consolidation paths towards medium-term budget goals by implementing major parts of the CSRs currently included in the European Semester process would be good policy. Such a reform would facilitate the reintroduction of the Pact. It would make the actual imposition of sanctions for noncompliance with new austerity or domestic reforms more credible and hence strengthen the political credibility and behavioural deterrence of the Pact. And it would bring additional momentum to the pursuit of the domestic economic reform policies that will increase member states' economic resilience in the post-pandemic European economy more than continuing to strive to get back to an early 1990s debt/GDP level. The Members of the European Parliament would have a key role to play in identifying relevant European Semester CSRs for incorporation into a reformed SPG, as well as utilizing their democratic mandate as elected representatives to strengthen subsequent monitoring of member states' pledged reform efforts.

1. INTRODUCTION

The Covid19 pandemic has caused the largest economic disruption in Europe since probably 1945. It has also - however - been met with a resolute macroeconomic policy response at the member state, euro area and not least EU level. Especially the policy innovations undertaken at the EU level with the adoption of the NextGeneration EU (NGEU) and aligned 2021-2027 Multiannual Financial Framework (MFF) for a total of tentatively €1,824.3bn[1] has moved European fiscal integration significantly forward. The €672.5bn (€312.5bn in grants and €360bn in loans) centralized Recovery and Resilience Fund (RRF), designed to disburse significant fiscal resources in the form of investment grants across the EU to address the adverse economic effects of the pandemic, and entailing fiscal transfers between member states, represents a milestone in European policymaking.

This paper argues that the inherent political tension between on the one hand the need to stimulate the European economy quickly to overcome the pandemic, and the legitimate desire to ensure that common funds are used according to common strategic priorities and within a robust oversight framework, will invariably be resolved in favour of the former short-term political concern. The paper proceeds to argue that the suspension of the Stability and Growth Pact (SGP) represents an opportunity to reform the Pact and introduce elements of the existing European Semester's country-specific-recommendations directly into the SGP's prescriptive policies. This would offer member states at risk of breaching SGP budget goals an alternative corrective "domestic reform implementation" policy path to short-term fiscal consolidation, while remaining in accordance with overall commonly agreed European economic policy goals.

Chapter 2 analyses the pandemic policy responses relevant for the European Semester at different government levels and discusses the standing of the pre-pandemic European Semester. Chapter 3 outlines the impact of the proposed NGEU and MFF on the European Semester, with a particular focus on the impact of the innovative grant-based RRF. And Chapter 4 analyses how the suspension of key elements of Europe's SGP's fiscal rule book during the pandemic will *de facto* require that the European Semester be reformed, and could incorporate CSRs into the SPG's policy prescriptions before the Pact can be reintroduced. Chapter 5 concludes and outlines the most fruitful policy choices available for the European Parliament in addressing the impact of the EU's pandemic policy response on the European Semester and broader economic policy priorities.

2. STATUS OF THE EUROPEAN SEMESTER IN EARLY 2020

2.1. The Pre-Pandemic European Semester

The twin crises in the form of the Global Financial Crisis and the Sovereign Debt Crisis that affected the euro area in the years after 2008 revealed significant deficiencies in the institutional design of the euro area as laid down initially in the Treaty of Maastricht in the early 1990s. Regional euro area-wide economic policy-making, as a consequence, failed to anticipate and quickly address the twin crises. The EU, and the euro area in particular, after 2010 implemented a suite of institutional changes aiming to reinforce regional economic governance and return to stable, sustainable and job-generating economic growth. The measures included the "Six Pack" and "Two Pack" legislative bundles aimed to, among other things, bolster a more forceful and flexible implementation of the Stability and Growth

[1] As proposed by the EU Council on July 21st 2020. The final agreement between the Council and the European Parliament may yield a (slightly) different total.

Pact (SGP), introduce the Macroeconomic Imbalance Procedure (MIP) and publish early euro area members' draft national budgets. The Treaty on Stability, Coordination and Governance in the EMU added a further layer of pan-European (though not EU) institutional deepening[2].

All European fiscal rules and economic governance requirements were to be implemented as part of the European Semester, the annual process of surveillance and coordination of member states' budget and macroeconomic policies. The European Semester consists of a repeated cycle of 1) Late autumn economic priority setting by the European Commission[3], which also publishes its annual Alert Mechanism Report (AMR) as part of the Macro-economic Imbalances Procedure (MIP); 2) Early year analytical member state- and euro area-specific economic reports [4]; 3) Spring "Country Specific Recommendations" (CSRs) for each member state's economic reforms and macroeconomic policies[5]; and 4) Summer/early autumn "CSR implementation phase" into national government budgets and policy planning for the following year. In principle, the European Semester, in comparison to the pre-2010 circumstances, should have provided a timelier monitoring of member states' implementation of commonly agreed reforms and policy goals, and pre-emptively facilitate policy corrections in cases of identified national shortcomings. The European Semester further – through ongoing dialogues with the European and national parliaments and other national stakeholders - intended to provide an inclusive policy process and consequent wider societal ownership for proposed economic reforms.

Several pre-pandemic studies, however, found the European Semester to be generally ineffective and with a limited and declining implementation rate of CSRs already by 2015-2018.[6] A detailed analysis of this very rapid decline in the efficacy of the process (which was streamlined, with the number of CSRs per country reduced since 2015) is outside the scope of this paper, but it seems clear that the scope of many CSRs has led national implementing policymakers to worry about loss of national sovereignty. The inclusion of abstract policy targets, such as the UN Sustainable Development Goals, in the Semester process will probably also have reduced the appeal of CSRs to national legislators. And finally, the reduced financial market pressure on many member states, witnessed following the forceful interventions of the European Central Bank (ECB) since 2012, may have permitted national policymakers' attention to wander elsewhere than focus on CSR implementation.[7] In sum, it is reasonable to conclude that the "European Semester" was already a policy framework in crisis by the time Covid19 hit Europe, and the pandemic crisis response by EU leaders once again fundamentally altered the EU and euro area's macroeconomic policy toolkit and institutions. When evaluating the future post-pandemic role of the European Semester, its long lingering problems are an important consideration. It is not - as a first approximation - likely to be good policy to attempt to further burden a policy process already in trouble with additional significant and politically contentious issues to solve.

[2] All EU member states, except Croatia and Czechia have signed the Treaty. Prior to Brexit, the United Kingdom had also not signed.

[3] These priorities are laid out in the "Annual Sustainable Growth Strategy" typically published in November.

[4] These country reports are typically published by the Commission in February.

[5] CSRs are typically published in May.

[6] See for instance Darvas and Leandro (2015, 2016), Bruegel (2017) and European Parliament (2019).

[7] The link between monetary policy and structural economic reform implementation was widely debated also in the run-up to the euro introduction. Duval and Elmeskov (2006) found descriptive evidence of a relative reduction in structural reform implementation in euro area members after 1999.

2.2. The Covid19 Policy Response and the European Semester

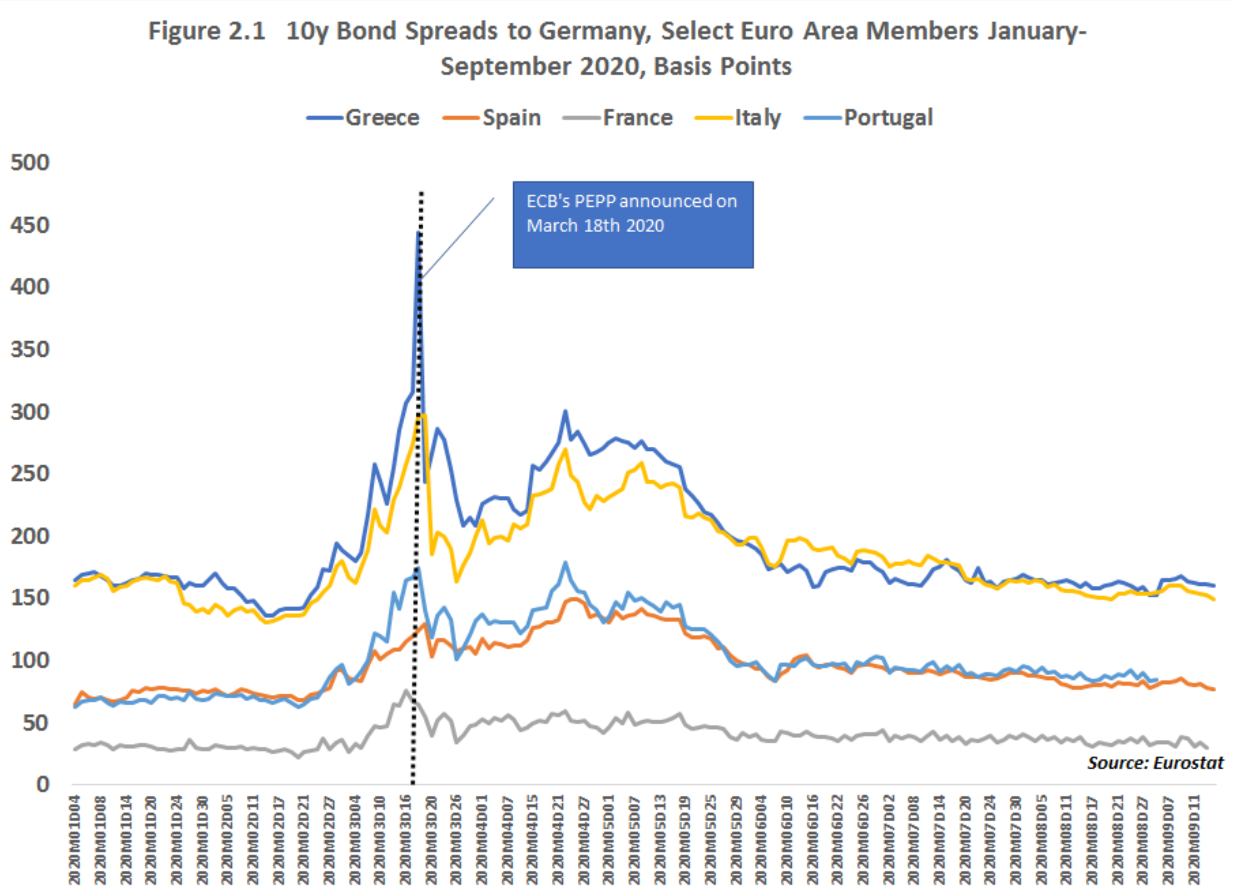
The European economic policy response to Covid19 has consisted of several complementary actions at the national, euro area and EU level. The interactions among them have implications for the future of the European Semester.

Member states have, reflecting their role as the dominant fiscal actors in the European economy, carried out most of the total fiscal expansion necessary to secure residents' incomes, employment and physical health. This will leave all EU member states with significantly higher post-pandemic debt levels. Given that one of the goals of the European Semester is to ensure sound member states' finances and avoiding excessive government debt levels, this will affect how the Semester is implemented going forward. High deficits during and higher debt levels after the pandemic will also very directly impact on member states' future ability to adhere to the SGPs debt-based criteria.

In the euro area, fiscal expansions in many member states have been greatly assisted by the ECB's implementation of its Pandemic Emergency Purchase Program (PEPP), which has, since its launch on March 18th 2020[8], committed the central bank to - in a flexible manner - expand its balance sheet by up to €1.35tr of overwhelmingly euro area sovereign bonds. This has, as intended, allowed all euro area members to commit the necessary fiscal resources to combatting the pandemic, without the risk of facing bond market financing pressures. The ECB's asset purchases have essentially neutralized the short-term financial market effects of euro area members' fiscal outlays, as spreads are now back at the pre-pandemic levels of January and February 2020. The success of the ECB's financial market interventions is illustrated in Figure 2.1.

[8] See ECB PEPP press releases at https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200318_1~3949d6f266.en.html and https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.mp200604~a307d3429c.en.html

Figure 1: 10y Bond Spreads



On April 9th, 2020, the Eurogroup and the finance ministers of the rest of the EU agreed an additional up to €540bn pandemic support package. In addition to more SME-focused lending by the European Investment Bank (EIB) and healthcare related expenditure, this package included two novel and precedent-setting aspects with direct implications for the European Semester process.

First, the Commission's Support to mitigate Unemployment Risks in an Emergency (SURE) program was established as a temporary instrument supporting member states in protecting employment during the pandemic, with favourable "back-to-back loans"[9] from the EU of up to €100bn[10] by *ultimo* 2022. This is easily the largest amount of money the EU itself has ever committed to raising in the financial markets for member state financial support[11], surpassing the 2011 total of €29.5bn to fund the European Financial Stability Mechanism (EFSM) support, offered to Portugal and Ireland that year. In contrast to the EFSM support, which came as part of the "Troika program" for these two member states, SURE funds will be made available to member states "*respecting the national competences in the field of social security systems*". Given that competences in the area of social security systems are essentially fully national (whilst the EU level competences are only concerned with the cross-border aspects of this

[9] A back-to-back loan sees the Commission issuing bonds in financial markets on behalf of the EU and on-lend those amounts based on the agreements concluded with individual member states. The Commission SURE bonds are fully backed by the EU budget, enjoys additional member state guarantees for 25 percent of the total issuance and will share the EU's AAA rating. See details in European Commission (2020a).

[10] See Eurogroup press release April 9th at https://www.consilium.europa.eu/en/press/press-releases/2020/04/09/report-on-the-comprehensive-economic-policy-response-to-the-covid-19-pandemic/

[11] 18 member states requested €90.3bn in SURE support in the first round and it seems certain that the program will be fully utilized by its closing date on December 31st 2022.

policy area), SURE funds will *de facto* be available to support existing national labour market institutions, without binding country-specific qualifying criteria or reform conditionality, beyond adherence to fundamental EU social and labour market standards and conventions. This is self-evidently in accordance with the special circumstances of the Covid19 pandemic, but nonetheless represents a significant departure from earlier EU policy precedent. Apart from financial rescues after 2010, country-specific macroeconomic conditionality, including the requirement to take relevant CSRs into account, has since the 2014-2020 been a general component to qualify for disbursement of EU Cohesion funds for instance.[12] Given the European Semester's focus on issues like labour markets, skills and social cohesion and numerous national CSRs in these areas, the availability of essentially unconditional SURE funds, may (further) adversely impact national governments' eagerness to swiftly implement relevant CSRs.

Secondly, the April 9th Eurogroup statement tasked the European Stability Mechanism (ESM) with setting up Pandemic Crisis Support (PCS) in the form of an ESM credit line of up to 2 percent of euro area Member States' 2019 GDP, supporting euro members' domestic financing needs of direct and indirect healthcare, cure and prevention related costs due to the COVID-19 crisis.[13] Importantly, as with SURE funding, this line of credit came with no country specific policy conditionality, as the PCS term sheet explicitly stated how "*[t]he only requirement to access the credit line will be that the requesting ESM Member States would commit to use ESM Pandemic Crisis Support to support domestic financing of direct and indirect healthcare, cure and prevention related costs due to the COVID 19 crisis*".

Given how the ESM was only a few years ago established with, according to Article 3, "[t*]he purpose.... to mobilise funding and provide stability support under strict conditionality, appropriate to the financial assistance instrument chosen, to the benefit of ESM Members which are experiencing, or are threatened by, severe financing problems, if indispensable to safeguard the financial stability of the euro area as a whole and of its Member States*", the PCS represents a dramatic (although temporary) shift in the intended use of ESM resources. This is clearly appropriate and in line with pandemic circumstances. But as with SURE resources, PCS funds could be used in policy areas covered by many of the European Semester's CSRs. And PCS clearly set the precedent that in this case euro area financial support can be available without country specific reform conditionality and could hence impact member states' implementation focus on the Semester's list of recommended domestic reforms.

In sum, both the SURE and ESM PCS initiatives, while called for by pandemic circumstances, represent a shift away from the type of potentially intrusively peer-group and Commission-monitored domestic economic reforms agenda that the European Semester comprises. Whereas clearly increasing the scope of centralized pan-European fiscal resources available to member states to fight the pandemic, and hence representing European fiscal integration, the "unconditional" character of the SURE and PCS initiatives seems likely to have ambiguous and potentially detrimental effects (beyond the immediate "political distraction" from the necessary focus on combatting the pandemic) on member states' implementation of CSRs. As such, while strengthening EU/euro area fiscal integration, they are not likely to advance the overall capacity of the EU and euro area to conduct a timely and coordinated macroeconomic policy that better promotes the implementation of relevant domestic economic reforms in member states. This means that improved short-term common fiscal capacity to address the pandemic fallout is not likely to extend to the member state level and often required reform implementation needed to strengthen long-term economic resilience. Only in operating

[12] See Vita (2018).

[13] See Eurogroup Statement on May 8th 2020 at https://www.consilium.europa.eu/en/press/press-releases/2020/05/08/eurogroup-statement-on-the-pandemic-crisis-support/

supplementary (and latently, in the case of PCS) to the main EU-level Covid19 policy initiatives might SURE and PCS work to strengthen the European Semester, even if overall euro area architecture is likely strengthened.

The EU level is where, by far, the biggest new pandemic policy initiatives have emerged with the agreement in late July among the EU leaders to support the EU economic recovery with a new innovative 3 years NextGeneration EU (NGEU) recovery instrument of €750bn and a revised €1.1tr 2021-2027 Multiyear Financial Framework (MFF) budget for the EU. Chapter 3 analyses these developments and their impact on the European Semester in detail, but it is relevant here to examine the impact of the EU's main new fiscal tool to combat the pandemic coming into being at the EU, rather than euro area level, and what this means for the European Semester.

Two political issues helped shift the EU's most dramatic fiscally integrative move ever from the euro area to the EU policy level. First, Brexit has removed perhaps the most important veto-wielder, the United Kingdom, from the EU budget decision-making process. This removed the large member state most implacably opposed to more fiscal integration at the EU level, a change that will have made EU-level fiscal integration easier in the long-run, too. Secondly, the coincidence that the pandemic hit Europe right at the time when the new MFF was to be negotiated anyway by EU leaders made a linkage between pandemic relief and the traditional EU budget feasible. Given the scope of fiscal transfers already present in the MFF, this linkage is likely to have made the agreement on the NGEU instrument (parts of which also have these transfer characteristics) easier for several EU leaders. Without this link to the regular EU budget negotiation, it is highly unlikely that the EU fiscal response could have reached the scale it has.

NGEU includes an investment grant-based component of €390bn to be disbursed over the three years 2021-23, equalling on average €130bn a year. In comparison, euro area leaders in October 2019[14] had agreed on a budgetary instrument for the euro area (the Budgetary Instrument for Convergence and Competitiveness – BICC) of €17bn as part of the 2021-2027 MFF, equalling just under €2.5bn a year. NGEU investment grant resources - in other words - amount to more than 20 times the planned scale of the BICC[15]. Given the still contentious negotiations to finalize NGEU and the next MFF in late 2020, it is clear that there are no prospects for a euro area-specific BICC-like instrument in the next MFF. The Commission pre-empted this political development in its May 28th updated proposal for NGEU and the 2021-2027 BICC[16], unambiguously stating that "*Consequently, the proposal for a Regulation of the European Parliament and of the Council on a governance framework for the budgetary instrument for convergence and competitiveness for the euro area is also withdrawn*."

In short, the increased EU-level fiscal integration embodied in the pandemic policy response has effectively killed off any political momentum for additional specific euro area fiscal integration for the foreseeable future. Once the EU Council Conclusions[17] from July 21st on the provisions of eventual repayment of the NGEU funds raised in financial market by 2026 are carefully considered, it moreover becomes clear that additional euro area fiscal integration will likely be made very difficult due to a possible very long repayment schedule for these EU funds. On the issue of repayment, the Conclusions state that repayment shall follow the "*principle of sound financial management, so as to ensure the steady*

[14] See Eurogroup press release at https://www.consilium.europa.eu/en/meetings/eurogroup/2019/10/09/

[15] During the 2021-2024 period, NextGeneration EU will on average disburse more than 50 times the annual resources planned for the BICC. Adjusting NextGeneration EU to the euro area only reduces this to about 45 times annual BICC resources.

[16] See European Commission (2020b, p. 2)

[17] See EU Council (2020a)

and predictable reduction in liabilities until 31 December 2058", but that no more than a maximum of 7.5 percent of the €390bn (€29.25bn) can be repaid in any single year. €12.9bn are allocated in the 2021-2027 MFF to NGEU interest payments, with any excess funds possibly used towards early repayment of also the borrowing principal.[18] Given that no explicit funds, beyond excess cash for interest, are allocated towards repayment, member states eventually face an unenviable choice. Either they increase their regular GNI-based or other direct national contributions to future EU MFFs, or they agree to cut the existing MFF elsewhere, or they decide to at least temporarily rollover the new EU debts, or they provide the Commission with new traditional own resources (TOR) budget revenues on its own. For as long as that debate is not settled, the prospects of additional resources for more euro area fiscal integration remain dim. And recalling that, in principle, EU leaders let it possible to begin repaying NGEU borrowings only by 2044[19], this situation could last for a generation. Crucially, however, given the new scope of the NGEU, the importance of further euro area specific fiscal integration is itself greatly diminished.

Proceeding with European fiscal integration at the EU, rather than euro area level, makes the task of implementing coordination and oversight processes easier for European policymakers, and especially for the members of the European Parliament. With the European Parliament's current committee structure, calibrated for oversight of common policy goals and investments made at the EU, not euro area, level and the Commission the driving force of all EU fiscal surveillance, a better opportunity exists to ensure in a timely manner that these investments are made in verifiable accordance with the EU's stated strategic priorities. In contrast, the Euro Group has no independent analytical capacities of its own, and the ESM is not organized to do continuous economic oversight. By choosing to create new capabilities at the EU level, EU leaders have facilitated the operation of existing EU policy coordination and governance mechanisms. This does not, however, as we shall see below imply that such policy coordination and oversight will be easily achieved.

3. NGEU AND THE EUROPEAN SEMESTER

3.1. The Recovery and Resilience Facility (RRF) – The Key Component of the NGEU

The co-legislators of EU budgetary policy - the European Parliament and the Council – have not at the time of writing reached a final agreement on the precise resource allocation for the NGEU and 2021-2027 MFF. It is clear though that the key NGEU component will be the dual-tasked Recovery and Resilience Facility (RRF), entrusted with both supporting member states' pandemic economic recovery and their longer-term economic resilience through promoting the implementation of relevant domestic economic reforms. Currently, the direct RRF financial support is envisioned by the Commission to reach €672.5bn (€312.5bn in grants and €360bn in loans).[20] Grant funding is intended to occur from 2021-23, in line with the EU Council's decision for 70 percent during 2021-22 and 30 percent in 2023. Table 1 shows the country breakdown of intended grant funding.

[18] If the Commission is granted new additional traditional own resources (TOR) revenues for its budget, these can also go towards NGEU principal repayment.

[19] If the maximum of €29.25bn is paid annually, full repayment of the €390bn can be achieved in 14 years, possibly from 2044 to 2058.

[20] See European Commission website with updated RFF grant allocation reflecting the EU Council decision of July 21st 2020 at https://ec.europa.eu/info/live-work-travel-eu/health/coronavirus-response/recovery-plan-europe/pillars-next-generation-eu_en

Table 1: RRF Grant Funding Distribution by Member State and RFF Grants as Share of GG Total and GFCF Expenditure

EU Member State	RRF 2021-2022 Grant Commitment, €bn (70%)	RRF 2023 Grant Commitment, €bn (30%)	2021-22 RRF Grant Share of General Government Total Expenditure, % (2)	2023 RRF Grant Share of 2021 General Government Total Expenditure, %	2021-22 RRF Grant Share of General Government Gross Fixed Capital Formation Expenditure, % (2)	2023 RRF Grant Share of 2021 General Government Gross Fixed Capital Formation Expenditure, %
Austria	2,082	913	0.5%	0.4%	8%	7%
Belgium	3,402	1,746	0.6%	0.7%	15%	15%
Bulgaria	4,326	1,655	8.8%	6.7%	95%	72%
Croatia	4,322	1,628	8.3%	6.3%	99%	75%
Cyprus	764	204	3.8%	2.0%	90%	48%
Czechia (1)	3,301	3,444	1.7%	3.6%	17%	35%
Denmark	1,216	338	0.4%	0.2%	6%	3%
Estonia	709	308	2.9%	2.5%	22%	19%
Finland	1,550	782	0.6%	0.6%	7%	7%
France	22,699	14,695	0.8%	1.1%	13%	16%
Germany	15,203	7,514	0.4%	0.4%	8%	8%
Greece	12,612	3,631	7.0%	4.0%	95%	55%
Hungary	4,330	1,927	3.2%	2.9%	27%	24%
Ireland	853	420	0.5%	0.5%	5%	5%
Italy	44,724	20,732	2.4%	2.3%	49%	45%
Latvia	1,531	342	5.9%	2.6%	50%	22%
Lithuania	1,952	480	5.2%	2.6%	54%	26%
Luxembourg	72	21	0.1%	0.1%	1%	1%
Malta	160	44	1.4%	0.8%	13%	7%
Netherlands	3,667	1,905	0.5%	0.5%	6%	6%
Poland	18,917	4,143	4.1%	1.8%	43%	19%
Portugal	9,107	4,066	4.8%	4.3%	91%	81%
Romania	9,529	4,271	4.9%	4.4%	53%	47%
Slovakia	4,333	1,502	5.0%	3.4%	62%	43%
Slovenia	1,195	363	2.6%	1.6%	30%	18%
Spain	43,480	15,688	3.9%	2.8%	81%	58%
Sweden	2,716	985	0.6%	0.4%	6%	4%
EU27	218,750	93,750	1.6%	1.4%	24%	21%

1) RRF grant numbers for Czechia on the Commission website does not comply with the 70-30 split agreed by the EU Council. 2) General government spending levels is assumed to remain constant from 2021 to 2022. *Sources: European Commission RRF Database; European Commission AMECO Database*

While member states' RRF contributions (i.e. member states' share of RRF eventual debt repayments) and therefore net national RFF contributions cannot at present be estimated[21], table 1 makes it clear how the Commission in its grant distribution entails to live up to the EU Council's determination to provide most financial aid to the countries to date most affected by Covid19.[22] Italy and Spain will be, by a significant margin, the largest recipients of RRF grant funding. Furthermore, Table 1 shows in columns 4 and 5 how RRF grant funds - in virtually all EU member states in 2021-23 - will only add a relatively small percent increase in total government gross spending over this period. This is in line with member states' themselves being the principal fiscal agents in the EU. And therefore (with - in the case of the euro area - the help of the ECB) member states are required to provide the bulk of the overall fiscal stimulus required to offset the economic impact of the pandemic. There are - in other words - clear and appropriate limits to how much of member states' overall pandemic recovery effort the RFF can finance.

On the other hand, columns 6 and 7 compare RRF grants to EU governments' expected gross fixed capital formation (i.e. essentially public sector infrastructure investments). Here it can be seen that if RRF grants were to be used exclusively to add to member states' fixed capital, RRF resources would - over the period from 2021-23 - nearly double the planned infrastructure investments in five member states, while boosting such investments by over 80 percent in Spain from in 2021-22 and almost half (at 49 percent) in Italy over the same period. At the EU level, RRF grants represents a material – if hypothetical – nearly a quarter increase in governments' gross fixed capital formation in 2021-2022, and a still sizable additional 20 percent in 2023. This highlights that RRF grants would, if exclusively spent by member states to improve infrastructure, make a real difference in this category of government spending in the aftermath of the Covid19 onslaught.

The differing scope for agreed common investment grants to address both overall member states' economic recovery (limited) and through - for instance - infrastructure investments to address their longer-term economic resilience (substantial) highlights the inherent tension between the RRF's two principal tasks. On the one hand, urgent economic recovery evidently requires that money is pumped into member states' economies as soon as possible, on the other hand, promoting countries' longer-term resilience and growth prospects entails a time-consuming careful consideration of a recipient country's underlying economic problems and - importantly - capacity to absorb EU funds and channel them towards productive long-term investments.

The issue of member states' absorption capacity, i.e. ability to productively spend money made available to them by the EU in accordance with commonly agreed policy goals, becomes highly relevant when considering that only about half of all available European Structural Investments Fund (ESIF) grants in the 2014-2020 MFF has been paid out to date.[23] Given that most RRF funds are expected to be disbursed by 2023 (and spent by 2026 at the latest), this assumes a *de facto* higher level of member state absorption capacity for RRF funds than they have often exhibited when receiving ESIF

[21] It is possible, via highly simplified assumptions regarding member states' eventual contributions to RRF debt repayment, to guesstimate what member states' net RRF contribution rate might ultimately be. The ECB (2020b, p. 83) includes such an estimate based on the assumption that member states' will ultimately repay the RRF based on the current share of EU GNI. The uncertainty about the timeframe of RRF repayment, the possibility of new TORs earmarked towards this purpose and differing member state economic trajectories, however, make such current assumption-driven estimates potentially misleading.

[22] The European Commission (2020b) describes how 70% of the total of €312.5 billion available in grants, the allocation key will take into account the Member State's population, the inverse of its GDP per capita, and its average unemployment rate over the past 5 years (2015-2019), always compared to the EU average. Meanwhile, for the remaining 30%, the formula will replace the 2015-2019 unemployment rate indicator by the observed loss in real GDP over 2020 and the observed cumulative loss in real GDP over the period 2020-2021.

[23] See daily updated ESIF fund distribution data at https://cohesiondata.ec.europa.eu/overview. Data reported here concerns payments made by the EU.

funds.[24] Partly the historically slow ESIF utilization rate can be attributed to reasons like delays in national co-financing and bureaucratic inertia that should be less present during a politically high priority pandemic recovery period. Yet, as some of the largest intended recipients of RRF money has some of the lowest revealed current 2014-2020 ESIF absorption capacities – e.g. Spain 39 percent, Italy 40 percent – the issue is urgent. The political imperative to disburse money quickly to try to advance the EU's cyclical recovery from Covid19, however, is likely to overrule concerns about member states' absorption capacity. Instead, the discretionary freedom that member states will acquire from this political situation to spend RRF resources swiftly and with the highest multiplier effect possible seems likely to prevail. This issue will be elaborated in the following section.

3.2. Anchoring the RRF in the European Semester Will Not Strengthen Reform Implementation

The RRF's implementation is expected to be not only embedded in the existing European Semester strategy, but - starting in 2021 - temporarily supplant it, as member states must submit "Recovery and Resilience Plans" (RRPs) in order to access RRF funds. These plans will temporarily take the place as an integral part of the traditional European Semester "National Reform Programs" and should be submitted to the Commission by April 2021.[25] The Commission subsequently plans to issue an analysis of member states' RRPs, replacing the regular European Semester country reports in 2021, and will not issue additional relevant Semester CSRs for member states which have submitted an RRP in 2021.[26] With an urgent need to integrate and direct European policy advice to member states towards boosting the recovery, it is a sensible approach to not have potentially duplicate or conflicting CSRs issued as long as RRPs govern the disbursement of RRF funds.

RRPs are expected by the Commission to be anchored in member states' existing CSRs from the 2019 and 2020 semester cycles, and specifically "*[u]nless the Commission has assessed the progress with these recommendations as 'substantial progress' or 'full implementation', all country-specific recommendations are considered to be relevant*." The Commission further expects that at least three identified EU priorities, if addressed in relevant national CSRs, are included in submitted RRPs. These are:

1) The application of the anti-money laundering framework, anti-fraud and anticorruption activities in the EU;

2) Reforms linked to improving the business environment, an effective public administration, the effectiveness of justice systems and in a broader sense respect of the Rule of Law; and

3) The fight against aggressive tax planning.

In principle, therefore, a robust European policy framework can be said to exist for ensuring that also RRF resources are accompanied by member state economic reforms relevant to common priorities and long-term economic growth rates and resilience. However, as highlighted above in section 2.1, the pre-pandemic European Semester suffered substantial deficiencies in member state adherence to CSR reform priorities. Indeed, figure 3.1 reproduced from European Commission (2020c, p. 17) makes it clear

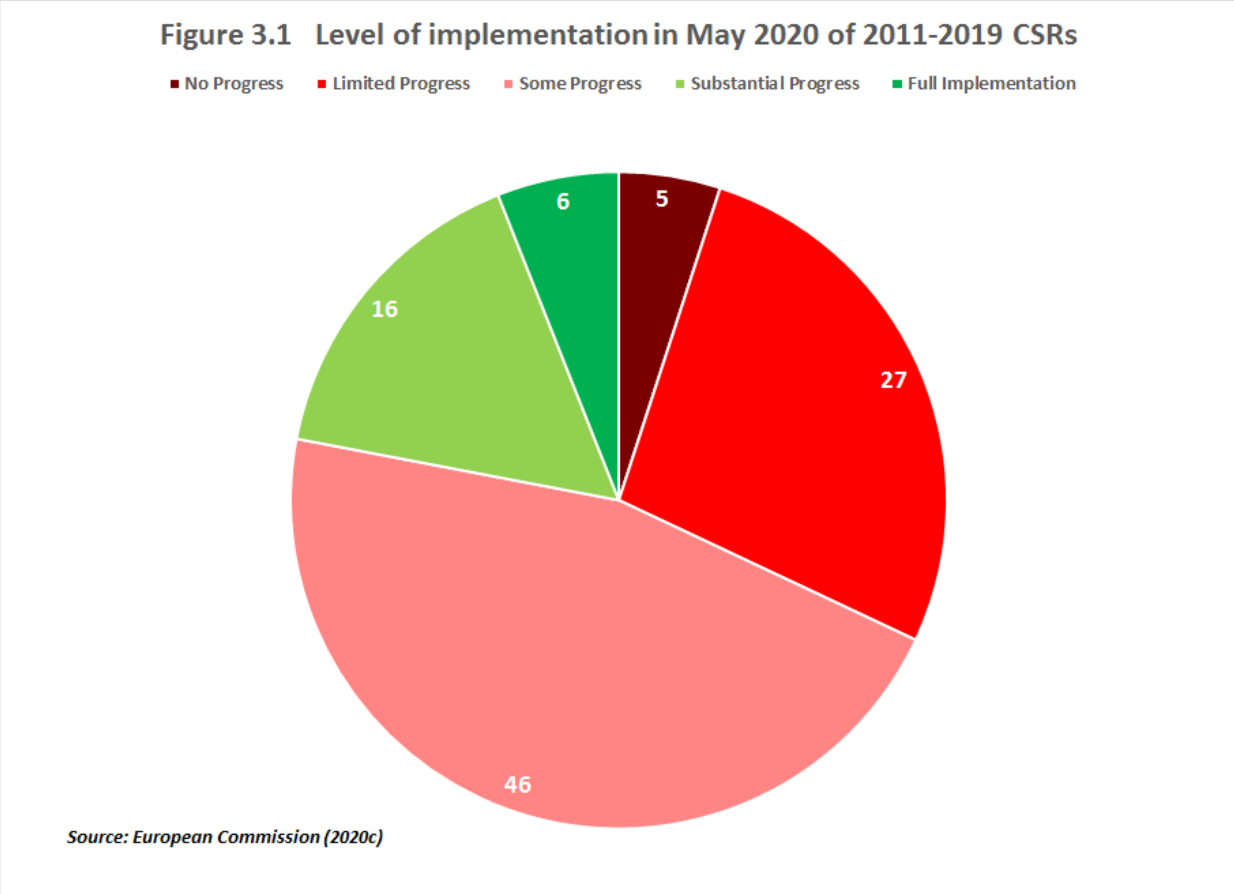
[24] See also Darvas (2020) for a discussion of this issue.

[25] In principle member states could submit both regular National Reform Programs for 2021 and a RRP by April 2021, but the Commission encourages these to come in the form of a single integrated document. See Annual Sustainable Growth Strategy 2021 FAQs at https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_1659

[26] The Commission will continue to issue CSRs on member states' budgetary situation in 2021 as prescribed under the SGP. This, however, is a largely meaningless exercise, given that the SPG general escape clause has been evoked. It predominantly serves the political purpose of having at least "some aspects" of the SGP still implemented, despite its general suspension.

that almost 80 percent of all CSR recommendations (shades of red in figure) adopted from 2011-2019 have witnessed such limited implementation progress that they would be still relevant for RRP inclusion and hence ultimately be part of the basis for disbursing RFF resources. EU member states can - in other words - access RRF resources by pledging to do what they should have in many cases promised to do literally a decade ago.

Figure 2: Level of Implementation of 2011-2019 CSRs



In fact, figure 3.1 in all probability is too optimistic in its 2011-2019 average assessment of CSR implementation rates, as the most recent data from 2019 (which together with 2020 CSRs are relevant to RRPs) is significantly worse. European Commission (2020c, p.17) states ominously "*[m]ember States have made at least "some progress" in 4 out of 10 of the recommendations addressed to them in July 2019*", whereas the comparable level in figure 3.1 would be 68 percent for the last 9 years. The basic question therefore is whether member states in the coming three years will be more willing to implement "pre-pandemic CSRs", as these should be now included in their RRP and - in principle - a condition for accessing RRF resources. It seems plausible that RRP commitments would carry more weight in national capitals than European Semester CSRs have in recent years, given the magnitude of the investment grants on offer from the RRF. Might the pandemic finally have provided the Commission with a "CSR reform carrot" big enough for member states to bite?

Alas for the prospects of CSR reforms in Europe, this seems unlikely, due to the RRFs temporary crisis fighting character. The economic imperative of ensuring that Europe's economic recovery continues will prove so strong that the Commission will feel compelled to disburse the RRF cash to member states according to the time schedule outlined in table 3.1, even if member states' RRPs might not be strictly in accordance with the Commission's specifications and actual reform implementation might be sketchy. Given the importance of avoiding any risk of a prolonged slowdown in Europe, due to the peril of hysteresis and scarring effects in labour markets and possible excess corporate bankruptcies from the pandemic, ensuring that all RRF funds are disbursed in a timely manner is more important than ensuring that many long overdue economic reforms are finally implemented. In a crisis as deep as the current situation in Europe, this must be the priority.

Given the generally broad definitions of "investments" and "reform" the Commission intends to adopt for the RRF and the broad scope of policies that can be financed, it is evident that a very wide range of member states' measures will become acceptable to unlock RRF grant funding. Per the Commission itself, the RRF "*will support investments and reforms that will have a lasting, positive impact on the economy and society….. [RRF] is consistent with a broad concept of investment as capital formation in areas such as fixed capital, human capital and natural capital…. Reforms should also be read broadly as relating to actions or processes aimed at making lasting improvements to the functioning of markets, institutional structures, public administrations, or relevant policies, such as the green and digital transitions.*"[27]

The very broad scope for member states to spend any RRF resources is moreover somewhat ironically evident in the actual CSRs issued to all member states in May 2020.[28] The first two sentences of the first 2020 CSR issued for all members reads "*In line with the general escape clause, take all necessary measures to effectively address the pandemic, sustain the economy and support the ensuing recovery. When economic conditions allow, pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment*." It is not difficult to see how member states can easily argue that a very extensive range of spending and investment ideas will be compatible with this CSR formulation. Member states will consequently often be able to allocate RRF resources with very few actual restrictions, while still in principle comply with the letter of the 2020 CSRs.

The Commission itself has a strong vested institutional own interest in seeing all RRF resources disbursed, irrespective of the reform implementation record of RRPs. Firstly, it is the case that the RRF represents the largest amount of commonly guaranteed EU financial resources ever authorized by member states in addition to the regular EU budget. Member states are not likely to accept Commission actions denying them access to their own money[29], due to simply noncompliance with RRPs. The ensuing political backlash against the Commission (and pro-EU national governments) by nationalist and anti-EU political forces for imposing country-specific conditionality on pandemic crisis assistance would be deafening. Were the Commission to prove obstinate in disbursing RRF funds, it would invariably affect the willingness of the EU Council to - in hypothetical future pan-European crises - copy the NGEU *modus operandi* and authorize the issuance of joint EU debt to help solve the problems at hand then. In short, if RRF disbursements were to be "withheld" by the Commission for "governance reasons", it could stop recent momentum for more fiscal integration in Europe in its tracks. This is a risk no Commission leadership can take.

Secondly, the Commission has an incentive to disburse all RRF resources, due to the possibility that member states may eventually grant the Commission new "own resources" with which to repay the

[27] The Commission's three different capital definitions are similarly broad in scope. Per the Commission website, fixed capital relates to investments in for example infrastructure, buildings, but also some intangibles like research and development, patents or software. Human capital is accumulated by means of spending on health, social protection, education, training and skilling. And natural capital is enhanced by actions aiming at increasing the share of renewable natural resources, protecting or restoring the environment, or by mitigating/adapting to climate change. See https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_1659

[28] Available at the Commission website at https://ec.europa.eu/info/publications/2020-european-semester-country-specific-recommendations-commission-recommendations_en

[29] Until the time at which the Council grants the Commission new TORs earmarked towards repaying the RRF grants, it is member states themselves that are ultimately responsible for repayment.

grant component of the RRF (and other NGEU and SURE) debts[30]. Such hypothetical new "own resources" in the form of new direct revenue streams flowing directly to the Commission would, even if earmarked initially for RRF debt repayment, likely prove permanent in nature, and would therefore represent a lasting strengthening of the Commission's financial independence from member states.

Despite the elaborate public linking of the RRF with the existing European Semester and the ability of the Commission to - in principle - hold the disbursement of large RRF financial resources to member states - due to their lack of implementation of CSR/RRP identified reforms - there is in reality virtually no chance that the Commission will take such steps. The RRF will hence not revitalize the European Semester process.

3.3. Individual Member States Cannot Block Disbursements of RRF Funds

In addition to the bureaucratic anchoring of the RRF in the existing European Semester process, the EU Council decision on July 21st included provisions to enable member states to interfere in the RRF grant disbursement process. The Commission must ask the Economic and Financial Committee (EFC) for an opinion on the "*satisfactory fulfilment of the relevant [reform] milestones and targets*" for RRF grant disbursement to a given member state, and the EFC, including national representatives here, must strive to reach a consensus. If this is not possible, and one or more member states object to another member state's eligibility, the President of the European Council can be requested to refer the matter to the top political forum at the next EU Council.

It is, based on the experience of EU economic policy making and fiscal surveillance, likely that *ad hoc* coalitions among member states will emerge in this process, facilitating deal making ensuring member states reciprocally drop opposition to each other's proposed RRF grants. If the matter is referred to the EU Council, the process is left deliberately vague and political, as the Commission cannot proceed with approval of payments until leaders have "*exhaustively discussed the matter*" in a process which, as a rule, should not take longer than three months (e.g. the next EU Council meeting). Again, at the EU Council level, political trade-offs across subject areas are likely to expedite the lifting of any member state's blocking of RRF disbursements to another.

It is, likely deliberately by the EU Council, left unclear precisely what happens if a member state upholds its veto in the EU Council and it (and the EFC) hence cannot reach a consensus on disbursement. The Commission though has stated that it intends to "*adopt the decision on disbursement under the "examination procedure" of comitology*". This implies - in the opinion of this author - that the Commission is, after the three months have passed and the matter has been "exhaustively discussed" in the EU Council, intent on taking a decision to disburse RRF grants or not and hence does not view a single member state block as a lasting veto. Adopting decisions under the "examination procedure" of comitology means that if a qualified majority of member states support the adoption of a Commission implementing act providing for disbursement to the vetoed member state, the disbursement will be approved. In other words, no individual member state can, if the Commission approves it, singlehandedly block an RRF grant disbursement to another member state. An objecting member state can only delay the cash being disbursed, and likely in the process extract various political concessions from other member states.

[30] Loan components of RRF and SURE will be repaid directly by the receiving member states, in accordance with the loan-on agreement between it and the Commission.

Only a coalition of member states representing a qualified majority opposed to a Commission implementing act can block the Commission from an intention to disburse RRF resources to a given member state. Given that the Commission is not likely to recommend non-disbursement, except in highly exceptional circumstances and then, likely, only for political reasons beyond the reform implementation demands under the European Semester, only widespread deep dissatisfaction among a qualified majority of member states with a given member's reform implementation record will suffice to block its access to RRF funds. This will prove a very high political threshold to reach, and *de facto* RRF resources will not be blocked by other member states for reform implementation reasons relevant to the European Semester.

On the other hand, it remains possible that individual member states can ultimately be denied access to RRF disbursements for other reasons. Unacceptable levels of fraud related to RRF money in a given member state is likely to result in such an outcome. It may though be difficult to ascertain such criminal activity in a timely manner, especially if member state government officials have actively participated herein. Co-legislators have also not yet finalized the provisions governing how member state adherence to general rule of law provisions will be required for access to RRF and other EU resources.

4. THE GENERAL ESCAPE CLAUSE WILL LEAVE A LONG SHADOW

4.1 Suspending the SGP Will Matter also for the European Semester

The Commission decision to evoke the General Escape Clause (GEC) in the SGP on March 20th 2020 and confirmed by the EU finance ministers on March 23rd represents a very significant development in European economic policy making. The SGP is a fiscal rules-based framework plagued by member states' non-compliance and arguably subject to too frequent reforms since its inception. Suspending it on the eve of what will probably be the most fiscally costly crisis in EU history was at once absolutely necessary, but is also likely to require fundamental changes to the Pact ahead of future reinstatement. This process will have significant implications also for how the entire European economic policy making process, including the European Semester, will function in the future.

It is evident from recent EU economic developments that 2020 will witness an intended, but still dramatic, increase in both EU members' general government deficits and gross debt levels. Figure 4.1 and 4.2 shows the currently projected deterioration in 2020.[31]

[31] These data are from the Commission's AMECO Database. The ECB in its recent September 2020 (ECB 2020) forecast assumes a slightly larger euro area deficit in 2020 at -8.8 percent of GDP. Given the ongoing deterioration in the number of Covid19 cases in Europe and the potential for renewed tightening of economic lockdown measures, the fiscal forecast for 2020 remains highly uncertain.

Figure 3: EU Member States General Government Deficit 2019 and 2020(p)

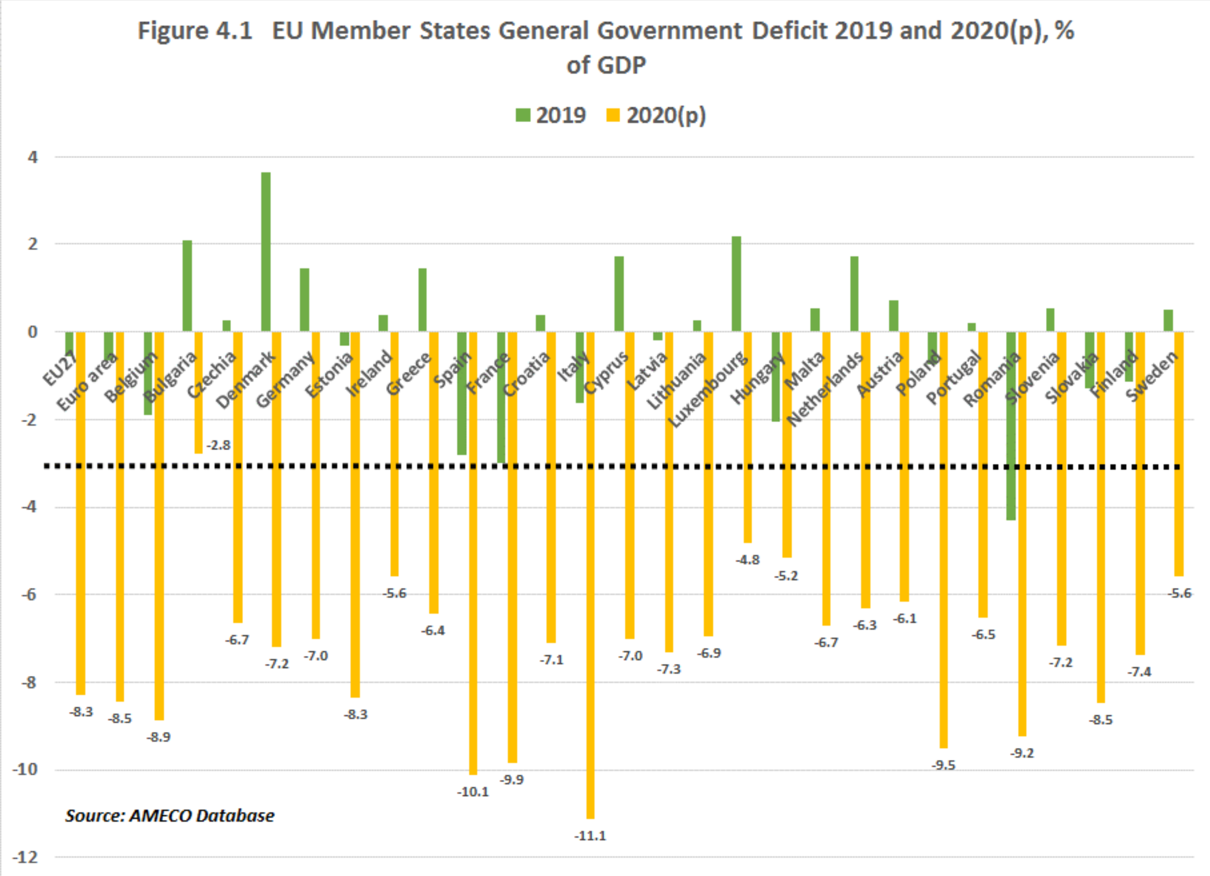
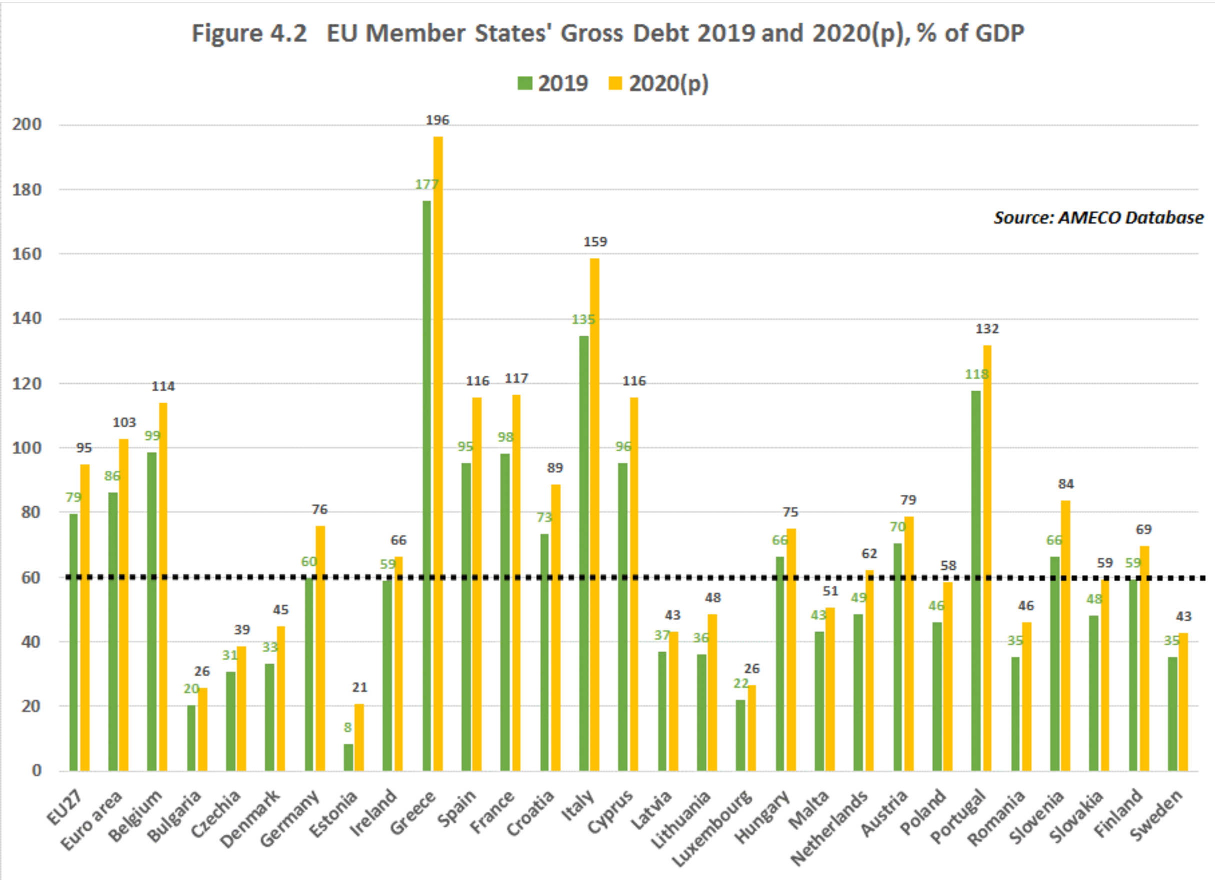


Figure 4: EU Member States' Gross Debt 2019 and 2020(p)



All member states, bar Bulgaria, are expected to breach the 3 percent SGP deficit threshold in 2020, while the combination of large deficits and projected declines in GDP in 2020 will push EU27 average government debt levels up by 16 percentage points of GDP to an all-time high of 95 percent. The Commission has announced that the SGP suspension will remain in place for at least 2021 and in any case for as long as the pandemic situation warrants.[32] The GEC stipulates that "*In the case of an unusual event outside the control of the Member State concerned which has a major impact on the financial position of the general government or in periods of severe economic downturn for the euro area or the Union as a whole, Member States may be allowed temporarily to depart from the adjustment path towards the medium term budgetary objective referred to in the third subparagraph, provided that this does not endanger fiscal sustainability in the medium term.*"[33]

Currently, the EU economy is projected to rebound strongly in 2021, and debt/GDP levels are likely to decline because of a combination of declining deficits and strong economic growth. Yet, even if the pandemic's economic impact wanes quickly in 2021 through the discovery of an effective vaccine or other medical Covid19 treatment breakthroughs and this forecast proves correct, it is plausible that the fiscal effects of the pandemic will be lasting for member states. Given the ongoing interventions of the ECB in euro area sovereign debt markets highlighted in figure 2.1, there is though not an immediate risk to member states' fiscal sustainability.

What is clear, however, from figures 4.1 and 4.2 is that a large number of member states would, if the SGP were reintroduced without changes after the pandemic is over, have to adjust their medium-term fiscal paths and medium-term budget objectives. Since reforms in 2011, the SGP has included an explicit link between approval of such shifts in member states' medium-term fiscal and budgetary objectives and "*the implementation of major structural reforms which have direct long-term positive budgetary effects, including by raising potential sustainable growth, and therefore a verifiable impact on the long-term sustainability of public finances*"[34].

Consequently, the manner and timing of the reintroduction of the SGP could in principle matter a great deal for member states' domestic reform implementation and hence adherence to many of their European Semester CSRs and new RRP reform and investment commitments. Given that many members will need to have approved more lenient post-pandemic fiscal consolidation paths under a reintroduced Pact, their incentive to offer structural reform implementation[35] to alleviate the amount of fiscal consolidation required will increase. This is particularly the case for members with the largest pandemic fiscal deterioration and in some cases, such as Italy, worst pre-pandemic debt situation.

4.2 Reintroducing the SGP Will Be Tricky

The Commission has committed itself to "*apply the full flexibility provided for in the EU fiscal framework for so long as is necessary to allow Member States to implement measures to contain the coronavirus outbreak and mitigate its negative socio-economic effects*". A multifaceted conflict, however, await the EU as it eventually will contemplate how to reintroduce the SGP. Section 3 above made it clear how the

[32] See Commission website FAQs here https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_500 and comments by Commission President Ursula von der Leyen on September 17th 2020, referenced in Politico here; https://www.politico.eu/article/von-der-leyen-no-timelines-for-ending-coronavirus-support-measures/?utm_source=POLITICO.EU&utm_campaign=7df99ebf48-EMAIL_CAMPAIGN_2020_09_18_05_11&utm_medium=email&utm_term=0_10959edeb5-7df99ebf48-189815853

[33] EU (2011). Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011, art 5(1).

[34] Ibid.

[35] The SGP pays particular attention to pension reforms introducing a multi-pillar system that includes a mandatory, fully funded pillar. This category of reforms on the other hand is not particularly relevant for the green and digital transitions emphasized in the NGEU.

enforcement of reform requirements related to the disbursement of RRF funds is likely to be erratic and basically trumped by the crisis need to inject all common resources quickly into the EU economy. This foreseeable outcome, though, is likely to lead at least some member states to look for alternative routes to try to impose a degree of European-level macroeconomic control over the fiscally weakest members of the EU.

One such backdoor could be an early reintroduction of an unchanged SGP. This could, in theory, compel the weakest member states to accelerate structural reform implementation to offset parts of a rapid and politically damaging post-pandemic fiscal consolidation and reorientation back on the path towards the medium-term budget objective. The Commission currently forecasts[36] that more than half of EU member states (14), including France, Italy and Spain, will exceed the 3 percent deficit limit in 2021, implying that an expeditious reintroduction of an unreformed SGP in 2022 would put many member states under pressure to fiscally consolidate and, by extension, potentially accelerate compensating domestic structural reforms to secure a less onerous consolidation path.

An additional risk exists that individual member states will, in the absence of a reintroduction of the SGP, rush to reintroduce their national fiscal rules framework, which in some notable cases, especially Germany, are considerably more stringent than the SGP itself. Given the danger to the overall fiscal stance of especially the euro area of such a scenario, in which fiscally stronger EU members begin post-pandemic consolidation perhaps prematurely, fiscally hawkish member states have some potential leverage to push for an early SGP reintroduction. In order to exploit such hypothetical leverage, such member states would though have to be willing to once again risk generating an unbalanced EU and euro area economic recovery, and complicate the ECB's monetary policy outlook and transmission mechanism.

An important question for all European economic policy after the pandemic is what precise impact the higher debt levels - incurred during the SGP suspension from late March 2020 - will have on future policy decisions. As discussed above, it seems certain that a number of member states would, under a reintroduced unchanged SGP, have to adjust their medium-term budget targets towards potentially substantial additional consolidation. Other paths, though, are also plausible, especially for the SGP debt criteria, which (unlike annual deficits) will weigh on member states long after the pandemic is over.

The EU could go explicitly dovish and mimic the fiscally lenient practice of the U.S. Congress, which regularly (eight times since 2013[37]) suspends the U.S. federal government debt limit, while policymakers cut a political deal to raise the limit. Crucially, any federal debts incurred during a suspension of the debt ceiling are automatically included in the next debt limit increase, voiding most of their effect on future policy. Following U.S. practice, EU policy makers could simply decide that new debts incurred during the SGP suspension would not be included in future SGP estimates of member states' gross debt. Such a decision would make the SGP reintroduction far less onerous for many member states and would be politically in line with the declaration of the pandemic as an "unusual event outside the control of the Member State".

At the same time, however, doing so would greatly complicate enforcement of many EU fiscal rules and make future debt sustainability analyses both politically and economically awkward. Even if debts were declared to be outside the Maastricht debt definition, they would still have to be serviced and hence economically add to a member state debt burden under evaluation. Hypothetical future Outright Monetary Transactions (OMT) programs in the euro area would also be greatly complicated.

[36] General government net lending for 2021 projected data from the Commission AMECO Database.

[37] See CRS (2019, table 1).

In an OMT program, the ECB purchases the sovereign debts of a crisis-stricken member state, after the national government has agreed an economic reform program with the ESM and had its debts declared sustainable. But would that be politically feasible or even legal, if the pandemic part of a member's debts had already been removed from the EU fiscal framework? Certainly, no matter what happens, any EU member facing future fiscal sustainability problems will claim that many of them arose during the Covid19 pandemic, and hence were "outside the control of the Member State". As a result, the member state would be certain to claim it deserve only very limited reform conditionality to get assistance. The suspension of the SGP has therefore already politically complicated the future enforcement of the EU fiscal rules, especially in future crises situations.

On the other extreme, the German government currently, after having suspended its national "Debt Brake" in both 2020 and 2021 for pandemic relief reasons, looks set to reintroduce its national debt rules by 2022. This would subject German fiscal policy to significantly stricter limits than the SGP itself, and could easily have both political and economic spill-overs to the rest of the euro area and EU. The tightness of national fiscal rules implemented as early as 2022 is a particular problem, given that it will still be the national government budgets that will have to provide the bulk of any needed fiscal stimulus, even if RRF funds are to be mainly disbursed in 2021-23. Were the EU to follow suit and essentially return to the old SGP by 2022, it would likely lead to many members having to tighten national fiscal policies, and run directly counter to the RRF goal of promoting and sustaining the EU economic recovery. *De facto*, therefore, it seems difficult to reintroduce an unreformed SGP before most RRF funds have been disbursed as currently planned by the end of 2023[38].

Reintroducing the SGP only by 2024 would however likely see many members' debt levels having reached and plateaued at such levels that simply reintroducing say the "Six Pack debt criteria" would not make much sense. Several members, such as Greece or Italy, would for instance probably then have debt/GDP levels of more than 160 percent of GDP, i.e. more than 100 percent of GDP above the statutory 60 percent debt limit in the Treaty. Under the current Excessive Deficit Procedure (EDP) and the debt criterion, a member can be put in the EDP unless it reduces the gap between its actual debt and 60 percent of GDP by 1/20th annually (on average over three years). Hence Greece and Italy would likely have to reduce their debt levels by up to 5 percentage points of GDP a year for many years to avoid semi-permanently being in an EDP. That is likely to be an impossible political and economic request to Greek and Italian governments, and if attempted it is certain to fuel anti-EU sentiment in these and similar fiscally situated member states. The longer the SGP remains suspended, the more compelling therefore becomes the need to reform it fundamentally, ahead of its reintroduction. Fortunately, a long SGP suspension will also give EU policymakers sufficient time during which to make it relevant for post-pandemic European economic policymaking.

[38] Given that RRF funds are not expected to be fully disbursed to member states until 2026, this logic in principle extends until then.

5. CONCLUSION: WHAT SHOULD THE EUROPEAN PARLIAMENT DO WITH THE EUROPEAN SEMESTER TO PROMOTE THE RECOVERY?

When a basic political conflict arises between the imperative of doing whatever it takes to quickly restore post-pandemic economic growth in Europe, and ensuring that commonly raised RRF resources are spent in line with detailed European economic priorities and promoting long-standing structural reform needs, the former political consideration invariably wins. No elected leader can, in a crisis as deep as the Covid19 pandemic, fail to do the utmost to protect the short-term wellbeing and income of people. Consequently, political attempts at steering crisis spending towards particularly goals - other than short-term wellbeing and income support - are likely to fail. This poses particular difficulties in establishing a governance framework for RRF spending, as many relevant institutional decisions must be taken now in the middle of the pandemic emergency, even if RRF resources will mostly be distributed in 2022-23 and the investment grants cannot directly be a substitute for member states' healthcare and welfare related spending.

The intended institutional embedding of the RRF into the existing European Semester and CSRs process may have been functionally helpful in securing the historic 21st of July agreement among the 27 EU leaders. However, in light of the strong political incentives among both member states and the Commission discussed in section 2 for expeditious and complete disbursement of RRF funds, it is not likely to materially affect the detailed use of RRF funds. Member states are not likely to adhere to detailed EU instructions on how to spend this money, and least of all according to many CSRs suggestions they have already been ignoring for years. They may though well choose to adhere to the very vaguely worded and recovery focused CSRs of May 2020 to at least pay lip-service to the process. The intended earmarking of around half of RRF funds to be allocated to decarbonization and digital transition investments is likely to be the extent of influence exerted over how member states will spend these resources.

Consequently, attempts by the European Parliament to try to establish a robust governance check on the use of RRF funds through the European Semester process is likely to fail, and would as such represent a misuse of Parliament's time and political capital. This is particularly the case, as RRF grants represent a novel and sizable EU-level instrument, around which other weighty political and governance questions swirl demanding the urgent attention of the European Parliament. These include broader Rule-of-Law (RoL) considerations and regular anti-corruption prevention measures[39] of particular relevance, when oversight of member states' access to the largest commonly funded pool of investment grants ever established is considered.[40] The European Parliament seems likely to have a better opportunity to impose more stringent RoL and anti-fraud provisions in the final co-legislator approved agreement on RRF and the 2021-2027 MFF, than crafting a governance framework wrought out of the existing European Semester process that will make limited real difference for how EU funds are spent by member states. Strict adherence to RoL and anti-fraud measures, however, are likely to also generally promote good economic governance and sustainable economic and fiscal policies.

[39] Autocratic political systems very often have district kleptocratic aspects, serving to enrich non-democratic leaders, their families and key supporters. Rule of Law concerns hence largely overlap with traditional fraud prevention measures in the oversight and governance framework for EU resources flowing to member states.

[40] The importance of these issues is self-evident for the entire NGEU and 2021-2027 MFF, the largest EU budget + supplemental package in EU history.

Pursuing these objectives is consequently pushing in the same general direction as the intent of the European Semester process.

The agreement among member states on the NGEU, and RRF in particular, will shift European fiscal integration to the EU level for the foreseeable future. The undercutting of momentum for further euro area fiscal integration will save the European Parliament the institutional costs of adjusting its existing committee structure to accommodate meaningful economic oversight of only euro area fiscal and other non-monetary policy structures. The recent expansion of the European Banking Union beyond the euro area further underlines how additional euro area-only structures inside the European Parliament will be superfluous.

Instead, the European Parliament's post-pandemic focus should be on working with the Commission and member states to secure a credible path for reform and reintroduction of the SGP. Given that SGP reform proposals must be initiated by the Commission, this would require that the European Parliament exert potentially potent political pressure on the Commission to act. This could for instance be in the form of repeated legislative resolutions calling for new proposals from the Commission along these lines. The timing of reintroducing the SGP must be closely related to the degree to which it is reformed. Certainly, in unreformed configuration, the SGP cannot sensibly be reintroduced before 2024, as it would dictate fiscal consolidation in many member states, at the same time the RRF would be trying to fiscally stimulate the EU economy. A reformed SGP, however, could likely be reintroduced earlier and easily become a potent force for the type of structural economic reforms often included in the European Semester CSRs.

The 2011 reforms of the SGP introduced a direct link, or perhaps more correctly termed trade-off, between the speed of a member state's required fiscal consolidation to adhere to SGP medium-term budget goals, and the member state's domestic implementation of growth and fiscal sustainability enhancing structural reforms. As discussed above, multi-pillar funded pension reforms were given particular attention as relevant offsetting reforms. Expanding the list of structural reforms with a "verifiable impact on the long-term sustainability of public finances" able to offset required short-term fiscal consolidation to include a larger share of reforms included in European Semester CSRs seems a sensible option. A larger and targeted part of otherwise often disregarded CSRs would be included directly into the SGP process, and in return the Pact could prescribe a less potent post-pandemic fiscal consolidation path in many member states, facilitating its potential early reintroduction.

Offering member states a "suite of relevant structural reforms" as a clear alternative policy path to additional short-term fiscal consolidation in order to adhere to the SGP would produce several advantages. An alternative "reform path" would mitigate the Pact's risk of pro-cyclicality (prescribing fiscal consolidation in an economic downturn). An explicit reforms-instead-of-consolidation path towards SGP adherence would offer member state governments implacably opposed - at the time of the SGP evaluation - to any short-term fiscal consolidation an alternative policy path within the Pact. Failure by a member state to embrace either short-term fiscal consolidation or a SGP "structural reform alternative path" would represent a more general rejection of European economic policy priorities than simply saying "NO! to more austerity". Such a rejection to take policy action along any European policy priority path is likely to ultimately make it easier for the Commission to propose, and for other member states to endorse, the imposition of SGP sanctions against the offending member state. Reforming the SGP and incorporating more elements of reforms underpinning CSRs into it in the post-pandemic period could therefore make it more likely that its coercive elements (the SGP's corrective arm) would actually be used, ultimately increasing its credibility and strengthening European economic policymaking.

The role of the European Parliament in first helping construct sound SGP "structural reform alternative policy paths" to short-term fiscal consolidation, and subsequently help scrutinize member states' SGP reform implementation record should be strengthened. Given the political controversy surrounding member states' implementation of many growth enhancing structural reforms, granting a direct role to elected members of the European Parliament in helping to identify the most relevant reforms to be included in an alternative SPG policy path would add political legitimacy and ownership to the process.[41] This could come in the form of requiring the Commission to publicly consult Parliament as part of designing an alternative reform policy path. Requiring the Commission to appear at Parliamentary hearings to lay out its conclusions regarding member states' ex post reform implementation record could also be considered.

Introducing elements of the European Semester CSRs into a reformed post-pandemic SGP and crafting a "reform path" alternative to the traditional fiscal consolidation to adhere to the Pact would - with certainty - lead to deemphasising the erstwhile dominant SGP debt and deficit reference values. While likely to be opposed by some, the current and future macroeconomic circumstances in the EU and euro area make a strong case for moving on from focus on debt and deficit reference values first formulated in the early 1990s.

During this earlier period, EU members (bar Belgium, Greece and Italy) had debt levels relatively close to 60 percent, and could reasonably expect GDP to grow at a nominal 5 percent[42], a level that combined with an "intended inflation rate" of less than two percent, meant that annual government deficits of up to 3 percent, would leave debt/GDP levels roughly stable, as real GDP would also grow at approximately 3 percent. The situation in the EU and euro area today is very different, and there can be no hope to ever go back to the macroeconomic situation of the early 1990s. Europe's demographic outlook has now shifted and potential growth rates and inflation expectations are thus considerably lower. Consequently, European interest rates are and will remain much lower and the debt burden that member states can carry will remain far higher than when the SGP reference values were conceived. The adverse impact of today's far higher debt levels than those prescribed by the SGP in numerous member states is consequently far more limited, and it makes little sense for the SGP to remain improperly focused on reducing a member state debt level figure back towards the 60 percent level. Given that both SGP debt and deficit reference values are included in Protocol 12 to the TFEU, and that treaty change is unrealistic, simply abandoning the reference values is not an option. Yet, Europe's post-pandemic fiscal reality calls for deemphasizing hasty enforcement of them, while reemphasizing the third pillar of EU fiscal surveillance in member states' medium-term budgetary objectives. This is best done by establishing an alternative "structural economic reform policy path" for member states to reach their medium-term goals while adhering to EU rules.

In the extremely low interest rate environment that will characterize the post-pandemic European economy going forward, it is not general government deficit and debt levels, but factors like countries' ability to employ more of its working age population gainfully, training workers for new and higher-skilled jobs, ensuring investment levels in European priorities like decarbonization and digital transition are adequate, or maintaining a distribution of income that enables broad-based consumption growth to continue across the income spectrum, that will influence the long-term sustainability of member states' finances. In other words, much of the policy agenda included in the

[41] The role of national MEPs would likely be crucial for such additional national ownership of the process to emerge, and would in many instances require national MEPs to unshackle their analytical contributions and votes from the priorities of national governments.

[42] Average nominal national currency denominated GDP growth in the then 12 EU members were 5.1 percent between 1992 and 1997. Source: IMF WEO Database October 2019.

European Semester's CSRs framework, but left untouched by the SGP. It would be a testament to European policymakers' understanding of the severity of the pandemic, if they, as part of their policy response to it, corrected also this mounting institutional flaw.

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This briefing paper argues that the political imperative to ensure that the economic stimulus from the EU's new commonly funded facilities is provided expeditiously will prevail against desires to create a robust governance framework for these funds within the European Semester process. The pandemic-related suspension of the Stability and Growth Pact creates a need to reform the Pact ahead of its future reintroduction. This presents an opportunity to incorporate more of the Semester's reform implementation agenda directly into the Pact's policy prescriptions.

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