BRIEFING

Economic Dialogue with the European Commission on the 2020 Country Specific Recommendations

ECON/EMPL on 27 May 2020

V. Dombrovskis, Executive Vice-President for An Economy that Works for People, P. Gentiloni, Commissioner for Economy and N. Schmit, Commissioner for Jobs and Social Rights have been invited to an Economic Dialogue on the launch of the 2020 Country Specific Recommendations (CSRs), in line with the relevant EU law.

This briefing note covers the main elements of the 2020 CSRs as proposed by the Commission (Section 1) on 20 May 2020, the EU/EA level economic responses to the pandemic (Section 2), the economic outlook (Section 3), the 2020 Euro Area Recommendation (Section 4), the implementation of 2019 CSRs (Section 5), and review of the European Semester and the deepening EMU (Section 6).

1. The draft 2020 Country Specific Recommendations

The objectives of the 2020 CSRs

According to the Commission, the European Semester should play a particularly important role now, given the size of the shock and the unprecedented nature of the economic policy measures being adopted by Member States. Ensuring effective economic policy coordination in the EU is of utmost importance. The Semester allows Member States to discuss their policies, exchange best practices and agree on a common way forward.

The priorities outlined in December 2019 in the Annual Sustainable Growth Strategy remain valid in the context of the pandemic, and therefore the draft CSRs reflect the four dimensions - stability, fairness, environmental sustainability and competitiveness. Furthermore, the Commission underlines that with the unprecedented economic policy measures adopted at national level (see overview table by the Commission services) and the increased role of the public sector in the economy, effective public administration and the fight against corruption and tax evasion needs to play an important role.

The 2020 draft CSRs place particular focus on the immediate measures to tackle and mitigate the socio-economic impact of the pandemic and on the measures to restart the economic activity. According to the Commission, urgent priorities concern investment in health-related issues, income support to affected workers, liquidity to firms (in particular Small and Medium Enterprises) and measures to support a symmetric recovery and preserve the integrity of the Single Market (see Figure 1 below).

Member States have been addressed with 3 to 4 CSRs (only Germany has been allocated 2 CSRs and Hungary has been allocated 5 CSRs). However, the proposed CRS cover many sub-policies and these are not always

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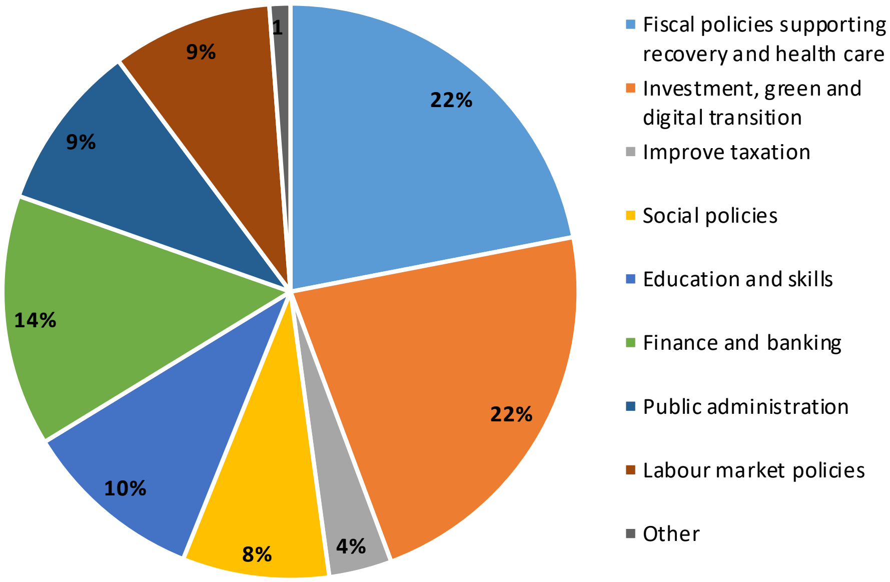
the same among the Member States. In some cases, sub-recommendations are not placed in the same manner across the CSRs. The CSRs are all of quite general nature.

For all Member States, the first CSR relates to using the fiscal policy to support recovery, notably the health sector, while safeguarding prudent fiscal policies over the medium term. Due to the activation of the escape clause of the Stability and Growth Pact (SGP), the wording for these fiscal policy related CSRs is more or less the same for all Member States, i.e., they do not include country specific fiscal targets.

Nearly all Member States have also been proposed one or more recommendation relating to labour, social and education policies, promoting public and private investments, access to finance for SMEs, and policies relating to public administration, pending their specificities and challenges.

Specifically, one may note that 11 Member States (BG, DK, EE, LV, MT, SE, IE, LU, NL, SK, FI) have been proposed recommendations relating to combating money-laundering, 7 Member States (HR, IT, CY, MT, PL, PT, SK) have been proposed a recommendation on the efficiency and/or independence of the judicial system, and 6 Member States a recommendation relating to policies combating aggressive tax planning (IE, CY, LU, HU, MT, NL). 3 other Member States (AT, FR, LT) were proposed recommendations on other taxation related issues, like adequate tax mix or simplification of tax.

Figure 1. Policy categories addressed in the 2020 draft CSR



Source: EGOV based on CSRs as proposed by the Commission for 2020-2021.

Notes: The categorisation of the CSRs used in this chart has been done by EGOV. When a CSR covers several of the policy areas included in this chart, the CSR is allocated to all the policy areas concerned and not just to one. The category "Fiscal policies supporting recovery and health care" includes fiscal policies supporting economic recovery, prudent fiscal policies (aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability) when economic conditions allow and reinforcing health care; the category "Education and skills" includes skills improvement, inclusiveness, the quality of education and access to education; the category "Finance and Banking" includes policies related to Anti Money Laundering, banking supervision, insolvency and access to finance; the category "Public administration" includes efficiency aspects, public procurement, the reduction of administrative burden, the judicial system and the involvement of stakeholders; the category "Labour market policies" includes active labour market policies, flexible working arrangements, short-time work schemes, the support of jobseekers and the preservation of job; the category "Other" includes post-programme commitments and the proportionality of emergency measures.

Adoption of the CSRs in the Council

- In June, the various Council formations will discuss the CSRs based on the preparatory work in their Committees and the European Council endorses the CSRs;
- In July, the ECOFIN Council formally adopts the CSRs.

Surveillance of public finances

In parallel to the assessment of the 2020 Stability and Convergence Programmes, the Commission took on 20 May 2020 a number of decisions under the Stability and Growth Pact.

The Commission adopted reports, as required by under Article 126(3) TFEU, for all Member States except Romania, which is already in the corrective arm of the Pact. These reports assess Member States' compliance with the deficit criterion in 2020, based on their plans or on the Commission's spring 2020 forecast. In addition, the reports for France, Belgium, Cyprus, Greece, Italy and Spain also assess compliance with the debt criterion in 2019 based on outturn data. The reports conclude that overall the analysis suggests that the deficit criterion (and for some countries the debt criterion) as defined in the Treaty and in Regulation (EC) No 1467/1997 is not fulfilled. The reports examine all the relevant factors and take into account the large and uncertain macroeconomic and fiscal impact of the pandemic. As these effects are still unfolding, the Commission considers that at this juncture a decision on whether to place Member States under EDP should not be taken[1].

The Commission will reassess Member States' budgetary situation on the basis of the autumn 2020 Economic Forecast, and the Draft Budgetary Plans to be submitted by euro area Member States by 15 October.

SGP escape clause

An expected severe economic downturn resulting from the COVID-19 outbreak led the Commission to conclude that the economic conditions warrant the activation of the general escape clause. The Finance Ministers of the Member States agreed with that assessment. The general escape clause does not suspend the procedures of the SGP. It allows the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact, while departing from the budgetary requirements that would normally apply. Specifically, it allows a Member State to temporarily depart from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term.

Latest enhanced Surveillance Report on Greece (May 2020)

Together with the CSRs, the Commission also released its latest enhanced surveillance report on Greece. The report will allow Eurogroup (EG) to decide on the release of additional funds equivalent to amounts stemming from central banks' holdings of Greek government bonds under the Securities Markets Programme and the Agreement on Net Financial Assets (ANFA) and a waiver for the step-up interest margin for certain loans provided by the European Financial Stability Facility. Provision of those additional funds was agreed in EG on 22 June 2018. The EG Work Programme for the first semester of 2020, adopted in December 2019, foresaw a discussion on Greece in March. The EG President reported after the meeting that "*We welcomed the good progress with reform implementation (...) outperform its fiscal targets for the fifth year in a row (...) Greece will also be able to make full use of the flexibility with the fiscal rules to deal with the consequences of the corona virus.*".

The Commission report signals the relevant impacts the corona crisis is having in Greek financial situation and the measures taken thus far to address the crisis. The Commission also concludes Greece has taken the necessary actions to achieve its due specific reform commitments under the financial assistance programme and recommends mobilising resources to step up efforts in areas affected by previous delays, including financial sector reforms, which it consider important to underpin confidence and support a sustainable recovery.

Surveillance of macro-economic imbalances

According to the Commission, surveillance under the Macroeconomic Imbalance Procedure is of the utmost importance. This year's recommendations take into account the need to tackle the pandemic and facilitate the economic recovery as an important step to prevent new imbalances from emerging in the future.

[1] Notwithstanding, in accordance with Article 3 of the EDP-Regulation (No 1467/97) the next steps will be:
1. Within two weeks of the adoption by the Commission of a report issued in accordance with Article 126(3), the Economic and Financial Committee shall formulate an opinion in accordance with Article 126(4).
2. Taking fully into account the opinion referred to in paragraph 1, the Commission, if it considers that an excessive deficit exists, shall address an opinion and a proposal to the Council in accordance with paragraphs 5 and 6 of Article 126 TFEU and shall inform the European Parliament thereof.

The Commission has proposed specific recommendation addressing macroeconomic imbalances for the three Member States that are experiencing excessive macroeconomic imbalances (Cyprus, Greece and Italy), as well as for eight[2] of the nine Member States that are experiencing macroeconomic imbalances (Germany, Spain, France, Croatia, Ireland, the Netherlands, Portugal, Romania and Sweden). Of the 45 CSRs proposed to countries experiencing excessive or macroeconomic imbalances, 31 are underpinned by the MIP. The Commission will reassess macroeconomic developments across the EU in its Alert Mechanism Report.

Surveillance of employment and social developments

In their recent communication accompanying the CSRs, the Commission proposed Member States to focus on short term response to tackle and mitigate the health and socio-economic impact of the pandemic. Nevertheless, preserving employment, improving social protection systems and strengthening social safety nets, as well as ensuring income support to affected workers, are among key priorities of the 2020 CSRs.

Despite the introduction of short-time work schemes, wage subsidies and support for businesses, the pandemic will have a severe impact on the labour market. The 2020 Spring Forecast, estimates that the unemployment rate in the EU is to rise from 6.7% in 2019 to 9% in 2020 and then fall to around 8% in 2021. Due to regional and territorial disparities across and within the Member States, some will see more significant increases in unemployment than others; notably workforce dependent on tourism are particularly vulnerable.

The new socio-economic reality after the pandemic underlines the need for collective efforts on tackling inequalities and poverty and protecting vulnerable groups. According to the Commission's assessment, there is a risk of fragmentation between been EU Member States and within societies, linked to a massive increase in unemployment, especially among young people and disadvantaged social groups. It is also expected that the crisis will have a significant impact on social conditions. Therefore the Commission recommends taking police actions to mitigate the social impacts and avoid a permanent rise in poverty and inequalities, to protect all workers. In particular, the priority should focus on groups that are likely to be hit hardest and that were already vulnerable before the crisis, such as workers on temporary contracts, the low-skilled, the involuntary part-time and self-employed, and migrant workers. In the coming weeks, the Commission will present proposals for a new skills agenda to make the Youth Guarantee more robust and to stimulate investment in workers skills.

2. EU/EA level responses to the economic and social effects of the pandemic

There has been a strong EU/EA response to the corona crisis across the whole spectrum of bodies (for more detailed information see here). The three pillar package agreed by Leaders on 23 April, on the basis of the 9 April Eurogroup report, remains one of the stepping stones. It is complemented by a Roadmap for Recovery, also agreed by Leaders on the 23 April, where the next Multi-annual Financial Framework (MFF) and a new EU Recovery Fund feature as part of the recovery stage. The following paragraphs summarise some of the elements of the EU crisis response.

A proposal for an EU Recovery Fund

The Commission is expected to make its proposal and present it in the plenary of the European Parliament on the same day as this Economic Dialogue with the Commission. Therefore, the paragraphs below present views expressed in the public domain in advance of the today's proposal by the Commission.

On 16 April, Commission's President Von der Leyen stated at the EP: *"There is only one instrument we have that is trusted by all Member States, which is already in place and can deliver quickly. It is transparent and it is time tested as an instrument for cohesion, convergence and investment. And that instrument is the European budget… And for that reason, the next seven year budget must be different to what we had imagined…We will*

[2] The Commission did not propose specific recommendation underpinned by the MIP to Sweden.

use the power of the whole European budget to leverage the huge amount of investment we need to rebuild the Single Market after Corona. We will frontload it so we can power that investment in those crucial first years of recovery.". On 13 May she added, before Parliament, that such facility would be linked to the European Semester.

On 23 April, the Heads of state or government agreed to work towards establishing a Recovery Fund. Leaders tasked the Commission to analyse the exact needs and to urgently come up with a proposal. Charles Michel, President of the European Council: "*This fund shall be of a sufficient magnitude, targeted towards the sectors and geographical parts of Europe most affected (…). We remain committed to giving the necessary impetus to work on the recovery fund as well as the MFF, so that a balanced agreement on both can be found as soon as possible.*"

The European Parliament adopted on 15 May a resolution, on "The New MFF, own resources and the Recovery plan", in line with Parliament's resolution of 17 April, where it called "*for the Recovery and Transformation Fund to be financed through the issuance of long-dated recovery bonds guaranteed by the EU budget, maximising the headroom and subject to a repayment plan* [... and] *urged for the Package to be disbursed through loans and, mostly, through grants, direct payments for investment and equity, and for the Fund to be managed directly by the Commission; believes that money should go to programmes within the EU budget, enjoying full parliamentary oversight and participation, and being subject to appropriate auditing and reporting requirements.*".

On 18 May, a "French-German initiative for the European recovery from the coronavirus crisis" was published, which called for the setup of an "*ambitious, temporary and targeted Recovery Fund in the framework of the next MFF, boosting a frontloaded MFF during its first years [...],* amounting to 500 billion €, to be financed by borrowing on markets on behalf of the EU, under the provision of a legal basis in full respect of the EU Treaty, budgetary framework and rights of national parliaments. The Fund would provide EU budgetary expenditure for the most affected sectors and regions on the basis of EU budget programmes and in line with European priorities. The Fund would be "*an extraordinary complementary provision, integrated in the own resource decision, with a clearly specified volume and expiry and linked to a binding repayment plan beyond the current MFF on the EU budget*". Furthermore, the proposed instrument *would "be based on a clear commitment of member States to follow sound economic policies and an ambitious reform agenda".* The proposal was welcomed by, *inter alia*, the Presidents of the ECB and of the Eurogroup.

On 23 May, the so-called "Frugal-four countries", namely Sweden, Austria, the Netherlands and Denmark, published a non-paper in reaction to the French-German proposal. The paper claims that only loans should be provided to Member States, if funds are obtained by the EU through borrowings ("loans to loans" approach). The paper argues for a European Recovery Fund based on a "*modernized EU budget*" that would ensures countries are "*better prepared for the next crisis. The recovery fund should be temporary and one-off, with a sunset clause after two years, and should not lead to debt mutualisation*". Loans would be underpinned by a strong commitment to reforms and to the fiscal framework.

SURE

The European instrument for temporary support to mitigate unemployment risks in an emergency (SURE) was agreed by Council on 19 May. The Commission proposal, dated 2 April, aims at establishing a financing facility of up to 100 billion euro in loans to finance national short-time work protection schemes. It allows the Commission to raise funds in capital markets, on the back of up to 25 billion euro Member States' guarantees, and lend the funds to Member States. The regulation is based on article 122 of the Treaty on Functioning of the European Union (TFEU)[3] and establishes a number of safeguards to protect the EU

[3] Article 122 of TFEU reads "*1. Without prejudice to any other procedures provided for in the Treaties, the Council, on a proposal from the Commission, may decide, in a spirit of solidarity between Member States, upon the measures appropriate to the economic situation, in particular if severe difficulties arise in the supply of certain products, notably in the area of energy. 2. Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned. The President of the Council shall inform the European Parliament of the decision taken".*

budget and Member State's guarantees. As set out in Council approved text, the regulation will apply for two years and can be extended for another 6 months if the crisis persists. The facility will be available once Member States commit to provide the guarantees.

For additional information please see specific EGOV briefing.

European Investment Bank and European Investment Fund

On 6 April, the Commission unlocked €1 billion from the European Fund for Strategic Investments, to serve as a guarantee to the European Investment Fund (EIF). This allowed the EIF to issue special guarantees to incentivise banks and other lenders to provide liquidity to at least 100,000 European SMEs and small mid-cap companies hit by the economic impact of the coronavirus pandemic, for an estimated available financing of €8 billion.

On 16 April 2020 the Board of Directors of the EIB proposed the creation of a €25 billion guarantee fund to enable the EIB Group to scale up its support for companies in all 27 EU Member States by an additional up to €200 billion. Such fund would serve as a protective shield for European firms facing liquidity shortages. It could be set up with contributions provided by the Member States and be open to participation by other EU institutions. The scheme would be implemented by the EIB and the European Investment Fund (EIF), in close partnership with national promotional banks, the European Commission and other financial partners and would create a level playing field for small and medium-sized companies in all Member States. The Eurogroup welcomed the initiative at its meeting of 9 April (point 15) and invited "*the EIB to operationalize its proposal as soon as possible*". EU leaders endorsed it on 23 April. The Eurogroup discussed the state of play of this facility at its 15 May meeting.

ESM Pandemic Credit Line

As part of the corona crisis response, the Eurogroup has agreed on 9 April an ESM Pandemic Crisis Support (PCS). On 8 May, the features and standardised terms of the instrument were agreed and on 15 May the credit line was finalised. It is based on current ESM precautionary Enhanced Conditions Credit Line and would allow providing loans of 2% of a Euro Area Member State GDP as a benchmark. There are no conditions attached besides using the lent funds to finance corona-related expenses.

On 8 May the Commission proposed a common template for the Response Plan that Member States will use to detail the costs incurred or planned to implement the policy measures to be associated with financing under the PCS. On 9 May, the Commission also concluded that all Euro Area Member States fulfil the conditions for accessing the PCS.

The main differences between a "standard" ECCL and the PCS relate to the conditionality (in the ECCL, detailed and country specific memorandum of understandinng, detailing the policy conditions a Member State commits to implement, is requested, whilst the PCS is based on uniform policy conditions for all Member States, as reflected in the Pandemic Response Plan); the monitoring (lighter surveillance in PCS than on ECCL) and pricing conditions (lower in PCS than on ECCL). It has been voiced in the media that a number of Member States have rejected recourse to the new credit line.

For additional information please see specific EGOV briefing.

Use of Cohesion Funds

A smarter use of cohesion funds is also considered in the package of measures put forward to deal with the corona crisis. That is particularly the case of the Coronavirus Response Investment Initiative (CRII) and of the Coronavirus Response Investment Initiative Plus (CRI Plus), which allowed making available unused 37 billion euro of Member States returns and of available funds for 2020. The adopted measures provided flexibility in funds transfers, simplified procedural steps linked to programme implementation, use of financial instruments and audit, and foresaw a 100% EU co-financing rate for cohesion policy programmes for the accounting year 2020-2021. Both packages are already in force, after adoption by the co-legislators.

In the 2007-2008 financial crisis, the cohesion policy was part of the crisis recovery plans, through the European Economic Recovery Plan. It is expected that it will again play a role, as referred by President Von der Leyen in her 13 May speech before Parliament.

The use of EU state aid

Recognising that the entire EU economy is experiencing a serious disturbance, the Commission adopted on 19 March a temporary State Aid framework that gave Member States a lot of flexibility to support their economies (based on Article 107(3)(b) of the Treaty).

Five types of aid were thereby allowed:

i. Schemes that provide direct grants, selective tax advantages, or advance payments to companies (up to €800.000), to address urgent liquidity needs.
ii. State guarantees for loans taken by companies from banks.
iii. Subsidised public loans to companies with favourable interest rates.
iv. Safeguards for banks that channel State aid to the real economy.
v. Member States got more flexibility to provide short-term export credit insurance in case that countries have become not-marketable risks.

A first amendment to that temporary framework, adopted on 3rd April 2020 on the same legal basis, extended the eligible types of aid. They now also include measures to facilitate corona related research and development, and to support the construction or upgrade of testing facilities and the setting up of production capacities for relevant products (e.g. pharmaceutical and medicinal products and equipment, protective clothing, disinfectants etc.).

A second amendment, adopted on 8 May, sets out the applicable criteria if Member States wish to provide recapitalisations and subordinated debt to companies.

Those measures, in particular recapitalisations, shall notably:

- only be granted if no other appropriate solution is available,
- ensure that Member States are sufficiently remunerated for the risks assumed,
- include an exit strategy, in particular as regards large companies that have received significant recapitalisation aid,
- and ensure that beneficiaries are subject to bans on dividends and share buybacks, and to a strict limitation of the remuneration of their management.

The Commission published a list of all Member States' coronavirus-related measures approved by the Commission, which is regularly updated.

The far-reaching relaxation of the State aid rules has sparked a discussion whether companies in Member States that have more financial firepower are gaining an advantage that can lead to a distortion of the level playing field and potentially to an asymmetric recovery. During a public hearing in the ECON Committee on 25 May 2020, Commissioner Vestager provided, under a number of caveats, the following information on notified state-aid by Member States:

47 % by Germany

18 % by Italy

16 % by France

4 % by Spain

2.5 % by Poland

Altogether, by 25 May 2020, 175 measures have been approved by the Commission of a total amount of EUR 2.1 trillion. The Commissioner stressed that those figures should be taken only as indicative, as they are just the budgets for the schemes, not actual payments, and that the budget figures for some schemes are not very precise.

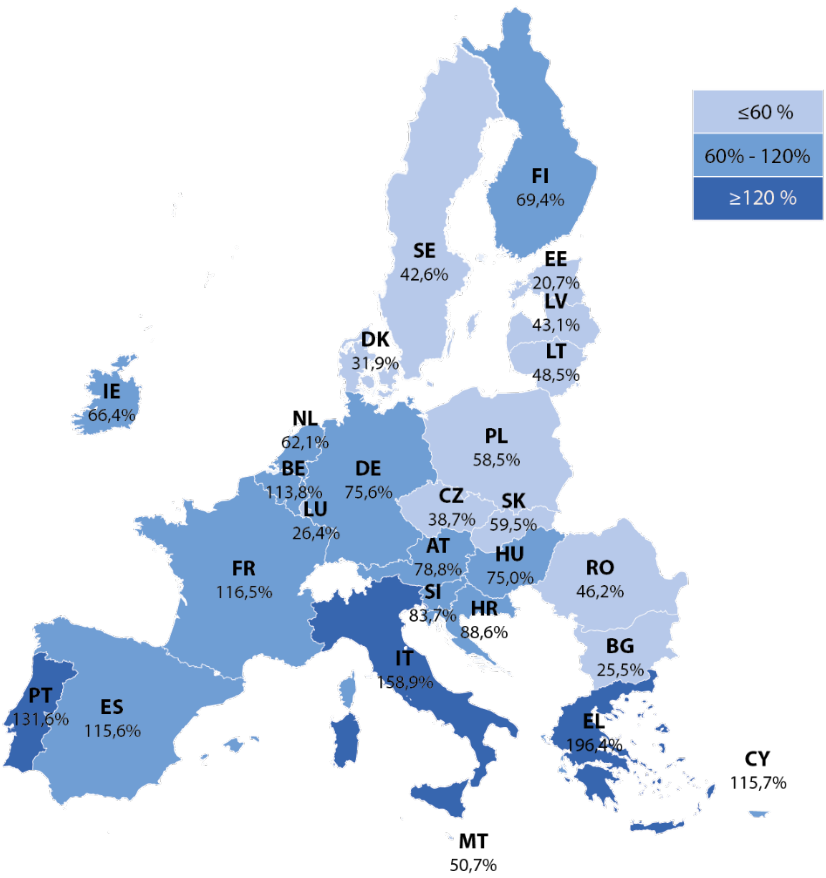
The entry conditions that companies have to fulfil to get access to State support schemes have become another controversial point. The basic rule says that beneficiaries shall not have been in difficulty before the corona crisis. However, some innovative small companies, like tech start-ups, earlier on operated at a loss in order to drive faster growth, which technically disqualifies them from the State support. Several industry associations have therefore written a joint letter to Commissioner Vestager, asking not to be excluded from vital emergency aid. In the hearing of 25 May, the Commissioner confirmed that this issue is looked into.

3. Economic outlook: focus on public debt

On 6 May 2020, the European Commission presented and published their spring economic forecast. Particular attention was drawn to the effects of the pandemic on public finances in EU Member States and the uncertainty related to economic estimates due to the unprecedented situation in the EU and globally. Below some elements from this economic forecast are highlighted.

Following the corona virus pandemic outbreak, in order to protect households, workers and firms, discretionary fiscal measures (around 3¼% of GDP) have been announced or implemented by EU Member States. Moreover, governments have provided sizeable state guarantees for loans to firms and other liquidity support (almost 24% of GDP in euro area).

Figure 2. General government debt in 2020



Source: European Commission's spring 2020 economic forecast available on the European Commission's homepage

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

After having been on a declining trend since its peak in 2014, the euro area's aggregate government debt-to-GDP ratio is projected to reach a new peak of close to 103% in 2020 before decreasing by about 4 pps in 2021 based on a no-policy-change assumption.

Under the baseline scenario, aggregated GDP is forecast to contract in the EU by about 7½% this year and to rebound by 6% in 2021. According to the Commission, this rebound would leave the European economy, at the end of this forecast horizon, about 3% lower than the output level implied by the autumn 2019 Commission forecast. Lower employment and investment reduce potential output, whereas the record-high uncertainty about jobs, incomes and sales, are set to hold back demand for some time.

The recovery is set to be incomplete, inter alia because spending on travel and recreational services will lag behind because restrictions affecting these activities may last longer and because the fiscal measures implemented to protect employment and workers' incomes will only limit rather than prevent a drop in household purchasing power this year. Moreover, uncertainty about employment and income prospects will likely ensure that precautionary savings remain higher than they were before the crisis well after the lockdowns have ended. According to the Commission, this suggests an only gradual ('U-shaped') recovery.

Uncertainty remains huge, and different assumptions than the ones underpinning the baseline scenario would lead to very different projections. According to the Commission, the risks to the forecast are extraordinarily large and concentrated on the downside. The pandemic could become more severe and last much longer than assumed, requiring more stringent and longer lasting containment measures than assumed in this baseline scenario.

As some of the Member States hit hardest by the virus are also those with the least fiscal space to respond, divergences across Member States could become entrenched if national policy responses are not sufficiently coordinated or if there is no strong common response at the EU level. According to the Commission, this could distort the internal market and ultimately threaten the stability of the euro area. Due to their strong interdependencies, an incomplete recovery in one country would spill over to all the other countries and dampen economic growth everywhere.

Globally, the pandemic period could also trigger more drastic and permanent changes in attitudes towards global value chains and international cooperation that would particularly hit open economies.

Overall, the Commission stresses that the pandemic's economic impact is likely to be highly complex and widely varied. The economic effects differ with respect to demand and supply factors and with respect to the time horizon of their impact. The duration of the effects depends on the duration of the pandemic, but also on whether changes to trade policies and globalisation attitudes, consumer behaviour, working methods and production chains become permanent. Moreover, debt accumulated during the downturn may exert a lasting impact on firms (e.g. bankruptcies), investors risk perception (e.g. debt sustainability concerns) and the banking sector (e.g. non-performing loans).

4. The 2020 euro area recommendation

The Commission presented its draft euro area recommendation (EAR) for 2020 as part of the 2020 Autumn Package on 17 December 2019 (draft EAR and the Staff Working Document). Compared to the 2019 EARs adopted by Council, the 2020 draft EAR are longer and provide more granular policy orientations. On these more granular policy orientations, one can highlight:

- a call for enhancing democratic accountability of the EMU (EAR 5)[4];

[4] Although not being fully clear what is envisaged by the Commission, recital 16 of the draft EAR reads: "*Additionally, the move towards intergovernmental solutions has not been matched by appropriate accountability at EU level. Therefore, improvements in the governance of the euro area bodies would be instrumental to increase democratic accountability*". Likewise, the SWD accompanying the draft EAR refer that "*it would also be important to integrate the intergovernmental agreements into Union law and under the European Parliament's oversight*".

- an alert that Member States need to be attentive to the economic outlook and stand ready to deliver a supportive fiscal stance at the aggregate level (respecting the SGP and national specific circumstances and avoiding pro-cyclicality) (EAR 2)[5];

- stronger emphasis on digital and environmental challenges, in line with the President Ursula von den Leyen political priorities, and a concern to ensure that social policies take these dimensions into account (in particular in EAR 3);

- different focus on the Capital Markets Union: the Commission proposes in the EAR 4 to "renew efforts" to complete the Capital Markets Union as most files have been completed now.

The February Ecofin and Eurogroup finalised the text that has been transmitted on 13 March to the 26-27 European Council for endorsement. Looking at the version transmitted to the European Council, compared to the Commission proposal, one can note:

- the inclusion of a reference to adopting differentiated fiscal responses if downside risks were to materialise;

- the deletion of the reference to reinforcing the democratic accountability of EMU (which the Council details, in its "comply or explain" note, by "*Democratic accountability arrangements are founded upon treaty provisions and secondary legislation and are complemented by regular dialogue with the European Parliament.*").

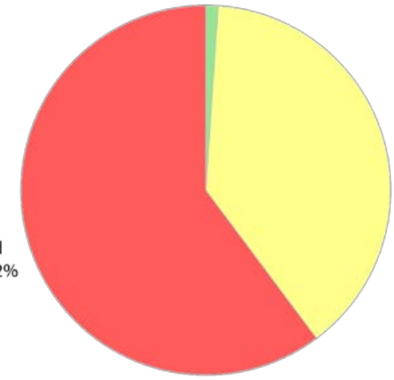
Considering the timing of discussions to finalise the proposal, the 2020 EAR do not reflect the impacts of the corona crisis nor the policy response being implemented, as recognised in the Council synthesis report of 17 March. Nevertheless, some of the concerns there expressed can still guide the policy response to the crisis and the recovery. That is in particular the case of expansionary fiscal policies being "*targeted, timely and temporary*", to avoid any negative longer term outcomes on the sustainability of public finances (one could also draw some lessons from the of the European Economic Recovery Plan).

5. Implementation of the 2019 Country Specific Recommendations

As indicated by Figure 3, EU Member States made at least some progress on almost 40% (37 out of 93) of recommendations under the 2019 European Semester (similar to the 2018 Semester cycle, when the corresponding number was 39%). Euro area Member States have had, taken together, a better implementation record than non-euro area Member States (this conclusion does not necessarily hold at individual country level). Countries whose currency is the euro made at least some progress on nearly 42% (27 out of 65) of the 2019 CSRs as compared to about 36% (10 out of 28) for non-euro area Member States. Table 1 provided some stylized facts on how the CSRs have evolved over the Semester Cycles.

[5] The SWD helps clarifying the Commission concerns here. Looking at the economic outlook, the Commission points out that Member States may be required to pursue expansionary discretionary fiscal policies. The Commission recalls the European Economic Recovery Plan and favourably assesses its impacts to counteract the effects of the 2007/2008 economic, financial and sovereign crisis. Nevertheless, the Commission highlights that such actions need to be "timely, targeted and temporary" and, in the draft EAR, further conditions expansionary measures to their compliance with the SGP, country specific circumstances and avoiding pro-cyclicality.

Figure 3. Implementation of the 2019 Country Specific Recommendations



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

Similarly to the 2019 Country reports, the 2020 Country reports by the Commission include for each country the overall multiannual implementation rate for CSRs adopted in 2011-2019 (and as with the annual assessments it excludes the assessment of compliance with the SGP related CSRs). However, the Commission has neither published the methodology underlying its multi-annual assessment, nor the country-specific multi-annual assessments at the level of CSRs (for more information see separate EGOV briefing).

Table 1: CSRs over the years - some stylized facts

European Semester Cycle	Total number of CSRs	Number of Member States	Minimum number of CSRs per Member State		Maximum number of CSRs per Member State	
2012	138	23	4	DE, SE	8	ES
2013	141	23	3	DK	9	ES, SI
2014	157	26	3	DK	8	ES, HR, IT, PT, RO, SI
2015	102	26	1	SE	6	FR, HR, IT
2016	89	27	1	SE	5	FR, HR, IT, CY, PT
2017	78	27	1	DK, SE	5	HR, CY
2018	73	27	1	DK, SE	5	CY
2019	97	28	2	DK, DE, EL, UK	5	CY, IT, RO
2020	104	28	2	DE	5	HU

Source: EGOV based on CSRs as adopted by the Council for 2012-2019 and proposed by the Commission for 2020.

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

6. The review of the European Semester and the deepening of EMU

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

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

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

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

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

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

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

A number of major EU projects to enhance the governance of the EMU have somehow been put on hold during the pandemic, as institutions concentrate of defining and implementing the policy response to the crisis. That is the case of completing the Banking Union or the Capital Markets Union projects.

On the Banking Union, the so called High Level Working Group on EDIS has been mandated to report back to the Eurogroup on June 2020 on implementation of the December 2019 roadmap for action. The ESM reform agreed in June 2019 has been put on hold, as Ministers and the ESM concentrate on crisis response through the new Pandemic Crisis Support (see specific EGOV briefing for details). As to the Capital Markets Union, a report from the Commission High Level Group is expected in the coming days, and might provide additional instruments to deal with the crisis. Its timeframe has, nevertheless, been impacted by the crisis.. As crisis response develops, these projects - and in particular the completion of the Banking Union and breaking the link between sovereigns and banks - will regain importance

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