BRIEFING

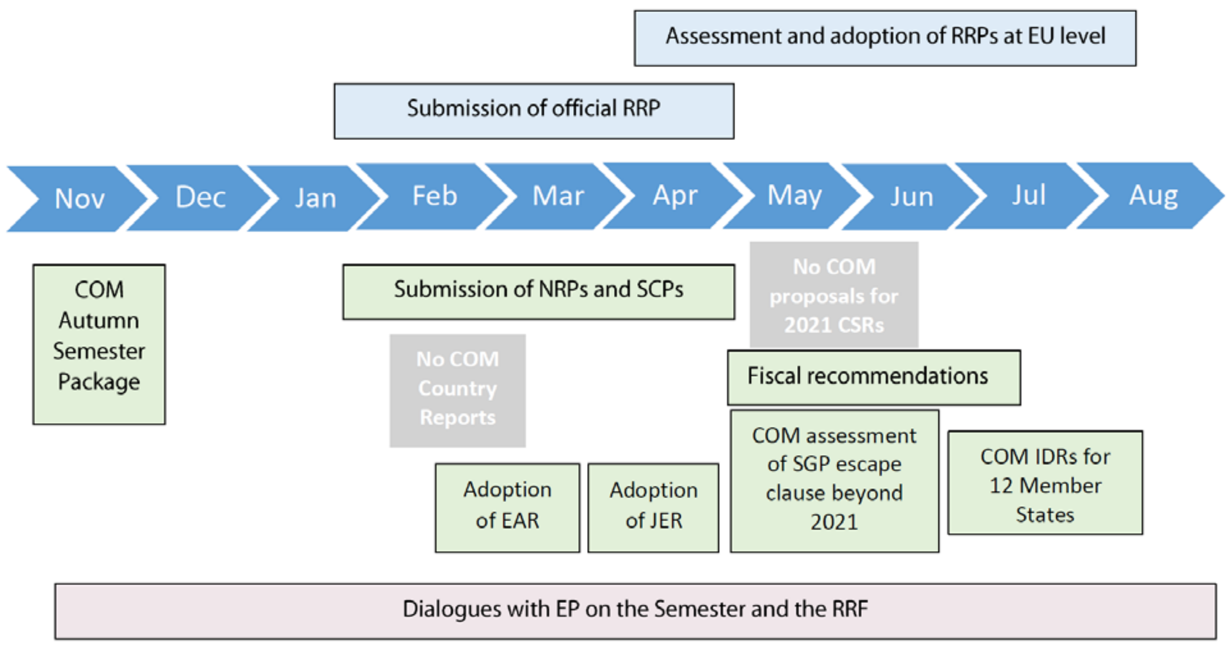
The European Semester during the Pandemic

Due to the pandemic, the European Semester for economic policy coordination will look rather different (in both form and substance) to what it was in previous cycles. This document provides an overview on how the various policy instruments comprised in the European Semester have been or are being implemented as part of the EU Recovery Plan, notably the interactions with the proposed Recovery and Resilience Facility.

1. The 2021 European Semester cycle

On 17 September, the European Commission spelled out in the Annual Sustainable Growth Strategy 2021 (2021 ASGS) its views on how the Recovery and Resilience Facility (RRF) would be temporarily integrated in the European Semester framework, while recognising that legislative work on the RRF was still to be finalised. The Recovery and Resilience Plans (RRPs), foreseen in the draft RRF regulation, to be submitted by Member States during spring 2021, will become the main reference document for the Member States' forward-looking economic policy initiatives.

Figure 1: Governance of the 2021 European Semester cycle



Source: EGOV based on 2021 ASGS, 2021 AMR, 2021 EAR, 2021 JER and the draft RRF Regulation.

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2. The main European Semester instruments during the pandemic

The need to mitigate the pandemic's adverse effects and support economic recovery are having implications on the instruments and policy recommendations in the 2020 and 2021 European Semester cycles[1]. Impacts are already being felt, notably, on fiscal surveillance (see point 3 below), on the macroeconomic imbalances procedure (see section 4 below), on the euro area recommendation (see section 5 below) and on the Joint Employment Guidelines (see section 6 below).

In addition, the setting up of the RRF further impacts the National Reform Programmes and the Stability or Convergence Programmes to be submitted by end of April 2021; the Country Reports to be produced by the Commission; and the Country Specific Recommendations to be adopted by the Council, as explained below.

The National Reform Programmes (NRPs)

For the current Semester cycle, the Commission is encouraging Member States to submit NRPs and RRPs in a single integrated document. On 6 November, the Council (ECOFIN) agreed with this approach and called for returning to a fully-fledged European Semester process as soon as possible, including its governance. Having the RRPs well integrated in the NRPs allows a holistic view of the Member States' investments and reforms programmes and enables consistency between both policies[2].

Stability or Convergence Programmes (SCPs)

Member States will present SCPs in accordance with established procedures, reflecting how they intend to support recovery and ensure sustainability of their public finances going forward, while taking into account the general escape clause of the Stability and Growth Pact (SGP). Based on the SCPs, the Commission may still propose recommendations on fiscal, bearing in mind the still active general escape clause.

The Country Specific Recommendations (CSRs)

The 2020 CSRs adopted by the Council in July 2020 focus on tackling the socioeconomic impacts of the COVID-19 pandemic and on facilitating economic recovery, while the 2019 CSRs covered reforms considered essential to address medium- to long-term structural challenges. According to the recitals of the 2020 CSRs, the 2019 CSRs remain pertinent and will continue to be monitored (see this EGOV note for an overview of the 2020 CSRs as proposed by the Commission).

The Commission spelled out in the 2021 ASGS its intention not to propose CSRs in 2021 (except on budgetary issues) for those Member submitting a recovery and resilience plan under the RRF.[3]

1 On 27 May 2020, the Commission presented its proposals for the EU Recovery Plan including a proposal for a regulation setting out the Recovery and Resilience Facility (RRF). Under the RRF, Member States can benefit of loans and grants to finance structural reforms and fight the impacts of COVID-19. To receive financing, Member States will present Recovery and Resilience Plans (RRPs) proposing a set of reforms and public investment projects. Such projects are to be aligned and assessed against the European Semester relevant recommendations, including the country specific recommendations.

2 In an expertise advice paper provided upon the request by the ECON Committee of the EP, Manuela Moschella (November 2020) argues that:

The long-standing dialogue and monitoring that takes place within the Semester can also be of help for EU institutions and Member States to identify the areas were implementation challenges are more likely to emerge in the near future and thus to account for them since the stage of preparation of recovery plans. Furthermore, by requiring Member States to present their recovery and resilience plans along with NRPs increase information about the synergies between the reforms and investments that will be financed under the RRF and those that fall within the pre-existing domestic reform and investment agenda. Such information advantage will also help minimize the concern that the RRF financing is going to be used for projects that would be ordinarily financed from national budgets.

3 In an expertise advice paper provided upon the request by the ECON Committee of the EP, Thomas Wieser (October 2020) makes the following point:

The Commission does not indicate what would be the case in the following years. A possibility would be to adopt CSRs each year, including in 2021, so as to make explicit the main objectives of the RRPs of each Member State, thereby also ensuring coherence with the EU objectives set out in the RRF Regulation. In addition, it could be a way to take stock of achievements and, if necessary, provide additional steering to the MS concerned.

The new National Recovery and Resilience Plans (RRPs)

The RRF regulation foresees the introduction of RRPs in which Member States set out their investment and reform programmes. On the basis of such programmes, to be reviewed and approved at European level, Member States will be able to receive grants and loans from the RRF.

The co-legislators (European Parliament and the Council) are currently discussing in the context of the RRF how to ensure that national policies reflected in the RRPs are aligned with pre-defined EU objectives and criteria, including the 2019 and 2020 CSRs (and 2021 euro area recommendation, where relevant) as adopted by Council. Such policies may be funded by the RRF.

The EP has asked the RRF to apply for policy areas related to:

(a) Green transition;
(b) Digital transformation;
(c) Smart, sustainable and inclusive growth, including economic cohesion, jobs, productivity, competitiveness, research, development and innovation, and a well-functioning single market;
(d) Economic, social and institutional resilience, including with a view of increasing crisis reaction and crisis preparedness;
(e) Health, and social and territorial cohesion; and
(f) Policies for the next generation, including education and skills.

According to guidance provided by the Commission in the 2021 ASGS, Member States should focus their RRPs on challenges and priorities generating the most lasting impact and strengthening growth potential, job creation, health systems and economic and social resilience and regional cohesion.

Due to the temporary nature of the EU funds available under the RRF, these funds should not replace recurring national budget expenditures or revenues *per se*, but instead be used as additional financial resources for achieving the EU value added objectives to be set out in the RRF Regulation[4,5].

The Commission will assess the compatibility of reforms and investments proposed in the RRPs with the eligibility criteria to be decided in the RRF Regulation. Such assessment will be done through analytical documents complementing the Commission proposal for a Council implementing act adopting each RRP at EU level. The EP has requested to be part of this EU decision making procedure, notably by replacing implementing acts by delegated acts. A delegated act would enable a stronger role for the EP.

Moreover, the Commission has indicated that the analytical documents on the RRPs will replace the Country Reports in 2021[6]. The Commission assessments of the individual RRPs will be published not later than two months after their submission by the respective Member State.

[4] In an expertise paper provided upon the request of the EP, Ben Crum (October 2020) stresses that:

However, as appropriate as this is, and as extensive as democratic control may be at the national level, the European dimension is critical to the RRF. The RRF is a European initiative because the money is collected at EU level and allocated in a way that testifies to a sense of solidarity between the peoples of Europe. It is also European because one of its primary concerns is about ensuring cohesion not only within European societies but also across them. And it is European because its main objectives (economic resilience in terms of growth and jobs, and the green and digital transition) have clear transboundary implicate.

[5] In another expertise paper, Jacob Kirkegaard (October 2020) makes a rather critical assessment:

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.

[6] During normal times the Country Reports are published in February each year and constituted the main analytical input for the country specific backward and forward looking assessments by the Commission.

In addition, according to the 2021 AMR, the Commission will publish the in-depth-reviews (IDRs) of those Member States assessed to have macro-economic imbalances under the macro-economic imbalances procedure.

Next steps:

- Inter-institutional negotiations on the RRF Regulation are on-going[7].
- The current and incoming Presidency of the Council have prepared a roadmap outlining the key steps of the 2021 European Semester in the relevant Council formations. The roadmap reflects the planned Council proceedings until summer 2021, reflecting as well how to integrate the RRF relevant dimensions.
- The Eurogroup is planning several meetings to discuss the progress on the RRPs.

Further reading:

- Thematic Digest: "The role for the European Semester in the recovery plan"
- EU/EA measures to mitigate the economic, financial and social effects of coronavirus - latest version

3. Limited fiscal policy surveillance during the pandemic

In March 2020, the COVID-19 outbreak led the Commission to conclude that a severe economic downturn was to be expected and that the activation of the general escape clause of the Stability and Growth Pact (SGP) was warranted. The Finance Ministers of the Member States agreed with that assessment.

The general escape clause allows a Member State in the preventive arm 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. If a Member State is in the corrective arm, the clause implies that the Council may decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory[8].

Given the abovementioned procedural framework, Member States have adopted budgetary, liquidity and economic policy measures (including schemes approved under temporary flexible EU State aid rules) to increase the capacity of their health systems and provide relief to those citizens and sectors that are particularly impacted; according to current Commission estimates, the national measures amount to about EUR 3 trillion (latest available information available here).

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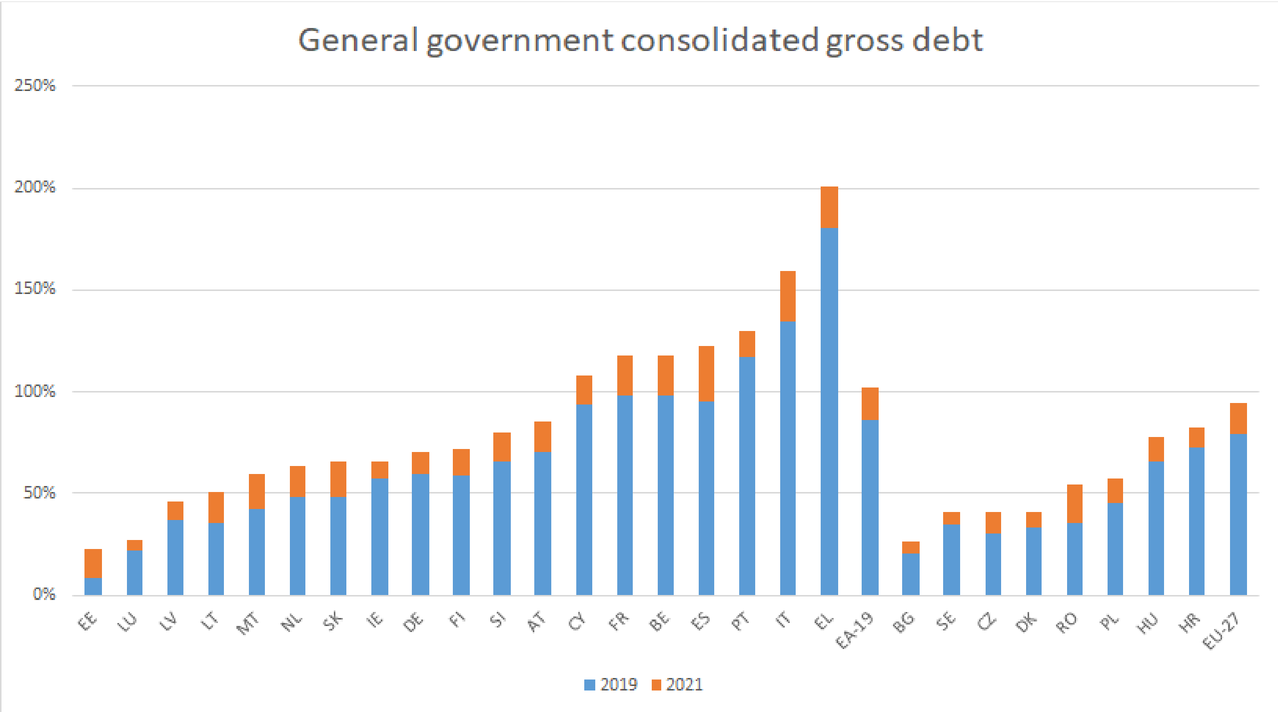
[7] Currently, inter-institutional negotiations are on-going on RRF Regulation (please see Commission proposal here, the position of the European Parliament (EP) here and the position of the Council here). In addition, the Council still needs to adopt the proposed changes to the EU own resources ceiling as agreed by the European Council, 17-21 July 2020 and the EP on 16 September.

[8] In July 2020, the European Fiscal Board (EFB) stated in a report assessing the fiscal stance appropriate for the euro area in 2021 that a review date and the conditions for an exit from the escape clause have not been indicated and should be discussed and agreed as soon as possible. It also noted that "*In principle, the clause should be deactivated as soon as the severe economic downturn in the EU and the euro area comes to an end. However, there is no commonly accepted or agreed definition of a severe economic downturn. The Commission and the Council may hold different views. Also within the Council views may diverge considerably, especially if the economic impact of the Covid-19 crisis differs across countries: some may soon embark on an upturn, others may experience negative growth for longer.*"

Figure 2: Public debt level in EU Member States during the pandemic



Source: EGOV based on European Commission 2020 autumn economic forecast

Against the background of the activation of the escape clause, the fiscal policy-related CSRs adopted on 20 July 2020 include for all Member States in the preventive arm of the SGP the following wording: "*Take all necessary measures, in line with the general escape clause of the Stability and Growth Pact, to effectively address the COVID-19 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 (...)*". In addition, the 2020 CSRs contain country specific elements, notably relating to strengthening the health care system.

In its opinion on the 2021 Draft Budgetary Plans of the euro area Member States, the Commission clarifies that "*In light of this need and the still high uncertainty about the economic consequences of the pandemic, the general escape clause will remain active in 2021. In spring 2021, taking into account updated macroeconomic projections, the Commission will reassess the situation and take stock of the application of the general escape clause.*" [9].

Next steps: the Commission to publish its opinions on the 2021 SCPs in late May, including possible fiscal recommendations, and the Council (ECOFIN) would approve these in June, while the Eurogroup is planning to discuss the 2021 DBPs on 16 December 2020 and lessons learnt on the fiscal framework and its implementation following the COVID-19 on 15 March 2021.

Further reading:

- Implementation of the Stability and Growth Pact during pandemic times - latest version
- Public finances in Euro Area Member States: Selected indicators - latest version

[9] Based on a request of the ECON Committee, a set of briefing papers by academics on how and when to deactivate the general escape clause of the SGP will soon be made available.

4. Surveillance of macro-economic imbalances

According to the 2021 Alert Mechanism Report published in November 2020, the current surveillance cycle of the European Semester is being temporarily adjusted to ensure consistent and effective implementation of the RRF, which will also affect the implementation of the MIP.

The Commission stresses that the RRF is an opportunity for Member States to implement reforms and investments in line with MIP-related recommendations that address the underlying and long-standing structural causes of existing macroeconomic imbalances.

As the 2021 AMR is carried out against the backdrop of the pandemic, it is being reinforced with a forward-looking assessment of risks to macroeconomic stability and on the evolution of macroeconomic imbalances. To this end, and compared to previous years, the Commission makes a greater use of forecasts and high-frequency data to gauge the potential implications of the pandemic (the annual MIP-scoreboard uses annual data, the latest data being from 2019 in the 2021 AMR edition).

The Commission underlines that a number of existing macroeconomic imbalances are being aggravated by the COVID-19 crisis. In particular, government and private debt-to-GDP ratios are on the rise. Going forward, private sector debt repayment might be challenged by subdued levels of economic activity, bankruptcies, and a weak labour market. Such debt distress would affect banks' balance sheets and further impair their profitability. At the same time, excessively buoyant labour cost and house price dynamics that characterised the recent past are expected to fade, but concerns may arise if such adjustments turns into excessive downward corrections, notably regarding house prices in Member States with already high household debt.

A number of the Member States highly impacted by the pandemic were in the recent past characterised by low potential growth. Hence, the pandemic could also be exacerbating economic divergences. In parallel, despite the large fall in world demand, a trade surplus is currently projected to persist for the euro area as a whole, highlighting that there could be further room to expand domestic demand at the euro area aggregate level to foster the recovery, while supporting the ECB's efforts to reach the inflation target.

The Commission concludes that in-depth reviews (IDRs) will be prepared for the Member States already identified in February 2020 with imbalances or excessive imbalances. IDRs will be conducted to assess whether existing imbalances are unwinding, persisting or aggravating, while taking stock of corrective policies implemented. Nine Member States are currently identified as having imbalances (Croatia, France, Germany, Ireland, the Netherlands, Portugal, Romania, Spain, and Sweden), while Cyprus, Greece, and Italy are identified as having excessive imbalances.

Next steps: Following an exchange of views of the AMR on 1 December 2020, the Council (ECOFIN) will adopt conclusions on 19 January 2021 and the Eurogroup will hold a thematic discussion on imbalances in the EA in the wake of the COVID19 crisis on 18 January 2021. The next set of IDRs will be published in spring 2021, jointly with the assessment of SCPs.

Further reading:

- Implementation of the Macroeconomic Imbalance Procedure - latest version

5. Guidance for employment and social policies

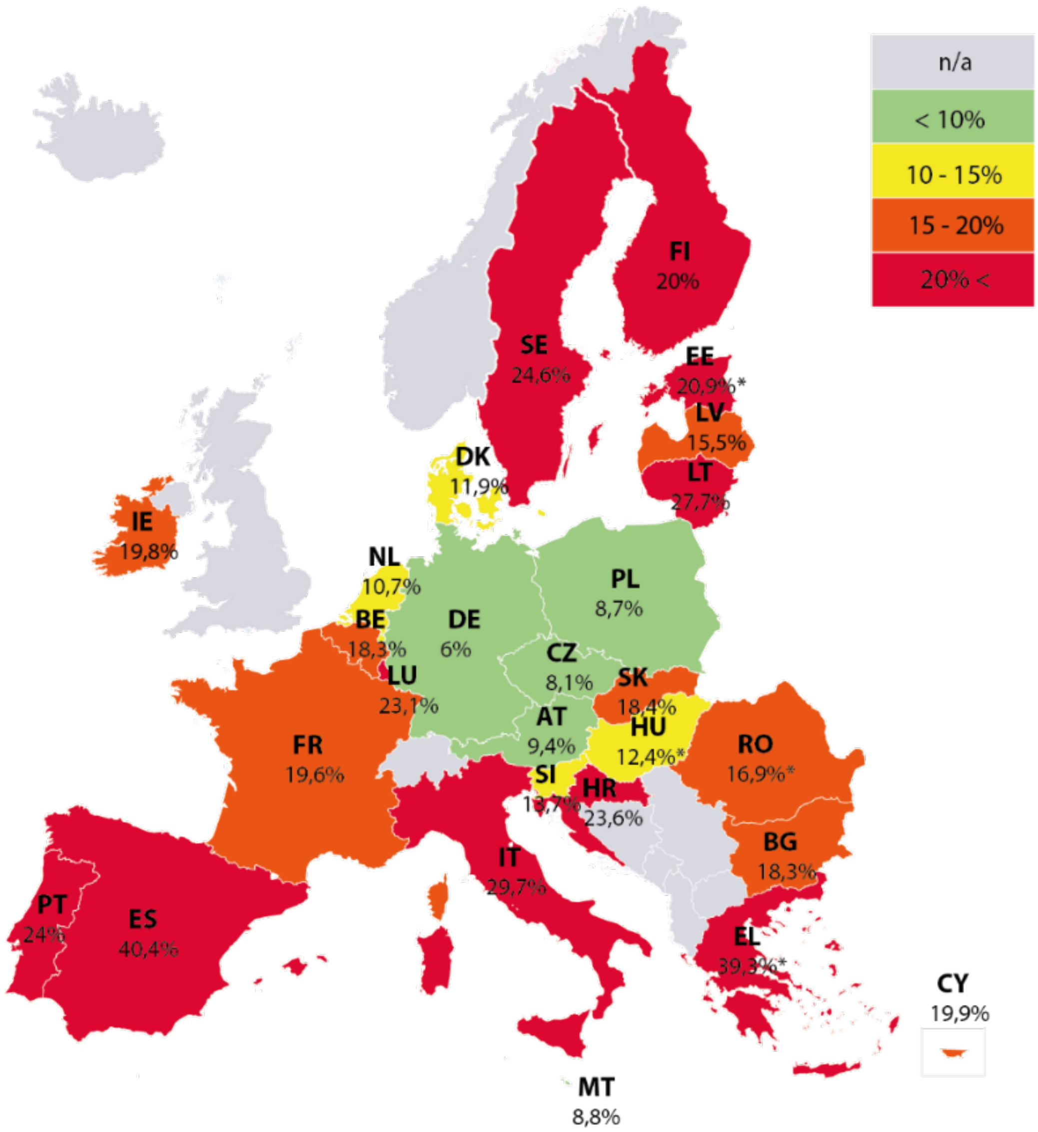
As part of the Autumn Semester package, the Commission proposed the draft Joint Employment Report 2021 (2021 JER) to be adopted jointly with the Council following an opinion from the EP. The draft JER highlights a number of priority areas that should aim to foster job creation; ease transitions from unemployment into employment and across sectors; improve economic and social resilience; and mitigate the employment and social impact of the pandemic crisis. In addition, the draft JER monitors Member States' performance in relation to the Social Scoreboard set up in the context of the European Pillar of Social Rights.

According the Commission, the economic shock to the labour market is being experienced differently across sectors and categories of workers. The fall in employment has affected workers in non-standard forms of employment to a greater extent. Youth unemployment has increased more markedly than unemployment for other age groups. The share of young people not in employment, education or training has also risen sharply. Non-EU born workers have also been severely affected

The Commission underlines that EU funding, including via the European Social Fund Plus (with the additional resources made available by REACT-EU) and the RRF should provide support to Member States to speed up the implementation of policy action in these domains.

Next steps: The Council (EMPL) had an exchange of views 3 December 2020 and will aim to adopt its conclusions on the JEP on 15-16 March 2021.

Figure 3: Youth unemployment (aged 15-24, % of labour force in September 2020)



Source: *Eurostat*

Note: * Latest data is available only for August 2020 (Estonia and Hungary), July 2020 (Greece) and June 2020 (Romania)

Box 1: Policy recommendations from the draft Joint Employment Report

Member States are invited to:

- Keep short-time work schemes in place as long as necessary and couple them with upskilling/reskilling schemes; as soon as conditions allow, introduce support for the reallocation of labour (e.g. via well-designed hiring incentives) notably towards green and digital economy, while protecting workers during the transition;

- Ensure that working environments are safe and well adapted to the new social distancing requirements, and that flexible working arrangements are widely available;

- Enhance labour market support and upskilling opportunities to address the increase in youth unemployment, notably through support for apprenticeships (in particular in SMEs), hiring subsidies, learning infrastructure, technology and equipment;

- Invest in Public Employment Services, notably to increase their capacity, modernise their ICT infrastructure, strengthen profiling systems, and provide staff with adequate skills;

- Promote collective bargaining and social dialogue; if statutory minimum wages are in place, ensure conditions for them to be set at adequate levels, through clear and stable criteria, and regular and timely updates, and with effective involvement of the social partners;

- Reform labour market regulation, as well as tax and benefit systems, to ensure that labour market segmentation is reduced and the recovery will boost quality jobs; make sure that workers on non -standards forms of work and the self -employed gain access to social protection;

- Invest in reskilling and upskilling, notably in digital skills, by reinforcing VET systems, supporting large-scale public private multi-stakeholder partnerships under the Pact for Skills, providing greater incentives to businesses and workers to engage in upskilling and reskilling, investing in infrastructure and equipment, including digital, supporting teachers and trainers; ensure equal access to education and training;

- Invest in sustainable social protection for all, supporting reforms to maintain and reinforce levels of protection, and improving the protection of those who are not covered; ensure adequate benefits, transferability of rights, access to services and support for the labour market integration of those who are able to work; invest in quality and accessibility of early childhood education and care and long -term care services; assess distributional impacts of policies;

- Invest in the renovation of residential and social housing; ease access to social and affordable housing where appropriate;

- Invest in healthcare system capacity including surge capacity, primary care, coordination of care, healthcare staff and eHealth. Reduce out-of-pocket payments, improve healthcare coverage and promote up-skilling and reskilling of health workers.

6. The 2021 Euro Area Recommendation

The Commission proposal for the Council's 2021 euro area recommendations (EAR), suggests that euro area Member States take action, individually, including through their RRP, and collectively within the Eurogroup during 2021-2022: The 2021 EAR cover five headings:

- *Ensuring a policy stance which supports recovery;*
- *Further improving convergence, resilience and sustainable and inclusive growth*;
- *Strengthening national institutional frameworks*;
- *Ensuring macro-financial stability*; and
- *Completing the EMU and strengthening the international role of the euro.*

One may note that on 30 November 2020 the Eurogroup reached an agreement on some of the elements included in the last heading above, notably on the reform of the European Stability Mechanism and the introduction of common back-stop to the Single Resolution Fund.

The Commission proposal for the RRF does not contain an express reference to the EAR. Differently, the Council adopted mandate for negotiating with the European Parliament establishes that the RRPs are to be consistent with the "*challenges* (...) *and priorities* (...) *identified in the most recent Council recommendation on* *the economic policy of the euro area for Member States whose currency is the euro"*[10]. The EP negotiating mandate contains provisions[11] of similar effect. If kept in the final text, such provisions reinforce the relevance of the EAR as orientations to euro area Member States economic policies, arguing for stronger and more transparent accountability around their adoption, monitoring and enforcement.

The Eurogroup is expected to discuss the 2021 EAR on 16 December 2020, while the Council (ECOFIN) would approve them on 19 January 2021.

Further reading:

- Recommendation on the economic policy of the euro area under the European Semester - December 2020

7. Review of the EU economic governance framework

The Commission published in February 2020 a Communication on "Economic governance review" with the purpose to start a public debate on the extent to which the current surveillance framework (as last amended in 2011 and 2013) has been effective in achieving its key objectives, namely: (I) ensuring sustainable government finances and growth, as well as avoiding macroeconomic imbalances, (ii) providing an integrated surveillance framework that enables closer coordination of economic policies in particular in the euro area, and (iii) promoting the convergence of economic performances among Member States.

Originally, citizens and institutions were invited to submit their responses to the questions set in the Communication by 30 June 2020. However, the public debate has been impacted by the need to focus on the immediate challenges of the coronavirus crisis. Therefore, the period of public consultation has been extended and the Commission is expected to return to the review exercise when the immediate challenges it faces have been addressed.

The ECON Committee has agreed to launch an own-initiative report titled: *The review of the macroeconomic legislative framework for a better impact on Europe's real economy and improved transparency of decision-making and democratic accountability* (Rapporteur *Margarida Marques*, S&D).

Further reading:

- Thematic Digest on EU Economic Governance Review
- The European Semester for economic policy coordination: A reflection paper (October 2019)

[10] Council negotiating mandate, article 14/2 and recital 16.

[11] See articles 14/2a (new), 15/3ab (new), 16/3/m (new) and Annex 2, point 2/1c (new) - point m.

ANNEX: EUROPEAN SEMESTER FOR ECONOMIC POLICY COORDINATION (Article 2-a 1 of Regulation No 1466/97)

1. In order to ensure closer coordination of economic policies and sustained convergence of the economic performance of the Member States, the Council shall conduct multilateral surveillance as an integral part of the European Semester for economic policy coordination in accordance with the objectives and requirements set out in the Treaty on the Functioning of the European Union (TFEU).

2. The European Semester shall include:

> *(a) the formulation, and the surveillance of the implementation, of the broad guidelines of the economic policies of the Member States and of the Union (broad economic policy guidelines) in accordance with Article 121(2) TFEU;*
>
> *(b) the formulation, and the examination of the implementation, of the employment guidelines that must be taken into account by Member States in accordance with Article 148(2) TFEU (employment guidelines);*
>
> *(c) the submission and assessment of Member States' stability or convergence programmes under this Regulation;*
>
> *(d) the submission and assessment of Member States' national reform programmes supporting the Union's strategy for growth and jobs and established in line with the guidelines set out in point (a) and (b) and with the general guidance to Member States issued by the Commission and the European Council at the beginning of the annual cycle of surveillance;*
>
> *(e) the surveillance to prevent and correct macroeconomic imbalances under Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances.*

3. In the course of the European Semester, in order to provide timely and integrated policy advice on macrofiscal and macrostructural policy intentions, the Council shall, as a rule, following the assessment of these programmes on the basis of recommendations from the Commission, address guidance to the Member States making full use of the legal instruments provided under Articles 121 and 148 TFEU, and under this Regulation and Regulation (EU) No 1176/2011.

Member States shall take due account of the guidance addressed to them in the development of their economic, employment and budgetary policies before taking key decisions on their national budgets for the succeeding years. Progress shall be monitored by the Commission. Failure by a Member State to act upon the guidance received may result in:

> *(a) further recommendations to take specific measures;*
>
> *(b) a warning by the Commission under Article 121(4) TFEU;*
>
> *(c) measures under this Regulation, Regulation (EC) No 1467/97 or Regulation (EU) No 1176/2011. Implementation of the measures shall be subject to reinforced monitoring by the Commission and may include surveillance missions under Article -11 of this Regulation.*

4. The European Parliament shall be duly involved in the European Semester in order to increase the transparency and ownership of, and the accountability for the decisions taken, in particular by means of the economic dialogue carried out pursuant to Article 2-ab of this Regulation.

The Economic and Financial Committee, the Economic Policy Committee, the Employment Committee and the Social Protection Committee shall be consulted within the framework of the European Semester where appropriate.

Relevant stakeholders, in particular the social partners, shall be involved within the framework of the European Semester, on the main policy issues where appropriate, in accordance with the provisions of the TFEU and national legal and political arrangements.

The President of the Council, and the Commission in accordance with Article 121 TFEU, and, where appropriate, the President of the Eurogroup, shall report annually to the European Parliament and to the European Council on the results of the multilateral surveillance. These reports should be a component of the Economic Dialogue referred to in Article 2-ab of this Regulation.

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