European Committee of the Regions

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OPINION

Economic governance review

THE EUROPEAN COMMITTEE OF THE REGIONS

- applauds the fact that on 20 March 2020 the European Commission presented its proposal – for the first time in the history of the euro area – to make use of the general escape clause already provided for in the current Stability and Growth Pact (SGP) in order to strengthen emergency budgetary measures in response to the COVID-19 pandemic;
- believes that the European economic governance framework is partly responsible for the sharp drop in public investment that occurred following the euro area crisis because it does not sufficiently take into account the distinction between current expenditure and investment expenditure. Between 2009 and 2018, public investment as a whole fell in the EU by 20% as a share of GDP. Investment by local and regional authorities decreased by almost 25% and by 40% or more in some of the Member States worst affected by the crisis;
- considers that the establishment of a "golden rule of public investment" in the European economic governance framework could prove a useful tool to end the adverse effects of current budgetary rules by eventually excluding net public investment from deficit calculations in the SGP;
- believes that the democratic legitimacy of the European economic governance system is too weak and that this endangers not only economic governance itself but also the European project as a whole;
- draws the attention of the Commission and its co-legislators to the fact that involving local and regional authorities more in the European Semester by means of a code of conduct would also make decisions more representative and give the Semester – and thereby economic governance more broadly – greater legitimacy;
- firmly believes that, after the COVID-19 crisis, it will be more important than ever to rethink the European budgetary framework so as to avoid making public investment and public services the adjustment variable again in future budget consolidation programmes.

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Rapporteur

Elio Di Rupo (BE/PES), Minister-President of Wallonia

Reference document

Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions – Economic governance review
COM(2020) 55 final

Opinion of the Committee of the Regions – Economic governance review

I. POLICY RECOMMENDATIONS

THE EUROPEAN COMMITTEE OF THE REGIONS

1. welcomes the European Commission's communication on the *Economic governance review*, presented on 5 February 2020, and the willingness it shows on the part of the Commission to reform the economic and budgetary rules;

2. also applauds the fact that on 20 March the European Commission presented its proposal to – for the first time in the history of the euro area – make use of the general escape clause already provided for in the current Stability and Growth Pact (SGP) in order to strengthen emergency budgetary measures in response to the COVID-19 pandemic;

3. believes that this escape clause should continue to apply until the financial and budgetary consequences of the COVID-19 crisis, in terms of both Member State debts and deficits, are fully known. The same logic holds for any gradual lifting of the temporary state aid framework at EU level, which can only be envisaged once the macroeconomic situation has stabilised and the European Commission, the Council of Ministers and the European Parliament have discussed their various positions;

4. also stresses that, according to the World Health Organisation, the pandemic could well continue for the next two years and that it seems likely that it will only be possible to finalise effective vaccines or medicines in 2021;

5. also points out that added to the social and economic impacts of the COVID-19 pandemic there have been radical economic and financial changes since the last reform of the SGP in 2013: interest rates are at a historic low and the real cost of public borrowing is negative in many countries, compared with around 3% on average in the euro area at the beginning of the decade;

6. consequently believes that the Commission should fully and thoroughly reassess the situation in each Member State and revise the economic governance review project;

7. emphasises that the European economic governance framework has major effects on all levels of government, more specifically local and regional governments, which are responsible for almost a third of public spending and more than half of public investment in the EU as a whole, with wide variations between Member States[1];

8. thinks that the SGP and other aspects of the current European economic governance framework currently have four major flaws: i) procyclical effects: a Member State in recession may be forced to reduce its spending at the risk of further aggravating the recession, despite the

[1] 2018 figures, Eurostat, data codes: TEC00023 and TEC00022.

situation-based flexibility set out in the 2015 interpretative communication[2], which is insufficient. This procyclicality has particularly affected public investment, which has too often played the role of adjustment variable in austerity policies; ii) complexity: multiple objectives, flexibility, exceptions, escape clauses and differences between the situations to be taken into account have resulted in an overly complex and technical framework that is moreover based on indicators that cannot be directly observed, such as structural deficit and the output gap; iii) lack of efficiency and effectiveness: although excessive deficits had almost disappeared in 2018, changes in debt were much less positive, even before the tax impact of the COVID-19 crisis in 2020. The number of Member States exceeding the limit of 60% increased from 9 in 2008 to 14 in 2018[3]. Applying financial penalties would be so counter-productive that it is not a credible option; iv) a lack of transparency and legitimacy: the economic governance framework's complexity and technicality make it opaque. Neither the European Parliament, local and regional governments, nor civil society and other stakeholders are really involved in it. Moreover, the current framework does not establish a correlation between the responsibilities of governance levels in the implementation of the SGP and only recognises collective national responsibility independent of effective budget management at the various levels. These structural flaws in the existing framework related to its adverse effects and its lack of efficiency and effectiveness have seriously harmed its legitimacy, particularly in the Member States that were worst affected by the euro area crisis and subjected to conditionality measures, thereby encouraging a rejection of the EU and a shift towards the political extremes;

9. points out, in line with the Commission's findings from the communication, that the six-pack and two-pack reforms have led to closer coordination of budgetary policies in the euro area. The strengthened surveillance framework served as a basis for Member States to consolidate their budgetary structures, even though the EU continued to suffer from very large regional and social heterogeneities before the outbreak of the COVID-19 pandemic;

10. welcomes the success of the social bonds issued by the Commission on 17 October 2020 to finance temporary support, amounting to EUR 100 billion, to mitigate unemployment risks in an emergency (SURE). This scheme will run until 31 December 2022 in the form of loans to Member States that need to mobilise significant financial resources to tackle the negative economic and social consequences of the COVID-19 pandemic in their country. The CoR considers that if the SURE programme has a lasting positive impact, it could pave the way for the establishment of a European unemployment reinsurance scheme;

Indicators

11. insists that national, regional and local governments and the public should be able to clearly understand the rules to be applied. To that end, the applicable rules must be based on indicators that are directly verifiable and that incorporate cyclically adjusted countercyclical stabilisation;

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2 European Commission (2015) – *Communication: Making the best use of the flexibility within the existing rules of the stability and* growth *pact;* ref: COM(2015) 12 final.

3 Eurostat, data code: TEINA225.

12. also believes that economic governance must strike a balance between indicators related to budgetary discipline and non-budgetary indicators. The CoR therefore believes that, in keeping with the macroeconomic imbalance procedure (MIP), which encompasses more varied indicators, including unemployment rates, a reformed economic governance must take into account the greater need for investment and the public spending required[4] to support transition in the key sectors of health, food, transport, digital technology and energy, including improving the energy efficiency of buildings. Some of this spending will have to be covered by national budgets to supplement private and EU funding. And there will also be pressure on public spending in adapting the economy to continuing climate change or cushioning the social impact of higher carbon taxes;

13. agrees with the criticism against using "potential GDP" as an indicator, potential GDP being the output capacity that can be realised by fully utilising the productive capital stock and labour supply without creating inflationary pressure. This concept ignores both energy as a factor of production, including the risk of productive capital becoming obsolescent sooner due to restrictions on the use of carbon-based energy, and the physical limits on expanding human activities;

14. also calls for a rebalancing to take revenues more closely into consideration. Cutting expenditure in the social, educational and health sectors is often seen as the easiest way to reduce debt in the short run, but coordinating fiscal policies and taking measures to prevent tax fraud can considerably ease pressure on public budgets. VAT fraud alone is responsible for losses of EUR 147 billion[5] annually, whereas the total deficit for all the EU Member States in 2018 was EUR 109 billion;

15. highlights the need for better coordination of economic policies of the Member States in order to reduce cyclical discrepancies and the differential in convergence; for the same reason also supports the Commission's wish to rebalance surpluses and deficits between the Member States. The Member States with current account surpluses should pursue more expansionary fiscal policies to stimulate domestic demand, while countries with structural imbalances due to weak productivity and competitiveness should increase their investment targeted at modernising their production activities. All the Member States must also increase investment in training, research and development, which is still insufficient at this stage to ensure the competitiveness of the European economy;

16. again suggests that the MIP be extended to auxiliary indicators relating to regional disparities. The CoR thinks that it could more fully take into account the progress made in the implementation of the 17 United Nations Sustainable Development Goals (SDGs) that cover not only environmental protection but also social, economic and governance criteria;

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4 EUR 260 billion a year (around 1.7% of EU GDP) is needed, according to European Commission estimates.

5 COM(2019) 8 final on "Towards a more efficient and democratic decision-making process in EU tax policy", p. 4.

Public investment and the golden rule

17. believes that the European economic governance framework is partly responsible for the sharp drop in public investment that occurred following the euro area crisis because it does not sufficiently take into account the distinction between current expenditure and investment expenditure. Between 2009 and 2018, public investment as a whole fell in the EU by 20% as a share of GDP. Investment by local and regional authorities decreased by almost 25%, and by 40% or more in some of the Member States worst affected by the crisis[6];

18. stresses that the European Fiscal Board established that Member States that had a high public investment rate tended to significantly reduce it during excessive deficit procedures (EDPs)[7], and that the Commission itself noted that the budgetary framework has not prevented a drop in investment or made public finances more conducive to growth and that neither the SGP's "investment clause" nor Article 126(3) TFEU (which requires the Commission to also take into account whether the government deficit exceeds government investment expenditure when determining whether the criteria are met for initiating an excessive deficit procedure) seem to have had a major impact[8];

19. emphasises that the CoR already felt in its opinion on the 2015 interpretative communication on the matter[9] that the existing flexibility in the SGP was too restrictive and limited to have any real benefits on public investment;

20. believes that high-quality and well-targeted public investment, grounded in territorial impact assessment and sound economic analysis in terms of public spending costs and benefits, must be countercyclical to benefit future generations. In this current context of extraordinary public spending needs, discouraging deficit financing for public investment could encourage underinvestment, to the detriment of future generations;

21. reiterates that the CoR has consistently called for public spending from Member States and local and regional authorities linked to Structural and Investment Fund co-financing to not be included in public or equivalent structural expenditure as defined in the SGP. This expenditure is, by definition, investment in the general European interest with a proven leverage effect in terms of sustainable growth;

22. considers that the establishment of a "golden rule of public investment" in the European economic governance framework could prove a useful tool to end the adverse effects of current budgetary rules by eventually excluding net public investment from deficit calculations in the SGP, which would not only preserve public investment during crises but would also discourage the extreme underinvestment (negative net public investment) that some Member States suffer from by penalising it. This measure could be applied as a priority to public investment in

6 Eurostat, data code: TEC00022.

7 European Fiscal Board (2019) – *Assessment of EU fiscal rules with a focus on the six and two-pack legislation*, p. 76.

8 COM(2020) 55 final, p. 10.

9 CoR (2015) – opinion *Making the best use of the flexibility within the existing rules of the stability and growth pact* – rapporteur: Olga Zrihen (BE/PES), adopted on 9 July 2015.

projects aimed at encouraging the transition to a sustainable society in environmental, economic and social terms, as defined in the SDGs and the Green Deal, as these investments are recognised as particularly important not only with regard to the recovery following the COVID-19 crisis, but also for the prosperity and quality of life of future generations. The CoR also advocates investing in human capital and skills to facilitate the transition to a climate-neutral, resource-efficient and competitive economy fit for the digital age;

23. calls on the Commission to present a white paper on an overhaul of economic governance based on the potential establishment of such a golden rule, after it has reformulated its proposals to take account of the economic and budgetary damage caused by COVID-19. The Commission should in its assessment also consider other instruments such as an expenditure rule[10], which on the basis of trend economic growth and the level of debt imposes a limit on the annual growth of total government expenditure, and can serve to safeguard public trust by boosting transparency, reducing administrative burdens and striking a balance between budgetary discipline and preserving sufficient capacity for public investment;

European Semester

24. stresses that economic governance, which is implemented in practice through the European Semester coordination cycle, lacks efficiency and effectiveness in terms of carrying out reforms. The scope of the reforms considered under the European Semester has never been defined in EU legal texts, particularly with regard to their relevance and their added value at EU level. This lack of definition limits potential interactions between reforms undertaken at national level and EU policies (financial legislation and programmes) and is problematic with regard to the principle of subsidiarity. The CoR agrees with the European Commission that, in future, emphasis must be placed on the environmental aspect of Member States' social, economic, budgetary and employment policies, in accordance with the European Green Deal;

25. reiterates that one of the main reasons for this low efficiency and effectiveness is that local and regional authorities are insufficiently involved as partners in designing and implementing reforms, even though 36% of all country-specific recommendations are directed at them and 83% of recommendations have a local or regional dimension[11];

26. firmly believes that its proposed code of conduct for the involvement of local and regional authorities in the European Semester[12] is still likely to rectify this lack of efficiency and effectiveness as local and regional realities would be better taken into account, and that it still needs to be implemented, especially as the European Semester has provided guidelines for cohesion policy since 2019, the management of which is shared between all levels of government;

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10 Benefits and drawbacks of an "expenditure rule", as well as of a "golden rule", in the EU fiscal framework. European Parliament study https://www.europarl.europa.eu/RegData/etudes/STUD/2020/645732/IPOL_STU(2020)645732_EN.pdf

11 CoR (2018) *Territorial analysis of the Country-specific Recommendations 2018*.

12 CoR (2017) opinion: *Improving the governance of the European Semester: a Code of Conduct for the involvement of local and regional authorities* – rapporteur: Rob Jonkman (NL/ECR), adopted on 11 May 2017.

27. encourages the European Commission to promote an examination of administrative capacity and tax decentralisation in the Member States with a view to verifying that the tasks entrusted to local and regional authorities are in keeping with the human, technical and financial resources at their disposal, while respecting the Member States' constitutions and the principle of subsidiarity;

Transparency and democratic legitimacy

28. believes that the democratic legitimacy of the European economic governance system is too weak and that this endangers not only economic governance itself but also the European project as a whole;

29. welcomes the inclusion of climate protection in the European Semester and expects it to provide both clear monitoring and an assessment of the effectiveness of climate protection measures, so that national progress in implementing Semester targets becomes more tangible;

30. draws the attention of the Commission and its co-legislators to the fact that involving local and regional authorities more in the European Semester by means of a code of conduct would also make decisions more representative and give the Semester – and thereby economic governance more broadly – greater legitimacy;

31. supports a reform of the Eurogroup, whose status needs to be put on a formal footing and updated with a view to a fully-fledged presidency, greater accountability to the European Parliament and more transparent proceedings, starting with publication of all minutes in detail;

32. stresses that, in light of the Conference on the Future of Europe, it firmly believes that the problem of the lack of democratic legitimacy in the EU, and more specifically its economic governance, can only be resolved if EU citizens are confident that all their major concerns are being addressed. Social standards, employment, environmental protection and sustainability aspects in line with the SDGs, and the fight against inequalities cannot be considered secondary to macroeconomic and budgetary imperatives. At the Conference on the Future of Europe it should therefore be possible to discuss changes to economic governance set out in the Treaty on the Functioning of the European Union;

33. believes that work must continue on resolving the euro area difficulties by re-establishing sound public finances, creating a robust banking system, moving towards Fiscal Union and stimulating sustainable economic growth;

Economic governance and the COVID-19 crisis

34. emphasises that local and regional authorities are at the forefront of the fight against the COVID-19 pandemic – which is having a significant impact on Europe – given their important responsibilities in terms of healthcare, social protection and economic support. In Italy and Spain, two of the worst affected Member States, local and regional authorities are also

responsible for more than 90% of healthcare expenditure[13]. Although many expenditure items are significantly increasing, local and regional government revenues are dropping and are greatly affected by the unprecedented economic slowdown. This is having a major impact on the budgetary balances of cities and regions and, consequently, those of the Member States;

35. stresses that local and regional authorities in many Member States are subject to stringent national budgetary rules that restrict increases in their expenditure, require them to balance their budgets, or limit their deficit and/or debt to levels that are often very low compared to those of the States;

36. urges the Commission, the Parliament and the Member States not to underestimate the risk that the COVID-19 crisis could aggravate regional disparities for three key reasons: i) the impact on health has been highly regionalised; some regions and cities have had a disproportionate number of cases and their ability to cope has varied; ii) as well as the direct impact of the emergency on the worst affected areas, longer or more stringent restrictions will exacerbate the economic slowdown and therefore the financial difficulties of SMEs and the self-employed, one of the key pillars of many regional economies, as well as of local and regional authorities; iii) some economic sectors (e.g. tourism) are disproportionately affected and the impact on subnational finances will therefore depend on local and regional sectoral specialisations and exposure to global value chains;

37. therefore calls on the European Commission and Member States for a clear roadmap designed with local and regional authorities, to help the latter back towards sustainable balanced budgets, bearing in mind the asymmetric impact of the ongoing pandemic and that an environmentally and socially sustainable recovery also must be an economically sustainable one;

38. thinks that the current situation highlights the real cost of the austerity policies that followed the euro area crisis, especially in terms of underinvestment in key public services. Austerity cannot be the response to this new crisis as well. Recovery strategies should include ambitious public investment plans designed to trigger an environmentally and socioeconomically sustainable recovery in the EU's regions and cities;

13 OECD (2020) – *Covid-19 and intergovernmental Fiscal Relations: Early responses and main lessons from the Financial Crisis*, ref: COM-CTPA-ECO-GOV-CFE(2020)2.

39. firmly believes that, after the COVID-19 crisis, it will be more important than ever to rethink the European budgetary framework so as to avoid making public investment and public services the adjustment variable again in future budget consolidation programmes.

Brussels, 10 December 2020

The president
of the European Committee of the Regions

Apostolos Tzitzikostas

The secretary-general
of the European Committee of the Regions

Petr Blížkovský

II. PROCEDURE

Title	**Economic governance review**
Reference(s)	COM(2020) 103 final
Legal basis	Article 307(4) TFEU
Procedural basis	Rule 41(b)(i)
Date of Council/EP referral/Date of Commission letter	
Date of Bureau/President's decision	
Commission responsible	Commission for Economic Policy (ECON)
Rapporteur	Elio Di Rupo (BE/PES), Minister-President of Wallonia
Analysis	6 April 2020
Discussed in commission	
Date adopted by commission	29 September 2020
Result of the vote in commission (majority, unanimity)	Majority
Date adopted in plenary	8-10 December 2020
Previous Committee opinions	
Date of subsidiarity monitoring consultation	

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