AK EUROPA

Position Paper
January 2022
Economic

EU Economic Governance Review

COM(2021) 662

Executive summary

The European Union needs a new **reform of economic governance that focuses on the sustainable development of prosperity and wellbeing.** The overarching goals must be made more concrete and actually relevant as a steering mechanism – especially in the country-specific phase of the European Semester.

Budgetary policy will continue to play a key role – but as a **key instrument to achieve these goals in general and economic cycle management in particular**, rather than being limited to the avoidance of "excessive" deficits. **Rules** that prioritise compliance with a certain deficit value are counterproductive and **should be replaced by a benchmark for structural revenue and expenditure net of investments**, that is **indicative** only, but at the same time clearer.

The minimum requirements of a reform are as follows:

- **Assets and liabilities** should be treated **symmetrically**, for example by means of a **golden investment rule**, whereby the permissible limits for new debt (= debt accumulation) are only controlled minus the net public investment (= asset accumulation).
- The **existing elements of flexibility** should be applied **more generously** in practice so that **debt reduction is not detrimental to other important goals**, such as full employment and climate protection. This must also apply to countries in an excessive deficit procedure.
- **More funds** need to be provided **at the European level** to contribute to effective fiscal and economic governance (like currently through the Recovery and Resilience Facility [RRF]).
- **Cooperation** between the Member States with respect to common objectives needs to be **stepped up.**
- **Decisions** must be made **more democratically and transparently**, as they are more likely to reflect the interests of the majority:
- All fields of European economic policy (including the country-specific phase of the European Semester) should be co-decided by the European Parliament or a form of euro area parliament.
- The Eurogroup needs to become more transparent: Both the positions of the national ministers and the preparatory work of the Eurogroup should be published at least in part.
- In the future, economic governance of the euro area should place particular importance on the ex-ante involvement of the social partners. A form of macroeconomic dialogue as well as the strengthening of social dialogue in general are needed for the euro area. Furthermore, civil society groups in general – for example, in the form of the European Economic and Social Committee – should be more closely involved.

AK's 10 specific reform proposals for EU economic governance:

1. Focus the EU economic governance on the overarching (economic) policy goals
2. The overarching goals must be made more concrete and actually relevant as a steering mechanism
3. Press ahead with institutional changes – in particular, give parliaments a greater role
4. Use only one indicative benchmark for structural expenditure growth combined with a golden investment rule
5. Ensure refinancing at favourable rates across the EU
6. Ensure transparent, clear, and broad-based decisions
7. Create EU fiscal capacities for times of crises and investments
8. Establish councils for the sustainable development of prosperity and wellbeing
9. Implement the Social Progress Protocol
10. Complete the banking union after a structural reform – with a "safe asset"

AK's position

The preamble to the Treaty on European Union defines the overarching goals of economic policy as "the strengthening and the convergence of their economies" and "economic and social progress for their peoples, taking into account the principle of sustainable development". The fundamental problem of the EU economic governance is that it is not geared towards specifying and managing these overarching goals, but primarily towards avoiding excessive budget deficits (and – since the Six-pack regulations – macroeconomic imbalances), as if with medium term balanced budgets, the overarching goals would be achieved automatically (despite decentralised economic policy). The dynamics following the economic crisis of 2008 showed that this is not the case – especially in comparison with the economic crisis triggered by Covid-19, which was consistently addressed in an expansionary manner.

The evaluation that is now underway should be used to create a reform that enables a more active, balanced, coordinated and democratic economic governance. The European Union needs a new reform of economic governance **that focuses on the sustainable development of prosperity and wellbeing** and is tailored to modern economic conditions. In the past 30 years, unemployment and global warming have become pressing structural problems; when speaking about price stability today, it is not only a question of combating inflation risks, but also deflation risks. All in all, the right framework needs to be established based on the Sustainable Development Goals (SDGs) and on the papers of the OECD and academics like Joseph Stiglitz, which have led at the European level, inter alia, to Council Conclusions for an "Economy of Wellbeing". The Commission has already taken steps in the right direction with the Green Deal – in particular with its new four-dimensional approach, which is similar to the AK's proposal for a new magic polygon of wellbeing-oriented economic policy. The important thing is now to align this approach even more closely with the overarching goals, to make it more specific and actually relevant within the economic governance framework – especially in the country-specific phase of the European Semester.

Growing awareness of the need to increase socio-ecological public investment, to focus economic policy on the sustainable development of prosperity and wellbeing, and to give greater democratic legitimacy to the European fiscal governance as well as the public debate launched by the Commission itself, give reason to hope that the new reform will bring genuine progress, rather than petering out once again behind the closed doors of the Eurogroup.

Consensus: better EU fiscal rules needed

There are numerous good reasons for a new reform of the European fiscal rules – especially at a time of major challenges, with historically low interest rates. There appears to be consensus that the large number of detailed rules existing in parallel, together with even more detailed exceptions, should be simplified and designed in a way that is more responsive to the economic cycle. There is also broad agreement on strengthening the European level and paying particular attention to public investment, given that net public investment in the euro area as a whole was negative in sum from 2012 to 2018, i.e. the accumulation of public sector assets came to a standstill. However, not only climate targets require considerably higher investments.

It should be noted that the establishment of the euro area entailed a loss of national scope for economic policy-making. Fiscal policy became the central remaining instrument at the Member State level. Based on the notion that the economy functions better the more the state is pushed back, fiscal policy in the scope of economic governance was reduced to avoid excessive deficits. As a result, key questions were omitted: How can the countries belonging to the euro area counteract an economic crisis? How can they jointly gear fiscal policy to the highest possible and convergent level of prosperity and wellbeing? How can parliaments exercise their basic budget rights? Today, however, it is evident that those questions are pivotal to every form of economic governance.

What are the problems of this type of fiscal policy?

This governance setup led to the expected problems. Firstly, unexpected economic downturns lead to unintended short-term overshoot of the fiscal rule limits. The expenditure cuts that are often introduced as a result – at least until the outbreak of the pandemic – then exacerbated the poor economic performance and placed an additional burden on public budgets through lack of state revenues and higher costs associated with increasing unemployment. A striking example from some time ago is that of Germany from 2001, whose government at the time (together with that of France), introduced a well-founded, albeit complex reform of the EU fiscal rules. The southern Member States in the wake of the "Great Recession" are more recent examples. Following a fundamentally sensible initial reaction applying national stimulus packages with the active support of the Commission, a combination of fiscal rules, discretionary troika decisions, and unbridled financial markets forced the southern Member States to adopt a harsh austerity course, with devastating economic and social effects.

Secondly, the general budgetary pressure tends to lead to a reduction in spending that can most easily be postponed or cut in the short term, namely in public investments. These are, however, particularly relevant for the economy as a whole and create long-term assets that contribute significantly to collective prosperity and wellbeing.

Better Governance as a result of the Covid-19-crises?

However, instead of correcting those errors, the fiscal rules were tightened even further by means of the Six-pack and Two-pack regulations. From summer 2013 onwards, in view of the clearly negative effects of the austerity policy, there was a gradual shift away from that approach, which was reinforced by the more flexible handling of the EU fiscal rules from January 2015. However, this new pragmatic approach falls short. Due to the economic crisis triggered by the Covid-19 pandemic, there is now the risk that such fundamental problems will become pressing again in the medium term. Instead of returning to the previous rules, a change of course is needed in the form of improved economic governance.

If a treaty reform takes place, it should be used to also enable formal co-decision-making powers of the European Parliament or a form of euro area parliament, as well as to amend the regulations for the euro area and eliminate one-sided economic policy provisions (including Articles 119, 126, 123 and 125 of the TFEU). Instead of cementing a particular policy into place, the EU treaties should set out rules that allow for a democratic debate about the best solution in line with current developments.

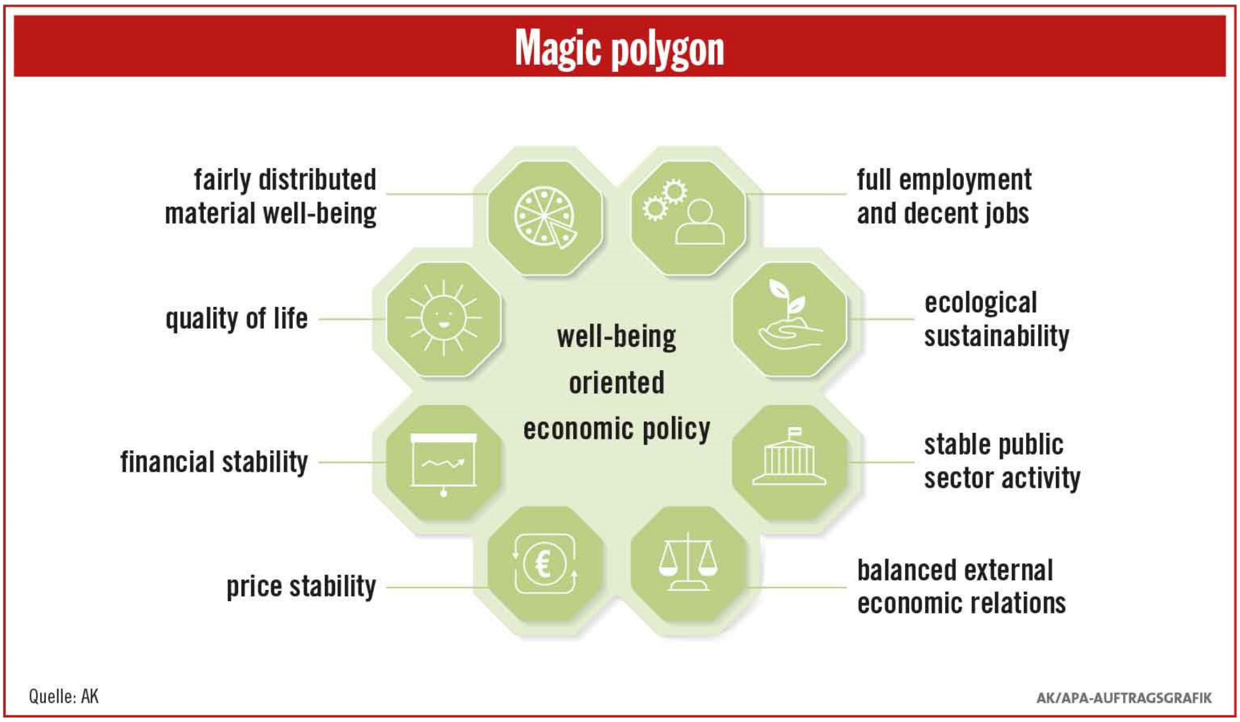
AK's reform proposals in detail

Reform proposal no. 1: Focus the EU economic governance on the overarching (economic) policy goals

The goals referred to in the preamble to the Treaty on European Union, namely the "strengthening and the convergence of their economies" and "economic and social progress for their peoples, taking into account the principle of sustainable development" are of particular note here. The goals can be made more concrete by drawing, for example, on the papers on the "Wellbeing Economy" or the SDGs.

In the last two years the Commission has already taken a number of steps in the right direction. These need to be consolidated now. Even more focus should be placed on the Green Deal and the analysis should be geared more closely to the SDGs.
The Commission's new four-dimensional approach, which largely corresponds to AK's proposal for a new magic polygon of wellbeing-oriented economic policy, can be of assistance as an analysis instrument.
In order to measure progress in achieving these goals and for a better survey of the social situation, suitable indicators are essential.

The "sustainability" of public finances is an abbreviated objective that needs to be expanded on. In general, the **task of public finances is to ensure stable government activity geared to sustainable prosperity and wellbeing**, and in particular **to stabilising economic activity, especially employment and investment.** The necessary financing needs to be ensured, in general through sufficient revenues. However, since economic governance focuses too strongly on the balance aspect, taxation options are largely left out of the picture. This applies in particular to safeguarding the tax base for profit-based and asset-based taxes, and curbing international tax competition, especially competition by unfair means. The improvements achieved last year now need to be continued and consolidated.



Reform proposal no. 2: The overarching goals must be made more concrete and actually relevant as a steering mechanism

The starting point for the analyses in the European Semester should always be the sustainable development of prosperity and wellbeing, from the Autumn Package and the country reports through to the country-specific recommendations. **The focal point should be the analysis for the EU and the euro area in particular**; and the country-specific section should be more closely geared to that. This applies in particular to the **fiscal policy** recommendations, where the sum of the country-specific recommendations should be consistent with the fiscal stimulus recommended for the euro area as a whole. A similarly specific coordination process should be strived for with respect to the other policy fields, for example for the **CO2 reduction targets, wage policy coordination** (through the social partners and with full tariff autonomy of the collective agreement partners) or reduction of the aggregate **current account balance**.

Currently the country-specific analysis is often limited to how the given country performs compared to the other countries or to targets that lack context. **The selection and weighting of the country-specific problems** in the scope of the country reports and the procedure to address macroeconomic imbalances remain unclear in some cases. Based on the progress with respect to the SDGs and the indicators for assessing the sustainable development of prosperity and wellbeing, European problem areas should first be identified and addressed and then tackled in the country-specific phase together with the country-specific challenges.

The **avoidance of excessive deficits** as a contribution to the availability of cheap financing on the capital markets makes sense as one objective among many but **should not be viewed as the absolute priority in isolation from current economic, social, and environmental challenges**, which generally call for more public spending. Not only does it lose sight of other aspects of stable and stabilising government activity, but it also overlooks the fact that the aim, paradoxically, can be jeopardised by apparently combating the problem with particular vigour. This is due to negative feedback effects (such as a decline in employment and demand due to spending cuts).

In view of the increasingly pressing issue of an overheated world and employment prospects for everyone, **a sufficient investment level or a growing public capital stock** is at least as important a criterion. The measurement of fiscal sustainability by the reference value for gross debt of 60% of GDP is a largely arbitrary and too restrictive target, which should be changed or at least extended or weakened. It was a cardinal error of the last governance reform that this reference value was given even greater importance with the “1/20” rule.

During the last governance reform, this analysis was partially taken into account by including **macroeconomic imbalances** in the framework, but the way in which these imbalances were handled has not proven effective. Their definition is unclear, and in practice – above all in the scoreboard – **application is too one-sidedly focused on the empirically questionable concept of price competitiveness.** This contributes to structural weakening of aggregate wage trends – and therefore also of demand trends in the monetary union as a whole. The fact that the procedure for avoiding and correcting macroeconomic imbalances has not been able to develop much steering relevance in its current form is therefore not only negative.

Reform proposal no. 3: Press ahead with institutional changes – in particular, give parliaments a greater role

Alongside these guiding principles in terms of content, institutional changes are also needed. Accordingly, in future **all economic policy decisions** – for example, in the context of the European Semester – should **no longer** be possible **without parliaments** at the European and national level.

Fiscal councils should be merged with the productivity boards and be developed into councils for the sustainable development of prosperity and wellbeing (see under reform proposal no. 7 in further detail). While these changes would not make the process any easier, they would provide it with more legitimacy as well as make it more transparent – and thus probably more effective. Legitimacy of the decisions can be strengthened by involving the European Parliament or a form of euro area parliament. Since the current foundations of EU economic policy in the treaties (in particular Article 121 and 126 of the TFEU) do not explicitly provide for co-decision-making by the European Parliament, the treaties must be amended to allow for the possibility of full co-decision-making.

To make the discussion process more effective, bilateral escalations between the Commission and national governments should be avoided. This **requires more European voices in the national public debates, well-founded decisions involving the parliaments, social partners, other civil society actors and the academic community, as well as more debate about national policies in the Council itself.**

However, it is an illusion to believe that countries can be influenced like a neo-classical "Homo oeconomicus" through incentives and sanctions. **In democracies, the sanctioning of governments is the exclusive preserve of the electorate** – the more effective this mechanism is in Europe, the greater the likelihood that European sanctions will harm the wrong actors, i.e. newly elected governments. Indeed, it may even have the effect of helping those parties that were responsible for previous mistakes to be voted back into government. Successful policies bear fruit in the medium term. Additional financial **incentives are not needed, but sometimes start up financing is required.**

Reform proposal no. 4: Use only one indicative benchmark for structural expenditure growth combined with a golden investment rule

The best solution would be to extend the scope for national fiscal policy and only to use a single clear benchmark for structural expenditure growth – dependent on the financial sustainability goals and long-term average real economic growth plus the ECB's target inflation rate. Beyond that benchmark, expenditures should only be made for investments (golden investment rule) or if public revenues are at least structurally increased to the same degree.

Such a benchmark should be strongly defended in the public debate with sound arguments, but not enshrined in law, as this would counteract an honest and qualified debate, as recent years have clearly shown. Planned **shortfalls** are also a problem with respect to the sustainable development of prosperity and wellbeing and **should be addressed in the same way as overruns**. In view of the pressure to maintain strict fiscal rules, the proposal made by the Macroeconomic Policy Institute (IMK), which stipulates mandatory compliance with the ceiling for government expenditure growth above a gross debt level of 90% of GDP, could be taken up as a compromise. Economic governance must therefore be put on the agenda in the scope of the planned debate on the "Future of the EU", without treaty amendments being a taboo.

In the meantime, further progress should be made towards the benchmark solution. At the end of 2018, with the stronger focus on the expenditure rule, a step in the right direction was already taken. Further steps allowing for greater flexibility should include the following measures:

- Better accounting of investments, by **including only depreciation** (instead of the current calculation using four-year averages of the nationally financed investments).
- **Expansive measures** to stabilise employment **that are limited in time should not be regarded as structural expenditures.**
- Not only in the current economic crisis triggered by Covid-19, but also in general The following rule should apply not only in the current economic crisis triggered by Covid-19, but also in general: If the fiscal rules are suspended due to a recession in the whole monetary area or the entire EU, the **fiscal rules should only apply again once unemployment has fallen back to the pre-crisis level**.

- The **cyclical adjustment** method should be switched to **simple long-term averages**, which are less convincing in theory, but prevent model-driven shocks and are considerably easier to handle and communicate.

- The **multiplier effect of discretionary measures should be taken into consideration** in the ex-ante surveillance of budgetary policy.

In addition, the scope for fiscal policy at the EU level should be expanded (see in more detail under reform proposal no. 7).

Reform proposal no. 5: Ensure refinancing at favourable rates across the EU

At times of crisis in particular, the financial markets themselves enter crisis mode – and are therefore highly unsuitable for the stable financing options that are of particular importance at that point. Once again the European Central Bank is acting quickly and appropriately in the current crisis. In view of efficiency losses due to the ban on primary market intervention and its generally too narrowly defined mandate, appropriate treaty amendments would need to be sought in the medium term.

Reform proposal no. 6: Ensure transparent, clear, and broad-based decisions

Economic policy decisions in the scope of the European Semester are technocratic and insufficiently participative. Neither the European Parliament, nor the national parliaments, play a decisive role. Social partners and other key stakeholders are at best consulted, with little consideration given to deviating opinions in many cases. The focus is on the Commission's own analyses, which are designed to maintain the appearance of being the only objectively right assessment.

Economic governance should above all foster frank and well-informed discussion about the sustainable development of prosperity and wellbeing. The broader the process and the more different interests are bundled into an overall package that can gain majority support, the more promising the result. For stronger legitimacy, the European Parliament should be involved in formulating the underlying approach and recommendations.

Transparency should be achieved above all through homogenous procedures, explanations, and public/parliamentary debates. Furthermore, ECOFIN and the Eurogroup should become more transparent so that a prior public debate can take place at the national level. Firstly, the positions of the national ministers should be published. Secondly, the preparatory work of the Eurogroup Working Group should be published at least in part. In addition, civil society groups – for example, in the form of the European Economic and Social Committee – should be more closely involved.

Reform proposal no. 7: Create EU fiscal capacities for times of crises and investments

The RRF is a key innovation of European economic policy. It should at least result in the availability of more funds for priority areas of EU economic policy, for example through fiscal rule exceptions for certain expenditure categories, such as investments (see reform proposal no. 4). In addition, forms of common financing of common objectives should be found – partially linked with new Community revenues, which in turn address economic policy goals, such as fair distribution and intact environment. Specifically, AK recommends two versions of a common fiscal capacity:

Firstly, the **RRF** should be put on a **permanent** footing to ensure that such an instrument is available again in crises of similar severity – and can be accessed more quickly, with fewer political conflicts. The criterion should be activation of the general escape clause (or a comparable mechanism). However, the weaknesses of the RRF should be corrected in the new instrument: The level of detail and bureaucracy should be reduced. The period of use should be shortened for a more targeted economic stimulus, and social goals, and in general the sustainable development of prosperity and wellbeing should be more firmly established. Involvement of parliament and social partners, as well as the public national debates, need to be improved, together with further restriction of the populist veto option in the Council in the operative process. As long as the country-specific recommendations remain focused one-sidedly on narrow concepts of competitiveness instead of on the sustainable development of prosperity and wellbeing, the RRF payments should not be conditional on the implementation of the recommendations. In addition, there is a need for strong parliamentary oversight of the Commission and governments during the process in order to hinder restrictive, one-sided reform targets at least.

Secondly, a **new investment fund** in the scope of the EU budget could be useful in order to ensure higher investments in the long term to promote sustainable and convergent development of prosperity and wellbeing in the EU with the focus on climate protection. In particular, if there is no majority for an exception for investments in the course of the governance reform, national investments concerning the Green Deal, digitalisation, and social challenges should nevertheless be more strongly financed by the EU. Otherwise the necessary increase in public investments cannot be brought about. The RFF has shown that investments can be increased if additional EU financing is available – and that the relevant policy priorities are then actually implemented.

Reform proposal no. 8: Establish councils for the sustainable development of prosperity and wellbeing

Economic governance should above all foster frank and well-informed discussion about the sustainable development of prosperity and wellbeing. **Financial sanctions are counterproductive since they hinder genuine debate.** In addition, they are unrealistic because there is a risk of violations in difficult times in particular, when there is no desire to further exacerbate a financial crisis.

A new advisory body should enrich the debate on sustainable development of prosperity and wellbeing with a strong information base. **Fiscal councils and productivity boards should be replaced by councils for the sustainable development of prosperity and wellbeing**. However, fiscal and productivity matters should continue to be addressed comprehensively in the councils as integral components of wellbeing-oriented economic policy. At the European level, there should also be an advisory body, whose analysis could conclude the past European Semester and serve as the informal start of the new European Semester. While the members of the council should be academics, they should cover a wide range of subjects and be nominated by the European Economic and Social Committee and by the European Parliament. The possibility for deviating minority votes to be published in the report in also important so that different opinions are made visible and can add to the political debate.

Reform proposal no. 9: Implement the Social Progress Protocol

Reform of economic governance needs to go hand in hand with reinforcement of the social dimension, for example with Social Minimum Standards (see DGB's response) especially for unemployment insurances and a "Social Progress Protocol" at the level of EU primary law. That includes, for example, prioritising fundamental social rights – including trade union rights – ahead of market freedoms, consolidation of the principle of equal pay and equal working conditions for equal work in the same place – especially in connection with tackling wage and social dumping effectively – and ensuring the autonomy of social partners. Moreover, progressive gender equality policies must be anchored, i.e. the gender perspective and the EU gender equality strategy must be mainstreamed in all phases of economic governance.

For democratic economic and budgetary policy at the EU level, all neo-liberal provisions (including Articles 119, 126, 123 and 125 of the TFEU) should be removed from the treaties. The current crisis in particular sheds light once again on how dangerous the inflexibility of these regulations is. Instead of cementing a particular policy into place, the EU treaties should set out rules that allow for a democratic debate about the best solution in line with current developments.

Reform proposal no. 10: Complete the banking union after a structural reform – with a "safe asset"

Completion of the banking union is an important component for a stable economic and monetary union and helps to reduce the fiscal risks of the Member States. The path towards a common EU deposit guarantee scheme, however, would first require structural reform of the banking sector to prevent deposit guarantee instruments from being used for investment banking risks. The idea of risk weighting of government bonds is dangerous since it could undermine the aim of safer and therefore cheaper bonds. Instead it would make sense to create a "safe asset" beyond the NGEU bonds that could be a decisive step towards Europeanisation of the banking market and also be an important instrument for common monetary policy.

This position paper is based to a large extent on the ETUI Working Paper "Towards a progressive EMU fiscal governance", which was drawn up together with economists closely linked to trade unions from the euro area heavyweights Germany, France, Spain, and Italy, as well as Greece and Ireland. A previous version was published in 2020 in a very similar form and with the unabridged answers in the scope of the first consultation (German/English).

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About us

The Austrian Federal Chamber of Labour (AK) is by law representing the interests of about 3.8 million employees and consumers in Austria. It acts for the interests of its members in fields of social-, educational-, economical-, and consumer issues both on the national and on the EU-level in Brussels. Furthermore, the Austrian Federal Chamber of Labour is a part of the Austrian social partnership. The Austrian Federal Chamber of Labour is registered at the EU Transparency Register under the number 23869471911-54.

The main objectives of the 1991 established AK EUROPA Office in Brussels are the representation of AK vis-à-vis the European Institutions and interest groups, the monitoring of EU policies and to transfer relevant Information from Brussels to Austria, as well as to lobby the in Austria developed expertise and positions of the Austrian Federal Chamber of Labour in Brussels.