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Embedding the Recovery and Resilience Facility into the European Semester

Macroeconomic coordination gains and democratic limits

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Policy recommendations

- The Recovery and Resilience Facility (RRF), which makes up the bulk of the 'Next Generation EU' plan, with 672.5 billion euros (€) in loans and grants (out of a total of €750 billion), has given new momentum to policy and political coordination in the EU. As embedded in the European Semester, however, it requires that the latter goes beyond its role of fiscal surveillance.
- The Recovery and Resilience Facility calls into question the balance between a technocratic view of the goals and their achievements, and a democratic view that can shape a genuinely European impetus.
- Broadening accountability for RRF management to the European Parliament and social partners at the national or European level would give European integration long-lasting momentum.
- Beyond the RRF, the production of European public goods financed by a truly European tax system, not by national contributions, would make it possible to establish a solid democratic basis for the EU's legitimacy.

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Introduction

In the context of the Covid-19 crisis, European cooperation has received new impetus with the adoption of a new budgetary tool at the supranational level, labelled 'Next Generation EU' (NGEU), containing a new facility dedicated to fostering recovery and resilience. Not only will the European Union (EU) provide the EU Member States with grants, but these grants and the loans that also make up part of the Recovery and Resilience Facility will be targeted towards the EU Member States hardest hit by the pandemic.[1] Thus, the RRF marks a sea change, with its spending oriented towards countries' needs, not their size – a principle that to date has been applied only to the allocation of cohesion funds – and with the issuance of a mutualised EU debt that will demonstrate more solidarity between the EU Member States. Also, a long repayment period has been set that will match the length of the crisis and its scars. Finally, opening up the discussion on own resources has led to a breakthrough.

Beyond these advantages, embedding the management of the RRF into the European Semester raises a few concerns. First, is the European Semester the proper institutional set-up for fostering and monitoring *policy* coordination in the EU? Judging from experience so far, this is far from evident. Second, is the governance of the RRF able to foster *political* cooperation between European countries and institutions?

The RRF, therefore, constitutes an important opportunity to rethink the European Semester and, as we will see below, to turn it into the policy coordination device that it has not been to date. Indeed, the European Semester – in which the RRF is embedded – has been more of a fiscal surveillance device than a coordination device. The European Semester was meant to foster both surveillance of Member States' macroeconomic policies and their coordination for the purpose of enhancing the effectiveness of fiscal and socio-economic policies. Between 2011 and 2013, the pre-crisis budgetary surveillance framework was strengthened by introducing a continuous process of monitoring and bargaining between the Commission and Member States (the first pillar). Under the second pillar, the scope of macroeconomic surveillance was widened to include other indicators of potential fragility, such as private debt and external imbalances, through the Macroeconomic Imbalances Procedure (MIP). Last but not least, the third pillar was the coordination of socio-economic policies within the scope of fostering common objectives such as growth, investment and job creation.

Nevertheless, during the sovereign debt crisis and beyond, macroeconomic coordination and attention to overall imbalances were virtually non-existent. European institutions focused almost exclusively on the first pillar, fiscal discipline. The monitoring role of the European Semester was the only one that was developed effectively.

In the absence of a genuine European investment plan, the coordination of national policies will be a key element of the Next Generation EU package.

1 The criteria for eligibility are detailed in Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility.

Thus, the issue of how to foster such coordination within the European Semester should be at the forefront of the EU debate. Moreover, the RRF itself raises governance and coordination issues. The governance of the RRF is central to providing appropriate *political cooperation* between different governing tiers in the EU, at the local and supranational levels. The expected proximity between the RRF and the needs of the population requires *accountability*, not only towards the institutions but also more directly to people themselves.

We argue that embedding the RFF in the European Semester's architecture could bring about a genuine leap in macroeconomic coordination that the European Semester has so far failed to achieve. The functional stabilisation of the EU requires such coordination. However, one must bear in mind that supranational coordination of still sovereign States will eventually come up against democratic limits. Indeed, coordination necessarily entails a reduction of political self-government, which is the ground for a sound democracy. European peoples are not ready to give it up. The prospect of establishing a European Semester as a coordination device should thus be appealing in light of an even more fundamental question: what is true European democracy and how could we achieve it? Our first hint in that direction would be to broaden the accountability of RRF management to the European Parliament and social partners at the national or European level. This would confer long-lasting momentum on European integration.

Rethinking the European Semester in light of the Recovery and Resilience Facility

The EU fiscal impetus that the RRF embeds has to act as a complement to, not a substitute for, national policies. In this regard, NGEU has been adopted in conjunction with the Multiannual Financial Framework (for a total of €1,850 billion) and the management of the RRF has been embedded in the European Semester. However, the RRF is dedicated mainly to boosting investment, while the European Semester is meant to enable EU Member States to coordinate their economic and social policies throughout the year and address possible challenges the EU may face. Actually, the European Semester pursues four separate goals: ensuring sound public finances, preventing excessive macroeconomic imbalances in the EU, supporting structural reforms, and boosting investment. This discrepancy between the RRF and the European Semester raises questions about the extent to which the European Semester is appropriate for managing the RRF. The question is legitimate because, beyond the letter of the regulations ruling the European Semester, the tool has so far been almost exclusively an instrument for enhanced budgetary surveillance. In order for it to be properly associated with the RRF, its original (and never implemented) task of acting as a coordination device should be revamped.

Unfortunately, the second and the third pillars were never developed. Despite an increasing consensus among economists concerning the fact that external imbalances rather than public finances were at the root of the sovereign debt crisis, only lip service was paid to the MIP. Countries in violation for external surpluses were not sanctioned, and other indicators –

such as private debt accumulation – were neglected. As for the coordination of economic policies, it was never an issue. The European Semester failed even in relation to basic objectives, such as accompanying the fiscal consolidation of peripheral Eurozone countries with a more expansionary stance in the core, so as not to plunge the EMU into a low inflation environment. Thus, despite the stated intentions, the European Semester ended up being nothing but an enhanced tool for budgetary *surveillance*, to increase pressure on Member countries to reduce their debt and deficit levels in accordance with the Fiscal Compact and the medium-term budgetary objectives.

The current situation is propitious to a thorough rethinking of the role of the European Semester. First, despite the tensions among Member countries during the negotiations on Next Generation EU, we observe for the first time for a long while a general acceptance of the principle that EU macroeconomic policies should be aimed at increasing cohesion and solidarity among Member States. The RRF, a tool for common debt issuance and risk sharing (albeit temporary and limited in size), is the most significant product of this new attitude. Second, the flaws of the current fiscal framework (procyclicality, excessive complication, bias against public investment) are today widely recognised, to the point that a few weeks before the pandemic started the European Commission launched a consultation process on reform of the Stability and Growth Pact (and relaunched it on 19 October 2021). Dropping the exclusive focus on strict targets in favour of enhanced coordination aimed at ensuring the medium-term sustainability of public finances is one of the options on the table (albeit with very limited political space at the moment). The management of the RRF, and possibly of permanent instruments for joint fiscal policy and common investment projects (see Creel *et al.* 2021) that might be created in the next years, would perfectly fit a European semester in which cooperation were to take a larger role than fiscal surveillance.

Keeping in mind the democratic limits of policy coordination

This potential improvement in macroeconomic coordination must, however, also be seen through democratic lenses. Indeed, European supranational coordination by definition limits the discretionary power of national democracies, that is to say, citizens' ability to shape their country's budgetary policy democratically. If macroeconomic logic requires additional policy coordination at European level, democratic logic requires that sub-federal governments and their parliamentary majorities respond to the preferences of the citizens who elected them, especially in the choice of the country's broad budgetary guidelines. The evolution of the European Semester from having a budgetary surveillance function to a macroeconomic coordination function would give substance to the dimension of solidarity between Member States. This would be a positive step. Here again, however, solidarity, which is necessarily linked to responsibility, could raise problems from the standpoint of national democracy.

The debate on coronabonds perfectly illustrates this dilemma. Member States accused of being tight-fisted, such as the Netherlands or Austria, are simply democratically following the preferences of their citizens. Imposing coronabonds on the Dutch, when they do not want them, raises a question of democratic legitimacy. But similarly, forcing other Member States to endorse austerity in the name of responsibility, when their citizens do not want it, poses the same problem of democratic legitimacy. These are not just theoretical considerations: the loss of democratic legitimacy may eventually be reflected in the ballot box with the rise of anti-EU populism. Here we are reaching the political limit of a European macroeconomic approach based mainly on the coordination of national socio-economic policies.

The accountability issue: finding a new role for the European Parliament

Beyond the economic and democratic issues of policy coordination, the RRF raises some questions of political governance. Indeed, the RRF is intended to reflect domestic needs in order to unfold its full effectiveness. The governance of the RRF is therefore central to providing appropriate *political cooperation* between different governing tiers in the EU, at the local and the supranational levels. While it is federal in nature – therefore requiring some checks and balances at this level – the planned closeness between the RRF and the needs of the population requires *accountability*, not only with regard to the institutions but also – more directly – to the people themselves. The RRF therefore calls into question the balance between an expert (or technocratic) view of the goals and their achievement, and a democratic view that will shape a genuinely European impetus.

Guttenberg and Nguyen (2020) have advocated that the accountability of RRF management may go beyond mere accountability to the European Commission and ultimately to the European Council. It may thus also involve national Parliaments and the European Parliament. As Eurobarometer (2021) shows, the Covid-19 crisis has enhanced ordinary EU citizens' willingness to become more involved in what matters for the future of Europe. In this respect, broadening the accountability of RRF management seems important if the RRF is to be able to instigate long-lasting momentum for European integration. Broader accountability may not only mean further involvement of, for example, the European Parliament, but also of social partners at the national or European level, which would be consulted on the adequacy of national investment programmes funded via the RRF.

Transparency and accountability are not absent from the management of the RRF. Article 25 of Regulation (EU) 2021/241 states that: 'the Commission shall transmit the recovery and resilience plans officially submitted by the Member States, and the proposals for Council implementing decisions (...) simultaneously and on equal terms to the European Parliament and the Council without undue delay', while Article 26 refers to a regular 'recovery and resilience dialogue', so that 'the competent committee of the European Parliament may invite the Commission every two months to discuss [matters related to the recovery and resilience plans]'. A singular feature here certainly is the pivotal role given to the Commission in achieving better accountability of national governments towards the European Parliament. More direct involvement of the former in relation to the latter may be contemplated.

In fact, the debate on accountability is far from new. There have already been some proposals to better embed accountability in the European Semester (for example, Martin *et al*. 2021). There have also been some proposals to better embed checks and balances on national fiscal policies by the European Parliament (for example, Creel 2021). Following the sovereign debt crisis, however, there are already many checks and balances regarding the use of fiscal tools in the EU. Beyond the Stability and Growth Pact, the European Fiscal Board (EFB) was established in 2016 to advise on the appropriate fiscal stance in the EU. While the National Fiscal Councils (NFC) monitor compliance with domestic fiscal rules in the Member States and thus enhance governments' internal accountability, the EFB also cooperates with NFCs to share best practices and common understanding on EU fiscal rules.

However, first it is not clear whether NFCs have to discuss economic spillovers in the EU of domestic policies. Secondly, NFCs and the EFB see their advisory role, and the ensuing aggregate fiscal stance, as embedded in the EU fiscal framework, which involves a complicated set of rules. Thirdly, fiscal accountability is blurred by the reliance on independent but technocratic institutions (members of the EFB and the NFB are nominated). Fourthly, the EU has set up an economic dialogue. In fact, economic dialogue is held mainly with the Commission and Eurogroup, although there are also *occasional* exchanges of views with Member State finance ministers. Having a regular economic dialogue with Member States is problematic at the level of the European Parliament, which lacks legal competence in this regard. However, there are certain cases in which there is a legal basis to invite Member States (for example, euro-area countries under enhanced surveillance following a macroeconomic adjustment programme or an excessive deficit procedure) but they remain specific and rare.

In contrast, regular and structured Fiscal Dialogues at the European Parliament (Creel 2021) would increase transparency and enlarge accountability in relation to European fiscal choices. Meanwhile, they may help governments to better internalise EU spillovers and better cooperate at the EU level. This proposal goes beyond Moschella (2020)'s recommendation of limiting the incorporation in the European Semester of the economic analysis of the complementarities and spillover effects of the policies supported by the RRF *only*.

The fiscal bet: opening a window towards a true European democracy

While these procedural rules on accountability certainly improve the democratic quality of European economic governance, they are not the heart of what a democracy is. European governance is democratic and can be further democratised, but then it is all about being more 'democratic' (democracy as an adjective). This says nothing about European democracy as such (democracy as a noun). Democracy cannot be reduced to its institutional dimension (its 'skeleton'), but also has a substantial dimension (its 'flesh'), which is essential and perhaps even more important. Democracy, in the modern sense, is the collective capacity of a political community to act on common reality through the production of common public goods desired by the largest number of citizens. This translates concretely into votes on the budget, namely the vote on tax revenues (the share of common wealth that the collective allocates to itself) and on public spending (common goods that the collective produces for itself). If European economic governance is based primarily on political cooperation between Member States, then democracy in the full sense of the term remains essentially at national level. We must thus ensure that national parliaments retain their full budgetary power, otherwise we will expose all Europe to the risk of devitalising national democracy. The mechanisms for including national parliaments in a European dialogue with European institutions are interesting and certainly contribute to the construction of an integrated European parliamentary system. However, this is only a secondary dimension of the issue of European economic governance's democratic legitimacy. European economic governance will become fully legitimate only if it is transformed into a genuine European economic government, no longer based primarily on the coordination of national budgetary policies, but on the conduct of a true European fiscal policy that reflects the preferences of Europeans as European citizens (and not merely the sum of national citizens).

The crucial issue of how European loans will be reimbursed harbours the threat of a political deadlock between Member States with the step back to intergovernmental funding and, as a result, an irresistible and unsustainable rise in domestic tensions. But it also opens up the historic possibility of a fundamental political leap towards a political Europe. Considering the amount of loans to be repaid and the virtual political impossibility of placing the reimbursement burden on the Member States' shoulders (that is to say, on national citizens), the question of a genuine European tax system becomes conceivable and feasible. Far from being a merely technical or economic issue, the dimension of taxation relates directly to politics. Only the production of European public goods financed by a truly European tax system, and not by national contributions, would make it possible to establish a solid basis of democratic legitimacy for the EU. Europeans *as European citizens* would decide what to allocate to themselves as a share of common wealth. This share of common wealth must be extracted from the colossal amount of private profits generated by the very existence of the internal market. Europe's real 'Hamiltonian moment' is not common indebtedness, but its possible political consequences for the advent of a European capacity to tax the internal market. American democracy was born from the slogan 'no taxation without representation'. European democracy might be born from the slogan 'no representation without taxation'.

It is noteworthy that the European Commission raised a new question for the review of EU economic governance, namely: 'in what respects can the design, governance and operation of the RRF provide useful insights in terms of economic governance through improved ownership, mutual trust, enforcement and interplay between the economic, employment and fiscal dimensions?'. We have thus shown that the RRF and the implications of the European Semester raise a trade-off between policy and political cooperation. This trade-off could be solved by the production of genuine European public goods financed by a truly European tax system and not by national contributions. Going in this direction would make it possible to establish a solid democratic legitimacy basis for the EU.

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