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CONCLUSIONS AND RECOMMENDATIONS

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INTRODUCTION

Elections to the European Parliament will be held from 6th to 9th June 2024 and will result in a new Commission with a new work programme that will propose and/or strengthen initiatives crucial to European integration itself. The elections to the Parliament offer European citizens the possibility of democratically deciding the future they want for Europe, since it is from this institution that the laws emanate that determine the direction to be taken to address the multiple challenges facing the European Union, both internal and global.

In this context, the ESC (CES, by its initials in Spanish) considered it appropriate to draw up a new report on the economic governance of the European Union,[1] this time focusing on its reform, stressing the importance of striking a balance between the objective of ensuring the macrofinancial stability of the Eurozone and the need to undertake the investment required by the European economy to meet the climate change and technological transformation, strengthen its competitiveness and job creation, and to increase levels of social and territorial cohesion, in an uncertain geopolitical environment.

The economic governance of the European Union refers to the system of bodies and procedures established for the economic coordination of the Union, given that most of the competences in the field of economic policy lie primarily with the Member States, particularly fiscal policy, labour and social policies and industrial policy. In important areas of economic policy, such as monetary policy, antitrust policy and trade policy, competence has been delegated exclusively to the European Union, so that they do not strictly speaking form part of what is considered "economic governance". However, since all these areas of economic policy are interrelated and need to be coordinated

NOTES

1 ESC Report 3/2012, *New Economic Governance in the European Union and Growth;* ESC Report 1/2014, *Developments in the Economic Governance of the European Union: Update to ESC Report 3/2012;* ESC Report 1/2016, *Analysis of the Economic Governance of the European Union*; ESC Report 2/2017, *The Economic Governance of the European Union. Annual Report*; ESC Report 2/2018, *The Economic Governance of the European Union. Annual Report;* ESC Report 3/2019, *The Economic Governance of the European Union. Annual Report;* ESC Report 3/2021, *The Economic Governance of the European Union. The Impact of the Pandemic;* ESC Report 2/2023, *The Economic Governance of the European Union. Spanish Presidency 2023.*

to ensure the smooth functioning of the European Union, this report deals with all of them in order to provide an overview.

The system of economic governance *stricto sensu* has evolved over time in response to the challenges facing the Union. Thus, until 2011, economic policy coordination among states was mainly based on consensus, with no binding rules, except in the framework of budgetary policy as defined in the Stability and Growth Pact. But the 2008 financial and economic crisis revealed fundamental problems and unsustainable trends in many European countries, and made it clear that the economies of the Union are strictly interdependent, so greater coordination of economic policies was deemed necessary in order to address these problems and boost growth and job creation.

To this end, the system of economic coordination institutions and procedures was reviewed and strengthened in 2011 and beyond. In particular, a new synchronised working method –the European Semester– was adopted to discuss priorities and coordinate economic and budgetary policies, as well as employment and social policies, under the European Pillar of Social Rights; the Union's surveillance of fiscal discipline was strengthened under the Stability and Growth Pact; new tools were developed to address macroeconomic imbalances (Macroeconomic Imbalances Procedure); and new instruments were created to deal with Member States in financial difficulties (European Financial Stabilisation Mechanism, European Financial Stabilisation Facility and European Stability Mechanism). In order to clean up the financial sector, the Union also promoted the achievement of the Banking Union with new rules and institutions, a single rulebook, a Single Supervisory mechanism and a Single Resolution Mechanism to prevent crises and ensure that the activity of financial actors is properly regulated and supervised, an unfinished process. The Capital Markets Union was also called for in order to have broad and deep financial markets that are globally competitive and capable of mobilising private capital.

Once the economic crisis was over, the Union established a process aimed at strengthening the architecture of the Economic and Monetary Union based on the 2015 Five Presidents' Report, which focused on achieving a true union of the economic, financial, fiscal and political spheres, a process that is still open and subject to debate and whose progress, generally insufficient, the ESC has been reporting on since then in monographic reports and in its annual reports.

In this context, in February 2020 the Commission launched a review of the economic governance framework, which included a public debate on the effectiveness of the various surveillance tools introduced or modified by the 2011 and 2013 reforms, especially those of fiscal control, to achieve its main objectives: to ensure the sustainability of public finances and growth and avoid macroeconomic imbalances; to provide an integrated surveillance framework to facilitate closer coordination of economic policies, especially in the Eurozone; and to foster convergence of Member States' economic performance.

But this process of reflection and consultation, which focused on the relative effectiveness of the framework of European fiscal rules, as also detailed in this report, was suspended because the outbreak of the pandemic caused such a severe economic disruption that it forced the Union to adopt unprecedented economic stabilisation measures focused on fiscal policy, such as the suspension of the application of the fiscal rules of the Stability and Growth Pact and of the rules of state aid or, notably, the creation of new temporary supranational fiscal instruments financed, for the first time in history, by the issuance of joint public debt, such as the SURE, which has already expired, or the Next Generation EU, which will be in force until 2026. The relative effectiveness of these funds in stabilising the economy and boosting transformative investment will also be assessed in this report.

The pandemic therefore posed a major challenge for the European Union, spurring further fiscal integration and risk pooling among Member States, but it also led to a very sharp increase in public debt levels. Moreover, the risks of severe exogenous shocks in the future have multiplied since then, including those arising from the climate emergency, the war in Ukraine and the Israeli-Palestinian conflict, the protectionist retreat of the major economies and the digital supremacy of the United States and China.

This scenario obliges the European Union to redouble its efforts to increase its economic and social resilience. This will necessarily require a significant scaling up of public investment, as well as incentives for private investment. This would make it possible to undertake, in an accelerated but fair manner, the ecological transformation of the economic system, to control the digital transition and its effects on society, and to achieve a certain strategic autonomy, both in security and defence and in industrial matters. In the current geopolitical context, investment in these areas is essential to maintain high levels of competitiveness, welfare and social and territorial cohesion.

Internally, it also faces weak economic growth (Annex 1) and challenges such as the rise of approaches contrary to the principles and values of the European Union in some Member States, the proliferation of protests over trade policy and/or the Green Pact, the demonstrated vulnerability of market unity to unexpected shocks, the persistence of inequalities, the growing need for defence coordination in an environment of increasing military tensions, and the need to address the weaknesses of the current approach to migration policy despite the European parliament's recent approval of the reform of European migration and asylum policy.[2] Moreover, all of these issues are also being considered in the context of a possible reform of the treaties, which does not enjoy the consensus of the Member States, but which seems necessary in the face of future enlargement.

2 On April 10, 2024, the European Parliament approved ten legislative texts to reform European migration and asylum policy. Once the Council formally approves the package, the laws will come into force upon publication in the Official Gazette. The regulations will begin to apply within two years. In the case of the Reception Conditions Directive, Member States will have two years to introduce changes to their national legislation.

So European citizens will go to the polls next June at a very delicate moment for the European Union, which requires audacity in order to decisively deepen its political integration. As the Autumn 2023 *Parlemeter* Eurobarometer reveals, more than half of Europe's citizens (53 per cent) want the European Parliament to play a greater role in the European Union's political integration. The majority also expressed interest in the upcoming elections to the European Parliament, in fact, two out of three people stated that they would vote if the European elections were held in a week, and European citizens continue to value membership in the European Union positively and even remain optimistic about its future.[3]

This is the context in which, in December 2023, under the Spanish Presidency of the Council, the reform of the fiscal governance framework was agreed, with the aim of finding a balance between the need to promote sustainable and inclusive growth and to reduce the public debt of the States. Furthermore, in order to facilitate the mobilisation of financial resources for investment, progress has been made to deepen financial integration in the European Union through the banking and capital market union. All of this will be reported in this report, as well as the need to advance the debate on European Union budgetary integration through the creation of adequately endowed permanent fiscal capacities.

3 "A large and stable majority of Europeans (72 per cent) think that their country has benefited from EU membership. The main reasons for thinking this are that the EU contributes to maintaining peace and strengthening security (34 per cent) and that EU membership improves cooperation between EU countries (34 per cent)." Eurobarometer Autumn2023/100.1: *Parlemeter: Autumn 2023 Survey: Six months before the 2024 European Elections.*

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On the occasion of the reform of the economic governance of the European Union, this Council issues a new report, in which it wishes to underline the importance of striking a balance between the objective of ensuring the macrofinancial stability of the Eurozone and that of undertaking the investments required by the European economy to face the climate challenge and technological transformation, to strengthen its competitiveness and job creation, as well as to increase the levels of social and territorial cohesion.

Fiscal rules are necessary in a monetary union to coordinate the fiscal policy of States, to promote prudent fiscal policies and to prevent individual imbalances from affecting the stability of the whole. In this sense, the European Union agreement reached under the Spanish Presidency of the Council was necessary, after four years with the rules suspended, to convey a message of unity, stability and solvency to the markets in a geopolitical context dominated by uncertainty.

The new approach is a step forward with respect to the fiscal surveillance framework in force until now because it simplifies it considerably, focuses on the medium term, favours the involvement of States by taking into account the characteristics of each country and allows a better reconciliation between fiscal sustainability and growth by giving more fiscal space to the most indebted countries to carry out investments and reforms. However, it does not fully resolve the main problems of the previous system: complexity, procyclicality and lack of protection for investment.

1. Indeed, despite the simplification effort, **it remains a complex system of rules**. The new fiscal surveillance scheme replaces the structural deficit with net primary expenditure as the control variable. But variables that are not directly observable are still present and are based on complex economic estimates, subject to uncertainty and methodological discrepancies. This is the case with the analysis of long-term debt sustainability, with the quantification of cyclical unemployment expenditure, with revenue forecasting and with the calculation of the structural deficit. It also includes indeterminate concepts that lend themselves to different interpretations, increasing the risk of political bargaining turning into arbitrariness.

It is therefore necessary that common, transparent and agreed methodologies are adopted, that estimates are independent, reliable, shared and fully replicable, and that the transparency of economic statistics and public accounting is strengthened.

2. Although there are improvements, **the new framework still hampers Member States' counter-cyclical fiscal policy**. One of the main weaknesses of the previous fiscal surveillance framework is that, in the absence of European fiscal stabilisation mechanisms, it was primarily designed to ensure fiscal discipline of States, making it difficult to cushion economic cycles or to counteract major shocks to their economies, which was one of the main reasons for the slow and fragile recovery of activity and employment after the 2008 financial crisis in Europe.

   On the positive side, the new system introduces more flexibility to undertake fiscal consolidation processes by setting net expenditure adjustment paths differentiated for each country and focused on achieving medium-term deficit and debt targets, with periods that can be extended up to seven years if reforms and investments are undertaken. Moreover, it maintains the exclusion of cyclical expenditure on unemployment from the expenditure rule so as not to cancel out the economic stabilisation capacity of this item. All of this allows adjustments to be less severe and more spread out over time, leaving greater fiscal leeway to the States than the previous system. Moreover, it introduces "national escape clauses" to allow a State to temporarily deviate from its adjustment path if there is a shock beyond its control that significantly affects its public finances, which is a notable advance over the previous framework.

   Moreover, the main objective remains to pursue national fiscal consolidation processes until public debt reaches 60 per cent of GDP, which is unrealistic.

   The creation of a budgetary capacity at Eurozone level would allow both asymmetric macroeconomic shocks and severe shocks affecting the euro area as a whole to be smoothed. The absence of such a budgetary stabilisation mechanism remains one of the main weaknesses of EMU economic governance.

3. Finally, **incentives for investment are introduced, but they are insufficient given the need to deal with the transitions underway**. The new governance framework incorporates some elements that seek to protect public investment in periods of fiscal consolidation and even to encourage it, in order to avoid a recurrence of what happened after the financial crisis, especially in the most indebted countries.

   Thus, more extended fiscal adjustment paths are allowed for the most indebted states on condition that they undertake reforms and investments in line with the Union's strategic priorities and recommendations, provided that they have positive effects on potential growth and fiscal sustainability. This greater flexibility

also requires rigorous analysis of their medium-term budgetary, economic and social impact, which is an incentive to develop systematic evaluations of public policies with shared methodologies, an area in which there is ample room for improvement at all levels.

Despite these advances, the new system is not without problematic aspects. On the one hand, it is not clear how investments will be evaluated and prioritized to approve fiscal consolidation programs and, where appropriate, their temporary extension, in particular, investments and reforms aimed at increasing European intangible capital. In this sense, it is necessary for the Commission to approve a consensual and transparent methodology for evaluating investments and strategic reforms, including social investment, that focuses on the impact of the measures on potential growth, socioeconomic resilience and the sustainability of long-term public debt.

But the fundamental problem with the new fiscal supervision framework is that it leaves the most indebted States with a very narrow fiscal margin to finance transformative investment. To expand this margin, States can undertake structural reforms that increase the efficiency of their spending programs and tax systems. But it seems advisable that, in addition, permanent European mechanisms of budgetary and financial support for State investment be created, if we want to prevent internal divergences within the European Union from increasing in the pace of transformation at the ecological and digital levels.

4. The new governance framework represents an **additional challenge for monetary policy, which must seek complementarity with fiscal policy and support each other in stabilizing the economic cycle**. The two-way interaction between monetary policy and fiscal policy, which occurs through different channels, highlights the need for mutually consistent monetary and fiscal policies.

   In the search for this complementarity, the starting point is the different institutional configuration of monetary policy, the responsibility of which corresponds to the ECB, and fiscal policy, the responsibility of the Member States. Hence, it is important to achieve a balance between the restrictions derived from the new fiscal framework, which the Member States must apply, and the tone of the ECB's monetary policy, in coherence with the achievement of the objectives of sustainable economic growth and price stability.

   Although in general the new fiscal framework favours the coordination of both policies in the euro zone and supports the effectiveness of monetary policy, there are three aspects that can generate some conflict and to which attention should be paid. The first affects the impact on economic recovery of the coexistence of a stricter fiscal stance with the delayed effects of monetary restriction; the second, the ability to reconcile the objectives of monetary policy and debt sustainability

that could be solved with the creation of a risk-free asset; and, finally, to the collision that could arise between the definition of the debt sustainability criterion according to the new framework and according to the ECB's Transmission Protection Instrument, which also defines and evaluates this criterion for its activation.

5. Likewise, it is worth remembering that, to strengthen the shock absorption capacity of the euro area, **completing the Banking Union is a priority**. But this requires a determined political commitment that would also contribute to strengthening the European project itself. There has been a general consensus, for years, on the importance of completing the Banking Union to avoid situations of financial instability, while contributing to the economic resilience and sustainability of the Union, but the objective of achieving the Banking Union is stalled. The lack of an agreement on the creation of a European Deposit Guarantee System prevents progress, which is even more serious when its creation is not proposed before 2025 once progress has been made in risk reduction and that agreements are reached to improve the regulatory framework of the banking system.

6. On the other hand, given the limited fiscal space existing in the European Union, **it is necessary to deepen financial integration by moving forward in the Capital Market Union**, to achieve more diversified, deep and competitive financial and capital markets that allow mobilising private capital and have the necessary financial resources to drive innovation and support investments within the framework of the Next Generation EU addressing the green and digital transitions.
   Ensuring the proper functioning of European capital markets is key to unlocking the private capital necessary to finance investment needs at European level, with a view to boosting economic and social competitiveness compared to other regions. In this sense, the Ecofin statement of intent of March 2024 is, whenever implemented, a decisive political commitment to foster a thriving European capital markets ecosystem, in line with its position as the largest single market in the world.

7. **The social dimension constitutes an integral part of the new economic governance** and the objectives of inclusive economic growth for the region. Although it maintains the reference values of the Stability and Growth Pact, the new framework is made more flexible to adapt to the individual circumstances of each country, offering greater room for adjustment and opportunities for social convergence. In response to the demands of the European Parliament, the new governance also allows strategic investments and reforms based on the European Pillar of Social Rights to be taken into account, as well as analyses of the risks for social convergence. The exclusion of national spending in the co-financing of programs financed by the European Union with social impact, such as the European Social Fund, in the calculation of net primary spending is progress in this sense.

On the other hand, given that fiscal surveillance will continue to be integrated into the framework of the European Semester, the European Council on Employment, Social Policy, Health and Consumers should be given greater weight in the multilateral supervision phase, due to its specialization in the scope of community social policies, and activate social dialogue in this matter, which can improve the quality of monitoring the social convergence of governance. The new social convergence framework will facilitate the monitoring and evaluation of its social impact.

8. However, **significant doubts remain regarding strategic social investments and reforms**. And the specific criteria on investments and reforms compatible with fiscal rules and debt adjustment plans are pending specification. The levels of public debt and structural deficit established for the adjustment periods could imply significant budgetary efforts and affect social investments and a path of inclusive growth.

   The European Parliament has asked the Commission for greater specification of the necessary reforms and investments, the commitment of the Member States to undertake social investments, especially those that affect development at the earliest ages, and greater flexibility in the adjustment of the smaller or indebted member states, among others. The European Economic and Social Committee (EESC), for its part, has also pointed out the need to promote well-designed reforms and investments in balance with sound economic and public finance policies and, in particular, those that promote social and territorial cohesion, since they can generate increases in productivity and greater economic growth, while allowing social objectives to be achieved.

   Specifically, social programs that result in an increase in European human capital, such as those aimed at strengthening the educational and employment activation system, at strengthening public health services and social protection and care systems, at promoting reconciliation of family and work life or promoting gender equality, should be evaluated in light of their medium-term budgetary, economic and social effects.

   Likewise, the monitoring mechanisms of the European Semester should integrate the childhood perspective. Not in vain, the most recent studies show that vulnerability during childhood entails high monetary costs for society as a whole and also show that the potential return on investment in strategies to combat child poverty is high in economic and social terms. In the same sense, it would be necessary to integrate the gender perspective into the economic governance of the European Union since economic and social prosperity depends, to a large extent, on continued progress in this area.

9. The new economic governance framework also faces the **growing investment needs required by industrial policy** as a way to recover what has come to be called sovereignty or strategic autonomy and promote the reindustrialization of the European Union.

10. The European Union, with the Green Deal Industrial Plan, confirms its transition towards a paradigm shift in the industrial strategy, after years of loss of weight of the industry in economic activity and given the evident vulnerable position of Europe in the global technological race and the challenge of fighting climate change. **An industrial strategy** is now proposed **beyond the simple improvement of the general framework of activity**, advocating direct intervention/promotion of specific sectors or branches of activity. In this regard, it is necessary to remember that the success of any industrial strategy requires commitment and cooperation between the European Union itself, the different Member States, social partners, industrial sectors and other parties related to industrial ecosystems.

11. To promote the clean technology industry, the Community regulatory framework for aid to companies has been temporarily made more flexible, with the risk of fragmentation of the internal market and deepening economic divergence between Member States. In any case, **the proliferation of exceptions to the rules on state aid only highlights the lack of a common industrial policy.** Progress should be made in a supranational aid model that allows the European Union to compete with other blocks at an international level, that ensures cohesion and links economic activity to the territory.
    While moving towards a genuinely community mechanism, the European Commission continues to try to ensure that the economic security of the European Union is not compromised by accelerated industrial geopolitics. In June 2023, it presented a strategy in this regard that must have new tools to detect risks to economic security, reinforcing existing ones that offer more information and data on the behaviour of productive activity; and in whose definition and design the participation of economic and social agents should be guaranteed.

12. The need to ensure the **same rules of the game must extend to the European Union's trade strategy**. Its lack is causing trade frictions, which appear to have been exacerbated by the need to accelerate the decarbonisation of the European economy, to fight climate change and to protect biodiversity. The trade of products from the primary sector and the agri-food industry constitutes a paradigmatic example.
    The ESC has been insisting for some time, firstly, on the need to guarantee coherence between environmental and digital objectives with Community trade

policy; secondly, in the convenience of accompanying these transformations with redistributive, industrial and labour policies that mitigate the impact on certain social groups, workers and/or companies and facilitate their adaptation, always through social dialogue; and, thirdly and finally, the need to continue working towards the revitalization of institutions that allow global challenges to be managed from a multilateral perspective, as is the case of the WTO.

13. The **deepening of the single market and greater economic integration are essential** for the European Union to continue being the leading trading power and maintain its negotiating capacity in international agreements. The single internal market constitutes in itself a geopolitical tool by offering: one of the largest integrated markets in the world, diversified sources of supply, opportunities for innovation and expansion of production, well-established social rights and fair working conditions. In the ESC's opinion, the fact that European Union products are safe, of high quality and manufactured in compliance with strict labour and environmental protection standards constitutes, or should constitute, one of the Union's main competitive advantages on global markets.
    This ESC shares the opinion of the European Economic and Social Committee which considers that for the single market to function it also requires a high level of infrastructure and public services in all European areas and regions, especially in those that are below the half. Having adequate physical and social infrastructure constitutes a strategic value to guarantee the economic and social competitiveness of the Union.

14. The greater flexibility of the new fiscal policy framework entails the intensification of the negotiation processes between the European institutions and the Member States. That is why, as this Council has been defending in previous editions of this report, it is considered positive that the European Parliament and the EESC have pointed out the need to reform the European Semester in order to **reinforce the presence of the social interlocutors and social, European and national dialogue**, as well as the participation of the social economy, as well as that of national Parliaments and local and regional authorities.

15. However, **the reform of economic governance has left aside the debate on the need to create** significant and permanent **supranational budgetary institutions**. That is why it is insufficient to face the enormous external and internal challenges that the European Union must tackle, and to which States with their own fiscal capacities cannot respond, no matter how much they coordinate their economic policies and strengthen their tax systems.
    The European Union's budget is so small that it conditions its ability to support high levels of political ambition and, particularly at the level of economic gov-

ernance, to be effective in three areas that demand joint actions: 1) cushion economic cycles and respond to major disturbances, in coordination with monetary policy, to guarantee the proper functioning of the Eurozone; 2) finance and support transformative investments that address the climate emergency, promote fair and sustainable development, increase social and economic resilience and strengthen European autonomy in strategic sectors; and 3) promote real convergence between the territories and social cohesion.

The positive assessment of the experience of SURE as a European tool for economic stabilization and of the Recovery and Resilience Mechanism as a European investment instrument, supports the idea that it is interesting and feasible for the European Union to equip itself with new permanent budgetary capacities, so that it can deploy, with a minimum degree of effectiveness, economic and social policies with European added value, that is, with benefits and guarantees that transcend national borders. Because, as it has been detailed throughout this report, the challenges facing the European Union are enormous in different areas and it is very difficult to address them with a central budget as limited and constrained as the current one.

16. Advancing towards greater budgetary integration would require a substantial increase in the income managed by the European Union, which involves **strengthening its own resources system** and also considering the **issuance of joint public debt** as a legitimate and permanent common policies financing tool.

    In terms of own resources, the current debate is focused on approving new figures to face the financial cost and the repayment of the debt contracted to finance the subsidies associated with the Next Generation EU, because the refinancing of the debt is not contemplated at the moment, nor make new issues to create new permanent funds. In this sense, the basket of new own resources proposed by the Commission could be enough to cancel the European debt and maintain the current budgetary resources of the European Union, but little more.

    In short, the mobilisation of mutualized financing to scale up investment in European public goods in order to strengthen the competitiveness of the European Union and preserve the European social model, although it is a necessity, does not seem to have any signs of a solution with the current schemes. This is undoubtedly the great challenge that the new community executive that emerges from the polls after the elections to the European Parliament to be held in June 2024 will have to face.