EU Communication and EU Recommendation

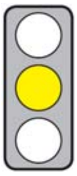
FIRST "EUROPEAN SEMESTER"

Status: 01 August 2011

MAIN ISSUES

Objective of the Communication and Recommendation: The Commission recommends to Member States measures to redress macro-economic imbalances and to pursue the strategy "Europe 2020".

Parties Affected: All citizens, companies, national governments and parliaments.



Pros: (1) Member States are called upon to consolidate their budgets quickly and to a greater extent than is statutorily required.

(2) The single market is to be further developed, in particular in the energy and transport sector.

Cons: (1) Abolishing the joint income taxation of married couples rather defeats the object of creating neutrality when it comes to deciding whether to raise a family or follow gainful employment.

(2) The "strategic use" of public procurement for industrial policy purposes is harmful to economic growth and entails the risk of resources being deployed inefficiently.

CONTENT

Title

1) Communication COM(2011) 400 of 7 June 2011: **Concluding the first European semester of economic policy coordination:** Guidance for national policies in 2011-2012
2) Recommendation SEC(2011) 807 of 7 June 2011 for a Council Recommendation **on the National Reform Programme 2011 of Germany** and delivering a Council opinion **on the updated Stability Programme of Germany, 2011-2014**
3) Council Recommendation 11391/11 on the National Reform Programme 2011 of Germany and delivering a Council opinion **on the updated Stability Programme of Germany, 2011-2014**

Brief Summary

► **Context and objectives**

– With the adoption of country-specific Council Recommendations, the first "European Semester" expires. It serves to contribute to the yearly ex-ante economic policy coordination of Member States [for further detail see the Communication on economic policy coordination COM(2010) 367; s. CEP Policy Brief].
– The "European Semester" is based on the strategy "Europe 2020" [COM(2010) 2020; s. CEP Policy Brief] and the planned reform of the Stability and Growth Pact (s. CEP Analysis).
– In the "European Semester", Member States submit to the Commission their National Reform Programmes, Stability Programmes (euro states) or Convergence Programmes (non-euro states).
  - The National Reform Programmes contain measures to promote growth and employment.
  - The Stability and Convergence Programmes contain the Member States' plans to stabilise public finances.
– The country-specific recommendations for action, which are based on the submitted national programmes, should be implemented by Member States within the 12 to 18 months following the recommendation.
– The "European Semester" is to monitor and correct "macro-economic imbalances", in particular regarding competitiveness and the indebtedness of Member States, and to ensure that the Member States' reform plans are in line with the targets of the strategy "Europe 2020". These are as follows:
  - The employment rate among citizens aged 20-64 is to be increased to 75% [for details see COM(2010) 682 cp. CEP Policy Brief],
  - Expenditure for research and development (R&D) is to be increased to 3% of GDP.
  - The "20-20-20 targets" of the EU – 20% less greenhouse gas emission, a 20% share in renewable energies and 20% more energy efficiency [cp. CEP Dossier, in German only, p. 8] – are to be implemented by 2020.
  - The percentage of persons with a university degree is to be increased to 40% and the percentage of persons without school-leaving qualifications is to be reduced to 10% [see COM(2010) 193 cp. CEP Policy Brief].
  - The rate of people "at risk of poverty" in the EU is to be reduced by 20 million.

► **Total evaluation of the Member States' voluntary undertakings [COM(2011) 400]**

– According to the Commission, the following aims of the "Europe 2020" strategy can be achieved on the basis of national commitments: a 20% reduction in emissions, a 20% increase in the share of renewable energies and reducing the school dropout rate to 10%.

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– Not achievable are the increase in the employment rate to 75%, raising R&D expenditure to 3%, increasing energy efficiency by 20%, raising the share of university graduates to 40% and cutting the poverty rate to 20 million.

▸ **Uniform recommendations to all Member States [COM(2011) 400]**

The Commission makes recommendations to all Member States regarding the following policy areas mentioned in the annual growth report [COM(2011) 11; s. CEP Policy Brief]:

– **Macro-economic stability, in particular budget consolidation**
  - In order to reduce public indebtedness, Member States should:
    - meet the agreed deadlines for correcting excessive deficits;
    - take "particular account of" growth-stimulating budget items such as investment in research, education and energy efficiency;
    - adopt reinforced fiscal frameworks (e.g. "debt brakes"); and
    - reform public administration and social insurance schemes.
  - States with a high current account deficit should link incomes to their productivity growth and thus foster competitiveness, and they should introduce structural reforms that encourage production.
  - States with high current account surpluses should further open their service sectors and network industries.
  - The stability of the financial sector and the credit supply to the real economy are to be ensured.

– **Reforming labour markets**
  - The statutory retirement age should be linked to life expectancy, the actual retirement age should be raised and the employability of older workers be should fostered.
  - Supportive measures for unemployed workers are to be "optimised".
  - Youth unemployment and the number of early school leavers should be cut.
  - Education and training standards are to be adapted to labour market needs.
  - Employment contracts should ensure an "effective and fair" combination of security and flexibility ("flexicurity"), where necessary also through "rebalanced" employment protection legislation.
  - Labour is to be relieved of tax burdens, in particular in the low-income sector and for low-skilled workers, and attention is to be shifted to "consumption and/or to support environmental objectives" (p. 7).
  - Member States are to make labour more attractive for second earners, in particular by removing tax burdens and by establishing childcare facilities and more flexible forms of employment.

– **Enhancing growth**
  - In order to stimulate competition in the service sector, the Commission demands:
    - that competition be promoted in network industries, such as transport and energy;
    - a "strategic use" of investments in public procurement (p. 7);
    - the removal of "unjustified barriers to entry" (p. 7); and
    - the further opening of free professions (e.g. engineers, architects, pharmacists and lawyers).
  - Corporate framework conditions are to be improved by:
    - providing a better supply of risk capital to "innovative companies", in particular to SME;
    - cutting red tape and creating more transparency in public procurement;
    - encouraging the formation of new companies and reducing administrative burdens.

▸ **Specific recommendations to Germany for the period 2011-2012 [SEC(2011) 807; 11391/11]**

The Council Recommendation (11391/11) is only cited where it deviates from the Commission's Proposal [SEC(2011) 807].

– **Recommendation 1: Budget consolidation**
  - Germany should implement its budget strategy for 2012 and the subsequent years as planned.
  - The debt brake enshrined in the German constitution should be fully implemented at federal state level and the controls and sanction measures be strengthened.
  - The growth-friendly consolidation course is to be maintained, in particular through education expenditure and more cost-effectiveness in health care and long-term care.

– **Recommendation 2: Financial sector**
  - Germany's financial sector still needs reforms. The structural weaknesses such as a lack of base capital from banks and public support measures are to be resolved through:
    - enhanced regulation and supervision; and
    - a restructuring of state-owned banks; they need a "viable and adequately funded" business model.

– **Recommendation 3: Increased labour market participation**
  - In order to further develop human capital, Germany should:
    - ensure more "equitable access" to education and training systems and an easier "transition" between different strands of the school system;
    - a budget-neutral reduction in the tax burden for the low-paid; and
    - increase the number of all-day schools and full-time childcare.

- In taxing couples, the joint income taxation should be replaced by a "system of individual taxation" (p. 4).
  The Council, by contrast, only wishes to monitor the effect of the "recent reforms" to reduce tax obstacles to second earners and, where necessary, take further action.

– **Recommendation 4(a): Implementation of the national energy concept**
  - In order to safeguard economic competitiveness, Germany should:
    - ensure the independence of energy production and transmission;
    - improve cross-border interconnections;
    - improve the "long-term cost-effectiveness" of the German Renewable Energy Act.

– **Recommendation 4(b): Boosting competition in the service sector**
  - Market entry and exit barriers in the service sector are to be reduced, particularly those in free professions and craft trades.
  - In network industries, in particular in the rail sector, there is not enough competition. Germany should:
    - unbundle infrastructure and transport services;
    - abolish cross-subsidisation between network operators and rail service providers;
    - strengthen the supervisory role of the Federal Network Agency; and
    - open the sales and ticket infrastructure of the *Deutsche Bahn* to competitors.

    The Council will not adopt the first two aforementioned recommendations of the Commission.

► **Statement on the updated Stability Programme of Germany, 2011-2014 [SEC(2011) 807; 11391/11]**
The macro-economic scenario of the Stability Programme is generally deemed plausible; however, the long-term availability of public funds is considered average.

Statement on Subsidiarity by the Commission

The Commission does not address the question of subsidiarity.

Policy Context

Progress will be evaluated by the Commission within its next Annual Growth Report and the next country-specific recommendations by the Commission.

Options for Influencing the Political Process

Leading Directorate General: Secretariat General

ASSESSMENT

Economic Impact Assessment

The "European Semester" takes economic policy coordination to the next level. Instead of only setting economic and fiscal policy targets as before, the EU now proposes additional concrete measures to national governments. These action proposals serve to achieve the set targets and, moreover, the EU now monitors the impact such actions have on national budget and structural policies.

Most of the recommendations are appropriate with regard to reducing the indebtedness of Member States and increasing their competitiveness.

In many areas, the growth and employment enhancing effects of the single market have not been able to fully develop as there are still obstacles. Consequently, the integration of the European single market should be promoted. However, it cannot be excluded that the "European Semester" might possibly slow down institutional competition between Member States and merely lead down to mediocrity. Yet these issues are mitigated by the fact that the recommendations are non-binding. Apart from these rather general considerations, the proposed measures are assessed as follows:

<u>Macro-economic stability, in particular budget consolidation:</u> The call for a swift consolidation of national budgets and for the strict observance of agreed deadlines to correct deficits is appropriate. In the course of the financial and economic crisis, public deficits and debts in Member States increased excessively. Nevertheless, **EU policy recommendations regarding budget planning should focus on the compliance with stability criteria rather than abusing national budget planning for EU targets**, such as the strategy "Europe 2020". Mixing economic with fiscal policy recommendations, such as the protection of certain budget items, makes it more difficult to enforce stability criteria and therefore is to be rejected.

The statutorily required annual **reduction of the structural deficit** by 0.5% of GDP (Art. 3 (4) VO 1467/97) **in many countries does not suffice to ensure a sustainable financing of state budgets** in the medium run. The recommendation to Member States **to consolidate budgets to an even greater extent than is statutorily required is therefore appropriate,** also in the case of Member States with a relatively low deficit, such as Germany.

To correct macro-economic imbalances, which are reflected in the different degree of competitiveness among Member States, those euro states with a structural current account deficit must improve their competitiveness through cuts in real wages and increased production. An equal pace for all Member States as propagated by the Commission does not suffice. The state debt crisis has clearly shown that macro-economic imbalances, in particular in the form of current account imbalances, are not sustainable in the long run and jeopardise the stability of the euro zone. Therefore, even states with current account surpluses need reforms. Germany, for instance, should indeed improve its investment conditions by further opening the service sector and network industries as well as ensuring the federal states' compliance with the debt brake.

Reforming labour markets: The recommendations regarding the labour market are appropriate in order to reduce unemployment, but in parts they lack substantiation.

Not valid is the recommendation that Germany **abolish the joint income taxation for married couples,** according to which couples are taxed jointly, in favour of an individual taxation so as to make labour more attractive to second earners. Here, the Commission **ignores the fact that the point of the joint income taxation of spouses is to ensure neutrality when it comes to deciding whether to raise a family or follow gainful employment**. Tax splitting eases the tax burden of couples compared to that of individual taxation. Income losses caused by taking over family duties are partially compensated for. The splitting tariff can lead to a higher individual tax rate for the second earner, but **the couple as an economic entity benefits from it**.

In order to really make labour more attractive to second earners, childcare facilities must be improved. For a parent's decision to follow gainful employment often fails due to lacking childcare facilities or inflexible working hours, but not due to their taxation. Flexible working hours, however, are subject to tight limits due to business needs.

Enhancing growth: **The proposals to improve the network structure in energy and transport are indispensable to complete the single market**.

Improvements in cross-border interconnections in the energy sector and the independence of energy production and transmission, as recommended to Germany, are key prerequisites for a competition-oriented implementation of the single energy market and for the infrastructure keeping pace with the politically driven development of renewable energies. Abolishing cross-subsidisation between network operators and rail service providers would stop the rather questionable option of assigning railway operation costs to infrastructure in order to increase network access costs, and would thus make it more difficult for competitors to enter the market.

The call to improve risk capital provision to "innovative companies" and SMEs is appropriate, for risk capital is indispensable to finance far-reaching innovation and therefore a precondition for high economic growth.

Harmful to growth, however, **is the** Commission's **call to use investments in public procurement "strategically"**. Obviously, this means that public procurement should be used as a means to expedite the development and introduction of selected technologies and as a lever for innovation, environmental protection or employment. Investment decisions should be left to the companies' own discretion, as they can best foresee future trends; thus the chances and risks remain in one hand. Any **exertion of influence through policy increases the risk of** sub-optimal investments being made and **resources being steered towards areas where they create inefficient productivity**. Moreover, this also entails the danger of free-rider effects.

Legal Assessment

Legislative Competency

The EU is entitled to recommend non-binding "guidelines" to Member States, to monitor their compliance and express warnings and country-specific recommendations (Art. 121 TFEU – Economic Policy Guidelines). Moreover, it is entitled to coordinate and monitor the budgetary discipline of the euro states in particular (Art. 136 TFEU – functioning of the economic and monetary union).

Subsidiarity

The coordination of economic policies in euro states at EU level is appropriate. For with the single currency, exchange rate adjustments – in reaction to macro-economic developments – are cancelled, with the result that the economic policy of a Member State has a real economic impact on another Member State.

Conclusion

Most of the recommendations are suitable for reducing the indebtedness of Member States and increasing their competitiveness. However, they should remain focused on the compliance with stability criteria and not use national budget planning as a means to implement EU targets. The proposals regarding the development of network infrastructures in energy and transport are indispensable for the completion of the single market. The call for an "individual" taxation of married couples ignores the fact that the aim of joint taxation is to create a neutrality when it comes to deciding whether to raise a family or follow gainful employment. A "strategic" use of public procurement is harmful to economic growth and entails the danger that resources are deployed inefficiently.