Assessing the autumn package of the 2019-2020 European Semester

This note suggests how to assess three of the documents that will be included in the Autumn Package of the European Semester 2019/20 to be adopted mid-December 2019 by the European Commission: the Annual Economic Review, the Recommendation on economic policy in the Euro area and the Alert mechanism on macroeconomic imbalances.

The Annual Growth Review

In its 2018/19 version the Annual Growth Review consists of three parts: an analysis of economic developments, the identification and the framing of the main challenges, and the selection of the “right priorities”. The 2018/19 version, like previous versions, focused on a strategy to enhance productivity and competitiveness. Integrating Sustainable Development Goals (SDGs) in the 2019/20 edition will require a substantial change of the narrative. Renaming the document to flag this change would give the right signal.

Part 1: Analysis

1. Does the Annual Growth Review (AGR) prioritize sustainability over productivity and competitiveness?
2. Which SDGs are prioritized and how are they linked to the economic performance?
3. Does the AGR include an analysis of changing physical conditions based on indicators of frequency of weather-related natural catastrophes, rising sea levels, drought etc. and of the possible impact on economic activities and revenues of various actors?
4. Does the AGR include an evaluation of potential benefits of reduced carbon energy production (e.g. on public health through reduced air pollution)?
5. Does the AGR include an analysis of the expected impact of Climate Change (CC) and other environmental issues on the main trade partners of the EU?

Part 2: Key challenges

6. Does the AGR present alternative long-term growth scenarios compatible with the 2030 climate targets, bringing together Investment/Growth/Change in energy efficiency/Share of non-carbon/renewable energy? Does it include any other form of forward-looking analysis related to the challenge posed to the economy by climate change or other environmental deterioration?

7. Does the AGR elaborate on the impact of the energy transition on certain sectors or regions?

8. How does the AGR frame the issue of sustainable use of resources?

9. Does the AGR refer to challenges raised under other European governance frameworks (in particular, Energy and climate governance)?

Part 3: Setting the right priorities

In the 18/19 edition of the AGR this part 3 is divided into 1) Investment 2) Structural reforms 3) Fiscal policy and financial stability.

10. Does the AGR refer to the investment gap required for the energy/ecological transition?

11. In key sectors relevant for the energy transition (building, transport, renewable), does the AGR refer to the need to strengthen public policies combining regulation, taxation, subsidies, professional training…with higher public investments?

12. Does the AGR point on the need to strengthen administrative and jurisdictional capacities to address environmental issues, especially CC?

13. While assessing the orientation of fiscal policy, does the AGR take account of the historically low interest rates, the accumulated gap in public investment and other productive expenditures, the long-term costs of not acting immediately on CC and other environmental challenges?

14. While assessing financial stability does the AGR include considerations on CC risks (physical, costs of transition, stranded assets and liabilities)?

Recommendations on the economic policy of the Euro area

Until now, recommendations for the Eurozone aimed at enhancing growth prospects and financial stability. They have not addressed ecological sustainability of economic activities. While public finance and regulation of the banking and financial sector have been prominent, the scope of policies under review has been nevertheless wider and covered those structural reforms deemed most relevant to augment productivity.

While short and formulated in general terms, the recommendations are important because they already set the framework for the country-specific recommendations to be adopted at the end of the Semester (in spring). Recommendations may concern the national or the European levels.

Questions

1. Do the recommendations look at the issues at stake not only through a productivity and stability lens, but also through an ecological sustainability lens?

2. Do the recommendations refer to other European governance frameworks (in particular, Energy and climate governance)?

3. How far do the recommendations take account of the recent criticisms of the fiscal rules by the European Fiscal Board, in particular on the lack of effectiveness for strengthening the quality of public expenditures?

4. Besides the size of public debt and deficit, do the recommendations take account of accumulated and rising investment gaps for meeting environmental goals?

5. Do the recommendations refer to needs assessments for public expenditures linked to policies addressing CC (for example, as included in the National Energy and Climate Plans)? Do the recommendations point to the need to reinforce planning and implementing administrative capacities for public policies and expenditures to address ecological goals, notably climate change mitigation and adaptation?

6. What conclusions do the recommendations draw from near zero or negative interest rates while high social return investments need to be financed, in particular to address CC?

7. Do the recommendations make a reference to the use of fiscal policy instruments pursuing a socially and politically suitable energy transition?

8. Do the recommendations hint at the need of a coordination of carbon pricing among Member States with the aim of putting carbon prices on trajectories compatible with the CC goals?

9. Do the recommendations refer to the need to restructure public subsidies away from carbon to renewable sources, in particular to reduce and eliminate coal subsidies?

10. Do the recommendations suggest reforms aiming at reorienting financial flows and banking activities to support the energy transition, and more generally activities favorable to the environment?

11. Do the recommendations address the issue of how to overcome short termism on financial markets? Do the recommendations point to the fact that national public banks like European ones need to play an active role in de-risking and enabling long term investments, compensating for market failures in the areas of energy efficiency and renewable energy as well as in other environmentally relevant areas?

Alert mechanism on macroeconomic imbalances

The identification of macroeconomic imbalances is an important part of the autumn package as it may trigger in-depth analysis and specific recommendations to Member States. The relevant regulation (1176/2011) defines macroeconomic imbalances as "macroeconomic developments which are adversely affecting, or have the potential adversely to affect, the proper functioning of the economy of a Member State or of the economic and monetary union, or of the Union as a whole." Imbalances are identified on the basis of core indicators compared to benchmarks. The core indicators include indicators of exchange rate, price and labor cost, of financial debt and assets as well as unemployment. In addition, several so called auxiliary indicators are taken into consideration.

We argue that macroeconomic imbalances reviewed under this mechanism should also include environmental indicators. Insufficient efforts by economic policies to protect the environment, in particular the climate, will result in a deterioration of the physical and biophysical conditions of economic activities and consequently adversely affect the proper functioning of the economy of the Union. Furthermore, economic policies are decisive to trigger the ecological transformation of the economy. We suggest to include as core indicators an index of average carbon pricing in each country (for example, as calculated by OECD) compared to a benchmark, e.g. 30€ the ton of CO_2, the level of emission of greenhouse-gas compared to the trajectory required to meet EU agreed objectives in 2030 and the change of energy efficiency of the economy compared to the trend required for meeting 2030 EU targets. Significant or year by year repeated deviation from the benchmark should trigger an in depth country analysis to identify economic and fiscal policies having the potential to correct these imbalances.

Questions

1. Does the Alert Mechanism include core indicators of imbalances related to climate change as well as auxiliary indicators related to SDGs?

2. How did the review of these indicators impact the final risk analysis for the European economy as a whole and for each Member State?