# REFORM DELIVERY TOOL

cep**PolicyBrief** No. 2019-03



## KEY ISSUES

**Objective of the Regulation:** A reform delivery tool aims to reward Member States with € 22 billion for making structural reforms.

**Affected parties:** Member States, EU economies

**Pro:** (1) The Tool may facilitate the implementation of minor structural reforms considered necessary but too burdensome.

(2) The risk that Member States might propose reforms which they intend to implement anyway, is reduced by the fact that only reforms identified by the EU will receive support.

**Contra:** (1) At € 22 billion, the volume is not large enough to trigger major reforms.

(2) The obligatory consultative collaboration of all Member States or the Economic Policy Committee in the Council (EPC) is desirable in order to limit the Commission's margin of discretion.

The most important passages in the text are indicated by a line in the margin.

## CONTENT

### Title

**Proposal COM(2018) 391** of 31 May 2018 for a **Regulation** of the European Parliament and the Council **on the establishment of the Reform Support Programme**

### Brief Summary

Note: Unless otherwise indicated, articles and page numbers refer to the proposal.

- **Context and objectives**
  - By way of structural reforms – e.g. reforms of the product, service and labour markets – economies adapt to changes in economic conditions. Structural reforms (hereinafter "reforms") have an impact – inter alia – on the competitiveness of economies and their resilience to economic "shocks", e.g. the bursting of a property bubble.
  - Since the economies of the EU are closely interconnected, Member States should coordinate their economic policies, including their structural reforms.
  - This will ensure that, when designing their economic policies, they take account of the impact on other Member States and on the stability of the EU as a whole (Art. 120, 121 TFEU).
  - This coordination takes place within the framework of the "European Semester" (see cep**PolicyBrief**). In the European Semester, the EU identifies economic and social problems in the Member States and makes recommendations for reform. However, Member States often fail to implement these recommendations for reform due to political and social costs arising in the short term [Memorandum, p. 1].
  - In order to increase the willingness of Member States to implement these recommended reforms, the Commission wants to build on the "Reform Support Programme" with a budget line of € 25 billion, for the period 2021–2027 [Memorandum, p. 2-4, 10 et seq.]. The Reform Support Programme contains [Art. 3 and 7 (2)]
    - a "reform delivery tool" with a volume of € 22 billion (hereinafter "Tool") [this **cepPolicyBrief**],
    - a "technical support instrument" with a volume of € 0.84 billion and a "convergence facility" with a volume of € 2.16 billion [see cep**PolicyBrief** 17/2018].
- **Main features of the Tool: supported reforms, allocation timetable and form of contribution**
  - The Tool rewards a Member State with money (hereinafter "award") as soon as the State has implemented previously agreed reforms. Only reforms that deal with the problems identified during the European Semester will be rewarded [Art. 11 (7), Art. 15 (4)].
  - Each Member State has the right to claim a fixed quota of the € 22 billion available under the Tool. The quotas are based on each Member State's proportion of the EU population [Art. 9, Annex I]. The quota is reserved for the Member State as soon as it has agreed on reform commitments with the Commission (hereinafter "allocation").
  - Allocations take place in three "phases" (Art. 10):
    - Phase 1: For 20 months after entry into force of the Regulation, the Commission makes € 11 billion available and calls on the Member States to submit reform proposals [Art. 10 (2)]. Each Member State may request from the Commission the allocation of its quota of this € 11 billion for the implementation of reforms [Art. 10 (1)].
    - Phase 2: Following the expiry of the first phase, the Commission makes a further € 11 billion available and calls on the Member States to submit further reform proposals [Art. 10 (3)]. A Member State may again request the Commission to allocate its quota of this € 11 billion for the implementation of reforms [Art. 10 (1)].

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  - Phase 3: The Commission determines the end of the second phase. Thereafter, the funds that have not been allocated to any Member State in phases 1 and 2 are made available by the Commission to all Member States [Art. 10 (4)]. Each Member State may request the allocation of an amount that corresponds to its fixed quota in phases 1 or 2. Where the funds, made available by the Commission, are no longer sufficient to cover all the allocations at this stage, each Member State's quota of these funds will be reduced proportionally by the same percentage [Art. 10 (5)].
- The Commission allocates the quotas to Member States irrespective of the costs of the reforms [Art. 15 (1) and (4); Art. 125 (1) (a) Financial Regulation (EU, Euratom) 1046/2018].
- The Tool involves a 5-step procedure.

► **Step 1: Proposal by a Member State**
- A Member State submits a "proposal for reform commitments" (hereinafter "proposal") to the Commission and thereby requests the allocation of its quota [Art. 11 (1)].
- The proposal contains [Art. 11 (1) and (3)]
  - detailed information on the implementation of reforms, in particular
    - milestones and targets to be achieved over a maximum period of three years,
    - internal arrangements for implementation of the reforms, e.g. sufficient staffing,
    - possible "investment costs related to the reforms" and
  - a set of reasons indicating in particular:
    - the importance of the reforms in view of the problems identified in the European Semester and
    - the economic and social impacts in the Member State itself and in other Member States.
- The Commission
  - must assist the Member State in drafting its proposal [Art. 11 (5)] and
  - may call on other Member States to share best practice with that Member State [Art. 11 (4)].

► **Step 2: Assessment by the Commission**
- The Commission assesses the proposal in how far it [Art. 11 (7), Annex II No. 3]
  - addresses the problems identified in the European Semester,
  - comprehensively addresses "interrelated and crucial" problems,
  - increases the Member State's economic performance and resilience to shocks,
  - will make a lasting impact by way of a sustainable change in policies and the way they are administered,
  - ensures implementation within three years by way of internal arrangements.
- Thus, an assessment will be made of the extent to which a proposal meets these criteria, using a rating system from A to C, where A indicates a high level and C a low level of compliance with a criterion [Annex II No. 3].
- The Economic Policy Committee within the Council (EPC) may give an opinion on the proposal [Art. 11 (9)]. This committee comprises of delegates from the Member States, the Commission and the European Central Bank.

► **Step 3: Decision of the Commission**
- Within four months of submission of the proposal, the Commission will adopt a decision specifying the reform commitments, the Commission's assessment of them and the award allocation [Art. 12 (1)].
- The assessment classifies the reform commitments as follows [Art. 12 (2), Annex II No. 4]:
  - As "major" if the final assessment scores "A" for all criteria, or a majority of A's over B's and no C's; the Member State will then be allocated its full award;
  - As "significant" if the assessment scores "B" for all criteria, or a majority of B's over A's and no C's; the Member State will then be allocated half of the full award;
  - As "insufficient" if the assessment contains at least one "C"; there will then be no allocation.

► **Step 4: Implementation**
- The Member State reports on the implementation of its reform commitments in the European Semester [Art. 14].
- Where reform commitments can no longer be implemented due to "objective circumstances" [Art. 13],
  - the Member State may request – once only – an amendment of its reform commitments and
  - based on this request, the Commission may amend its decision within four months.

► **Step 5: Payment and monitoring**
- Where reform commitments have been met, the Member State submits a request to the Commission for payment of its award; within two months, the Commission assesses whether the milestones and targets have been implemented [Art. 15].
  - In the case of a positive outcome, the Commission pays the award in one instalment [Art. 12 (3), 15 (4)].
  - Where milestones and targets have not been satisfactorily met, the Commission must [Art. 15 (5)]
    - suspend payment of the award, in whole or in part, and allow the Member State to present its observations and
    - lift the suspension once the necessary steps have been taken to implement the commitments or
    - cancel the award if no measures are taken within six months of the suspension.

– A Member State must repay its award to the Commission if – within five years after payment of the award – the steps that resulted in compliance with reform commitments [Art. 16 (1) and (2)] are reversed or significantly modified by other measures.

## Statement on Subsidiarity by the Commission

The Commission has expertise and country-specific knowledge about the structural reforms required in Member States and is therefore "best placed" to identify, together with the Member State concerned, which reforms should be carried out.

## Policy Context

Following the 2015 "Five President's Report" on Economic and Monetary Union (EMU), the "Commission's Reflection Paper on deepening the EMU" proposed offering incentives to Member States to carry out reforms. In 2017, the Commission submitted a pilot project for a reform delivery tool [see cep**PolicyBrief** No. 2018-08] together with a Communication on completing the EMU.

## Legislative Procedure

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| 31 May 2018 | Adoption by the Commission |
| Open | Adoption by the European Parliament and the Council, publication in the Official Journal of the European Union, entry into force |

## Options for Influencing the Political Process

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| Directorates General: | Secretariat General |
| Committees of the European Parliament: | Budgets, Economic and Monetary Affairs (leading), Rapporteurs: Eider Gardiazabal Rubial (S&D, Spain), Caroline Nagtegaal (ALDE, Netherlands) |
| Federal Ministries: | Finance Ministry |
| Committees of the German Bundestag: | Budget (leading) |
| Decision-making mode in the Council: | Qualified majority (acceptance by 55% of Member States which make up 65% of the EU population) |

## Formalities

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| Competence: | Art. 175 (3) TFEU (specific actions on cohesion policy) |
| Form of legislative competence: | Art. 4 (2) TFEU (shared competence) |
| Procedure: | Art. 294 TFEU (ordinary legislative procedure) |

# ASSESSMENT

## Economic Assessment

The governments of the Member States should have an interest in the implementation of reforms because reforms increase competitiveness and gross domestic product. Nevertheless, governments frequently refrain from comprehensive reforms as these often lead to disadvantages for some groups of voters which turn them against their governments. In addition, electoral terms are not generally aligned with the time it takes for the benefit of reforms to become evident.

Since the economies of the EU are so closely interconnected, failure to make reforms in one Member State can have a negative impact on other Member States. This applies in particular to the eurozone countries. If capital markets lose confidence in the solvency of a eurozone country due to a failure to make reforms, it could jeopardise the stability of the whole currency union. Support for reforms is therefore in the interest of the EU as a whole, and the eurozone in particular. Eurozone countries are however at odds about which reforms should be implemented in which country. Disunity exists in particular on the issue of how to remove current account imbalances in the eurozone. Countries with a current account deficit want countries with current account surpluses to reduce these, whereas the latter want the former to implement reforms to increase their competitiveness.

**The Tool** proposed by the Commission **may facilitate the implementation of minor reforms which are seen** by some Member States **as necessary but too burdensome**. **At € 22 billion, the volume** of the Tool is **not large enough to trigger major reforms**, which are likely to reduce the current account imbalances in the eurozone, because the financial incentives are too small.

The Commission's proposal to allocate the funds in fixed quotas is appropriate. Such allocation does carry the risk that support will be given to reforms in a Member State that have little positive impact on other Member States, e.g. because the Member State is very small. However, allocation of quotas based solely on the positive impact of a reform – and therefore not involving a fixed quota for each Member State – could make large Member States, in particular, delay reforms until their impact is large enough to ensure they receive an award. In addition, fixed quotas also prevent the actual amount of the award being determined in non-transparent negotiations with the Commission.

It is appropriate to allocate the quotas irrespective of the costs of a specific reform because these costs cannot be accurately determined in advance resulting in additional discussions between Member States and the Commission.

**The requirement that the procedure must be initiated by a Member State emphasises**, on the one hand, **national responsibility for the reforms.** On the other hand, there is **the risk that Member States might propose reforms which they would have implemented anyway.** However, this risk **is reduced by the fact that only reforms addressing challenges identified in the European Semester are eligible**. It should also be taken into account that the implementation rate of reforms recommended in the European Semester is currently very low. This risk is further limited since the Commission assists the Member States in making their proposals as well as assessing the proposals and monitoring compliance with the milestones, targets and timetables.

**Payment of the award in a one instalment following implementation of the reforms,** on the one hand **increases the likelihood that the reforms will actually be completed**. On the other hand, it reduces the incentive to use the Tool because there is a possibility that the reward will be paid out when a new government has taken office.

## Legal Assessment

### Legislative Competency

In order to strengthen economic, social and territorial cohesion within the EU [Art. 174 TFEU], the EU can create specific funding instruments outside the regulatory scope of the existing funds [Art. 175 (3) TFEU]. The Tool can be adopted on this legal basis, as long as the supported reforms promote cohesion [Art. 120, 121 (1) TFEU, Art. 3 (3) TEU].

### Subsidiarity

Unproblematic as Member States cannot create a common Tool that encourages reforms across the EU. Since reform commitments are prepared in close cooperation with the Commission and possibly other Member States, such coordinated action may make reforms by Member States more effective. The Commission's claim, however, that it is "best placed" to identify, together with the Member State concerned, which reforms should be carried out, is unconvincing.

### Proportionality with respect to Member States

Every Member State is free to decide whether to commit to reforms; so the Tool as such does not intervene in the Member States' institutional responsibility for their national economic policy [Art. 120 TFEU]. Nevertheless, **the Commission should refrain from overextending its** designated **powers by specifying,** or attempting to specify, **the details of the reforms** because the EU is only permitted to formulate guidelines on economic policy (Art. 121 (2) TFEU]. The Commission must allow Member States scope for discretion regarding the design of reforms, in other words their economic policies.

### Compatibility with EU Law in other respects

It is unclear how and by what methodology the criteria, such as "increasing economic performance", will be applied by the Commission when assessing reform commitments. The Commission enjoys a wide margin of discretion, which may give rise to legal uncertainty [Art. 2 TEU], but given the complexity and the range of possible reforms, more precise rules are virtually impossible to draft. Therefore, **in order to reduce the Commission's margin of discretion, the obligatory consultative involvement of all Member States**, and potentially of their independent economic advisory bodies, **or of the EPC,** in the Commission's assessment and decision, **is desirable.** This would also help to develop a transparent, predictable and consensual assessment methodology that would promote legal certainty.

## Conclusion

Although the Tool may facilitate the implementation of minor reforms that are considered necessary but too burdensome, at € 22 billion, the volume is not large enough to trigger major reforms. The requirement that the procedure must be initiated by a Member State emphasises the national responsibility for reforms. The risk that Member States might propose reforms which they would have implemented anyway, is reduced by the fact that only reforms identified previously in the European Semester, are eligible. Payment of the award in one instalment following implementation of the reforms increases the likelihood that the reforms will actually be completed. The Commission should refrain from overextending its powers by specifying the details of the reforms. An obligatory consultative collaboration of all Member States or the EPC is desirable in order to limit the Commission's margin of discretion.