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# Instrument for convergence and competitiveness

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The eurozone countries have agreed to create an "instrument for convergence and competitiveness": Eurozone countries that implement structural reforms will receive money that they must use for investment by way of co-financing. An overall annual volume of € 2.4 billion is under discussion. This cepInput evaluates the instrument as follows:

- No eurozone country will carry out reforms which contradict its economic policy ideas simply to obtain money from the instrument, especially since the volume to be allocated to all countries is very small.
- The strong position of the Heads of State and Government of the eurozone countries, when it comes to the choice of reforms and investments that are eligible for support, is problematic. There is a danger that only those reforms and investments will be chosen that the eurozone countries would in any case carry out.
- The instrument threatens to overload an already excessively complex European Semester through which the EU states are to coordinate their economic and fiscal policy.

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# 1 Political context

On 22 June 2015, the then five Presidents of the EU – Jean-Claude Juncker (President of the European Commission), Donald Tusk (President of the European Council), Jeroen Dijsselbloem (President of the Eurogroup), Mario Draghi (President of the European Central Bank) and Martin Schulz (President of the European Parliament) – presented proposals on how the Economic and Monetary Union (EMU) could be completed.[1] Four years later, on 12 June 2019, the EU Commission published a Communication[2] in which it takes stock of the situation: It states therein that "the political will to complete the EMU (…) has slowed against the backdrop of a more favourable economic context"[3] so that "important gaps remain in the architecture of the EMU"[4]. These gaps essentially result from the fact that the Member States could not agree on how to close them. The Commission is therefore calling on the EU Heads of State and Government to make progress on these proposals in the short term.[5]

In particular, the Commission has called on the Member States to "reach an agreement on the main features of the Budgetary Instrument for Convergence and Competitiveness"[6] (hereinafter: BICC) and "to agree on its size in the context of the Multiannual Financial Framework".[7] The Member States responded to this appeal and, four months later, on 9 October 2019, agreed on the main principles of the BICC.[8] The following Chapter 2 presents these principles. They will then be assessed in Chapter 3.

# 2 Instrument for convergence and competitiveness

The BICC will contribute to economic convergence and to strengthening competitiveness, particularly[9] in the eurozone, by promoting structural reforms and public investment.[10] Specifically, BICC provides that eurozone countries that implement structural reforms will receive money which they must use for investments by way of co-financing.[11] This will increase potential growth and boost the resilience

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1 Cf. Five Presidents' Report (2015): Completing Europe's Economic and Monetary Union, online at: ec.europa.eu/commission/publications/five-presidents-report-completing-europes-economic-and-monetary-union_en

2 Communication COM(2019) 279.

3 Communication COM(2019) 279, p. 2.

4 Communication COM(2019) 279, p. 2.

5 Cf. Communication COM(2019) 279, p. 11.

6 Communication COM(2019) 279, p. 11.

7 Communication COM(2019) 279, p. 12.

8 Cf. Centeno M. (2019): Remarks by Mário Centeno following the Eurogroup meeting of 9 October 2019, online at: https://www.consilium.europa.eu/de/press/press-releases/2019/10/10/remarks-by-mario-centeno-following-the-eurogroup-meeting-of-13-september-2019/.

9 Officially, BICC also applies to Member States that have not introduced the euro but participate in Exchange Rate Mechanism II. Currently this is only Denmark. Since the instrument is thus primarily aimed at eurozone countries, only they will be considered herein.

10 Term sheet on the budgetary instrument for convergence and competitiveness (BICC) of 10 October 2019, online at: https://www.consilium.europa.eu/en/press/press-releases/2019/10/10/term-sheet-on-the-budgetary-instrument-for-convergence-and-competitiveness-bicc/.

11 BICC thus contains elements of the contractual partnerships proposed by German Chancellor Angela Merkel in 2012.

and adaptability of the eurozone countries.[12] A separate budgetary instrument will be created for the other Member States.

It is still unclear how much money the BICC will be endowed with. A budget of € 17 billion for the period 2021 to 2027 is currently under discussion.[13] The BICC would thus have approx. € 2.4 billion per year to support reforms and investments. The final BICC budget is to be defined within the framework of the negotiations on the next Multiannual Financial Framework 2021-2027.

Although the final BICC budget has not yet been fixed, the Member States have already agreed on how to allocate the money.[14] Thus at least 80% of the budget will be allocated by the EU Commission according to a key which takes account of both the population and the per-capita GDP of the eurozone countries, whereby countries with a lower GDP per capita will receive more money than those with a high GDP per capita. The exact weighting is not yet clear but all eurozone countries will get back at least 70% of the money that they paid in. Up to 20% of the available funds can be used by the Commission for particularly ambitious reform and investment packages with no additional requirements. In all cases, co-financing of 25% by the respective Member State is envisaged, which may be reduced to 12.5% in the event of severe economic circumstances in a Member State.[15]

Member States have also broadly decided on how BICC will be managed. It is proposed that "strategic reform and investment priorities" will be defined at the beginning of each year at a meeting of the eurozone Heads of State and Government. It can be assumed that each eurozone country will then receive a recommendation with country-specific guidelines containing a list of reforms and investments that could be supported by BICC.[16] Thereafter, eurozone countries can submit their reform and investment proposals to the EU Commission. Each eurozone country is to submit both reform and investment proposals, a so-called "reform and investment package". The packages will also contain an implementation plan for the reforms consisting of interim and final targets, a cost estimate for the reforms and investments as well as an explanation of the costs. The level of financial support that each eurozone country can receive from BICC depends on these costs. The Commission evaluates the packages, in conjunction with the Eurogroup. If the assessment is positive, the Commission will accept the package.

If the package is accepted, the eurozone countries must keep the Commission and the other Member States informed of the progress made in implementing the reforms and investments, during the European Semester through which the EU states coordinate their economic and fiscal policy. The Commission evaluates the progress. It will also be discussed in the Eurogroup. Money is paid out in tranches by the EU Commission. A tranche will be paid out when an interim or final target has been reached. If a Member State fails to reach the interim or final targets, the money will not be paid out.

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[12] Cf. Centeno, M. (2019): Summing-up letter, Eurogroup in inclusive format 9 October 2019, online at: https://www.consilium.europa.eu/media/41173/summing-up-letter-eg-9-october-2019.pdf.

[13] Cf. European Council (2019); Explainer on the euro area budgetary instrument, online at: https://www.consilium.europa.eu/en/policies/emu-deepening/bicc-faq/.

[14] Cf. Centeno, M. (2019): Summing-up letter, Eurogroup in inclusive format 9 October 2019, online at: https://www.consilium.europa.eu/media/41173/summing-up-letter-eg-9-october-2019.pdf

[15] Cf. Centeno, M. (2019): Remarks by Mário Centeno following the Eurogroup meeting of 9 October 2019, online at: https://www.consilium.europa.eu/de/press/press-releases/2019/10/10/remarks-by-mario-centeno-following-the-eurogroup-meeting-of-13-september-2019/.

[16] Cf. COM(2019) 354, p. 6

## 3 Assessment of the BICC

Basically, it is the task of the individual eurozone countries to carry out necessary reforms and to finance appropriate investments. The eurozone countries are, however, so closely interwoven that a crisis in one eurozone country can also have an adverse effect on the other eurozone countries. The occurrence of such a crisis is not beyond the bounds of possibility. Italy, in particular, is faced with major fiscal and economic policy challenges.[17] The example of Italy clearly shows that, as yet, neither economic nor fiscal coordination between eurozone countries is working. Effective coordination is, however, necessary to enable coherent development of the eurozone countries. That is the only way to avoid crises in the eurozone.

The reason why the coordination of economic and fiscal policy is not working is that there is a lack of consensus between the eurozone countries as to how convergence between them can be achieved. The ideas about "appropriate" economic and fiscal policy are too diverse. Thus, for example, numerous eurozone countries are calling on Germany to take measures to reduce its current account surpluses. Germany, however, considers it to be the eurozone countries with a current account deficit who are obliged to take action. It is a similar situation with fiscal requirements: some eurozone countries are calling for a more expansive fiscal stance from Germany in order to increase domestic consumption and inflation in the eurozone. Germany, on the other hand, wants eurozone countries with an expansive fiscal stance to take austerity measures in order to avoid jeopardising fiscal stability. Consequently, the economic and fiscal policy recommendations, that the EU Commission makes every year to the Member States, frequently contradict the Member States' ideas on economic and fiscal policy. As a result, the recommendations are not implemented.

The BICC will not solve this fundamental problem. No Member State will carry out a reform that is contradictory to its ideas on economic policy simply to obtain money from the BICC. In the best-case scenario, the BICC results in a eurozone country carrying out reforms which, although considered to be appropriate in principle by the population, give rise to significant opposition from individual groups. The BICC money could help to overcome this opposition. BICC's annual budget, currently under discussion, of just € 2.4 billion, which also has to be allocated to all eurozone countries, makes this unlikely, however.

Irrespective of this fundamental problem: the obligation to use the money from the BICC for investment is appropriate because many reforms, such as labour market reform, only give rise to a low level of direct costs. Refunding these would not be sufficient to overcome any potential opposition in the country. It is also appropriate that every eurozone country gets back at least 70% of the money that it has paid in because all eurozone countries should contribute to economic and fiscal convergence of the eurozone by way of reforms. This makes it possible. The strong position of the Heads of State and Government of the eurozone countries, when it comes to the choice of reforms and investments that are eligible for support, is problematic in this regard. There is a danger here that only those reforms and investments will be chosen that the eurozone countries would in any case carry out.

Finally, the BICC threatens to overload an already excessively complex European Semester. In particular, care must be taken to ensure that the country-specific guidelines given to eurozone

[17] Cf. Gasparotti (2019): Addressing the Italian malaise, online at: https://www.cep.eu/en/eu-topics/details/cep/addressing-the-italian-malaise.html

countries in the framework of BICC are in line with the country-specific recommendations that are currently already sent each year to the Member States.

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