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MACROECONOMIC INSTABILITY IN THE MEMBER STATES OF THE EUROPEAN UNION AND ITS REFLECTION BY COHESION POLICY

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Abstract

One of the main tasks of the economic policy of the European Union is to help solve the macroeconomic imbalances in the member countries. A sophisticated system of economic governance makes it possible to prevent imbalances, monitor them and formulate the necessary economic policy recommendations. The main objective of the article is to analyze the current situation in member economies in 2024 (on the example of the Czechia). It also notes whether the current policy of economic, social and territorial cohesion reflects the needs of EU countries from the point of view of re-establishing macroeconomic balance. The method used is description and reasoning. The contribution of the article is to draw attention to the situation of the Czech economy in the European context.

Keywords

Economic Governance, European Semester, Macroeconomic Imbalances, Macroeconomic Stability, Productivity, Environmental Sustainability, Fairness

I. Introduction

The role of the European Union as an actor in international political economy has considerably increased in recent decades (Lütz, 2021). To the outside world, the EU keeps repeating that peace and stability are possible only where there are well-governed democratic states. Writing a scientific article about macroeconomic instability in the EU member states and about the European Semester is important for several reasons.

First, it is a contribution to the academic community. The European Semester is a complex and multifaceted process that involves various stakeholders, institutions, and policies. A scientific article can contribute to the existing knowledge and understanding of this process, providing insights that can be used by researchers, policymakers, and practitioners.

The European Semester is a crucial mechanism for implementing EU economic policies, such as the European Pillar of Social Rights, the European Union's 2030 Strategy, and the EU's economic governance framework. A scientific article can analyze how these policies are implemented and evaluated at the national level, identifying best practices and areas for improvement. Identification of possibilities and opportunities is also a benefit. The European Semester is not without its challenges, such as the need for increased coordination among member states, the complexity of the process, and the limited resources available to implement reforms. A scientific article can identify these challenges and opportunities for improvement, providing recommendations for policymakers and stakeholders.

This research also supports evidence-based policy making. A scientific article can provide an evidence-based analysis of the effectiveness of the European Semester, helping to inform policy decisions and ensuring that they are based on empirical research rather than anecdotal evidence.

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To write a scientific article about the European Semester, you can apply the following methods:

- Literature review: Conduct a comprehensive review of existing literature on the European Semester, including academic articles, policy documents, and official reports.
- Case studies: Choose a specific country or sector to analyze in-depth, examining how the European Semester has been implemented and evaluated at the national level.
- Comparative analysis: Compare the experiences of different countries or sectors, identifying best practices and areas for improvement.
- Quantitative analysis: Use quantitative data to analyze the impact of the European Semester on economic indicators such as GDP growth, unemployment rates, or public debt.
- Qualitative analysis: Conduct interviews or focus groups with stakeholders involved in the European Semester process to gather insights into their experiences and perceptions.
- Theoretical framework: Use a theoretical framework to analyze the European Semester, such as institutionalism, neofunctionalism, or governance theory.
- Methodology: Use a mixed-methods approach that combines qualitative and quantitative data to provide a comprehensive understanding of the European Semester.

By applying these methods, you can write a high-quality scientific article that contributes to our understanding of the European Semester and its impact on EU economic policies. We will try to do it at least partially. The main objective of this article is to analyze the current situation in member economies in 2024 (on the example of the Czechia).

II. Why Does the EU Evaluate the Macroeconomic Situation of Member Countries?

In recent years, the EU and its member states have become more geo-economic in the way they act internationally (Youngs, 2021). To achieve success on a global scale, the European Union (EU) needs to regularly evaluate the macroeconomic situation of its member countries through a system of collective measurement of macroeconomic stability and development. This activity has several reasons:

- Macroeconomic stability: the EU understands macroeconomic stability as a key factor for citizens' well-being, employment, economic growth and financial stability. Therefore, it focuses on monitoring and analyzing macroeconomic factors such as inflation, unemployment, public finance deficit and others.
- Risk sharing: the EU identifies macroeconomic risks that may threaten the stability of financial systems and monetary policy in member countries. By sharing information and analyzing these risks, the EU can help member countries take preventive steps and reduce the economic consequences of negative events.
- Economic growth: The EU focuses on supporting the economic growth of member countries through the single monetary policy (ERM II) and other instruments such as structural funds or the European Union Investment Fund (EIF). Analysis of the macroeconomic situation helps to identify areas where support is needed to stimulate economic growth.
- Monetary stability: the EU understands monetary stability as essential for the integration process of member countries and for the functionality of the euro single currency. Therefore, it focuses on monitoring the monetary policy of member countries and identifying risks that may threaten monetary stability.
- Compliance with the rules: The EU has set rules for fiscal policy and monetary policy that apply to all member states. Analysis of the macroeconomic situation helps to ensure that Member States follow these rules and do not exceed fiscal or monetary constraints.

The EU uses several tools to monitor the macroeconomic situation of member countries, including analyzes of economic indicators (for example GDP, inflation, unemployment), monitoring of fiscal and monetary indicators (for example public deficit, credit limits), analytical studies on the macroeconomic situation and outlook, discussion process with member states.

Overall, it can be said that evaluating the macroeconomic situation of member countries is key to the functioning of the European Union as a whole and to the promotion of economic growth and stability within it.

The revised legislation (European Parliament, 2024) reforming the EU economic governance framework came into force on 30 April 2024. The reform addresses the shortcomings of the previous framework, making it simpler, more transparent and effective, with greater national ownership and better enforcement. The reformed framework aims to strengthen debt sustainability through gradual fiscal consolidation while safeguarding public investment. It promotes sustainable and inclusive growth in all Member States through reforms and investments, including in strategic areas such as the green and digital transition, social and economic resilience and the implementation of the European Pillar of Social Rights, energy security and the build-up of defence capabilities. The reformed framework will be fully embedded within the European Semester.

At the heart of the new framework, Member States are expected to prepare medium-term fiscal-structural plans, in which they will set out their expenditure paths and their priority reforms and investments for the coming four years. The credibility of the new framework will be underpinned by the association of national parliaments and other national stakeholders, including independent fiscal institutions and social partners, in particular when preparing the plans. This process should strengthen national ownership by providing Member States with greater leeway in designing their fiscal adjustment paths, and setting out reform and investment commitments, in line with the common priorities of the EU and necessary investments in European public goods.

The entry into force of this legislation marks the end of the economic governance review, which the Commission launched in February 2020. On 26 April 2023, the Commission came forward with legislative proposals (European Commission, 2023).

III. European Union Cohesion Policy Tools to Establish Macroeconomic Stability in Member Countries

The cohesion policy of the European Union (EU) can contribute to the establishment of macroeconomic stability in member countries through several traditional tools. Especially with the use of structural funds: The European Regional Development Fund (ERDF) and the Cohesion Fund provide financial support to regions and countries with lower GDP per capita, enabling them to invest in infrastructure, human capital, and research and innovation. This can help reduce regional disparities and promote economic growth, which is essential for macroeconomic stability. Investments in human capital are also important. Investing in education, training, and labor market policies, cohesion policy can help improve the skills and employability of the workforce, increasing their adaptability to changing economic conditions and reducing labor market imbalances. Cohesion policy also enables the development of infrastructure. The construction of roads, railways, ports, and other infrastructure projects financed by cohesion policy can improve connectivity, reduce transportation costs, and increase trade volumes, which can contribute to economic growth and stability. Cohesion policy can promote regional competitiveness by supporting research and innovation projects, entrepreneurship initiatives, and the development of clusters and innovation hubs.

The European Agricultural Fund for Rural Development (EAFRD) supports rural areas by promoting sustainable agriculture, forestry, and rural development. This can lead to increased food security, reduced poverty, and more stable rural communities.

In addition to the mentioned financial instruments, others are also available.: The European Investment Bank (EIB) and other financial institutions can provide loans and guarantees to support investments in key sectors such as energy, transportation, and healthcare, which can help stabilize the economy. The EU's macroeconomic surveillance framework helps monitor member states' economic performance and identify potential risks to macroeconomic stability. This enables the EU to provide early warnings and policy recommendations to member states. The EU's State aid framework ensures that public support to companies is granted in a way that promotes competition and does not distort the internal market. This helps maintain macroeconomic stability by preventing excessive state intervention in the economy. The EU's tax policy coordination helps maintain a stable tax environment across member states, reducing the risk of tax competition and ensuring a level playing field for businesses.

It can therefore be concluded that the European semester process brings together the EU's economic governance framework with cohesion policy. It ensures that member states' economic policies are aligned with EU priorities and promotes coordination among member states. By using these tools, the cohesion policy of the EU can contribute to establishing macroeconomic stability in member countries by promoting economic growth, reducing regional disparities, and ensuring a stable business environment. The new temporary Recovery and Resilience Facility is a key element of the NextGenerationEU plan, which will provide €800 billion (in current prices) to support investment and reform across the EU. Through the Recovery and Resilience Instrument, the Commission raises funds by borrowing on capital markets (issuing bonds on behalf of the EU). It then makes these funds available to Member States, which enable them to implement ambitious reforms and investments to ensure that their economy and society in general are more sustainable, resilient and ready for an ecological and digital transformation in line with EU priorities, and to address the issues listed in recommendations for individual countries within the European Semester for the coordination of economic and social policies.

The Recovery and Resilience Instrument also plays an important role in the implementation of the REPowerEU plan, through which the Commission responds to the socio-economic difficulties and disruption of the global energy market caused by the Russian invasion of Ukraine.

Since joining the European Union, the Czech economy has proven that the EU's cohesion policy has contributed to the elimination of disparities to a large extent. Czechia's economic growth rate was higher in regions that received more EU funding (around 3.5 %) compared to those that received less funding (around 2.5 %). Czechia has made significant progress in reducing regional disparities with the difference in GDP per capita between the richest and poorest regions falling from 30 % in 2000 to around 15 % in 2019. The EU funds were used to finance important infrastructure projects, such as the expansion of the Prague airport, the modernization of highways and the development of public transport systems. These investments had a positive impact on economic growth and employment. EU funds have also been used to support social programs such as education, healthcare and housing initiatives. A study by the Czech Statistical Office found that these programs have a positive effect on reducing poverty and social exclusion (Czech Statistical Office, 2024). It has been proven that Czechia is generally efficient in using EU funds, with an average spending rate of around 90 %. However, there were some problems with delays in project implementation and reporting of irregularities.

IV. Macroeconomic Situation in the EU Countries in Spring 2024

European Semester (European Commission, 2024a) Spring Package provides policy guidance to enhance the EU's competitiveness and resilience and maintain sound public finances.

Over the past five years, the EU has demonstrated a high degree of economic and social resilience in the face of major shocks, thanks in particular to a coordinated policy response (European Parliament, 2024). The EU and its Member States have successfully faced the socio-economic consequences of the COVID-19 pandemic, Russia’s war of aggression against Ukraine and the related energy price

surges and inflation hikes. While the EU's economy posted a strong recovery after the pandemic, the fallout from the energy crisis sparked by Russia's war of aggression led to a marked slowdown in 2023. Growth is expected to pick up gradually over the course of this year and next.

The European Semester for economic and social policy coordination has supported policy responses, aimed at delivering a sustainable recovery and the green and digital transition, while strengthening the resilience of the EU. It identified Member States' specific reform and investment needs, tackling both long-standing and new challenges, and guided their responses to the COVID-19 crisis and the energy supply and price shocks. The country-specific recommendations (CSRs), proposed by the Commission and endorsed by the Council in the context of the European Semester, were the basis for the programming under cohesion policy and for the national recovery and resilience plans (RRPs), including the REPowerEU chapters, which Member States prepared to meet the above-mentioned challenges within the framework of NextGenerationEU.

Furthermore, the Semester remains key for the implementation of the European Pillar of Social Rights and the achievement of the EU 2030 headline targets for jobs, skills and poverty reduction. The European Semester has enabled EU funding instruments to support EU policy objectives in a targeted and efficient way. The ongoing implementation of the Recovery and Resilience Facility (RRF), including the introduction of dedicated REPowerEU chapters in national RRPs, the Technical Support Instrument, and the use of cohesion policy funds, continue to play a pivotal role in shaping reform and investment agendas in all Member States.

As set out in the Annual Sustainable Growth Survey, the 2024 cycle of the European Semester explores complementarities and synergies between different EU funding instruments and Member States' reform and investment actions and takes stock of the ongoing implementation of RRPs and cohesion policy programmes. The RRF has disbursed over EUR 240 billion to Member States in grants and loans so far, representing 37 % of total funds available. Also, over EUR 256 billion has been disbursed under the cohesion policy funds since the beginning of the COVID-19 pandemic (European Commossion, 2024).

As illustrated in this year's country reports, these instruments and other EU funding programs have supported the EU's recovery towards a greener, more digital, fairer and more resilient future through job creation, improved competitiveness, macroeconomic stability and territorial and social cohesion. In addition, this Semester cycle provides guidance in view of the forthcoming mid-term review of cohesion policy programmes. It includes a call to make use of the opportunities provided by the Strategic Technologies for Europe Platform (STEP) initiative to support the development of manufacturing capacities in critical technologies, while promoting a level playing field.

The EU is determined to take further steps to ensure its long-term competitiveness, prosperity and leadership on the global stage and to strengthen its open strategic autonomy. The EU and its Member States have strong assets to build on: highly qualified workers; excellence in research; quality infrastructure; a solid manufacturing base in key sectors; a strong services sector; highly developed social welfare systems and a comprehensive green and digital transition strategy. Additionally, the four freedoms of the single market are a powerful engine for convergence and growth, promoting a highly competitive social market economy, economic, social and territorial cohesion, and a level playing field.

Economic convergence is particularly evident for the thirteen Member States which joined the EU since 2004 and have witnessed an impressive, uninterrupted economic and social catch-up, resilient to the major crises that the EU has weathered. Nonetheless, the EU economy faces challenges to its competitiveness, with low productivity growth, intensified by weak investment dynamics and persistently high labour and skill shortages. There is also ample room for further upward economic and social convergence, both between and within Member States. The EU will continue to address the structural challenges that hamper its competitiveness and resilience. This requires deepening the single market across its four dimensions; well-focused investments at EU, national and regional level; and an ambitious reform agenda. In addition to the analysis provided by the EU

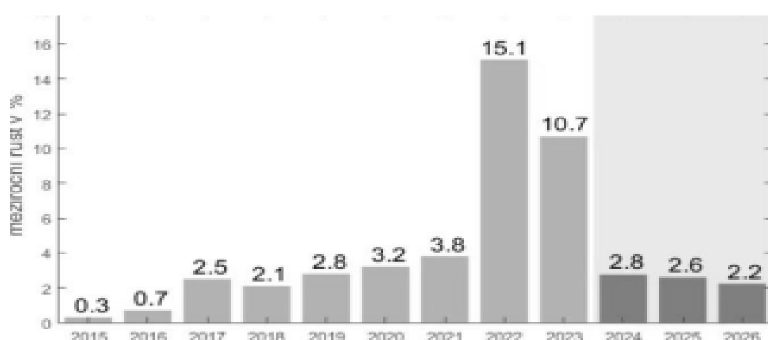
Commission, the high-level report by Enrico Letta lays out concrete proposals to inform the discussion about the future of the single market around key priority areas (European Commission, 2024b). Further guidance will be provided by the high-level report on the EU's competitiveness by Mario Draghi (Eurochambres, 2024).

In this Spring Package (2024), the Commission provides analysis and proposes CSRs to address major bottlenecks and to put in place the right conditions to boost competitiveness, while aligning such actions with the EU's pursuit of the UN's Sustainable Development Goals.

V. Macroeconomic Situation in the Czechia and Recommendation on the Economic, Social, Employment, Structural and Budgetary Policies

The situation in the Czechia worsened year-on-year, mainly due to high inflation and low added value. Within the European Union, the Czech Republic fell to the twenty-third position. Only four EU states exceeded our inflation with their high prices. And although in the second half of 2023 inflation across Europe was again curbed and returned to its original values, the Czech Republic did not succeed quickly enough. Inflation stabilized at the level of the inflation target only at the beginning of 2024 (ČS, 2024).

Figure 1 Inflation in Czechia (CPI, %)



Source: Česká spořitelna (2024)

Figure 2 Forecast for the Czech Economy (%)

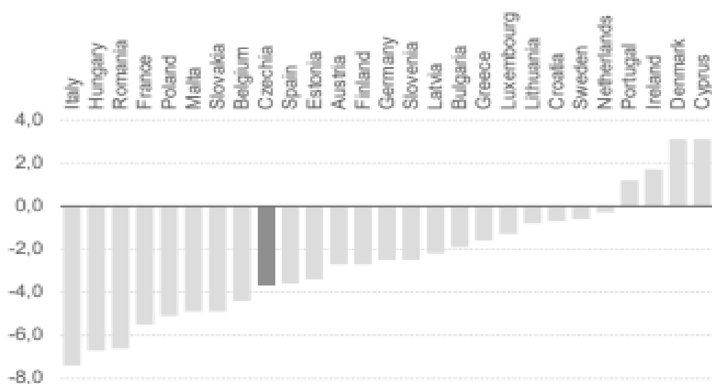
	2022	2023	2024	2025	2026
HDP	2,9	0,0	1,1	3,0	3,0
Celková inflace	15,1	10,7	2,8	2,6	2,2
Míra nezaměstnanosti	2,2	2,6	3,1	3,6	3,8
Nominální mzdy	5,3	7,5	6,6	5,3	4,9
Reálné mzdy	-8,5	-2,9	3,7	2,6	2,6
Hlavní sazba ČNB	5,94	6,99	5,16	3,70	3,08
EUR/CZK	24,6	24,0	24,9	24,5	24,2

Source: Česká spořitelna (2024)

The next fundamental problem of the Czech economy is the low added value that we have been dealing with for a long time, whether we compare it to the total production or in terms of the added value of exports.

On the other hand, the Czech economy can be positively evaluated in terms of its diversification, thanks to which we have the third highest economic complexity in the EU. Also the situation in public debt can also be considered as still satisfactory. However, an increase from 37.7 % to 44.2 % in relation to GDP was recorded during the last three years.

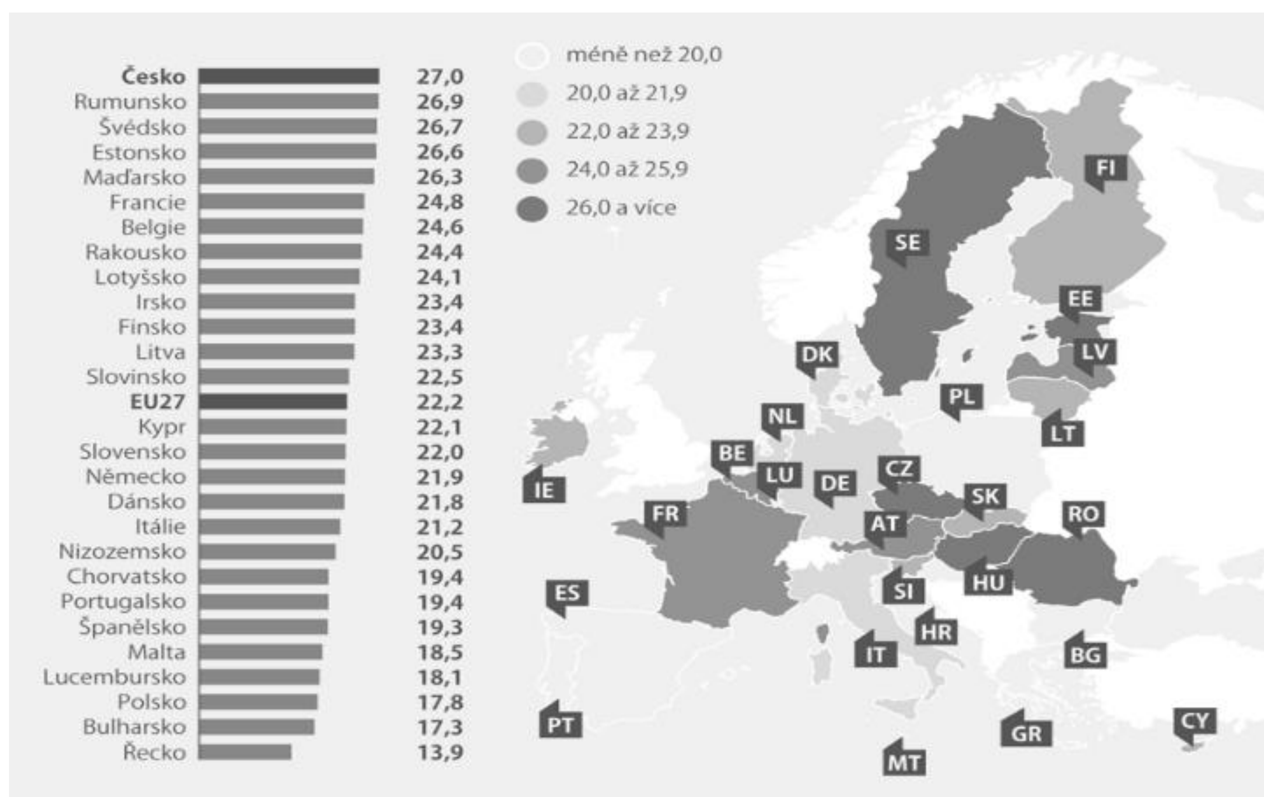
Figure 3 Government Balance (% GDP, 2023)



Source: Česká spořitelna (2024)

In terms of investment growth, the Czechia is one of the countries that record above-average investment activity within the EU. In 2023, investments increased by 4 %. The share of expenditure on the creation of gross fixed capital to GDP then reached 27 %, which is the highest within the EU. From the point of view of the composition of investment activity, it is evident that in the industrially oriented Czech Republic above average investments are made mainly in machinery and equipment.

Figure 4 Share of Expenditure on Gross Fixed Capital Formation in GDP in the EU Countries (%, 2023)



Source: Czech Statistical Office (2024)

Czechia was therefore recommended (European Commission, 2024c) to take the action in 2024 and 2025 to:

- submit the medium-term fiscal-structural plan in a timely manner. In line with the requirements of the reformed Stability and Growth Pact, limit the growth in net expenditure in 2025 to a rate consistent with maintaining the general government deficit below the 3 % of GDP Treaty reference value and keeping the general government debt at a prudent

level over the medium term. Take measures to ensure the long-term fiscal sustainability of the pension system. Lower tax and benefit disincentives for parents to return to work to promote higher female labour market participation. Improve incentives for people close to retirement to continue working. Take steps to increase revenue from recurrent property taxes.

- strengthen administrative capacity to manage the recovery and resilience plan, accelerate investments and maintain momentum in the implementation of reforms. Address emerging delays to allow for continued, swift and effective implementation of the recovery and resilience plan, including the REPowerEU chapter, ensuring completion of reforms and investments by August 2026. Accelerate the implementation of cohesion policy programmes. In the context of their mid-term review, continue focusing on the agreed priorities, taking action to better mobilise private sector resources, including through the use of innovative financial instruments, while considering the opportunities provided by the Strategic Technologies for Europe Platform initiative to improve competitiveness.
- strengthen the capacity of Czechia's public administration to attract, retain and develop talent, particularly those with analytical, managerial and IT skills. Reduce departmentalism and strengthen strategic steering capacities to improve consistency across policies. Support cooperation among municipal administrations, including by providing support for administrative capacity building targeted to structurally affected regions.
- boost innovation by improving technology transfer from academia to businesses, supporting the creation of spin-offs and start-ups, and increasing participation in tertiary education. Strengthen the competitiveness of the economy by addressing skills mismatches, simplifying the recognition of foreign qualifications, and by increasing the labour market participation of underrepresented groups.

VI. Conclusion

Achieving an environment that leads to sustainable convergence in the Czech Republic requires a targeted economic policy, including structural reforms aimed at ensuring macroeconomic stability (ECB, 2024). The Czech Republic faces the challenge of how to strengthen its potential for economic growth and increased productivity. Persistent inefficiencies in the business environment and growing labour shortages weigh on potential growth. Further efforts are also needed to remove unnecessary restrictions on doing business and new firms entering the market. Moreover, skill mismatches in the labour market need to be addressed by improving vocational education and training, and by removing impediments to flexible working arrangements. Owing to adverse demographic trends, employment creation will also require larger labour market participation of under-represented groups, especially young people, which is lagging significantly behind the EU average. Against this background, it will be important to ensure an efficient and effective absorption of the EU funds allocated to the country. With regard to macroeconomic imbalances, the European Commission did not select the Czech Republic for an in-depth review in its Alert Mechanism Report 2024.

At the same time, the intended goal was fulfilled and it was confirmed that the improved system of economic governance meets the current needs and is in compliance with the priorities of the new EU Commission.

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