STRATEGY FOCUS

European Elections 2024 – Could they be a real game changer?

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The economic growth gap between the United States and the euro area has been reported in detail. And, while it is true that activity in the US is expected to be much stronger than in the euro area in 2024 (2.7% versus 0.8% according to the IMF), it is worth putting this into perspective. On the one hand, a significant proportion of this gap can be explained by demographics – population growth in the US is more than twice that of the euro area (0.5% versus 0.2%). The growth gap per capita therefore is less significant, albeit still large (2.2% versus 0.6%). Also, the euro area economy, which already suffered more from the Covid pandemic, has had to deal with a surge in gas prices following the invasion of Ukraine by Russia – a shock that has not been as severe in the US. When we take these two effects into account, the economic situation in the euro area does not seem quite so bad.

The core of the problem relates more to the medium- to long-term outlook, what economists refer to as potential growth, than to the short-term outlook. Low population growth combined with weak productivity gains are keeping growth at a slow pace in the euro area, in contrast with the US. These issues will obviously be central to the European Parliament elections being held between 6 and 9 June: how to bolster medium-term growth and at the same time meet climate and demographic challenges without putting public finances sustainability at risk.

Often overlooked or played down, these elections will be important for the European Union (EU) given the many heated issues that will require action by the new Parliament and the resulting new European Commission.

In this document, we look firstly at the importance of the European Parliament, the balance of powers between the different political groups, and what the polls say. The latter are less reliable for these elections than for national elections due to a lack of voter interest. Nonetheless, they do provide some pointers: a swing to the right by the Parliament seems very likely, with a fresh rise in extremes, but the outgoing coalition (centre right, centre left and liberals) is expected to maintain a majority (if smaller).

Then we look at the economic challenges awaiting the new Parliament (weak productivity in particular) and draw up a (non-exhaustive) list of projects that will be on the Parliament and the Commission's agenda (overhaul of the single market, completion of the European architecture, strategic autonomy, etc.).

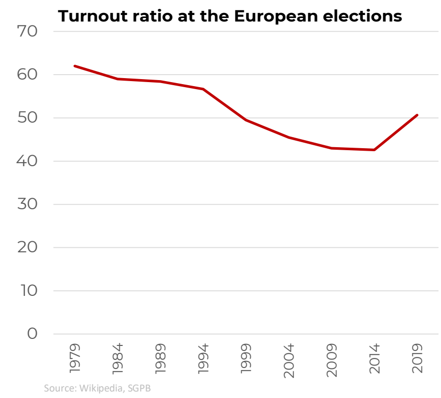
A Parliament with broader powers but suffering from a democratic deficit

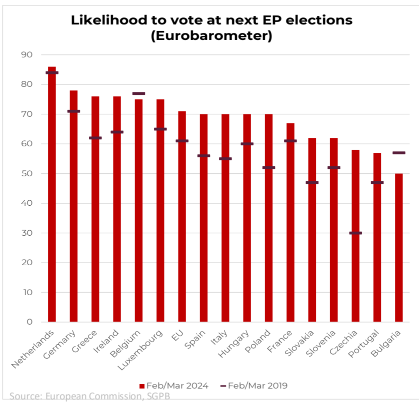
Elections that rally little interest. Every five years, the citizens of the EU's 27 member countries (this is the first without the UK) elect EU parliamentary members. This year, the elections will be held from 6 to 9 June, during which 720 candidates will be elected on a proportional basis for all countries through one round of voting.

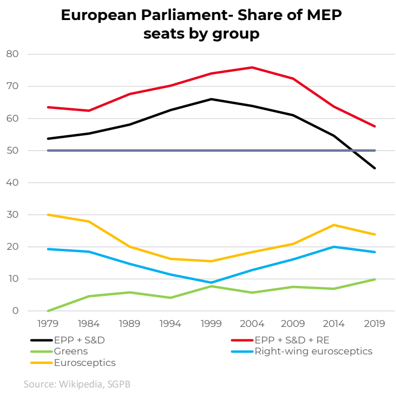
The participation rate for these elections is usually low: 62% for the first election in 1979 and 50.7% in 2019, with the lowest level of 42.7% seen in 2014 (see chart below) – a strong evidence of a democratic deficit (whether perceived or real) in the European institutions. With Europe facing many challenges (geopolitical if not military, demographic, ecological, etc.) and the EU having played a major role during the last term (Covid, vaccines, NGEU, war in Ukraine, etc.), the turnout could rise again. The Eurobarometer, the EU official public opinion survey, which was recently published by the Commission, suggests this may be the case: the share of citizens who say they will probably vote has increased from 61% before the 2019 elections to 71% recently. What's more, the intention to vote has increased in 21 of the 27 EU countries.

A different balance of powers within the Parliament. Reflecting national situations, the balance of power within the European Parliament has changed. It has for a long time been dominated by two major political groups: the centre-right EPP and the centre-left S&D Group. Up until 2019, these two groups together held a majority in the Parliament and alternated the holding of key positions including the Commission presidency. However, their position has weakened over time, with their combined share falling from more than 60% after the fall of the Berlin wall to 54% in 2014. To hold on to a majority in 2019 they had to form a triparty alliance with the Renew Europe group and enter into ad-hoc agreements with other groups, like the Greens.

Eurosceptical and anti-establishment parties have gained ground and seats in recent elections. Up until now, however, their blocking power has been limited, mainly coming into play if the main political forces did not agree. Moreover, these parties are fragmented (between extreme left, extreme right and eurosceptical) and disagree on key topics such as immigration, Russia and the European budget.







An election that is more important than it may seem. Despite citizens' lack of interest, the European Parliament is the only European Union institution that is democratically elected. While initially it played more of a consultative role, the Parliament has increasingly gained in political power. Today it is a co-legislator, adopting the European budget and laws jointly with the Council of the European Union (EU Head of States). It also elects and controls (and may remove) the European Commission. The laws adopted by the European Parliament are transposed into national law. As such, a majority (80% according to the report from former Italian PM Enrico Letta) of member states' laws come from decisions taken by the European Union.

In recent years, in fact, the Parliament has played a key role in decision-making and in shaping various major European projects, such as the Next Generation EU (NGEU) economic recovery plan, the European Green Deal and the Brexit negotiations.

The European Commission, a key institution controlled by the Parliament. One of the European Parliament's greatest powers is its capacity to elect and control the European Commission.

- The President is selected by qualified majority by the Heads of State but must obtain an absolute majority within the European Parliament. The European Commissioners (one per country) are nominated by the member states in consultation with the Commission President. They are then subject to hearings at the European Parliament after which the latter votes to approve the entire Commission. To date, the Parliament has never rejected the presidential candidate, or the Commission, proposed by the Heads of State. Nonetheless, the ability to do so gives the Parliament real influence in the selection of the Commissioners. It has happened in the past that certain candidates decided to withdraw from the selection process following a negative opinion by the Parliament in order to avoid the Parliament rejecting the Commission as a whole.
- The Commission is accountable to the Parliament, which has the right to adopt a motion of censure against it (based on a two thirds majority). Such a motion has never been successful but in 1998 the Santer Commission was forced to resign after losing its absolute majority in the Parliament.

Thus, the European Parliament holds real power over the European Commission. The Commission, for its part, is an important EU institution, responsible for overseeing European interests and proposing new European projects. The Commission also negotiates free trade deals on behalf of member states (one of the few EU exclusive competences). These agreements must then be adopted by the European Parliament and each member state parliament.

The last Commission was instrumental in the EU adopting increased interventionism, for example its negotiation of the price and organisation of delivery of vaccines against Covid, implementation of the recovery plan, all of which under the meticulous and almost permanent control of the Parliament.

What do the polls say? Should we believe them?

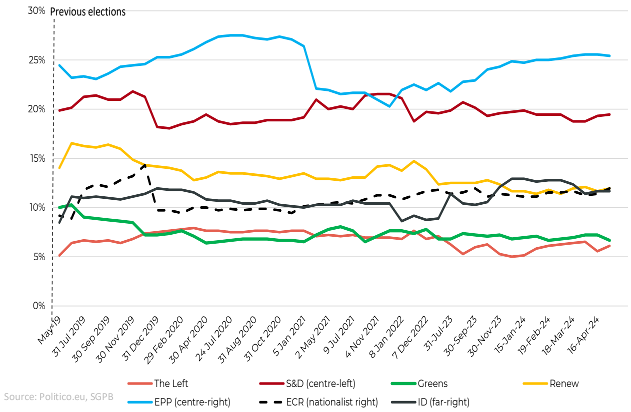
Voters are more undecided than in national elections. Opinion polls are a representation of public opinion at a given time, and not a prediction. An additional factor seems to be affecting the European elections: the lack of voters' interest means many will make up their mind at the last minute. Previous elections have seen parties make gains in the final weeks before election day or fare much better than anticipated.

But polls are the only tool at our disposal for gauging the balance of power to come, the best option is to apply a sufficiently large margin of error to take these uncertainties into account.

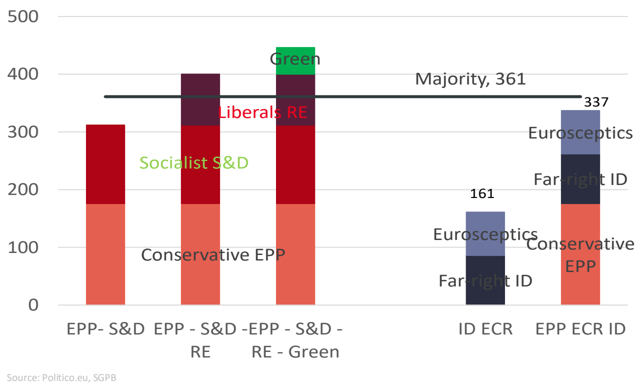
A Parliament that is expected to remain fragmented. The current majority is made up of the centre-right EPP, the centre-left S&D and the Renew Europe group with nearly 60% of seats. The anti-establishment parties, ID (extreme right) and ECR (anti-federalist right), represent 18% of seats; the left-wing parties and greens hold 5% and 10% of seats respectively.

This fragmentation is expected to continue after the current elections. In fact, according to the polls, Renew Europe (-2% of seats) and the greens (-3%) should be the main losers at the benefit of the Eurosceptic and right-wing anti-establishment parties, ID and ECR (+3% each). These elections therefore are expected to cause a swing to the right for the Parliament.

European elections opinion polls (% of seats)



European Parliaments - Different possible coalitions (number of seats)



No major change in the balance of power likely. According to these polls, and with a substantial margin of error, the EPP-S&D-RE coalition should keep a majority, but it will be nearly twice as small as before. This means greater compromise which could lead to increased paralysis or political stalemate.

The right-wing anti-establishment parties are set to increase from 18% to 23% or from 23% to 27% if we add in the left-wing Eurosceptic parties. Their blocking power will therefore be strengthened but it will remain marginal, i.e. solely in the event of disagreement among the more mainstream parties. Moreover, the majority of these parties have mitigated their Eurosceptic stance since while they oppose greater integration, they have dropped calls to leave the EU (with a few exceptions).

Given the expected shift to the right after these elections, an alliance between the conservative right-wing parties (EPP) and Eurosceptic and far-right parties has frequently been mooted. However, not only does it seem unlikely that such a coalition could obtain a majority but it would seem difficult from a political perspective insofar as it would involve, among other things, an alliance between the German conservative CDU/CSU and the extreme-right AfD.

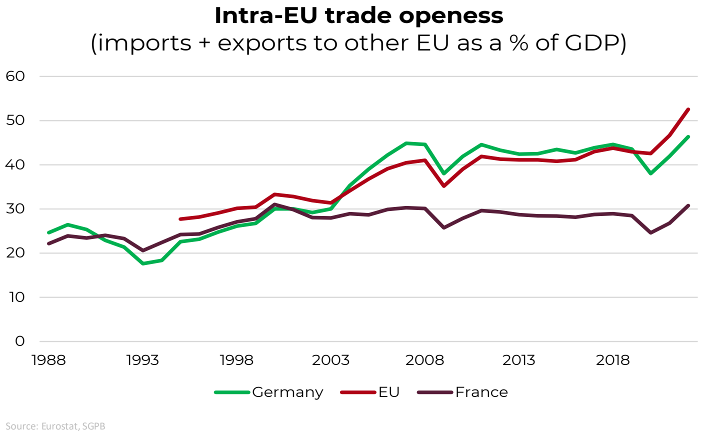
Moreover, the EPP and the Eurosceptic parties disagree fundamentally about the future of the EU (the EPP being pro-European and non-federalist and the Eurosceptics being nationalist). Even between the Eurosceptic parties themselves, significant differences exist concerning Russia (Hungary vs. Poland), immigration (Hungary vs. Italy) and even budgetary rules (Netherlands or Finland vs. Italy).

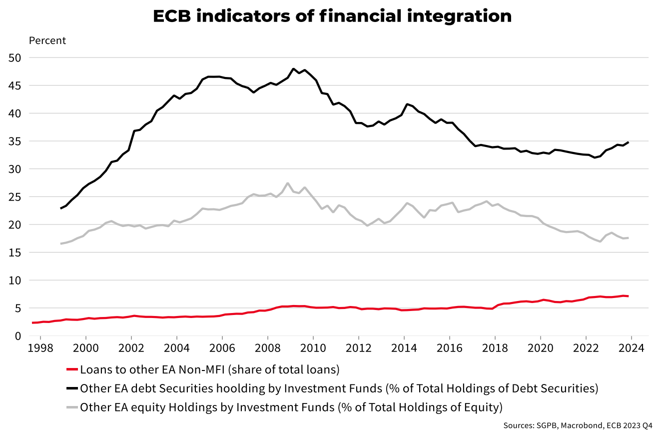
Economic challenges at stakes

Economic growth in the EU is the main struggle. Since the creation of the European Coal and Steel Community in 1951, and then the Treaty of Rome and the European Economic Community in 1957, the European project has evolved continually through deeper cooperation (with the single market and the single currency in particular) and enlargement (from six to 27 members).

The single market was pioneered by Jacques Delors in 1985. Its aim was to strengthen economic ties between the member countries and bolster their development through the free movement of goods, services, capital and people. Stronger economic ties were largely achieved: the share of intra-European trade in the EU GDP has almost doubled since 1993 (at close to 50%), with a large increase in Germany in particular.

The free movement of people was launched with the establishment of the Schengen Agreement in 1995. The free movement of capital is more remote: for example, savings continue for the most part to be placed in the country of origin and pan-European banks are virtually non-existent. EU integration in this sector has yet to be achieved, which is the main purpose of the Capital Markets Union, a project launched in 2014 but still in its early stages.

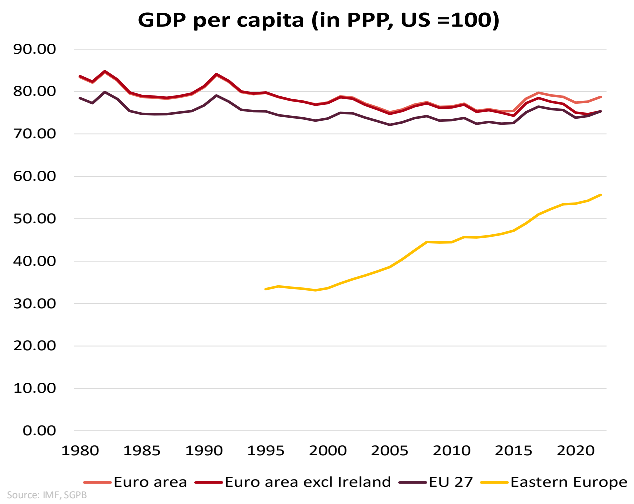


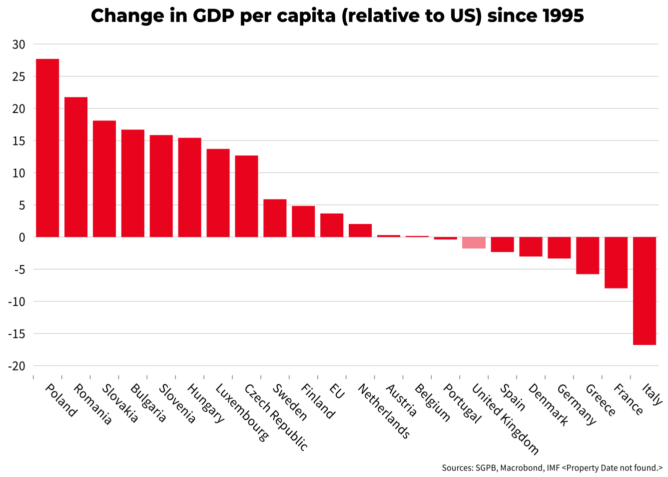


Lack of convergence. The second objective of the single market, to bolster development, has been a more tempered affair. Euro area GDP per capita (relative to the US) has fallen noticeably, by more than 4 percentage points since 1980 (by 8 percentage points if we exclude Ireland for which the significant weight of multinational companies distorts the GDP figures).

At the same time, the process of economic convergence (within the EU) has enabled Eastern European countries that joined the EU in 2004 to see a sharp increase in their standard of living. Although among those countries, some have fared better than others: the Baltic countries, the Czech Republic, Hungary and Poland have seen a sharp increase in their GDP per inhabitant while Bulgaria and Romania lag behind.

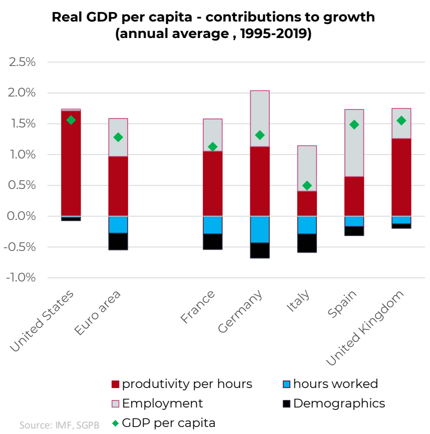
Significant differences are also visible between the euro area countries: there has been little improvement in Spain or Portugal since 1995 while France and Italy have seen their GDP per capita fall (particularly since the financial crisis). Greece, for its part, has seen a sharp fall in its GDP per capita since 2008, shedding 25 percentage points due to the measures implemented in 2010. These differences between its member countries show that the EU is not the only reason for the continent's economic underperformance: national economic policies are also a factor.

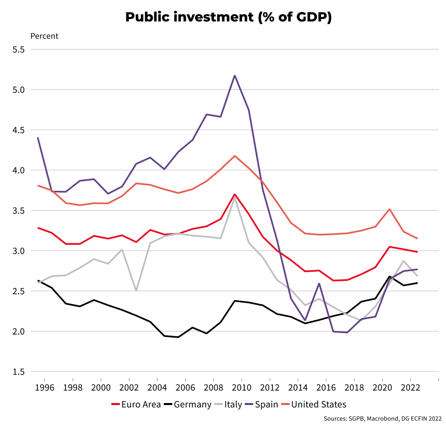


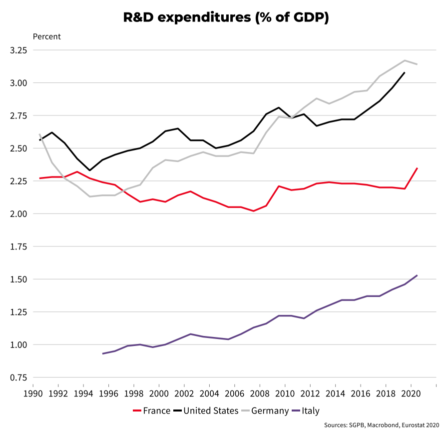


Small gains in productivity. The main reason for this underperformance in relation to the United States is weak productivity gains. Between 1995 and 2019, euro area GDP growth per head averaged 1.3% a year compared with 1.6% for the United States. The bulk of this gap stems from lower productivity gains (1% a year compared with 1.6% in the United States). This weak productivity is particularly evident in Italy, especially during the noughties. In France and Germany, it has been particularly evident in the recent period (2022-23).

While part of this weak productivity in Europe remains unexplained, several reasons can be identified: many years of underinvestment in the public (and private) sector, structurally low expenditure on research and development and misallocation of private savings.



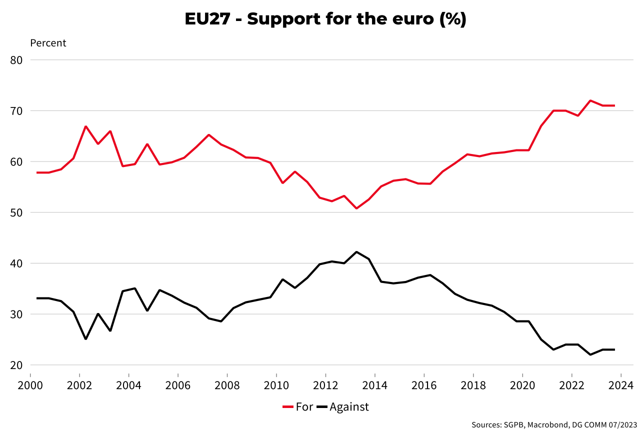


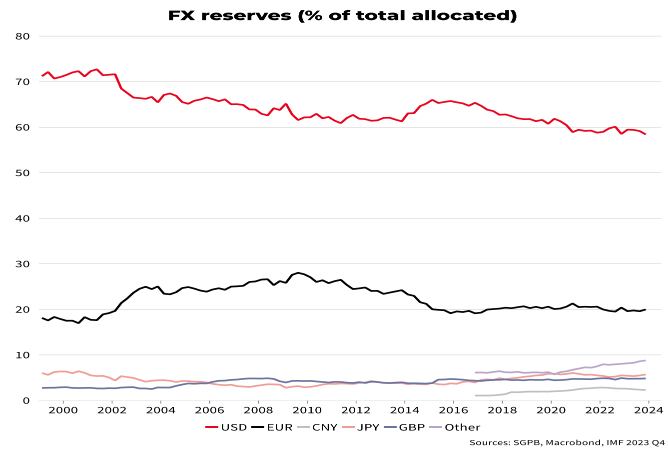


New-found confidence in the euro. During the years following the financial crisis, the very survival of the euro seemed to be at risk, whether during the sovereign debt crisis in 2011-12 or the Greek crisis in 2015. Increased intervention by the European Central Bank was needed ("whatever it takes" speech by the then President Mario Draghi) along with emergency measures at the EU and national levels.

Several years later, and particularly since the Covid crisis, confidence in the euro shows a strong recovery. This is particularly the case for European citizens, whose support for the euro has rebounded to more than 70% versus a low of around 50% in 2014 (see chart below).

Confidence in the single currency can also be measured by the share of the euro in allocated currency reserves. Here, the situation is more tempered: the euro has never regained the record share of 28% of currency reserves seen in 2008. It has nevertheless stabilised at a high level of 20% and remains by far the second most important currency internationally after the US dollar.



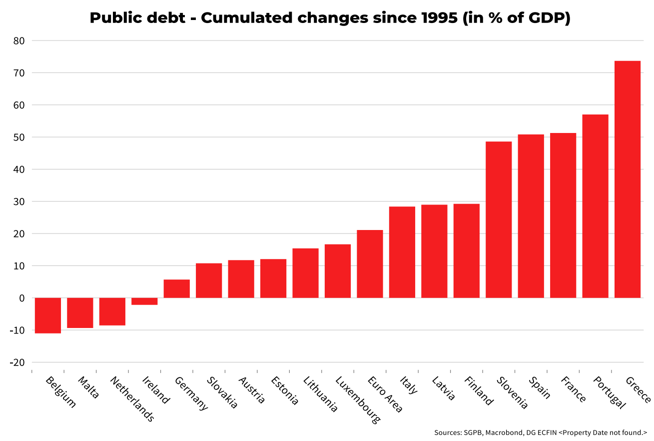


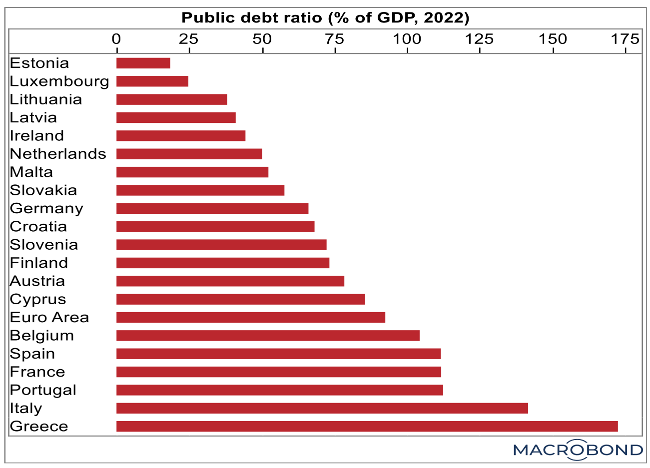
But the euro is suffering from its original sin. That said, the euro continues to suffer from one major drawback: unlike monetary union, the countries of the EU have not yet figured out how to implement its corollary, budgetary union. This has three main consequences:

- Firstly, **economic policy in the euro area is imbalanced**: while monetary policy applies to the entire euro area, budgetary policy is a national affair and depends on the state of local public finances, thus potentially limiting harmonisation and therefore efficiency of economic policy.
- Next, the lack of budgetary union also signifies a **lack of centralised fiscal** (or federal) **capacity** and thus a lack of redistribution between member states. The European budget remains too small (around 1% of GDP). The NGEU recovery plan adopted in 2021 contains a redistributive component but it is of an exceptional and one-off nature.
- Due to the lack of budgetary union, there are no **risk-free European assets** that can be backed by the euro, thus limiting the potential for using the euro in international trade.

In this context, and despite the successive reforms of the Stability and Growth Pact, the public finances of the member states have evolved differently. Since the creation of the euro, the ratio of public debt to GDP has increased significantly in Greece, Portugal, France, Italy and Spain while it has fallen in Belgium, the Netherlands and Ireland and has remained almost stable in Germany.

Thus, instead of convergence – one of the stated objectives of the EU – we have seen a divergence of public finances. The EU in itself cannot be considered solely responsible for this situation but it remains nevertheless one of its major failures.





SOCIETE GENERALE
Private Banking

The next Parliament's agenda

Reform the single market. The new Parliament and the new Commission will have to tackle the aforementioned economic difficulties, especially if the anti-establishment parties make gains as predicted in the polls. To resolve the issue of the fall in relative living standards, an overhaul of the fundamentals of the single market is already under discussion (particularly in light of the recent report by Enrico Letta (here) and the forthcoming report from Mario Draghi). This will undoubtedly involve a modification of the rules of competition to allow the creation of European champions, but also tax harmonisation, SMEs and innovation incentive measures, and less economic openness internationally.

Achieving greater budgetary integration – in terms of the convergence of national policies or budgetary union – will also be one of the biggest challenges for the next Commission. It must, on the one hand, implement and ensure compliance with the new budgetary rules arising from the reform adopted by European heads of state at the end of 2023 and by the Parliament a few weeks ago. The Commission's first decision after the European elections could be to place several countries, including France and Italy, under fiscal surveillance (excessive deficit procedure) from June.

After that, it may begin negotiating new EU budgetary means with the member states and the Parliament to deal with future challenges. The first among these potentially being the NGEU recovery plan which expires at the end of 2026. Several countries will undoubtedly seek to maintain (or at least extend) it in order to continue benefiting from budgetary support, particularly given the deterioration in local public finances (see our previous text on public finances).

Next, when the Commission presented the Green Deal in 2019, it mentioned a requirement of around EUR 1,000 billion. Thus far, a total of only around EUR 300 billion has been allocated to combating climate change in Europe.

Finally, fresh expenditure will have to be committed, potentially at European level, for military purposes, in relation to strategic autonomy and for the new competition policy.

Finalisation of the Banking Union. Although not widely known, this project is no less important than monetary or budgetary union. The Banking Union hinges on three pillars. The first (banking supervision) has been completed, and the ECB is now the oversight body for most financial institutions in the euro area. The second (resolution mechanism) is in the process of finalisation. The third (European deposit guarantee mechanism) lays dormant, with member states opposed to the different options put forward for implementing it. Without this third pillar, the risk is high of a negative feedback loop between banks and states, i.e. between the states that guarantee the deposits placed within national banks and these banks which hold their countries' sovereign bonds. This remains a risk for financial stability in the euro area and could revive fears around the very survival of the euro.

Respond to new challenges with strategic autonomy. For several decades, the EU has been one of the biggest supporters of globalisation, signing several free-trade agreements. However, around the mid 2010s, things started to change, firstly with the election of Donald Trump as president of the United States and his decision to impose tariffs not only on China but also on the EU.

After that, the Covid crisis demonstrated a need to relocate certain sectors due to supply chain issues. More recently, the EU has become aware of its vulnerability and its dependence on certain countries, such as China which supplied it with most of the materials required for its zero-carbon emission objective, or Russia for much of its gas consumption.

Finally, with the invasion of Ukraine by Russia and the return of tensions in the Middle East combined with the possibility of military and political disengagement by the United States, the need for the development of a European defence system has emerged.

From all of this has surfaced the notion of strategic autonomy, which means the EU intervening to protect entire sectors and areas of the economy. In this regard, the EU has put in place several programmes and measures, such as REPowerEU (energy), the CHIPS Act (semi-conductors) and the Critical Raw Materials Act. The new Parliament and the new Commission will undoubtedly want to enhance these projects further.

Institutional reform. The two ways by which the EU has evolved, namely deeper cooperation and enlargement, have for some time seemed incompatible. With future enlargement to allow Ukraine as well as Moldavia, Albania, and others to become members (even if this is some time away), changes in the EU institutional framework now look inevitable: whether in the democratic process (towards transnational lists of candidates and/or strengthening of the powers of the Parliament) or decision-making processes (end of unanimous vote by Heads of State). These changes could also help to progress towards greater integration.

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