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ARE HARD TIMES THE MOTHER OF INVENTION?

Efficiency & Legitimacy of Crisis-born European Modes of Governance

ROUNDTABLE 2 BACKGROUND NOTE 2

The Slow-burning crisis in EU economic governance and the Global Debates on Macro-economic policies:

The Nature of Structural Reforms Prompted by the European Semester

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RESEARCH SUMMARY

During the fast-burning Eurozone crisis (Tsingou, 2014), decision-makers sought to harden the pre-crisis tools of coordination with a view to prevent the errors allegedly committed in the past. Hence, the moribund Stability and Growth Pact (SGP) has been buttressed by the "six-pack" and "two-pack" legislation as well as by the Fiscal Compact. A new procedure, called the Macroeconomic Imbalance Procedure (MIP), has also been set in motion for the purpose of monitoring imbalances in the EU. The EU has also redefined its growth strategy, replacing the former Lisbon strategy with a new one called "Europe 2020". Finally, the European Semester has been created in order to integrate all these various procedures under the same umbrella. These developments have given rise to an increasingly important literature in EU studies focusing on policies, policy processes, and inter-institutional politics. The first part of this note takes stock of this research, starting with the policies underpinning the EU macroeconomic governance, then looking at the policy processes on which they rely, and finally addressing the shifting roles of institutional actors in tackling slow-burning crises.

NORMATIVE AND IDEATIONAL FRAMES UNDERPINNING CURRENT MACRO-ECONOMIC CHOICES

Austerity versus investment

In order to make sense of the policy solutions that lie at the heart of the EU's post-crisis economic governance, it is essential to understand that the Eurozone crisis was first and foremost framed as one of public debt (Schmidt, 2015: 37). The revelation by Greek Prime Minister Papandreou of his country's actual debt figures in 2009 fueled mounting fears of a contagion to other Southern countries, where public debt levels were already very high (Italy) or increasing fast (Spain and Ireland). In this context, the main concern for governments in the Eurozone was to reassure financial markets by showing their determination to limit public profligacy through "hardening" the existing rules. There was indeed a strong perception at the time that the pre-crisis design of the Economic and Monetary Union (EMU) had been too weak to constrain Member States' behavior and had let political considerations interfering with the activation of sanctions (Pisany-Ferry, 2012). The problem was therefore primarily framed as one of "moral hazard", which partly explains the solid resistance that other potential solutions, such as advancing fiscal integration through the issuance of Eurobonds, have met (De Grauwe, 2016). No matter that the northern countries were much less affected by such a dangerous public debt dynamic (De Grauwe, 2010), the mantra was that fiscal consolidation should apply in all countries.

However, as the crisis shifted from a fast-burning to a slow-burning phase, the emphasis put on fiscal consolidation has partly decreased, as attention has increasingly turned to its adverse side-effects on aggregate demand and long-term growth prospects . Especially with the arrival of the Juncker Commission, a new narrative has gradually built up that pointed weak investment as hampering the economic recovery of the Eurozone. Hence, in its 2015 Annual Growth Survey (AGS), the Commission identified investment as the third pillar of the EU's economic policy strategy alongside fiscal responsibility and structural reforms. A new Investment Plan for Europe has also been created with the aim of mobilizing investments in support of the real economy and helping create a business-friendly environment. Furthermore, the Commission published in January 2015 an interpretive communication on the flexible application of the SGP. In a nutshell, this communication stated that Member States in the preventive arm of the Pact could deviate temporarily from their budgetary objectives to accommodate investment under certain conditions. It also explained that the Commission would take account of the cyclical situation of individual Member States under the preventive arm of the SGP and would also exclude budgetary developments which are outside the control of governments under the corrective arm. Nevertheless, although the Commission's stance on budgetary rules has undoubtedly softened, fiscal consolidation has always come first in the list of Country-Specific Recommendations (CSRs) since the first round of the Semester.

Structural reforms and macroeconomic imbalances

Alongside fiscal consolidation and investment came the "structural reform" rhetoric. With no opportunity left to foster economic growth via fiscal stimuli, the case was made that Member States should embark on the path of reforming their economies to make them more competitive, to generate growth and, ultimately, to help in reducing public debt. The Europe 2020 strategy was elaborated in 2010 by the Commission services – especially DG ECFIN (Copeland and James, 2012: 10) – in order to give substance to this reform agenda.

The five objectives targeted by this strategy cover employment, research and development, climate change, education and social inclusion. Yet, several scholars have drawn attention to the subordination of these objectives to austerity imperatives. This is due to the fact that this strategy is highly dependent on government expenditure (Barnard, 2012) and has a much weaker legal basis compared to the revised SGP (de la Porte and Heins, 2014: 169). What is more, there is evidence that the EU2020 objectives are to a large extent framed in a purely economic perspective, thereby neglecting the aim of contributing to equality or social inclusion. For instance, the references to the fight against social exclusion and poverty (Peña Casas, 2012: 179), and to education and training policies (Agostini and Natali, 2016), seem to be interpreted almost entirely in terms of activation and participation in the labour market. These findings are consistent with more recent work on the subject (Crespy and Vanheuverzwijn, 2016).

However, some authors have stressed the progressive "socialization" of the policy orientations of the European Semester (Zeitlin and Vanhercke, 2015, 2016). In their perspective, the shifting policy priorities put forward in the AGS, the launching of numerous pacts and packages, and the expansion of the CSRs to the social sphere attest to a gradual rebalancing between economic and social objectives in macroeconomic governance. Yet, the relative decline in the volume of socially oriented CSRs in the Semester 2015, even though it resulted from the Juncker Commission's decision to limit the total number of recommendations (Vanhercke, Zeitlin and Zwinkels, 2016: 11), seems to call this trend into question. In fact, social recommendations were "mainstreamed" into recommendations related to labour market policy, education or taxation. This "mainstreaming" might therefore support the argument that, even though social inclusion has become a relatively important discursive element in legitimizing the Semester, social concerns remain nevertheless subordinate to other policy objectives, among which growth, fiscal consolidation and unemployment reduction are the more prominent (Crespy and Vanheuverzwijn, 2016).

Underpinning this "structural reform" rhetoric is the general assumption that for the EMU to become more resilient, it needs to move closer to an optimum currency area (OCA). As is well-known, the institution of a monetary union makes it no longer available for member countries to use national exchange rate policy to adjust their economies to asymmetric shocks. According to the OCA theory, sharing some properties can, however, compensate the absence of this instrument of economic policy. These properties (see Mongelli, 2008, for a detailed discussion) include price and wage flexibility, labour mobility, financial market integration, economic openness, diversification in production and consumption, similarities of inflation rates, fiscal integration and political integration. From all these policy solutions, it is notable that decision-makers have chosen to focus on those which call for national rather than European action. Hence, the prevailing view was that national economies – instead of the Eurozone's institutional structure – should be reformed in order to improve the adjustment capacity of the Eurozone to asymmetric shocks. The decision was therefore made to set up the Macroeconomic Imbalance Procedure (MIP) to monitor a broad range of macroeconomic indicators at Member State level, with a view to limiting risky macroeconomic misalignments (see below for procedural aspects). By contrast, the European-level solution, i.e. designing mechanisms of fiscal transfers between EZ Member States (See the "Four Presidents' Report, 2012; Andor, 2016), was eventually not retained, possibly because of the abovementioned "moral hazard" issue.

From a substantive standpoint, the MIP has been criticized for the asymmetry of its rules with regard to macroeconomic adjustment. In particular, the thresholds provided in the scoreboard to indicate an imbalance in the "current account balance" are asymmetric triggers insofar as they refer to +6 per cent of GDP for surpluses and -4 percent of GDP for deficits (Moschella, 2014). As a result, the European Commission has been criticized for its propensity to favor internal devaluation in the so-called "deficit countries", usually from the periphery of the EZ, while turning a blind eye on the "surplus countries" (De Grauwe, 2012). Yet, although this was certainly true during the first rounds of the Semester, a closer analysis (Vanheuverzwijn, 2016) reveals that the Commission has increasingly taken a tough line with regard to "surplus countries". In this respect, It is notable that in the Semester 2014, the Commission announced that Germany had actually exceeded the threshold for current account balance each year since 2007 . The 2015 exercise of the MIP reiterated this analysis and went even further by shifting Germany from the second to the third category of severity of imbalances.

To sum up, although there are encouraging signs of change in the policy solutions prescribed by the EU Commission towards more concerns for investment, social inclusion and symmetric macroeconomic adjustment, several elements lead us to question their true significance.

MACRO-ECONOMIC AND FISCAL MODES OF GOVERNANCE AFFECTING THE IMPLEMENTATION OF STRUCTURAL REFORMS WITHIN INDIVIDUAL COUNTRIES

At the core of the EU's post-crisis economic governance is the European Semester. This meta-coordination procedure has been set up to integrate the various existing coordination processes into a single annual policy cycle. This cycle is punctuated by four pivotal moments: the publication of the AGS by the Commission in November, which sets the economic priorities for the year to come; the release of the "Country Report" in February, which presents the Commission's analysis of socio-economic challenges in each Member State; the sending of Member States' "National Reform Programmes" (on economic policies) and "Stability or Convergence Programmes" (on budgetary policies) in April; and the Commission's proposals of Country-Specific Recommendations in May, which are then to be endorsed by the Council in late June.

For it deliberately interconnects various instruments with different degrees of hardness (Bekker, 2015), the European Semester can be defined as a hybrid mode of governance (Trubek and Trubek, 2007). Besides exchange of best practices, benchmarking and peer review, which were characteristic of the coordination of economic policies in the pre-crisis context (de la Porte and Pochet, 2012: 339), the European Semester now also involves harder instruments to enforce national compliance with the European recommendations. As far as macroeconomic issues are concerned, the MIP entails a greater surveillance of a series of macroeconomic indicators at Member State level, and provides potential corrective actions in case of non-compliance with the agreed thresholds thereof. In the budgetary field, the revision of the SGP has enhanced the budgetary surveillance and the sanctions in case of non-compliance with the rules have become quasi-automatic with the introduction of the reverse qualified majority voting (RQMV).

Yet, little is known about the actual impact of these new instruments at national level. No sanctions have ever been taken so far, whether in the framework of the SGP or of the MIP. Concerning the budgetary dimension, 26 out of the 28 Member States have been running an excessive deficit procedure (EDP) since the eruption of the crisis. At the time of writing, nine Member States are still in breach of the budgetary rules, whereas the other seventeen have got out of the corrective arm. This is perhaps a first indication of how seriously this procedure is taken by most Member States. Whether it is to reassure markets or to abide by the rules, Member States tend to respect their fiscal commitments. However, the picture is more mixed when it comes to the MIP recommendations, or to other recommendations which do not have a strong legal basis – the so-called "Semester recommendations". Regardless of methodological considerations, several studies show that very few of them have been fully implemented at national level (Darvas and Leandro, 2015; see also the study of the European Parliament EGOV unit, 2014).

There are a number of factors, both at national and EU level, that might account for this weak implementation record. At national level, possibilities for reform are likely to be affected inter alia by institutional settings, the presence of veto players and vested interests, or by ideological and partisan reasons. At European level, the two major impediments to the implementation of the CSRs usually identified are their soft law nature and the lack of political ownership at national level. For instance, as regards the MIP recommendations, even though failure to act at national level may theoretically lead to sanctions, it remains that the Commission has never put any Member State in the corrective arm of the MIP, which calls the threatening character of the whole process into question. As far as national ownership is concerned, new initiatives have been launched in 2015 with the purpose of improving the involvement of national stakeholders, including parliaments, in the Semester. However, the participation of national parliaments in the Semester remains highly variable depending on the country (Kreilinger, 2016).

SHIFTING ROLES AND PROSPECTS OR REGULATORY AND SUPERVISORY ACTORS IN TACKLING SLOW-BURNING CRISES

One important disagreement in the scholarly literature revolves around the question of which institution – the European Commission or the European Council – is in the driver's seat of the European Semester (Carstensen and Schmidt, 2015).

On the one hand, intergovernmentalists concur in seeing the European responses to the crisis, including the European Semester, as being broadly dominated by an intergovernmental logic (Puetter, 2012, 2014; Bickerton et al. 2014; Chang, 2013; Fabbrini, 2014). A reason given for this would be the constant reluctance on the part of Member States, especially since the Treaty of Maastricht, to further delegate some of their authority to traditional supranational institutions. On the other hand, neo-functionalists or supranationalists advance the claim that the recipes of the good old Community Method have not been entirely swept away in the aftermath of the crisis (Bauer and Becker, 2014; Niemann and Ioannou, 2015; Dehousse, 2015; Dawson, 2015). They notably justify this viewpoint by the important oversight authority granted to the Commission in the Semester as well as its ability to address detailed recommendations to the Council which are broadly insulated from national veto through the newly introduced "reverse qualified majority voting" procedure (Dawson, 2015:4).

Irrespective of which side is right or wrong, recent work has stressed the importance of looking beyond the fast-burning phase of the crisis, where Member States arguably took the center stage, to account for the power distribution between institutions during the slow-burning phase of the crisis. In particular, there are reasons to believe that the European Commission holds an important discretionary power in the European Semester, as exemplified by the recent communication on flexibility and the German "surplus issue" (Dehousse, 2015; Schmidt, 2015; Vanheuverzwijn, 2016). This may be explained by the numerous uncertainties that were left in the legal texts which are at the foundation of the different coordination procedures of the Semester. However, this should not lead us to think that Member States are only second-tier actors. Quite the contrary, in fact, they seem to keep a firm hand on the process, perhaps especially at the decision-taking stage. Despite lack of evidence thereof, their influence may possibly depend on various factors such as their macro-economic situation, their ability to form voting coalitions with other Member States, and their capacity to persuade the Commission of the rightness of their position.

PREVELANT RESEARCH QUESTIONS

How to account for the evolving nature of the policy solutions put forward in the EU's macroeconomic governance?

While there is some evidence that policy solutions put forward in the EU's macroeconomic governance have changed over time, it remains to be seen where these changes come from. Some scholars suggest that ideational entrepreneurs in the Brussels-based policy-making ecology might have their influence thereon (Coman and Ponjaert, 2015). But a process of diffusion of ideas might well exist also between international organizations such as the OECD, the IMF and the European Commission. It may also be the case that policy solutions prescribed at the EU level are the product of an iterative process of information-sharing and deliberation between the Member States and the Commission during the European Semester, as well as within the Commission itself.

Under what conditions and to what extent the EU's post-crisis economic governance affects the implementation of reforms at national level?

The legitimacy of the EU's post-crisis economic governance partly rests upon its ability to provide policies that are perceived as appropriate and effective by the public (Schmidt, 2015). In this regard, the low implementation record of the country-specific recommendations at national level may call the legitimacy of the whole process into question. However, little is known about the mechanisms that lead to reforms within Member States. In particular, the question arises as to whether the implementation of the CSRs follows a logic of compliance, of persuasion, of mutual learning, or comes in response of other kind of logics.

What are the consequences of these hybrid policy-making modes on legitimacy and accountability?

The European Semester can be depicted as a "hybrid" mode of policy-making where rules-based governance coexists with techniques of open co-ordination and intergovernmental decision-making (Armstrong, 2013; Dawson, 2015). The challenge is therefore to build up mechanisms for political and legal accountability for this new form of governance, which is halfway between supranationalism and intergovernmentalism.

POLICY ASSESSMENT

POLICY SOLUTIONS: TOO LITTLE TOO LATE?

More than six years after the crisis erupted, the Eurozone's economic recovery remains sluggish, so much so that even the best pupils are struggling to reach their pre-crisis growth rates. As for countries of the so-called periphery, most of them have much higher debt to GDP ratio than before the crisis and are experiencing higher levels of poverty and social exclusion. Unemployment, and especially youth unemployment, has reached record levels in several countries across Europe (in 2014, it was at 26.5% in Greece, 24.5% in Spain, and 14.1% in Portugal, to name but a few (Eurostat)). In some countries, cuts in public spending in the social sector have resulted in increased levels of homelessness, child poverty, less access to quality medical care, and even less access to essential levels of food (see Caritas Europe report 2015). Through its devastating consequences on citizens' trust but also on our societies' human capital, austerity such as that applied for countries under conditionality mortgages the future of our economy. Furthermore, structural reforms, especially when they mean bringing down the workers' wages and their levels of protection in employment, have the potential to accentuate the lack of aggregate demand in the Eurozone and to instill a sense of uncertainty that might ultimately lead to political problems (Schmidt, 2015).

There are signs of the tide turning towards a more balanced approach to fiscal policy and structural reform. Unfortunately, though, it seems a matter of too little, too late. Firstly, fiscal consolidation remains goal number one and can build on strong legal bases that cannot be overridden so easily. Secondly, although the new Commission has started to admit the problem of the investment gap in Europe, the Juncker plan to boost investment is far from being the panacea. Instead, it seems to take the form of a mere public insurance scheme to private sector investment, coupled with new commitments to structural reforms aimed at making life simpler for enterprises. Thirdly, another persistent problem which has only started to be recognized is the lack of a genuine European perspective with regard to fiscal consolidation. In particular, it has been proven that the simultaneous implementation of consolidation plans in every country of the Eurozone between 2011 and 2013 has increased their recessionary impact (DG Trésor, 2016). And fourthly, structural reforms, even when they refer to education or social policy, tend to focus exclusively around "activation" measures while neglecting their social investment dimension and their contribution to aggregate demand.

POLITICAL LEGITIMACY AND ACCOUNTABILITY: FIRST ATTEMPTS AT REDUCING DEMOCRATIC IMBALANCES

As explained above, the European attempts at improving the output legitimacy of the new economic governance have not fully borne fruit and have proven limited. The same can certainly be said for its input and throughput legitimacy. Since its first round in 2011, the European Semester has gone through some important procedural changes which have aimed at involving national stakeholders more actively in the process. However, while these changes have certainly made it more efficient as a bureaucratic process, they fall short of reducing some other important sources of democratic imbalances. The process indeed still denies political voice to many actors likely to be affected by its decisions. At EU level, even though the involvement of the social partners has improved over the past few years, more needs to be done to give them more influence on the process. Likewise, the European Parliament's power of scrutiny over the Commission remains scarce. At national level, there is evidence that a great number of parliaments have not adapted enough to the European Semester (Kreilinger, 2016). The involvement of social partners at national level also varies depending on the country. A recent report shows that only in 10 countries are the national social partners involved in some way in the definition or the implementation of the CSRs (Eurofund, 2016).

POLICY SUGGESTIONS

1. Place greater emphasis on the Eurozone-wide needs for fiscal consolidation/macroeconomic adjustment (e.g. through greater consideration for the Eurozone recommendations)
2. Establish automatic macroeconomic stabilizers (e.g. through a European unemployment insurance)
3. Strengthen the focus on social investment initiatives at national level (e.g. by exempting them from SGP deficit requirements)

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