Round-Table 4 / WORK PACKAGE 2

EUROPEAN GOVERNANCE & THE TWIN NECESSITIES OF TACKLING THE FINANCIAL CRISIS AND ENSURING FINANCIAL SUSTAINABILITY

RESEARCH NOTE

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Research Background Note for the AGORA Forum 15/16 June 2015, Brussels – Work Package 2: Financial and Fiscal Sustainability[1]

Table of Contents

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First reflections on the economic leg of EMU

The crisis that unfolded in 2010 has induced a wide area of policy responses to achieve financial and fiscal sustainability in the EU. A first set of policy responses relates to banking supervision and macro-prudential oversight of the financial sector, most notably the creation of a Banking Union and the European System of Financial Supervision. The second set of policy responses relates to financial assistance for certain Member States and mainly concerns the Economic Adjustment Programs (e.g. for Greece) and the setting up of the European Stability Mechanism and its predecessors. A third set of policy responses relates to the reinforcement of the economic governance framework for macroeconomic and fiscal surveillance. Each set of policies produces its own, but often interlinked, set of questions in terms of effectiveness and legitimacy, which will be addressed in Work Package 2. This research note is primarily focused on the third set of policy responses relating to economic governance for the Member States that are not under financial assistance programs. It provides for a short description of the institutional design, it identifies some recent developments and challenges and poses some questions to start our debates and which will feature prominently in our work to come.

The institutional design of the economic governance framework: a short oversight

Policies

The economic leg of EMU has since its introduction hinged on two main policies: budgetary rules as defined in the Stability and Growth Pact (SGP) and economic coordination on the basis of Broad Economic Policy Guidelines (BEPGs). The SGP is famous for its 3% rule on deficits and its 60% rule on government debt. The BEPGs offered guidelines to Member States (MS) and the Community on macroeconomic and structural issues, ranging from wage developments to financial-market integration. The implementation of these guidelines was monitored through a system of multilateral surveillance and political sanctions in the form of non-binding recommendations adopted by the ECOFIN Council. By the time the BEPGs were adopted they would have gone through an intense process of review, consultation and discussion, involving many actors at the European and national level. With the introduction of the Lisbon Strategy in 2000, the Council decided that the BEPGs should focus increasingly on the medium- and long-term implications of structural policies and reforms. After the 2005 evaluation of the Lisbon Strategy by the Kok Group, which called for more active peer pressure and enforcement, a few new elements were added, such as National Action Programmes and an Annual Progress Report. DeRoose et al. concluded that while the BEPGs have demonstrated to be a valuable instrument for cooperation between policy-makers and coordination of policies, there was a lack of peer-pressure between MS on implementation, the BEPGs were seen as too country-specific and resulted in too little parliamentary debate and oversight (DeRoose et.al. 2008).[2]

The SGP was based on a preventive and a corrective arm. The former included national Stability and Convergence Programmes and an early warning mechanism, the later involved an Excessive Deficit Procedure, recommendations, the concept of 'exceptional circumstances' and after persistent breaches the possibility of fines. After several MS consistently breached the rules and no fines were imposed, the SGP was reformed in 2005. The 2005 innovations included a move away from uniform rules to more differentiation and better inclusion of the economic situation and developments based on structural reforms (EC, 2013).

The euro crisis underscored the interdependence of European economies and highlighted weaknesses in the economic governance framework. In particular it showed the existence of huge macroeconomic imbalances and the fact that previous years of economic growth had not led to sufficiently strengthened budgetary positions in most MS. During the crisis therefore a broad set of measures was introduced in order to preserve the single currency and strengthen the governance framework. These included the Six-Pack, the Two-Pack and the Intergovernmental Treaty on Stability, Convergence and Governance (TSCG). The Six-Pack reformed both the preventive and corrective arms of the SGP and established the Macroeconomic Imbalances Procedure (MIP) aimed at preventing economic imbalances. It furthermore introduced a new graduated system of sanctions for euro area countries; an expenditure benchmark to assess progress towards medium term objectives; it further specified how the debt criteria should be applied and finally it introduced the European Semester and a framework for national fiscal surveillance. The latter two will be explained in more detail below.

[2] Interestingly, DeRoose (DG ECFIN) gave the exact same analysis of the merits and challenges of the European Semester at an expert event on Economic Governance on 29th January 2015, De Balie, Amsterdam.

The Six-Pack was complemented by the Two-Pack in 2013, which further reinforced the monitoring and surveillance in a common budgetary timeline and tightened the surveillance for euro area MS in the Excessive Deficit Procedure. Finally, the TSCG was introduced, mainly as a means of reassurance of the credibility of the budgetary discipline to the financial sector by providing for a balanced budget rule to be enshrined in national constitutional law. It has an ambiguous status, since putting fiscal policy in a legal straight jacket has so far not proven to be very effective and difficult to enforce (Gros & Alcidi 2014).

All in all the policies integrated the different aspects of budgetary and economic surveillance into a single process, with increased monitoring at both national and European level and increased possibilities to apply sanctions.

Process

The euro crisis is not just the result of a crisis in public debt but is part of a much wider set of macroeconomic and financial developments that are now monitored in a streamlined process called the European Semester. The European Semester brings together the various innovations in economic governance as described above and includes several European strategies, most notably the EU2020 strategy and the Euro Plus Pact, whilst also including more specific policy documents relating to e.g. financial sector sustainability or poverty reduction. It furthermore involves a complex web of interactions between the Commission and various national, European and civil society actors and is based on a collaborative process between various DGs within the Commission itself (see e.g. Zeitlin & Vanhercke, 2014).

For all its complexities the main structure is the following: in the autumn of each year the Commission presents its economic forecasts and growth agenda in the Annual Growth Survey (AGS) and monitors MS on potential imbalances in the Alert Mechanism Report (AMR). These analyses are discussed by the EP and MS and adopted by the Council. The AGS forms the basis for the economic priorities that will feature throughout the cycle. The AMR selects MS that will be subject to an in-depth review of their imbalances. In the spring each MS presents a National Reform Program on their economic policies and a Stability and Convergence Program on their budgetary plans. On the basis of these documents, its own

Country Reviews, and the results of multilateral surveillance by MS representatives in joint committees advising the Council, the Commission issues Country Specific Recommendations (CSRs). These are in turn debated and amended by MS committee representatives before being adopted by the Council, after which they can be implemented by the MS. Finally; MS are placed in a two by six matrix on the basis of how deep the imbalances or budgetary problems are to maximize peer-pressure possibilities. The political obligations of each MS thus depend on their position in the matrix, based on their imbalances and fiscal health. Well-performing MS are encouraged to implement CSRs, while others receive a more coercive approach and reluctant MS could potentially face financial penalties under the Excessive Deficit Procedure or the Excessive Imbalances Procedure.

<u>Principles</u>

The discussion on the underlying strategy of the economic governance framework seems to have converged in what is known as the 'holy triangle' of fiscal consolidation, structural reform and investment. After a short period of counter-cyclical policy in many MS at the offset of the crisis in 2008-2009 (European Economic Recovery Plan) followed a long period of austerity in the EU. This was also reflected in the first cycle of analysis and recommendations from the new economic governance framework in 2011, which primarily focused on fiscal consolidation (EC, 2010). The rules-based system was to deliver credibility (in the absence of financial firepower at the European level), whilst MS were in a head-to-head with the financial markets to preserve the currency and return to stability. Much of the early literature describes the economic governance framework as a toughening of the fiscal discipline and legal straightjacket (see e.g. Scharpf, 2011).[3] However, Mabbett & Schelkle find that in fact this has not been reflected in recommendations and decisions in later Semester cycles. Deadlines for adjustment are pushed with reference to 'relevant factors' and 'exceptional economic circumstances', while verdicts on current outturns continue to reflect fragile economic conditions. Additionally MS are repeatedly urged to adopt 'growth friendly structural measures' drawn from a limited and familiar menu: pension reform, improvements to public administration, changes to wage-setting institutions, and measures

[3] Criticism has furthermore emphasized the negative effects of the simultaneous turn towards fiscal consolidation of all Euro area MS. See e.g. M. Blyth (2013) *Austerity: The History of a Dangerous Idea,* Oxford University Press.

to liberalize the services sector and network industries. Finally, MS are urged not to cut investment in education, R&D and innovation (2014).

The focus of the Semester was coined with the term 'growth friendly fiscal consolidation', with the aim of achieving the priorities as set out in the Europe 2020 strategy and encompassing Euro Plus Pact. The link between fiscal consolidation and structural reform was further specified in the 2015 Commission document on the use of flexibility (EC, 2015). The Commission has so far shied away from using coercive measures such as sanctions, even though they could arguably have done so in various cases. The document on flexibility was an answer to criticism on the ambiguous use of leniency on budgetary norms by the Commission, most notably in the case of France. It further specified the link between fiscal targets and progress on structural reform by amongst others creating further distinctions between different levels of excessiveness in macro-economic imbalances.

Finally, the Juncker Commission pushed for a third pillar in the strategy, which is an increased focus on investment, to counter criticisms of the perceived supply-side only focus of the framework (see e.g. DeGrauwe & Yuemei, 2014). The 2015 recommendations following from the economic governance framework have a strong focus on creating the right conditions for investment (EC, 2015b), while the Commission works at the same time on a new investment fund (EFSI), the ECB has introduced quantitative easing and MS have repeatedly pledged more capital to the European Investment Bank (EIB).[4]

<u>Levels</u>

Much of the academic literature and media attention has focused on the innovations in macroeconomic and fiscal surveillance on the European level, such as the Semester. One level of analysis is indeed on the horizontal axis; the institutional framework of Commission, Council and EP. However, equally important to achieve macroeconomic and fiscal sustainability are the recent innovations at the MS level and the vertical axis of interaction; MS bodies, their common networks and the Commission. An important innovation of the Six-Pack was the directive on requirements for budgetary frameworks for the MS, which

[4] Each of these steps can be criticized on how effective they are in terms of countering the 'supply-side only' arguments of critics and establishing a genuine pro-investment strategy.

amongst others sets minimum requirements for national fiscal frameworks, a domain which formerly remained at the full discretion of the MS. National fiscal frameworks reflect the full set of rules, procedures and institutions that shape fiscal policy-making at the national level, such as clear medium-term budgetary planning and monitoring, strong budget coordination arrangements between different levels of government, reliable statistics, unbiased macroeconomic and budget projections and not least of all independent fiscal councils. Similarly the Six-Pack introduced financial sanctions for statistical fraud and set minimum standards for independent authorities and auditing of data by Eurostat.

Effective monitoring and early detection of macroeconomic and fiscal imbalances relies to a large extent on the establishment of a clear and effective national budgetary framework controlled by a fully independent fiscal institution. Additionally fiscal institutions play an important role by potentially providing sound and realistic projections, which are essential for budgetary planning and an informed political debate. The analysis of the interaction of the fiscal institutions with DG ECFIN and within the network for fiscal institutions (EUNIFI, which held their first meeting in 2013) can provide for important insights on achieving a multi-level design for macroeconomic and fiscal monitoring in the EU. However, so far the effectiveness of national fiscal framework suffers from a lack of full implementation of the directive (ECB, 2013) while networks for the fiscal institutions as forum for discussion, evaluations and peer-review have yet to reap their full potential (Schout & Mijs, 2015).

Preliminary reflections on the Semester

This section provides with an overview of different angles to look at the European Semester. Each part finishes with a few possible research questions. The first part looks at the Semester from a theoretical angle. The second part describes some of the controversies of the Semester in providing an economic recipe for MS. The third part reflects on the governance mechanisms behind the Semester. The fourth part discusses some legitimacy questions. The final part looks at the longer term viability questions of the EMU (slow-burning crisis).

<u>Theoretical reflections</u>

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The post-crisis economic governance innovations represent a new step in the integration process, which has in turn induced a debate among integration scholars on the application and suitability of different integration theories. Firstly, whether the post-crisis framework is the result of liberal intergovernmental mechanisms as argued by e.g. Schimmelfennig (2015) or neo-functionalist processes as argued by e.g. Niemann and Ioannou (2015). But perhaps more importantly whether the innovations have led to a strengthening of the intergovernmental decision-making mode (e.g. Puetter, 2012) or even a new type of intergovernmentalism (Bickerton et.al., 2015) or whether it has led to a strengthening of the role of the Commission (e.g. Bauer & Becker, 2014). While one can note a strong turn towards intergovernmentalism in dealing with program countries, which have especially seen the role of the Euro group increased, this is not necessarily the case for the Semester. This research note starts from the premise that when looking closely at the dynamics and evolution of the European Semester, terms like supranationalism or intergovernmentalism fall short of fully explaining the web of interaction that has been created.

The Semester builds on and further extends the pre-crisis framework by adding amongst others increased differentiation and means for coercion. While formally sanctions are possible in this framework, the Commission has so far shied away from using them. It is questionable whether sanctions will be activated at all, since these would be based on legally ambiguous concepts such as a structural deficit or the implementation of structural reforms (Moschella, 2014). In this sense the new framework represents less of an institutional big bang than perhaps initially presumed. However, the whole process itself, especially the common timeframe of the Semester including its mechanisms of enforcement, can have a strong disciplinary effect. Yet, analysis of the first set of CSRs and In-Depth Reviews between 2011-2014 suggests that the EDP and MIP procedures remain within the sphere of soft law (Dawson, 2015). The main mechanism for enforcement thus remains dialogue, enhanced monitoring and peer pressure. The academic literature on new modes of governance thus provides useful insights in assessing the new framework (see e.g. Borras & Radaelli, 2015). At the same time the Semester can be seen as considerably more coercive and focused on coordination rather than differentiation than under earlier open coordination procedures.

What is clear is that the Commission and Council each have seen their role changed in recent years. At the same time national frameworks for monitoring are being build up as discussed above and specialized committees of Member State officials are engaged at various stages of the process, by mechanisms of peer review, monitoring and multilateral surveillance (Zeitlin & Vanhercke, 2014). To conclude, the post-crisis governance contains elements of intergovernmentalism and supranationalism while at the same time reflecting a new modes of governance architecture. The post-crisis governance also departs from the mechanisms of legal and political accountability present in previous forms of EU decision-making, which invites scholars to revisit debates on underlying narratives and trade-offs between legitimacy and effectiveness in the Semester. This results in the following research question:

- How can the European Semester be characterized in governance-theoretic terms?
- What do different governance theories lead us to expect about the effectiveness and legitimacy of the European Semester as a new governance process?

<u>Reflections on the rationale</u>

The architects of EMU realized that the interplay between monetary and fiscal policies and the increased interdependence of and spillovers among countries sharing a single currency meant that national fiscal policies could not be allowed to impose disproportionate costs on other participants. By imposing a common framework within which Member States would set budgetary policy, the possibility of negative impacts on other euro area countries - whether stemming from the inflationary impact of large deficits or the destabilizing effect of unsustainability or insolvency – could be reduced (EC, 2013). The original architecture therefore provided for a system of clear rules, most notably the famous 3% and 60% rule. While these could in theory be relatively easily enforced (even though this has to date never been the case and the relevance of these norms in today's economic outlook is questionable), the current system has become more complex.

Potential sanctions on budgetary norms have been linked to progress on structural reforms and in turn the coerciveness of recommendations on the macroeconomic side depends on a MS fiscal conditions. But here a rules-based system has its limits in preventing a crisis. As argued by Daniel Gros in an EP hearing for example, Spain had a good fiscal health at the start of the crisis, it was mainly macroeconomic imbalances that led to subsequent fiscal problems. The Commission was well aware of the imbalances and had given Spain several recommendations, which were not fully implemented. Would intervention have been legitimate? (Gros, 2014). In the post-crisis set-up there is the Excessive Imbalances Procedure to deal with large shocks, in theory this mechanism could have been applied to Spain. But, this does not solve more fundamental concerns. Identifying when an imbalance is excessive is controversial, there can be many diagnoses on what has caused the imbalance and what the best solution is for rectifying it. Furthermore, with the rationale of the Semester being the mitigation of spillover effects the question becomes: when and in what way does an imbalance in an economy have an impact on other MS in such a way that action at the European level is justified? In a later EP hearing Gros argued that often we do not know how fiscal policies of one country affect another. The spillover effects also differ per MS and this is equally true for structural reforms, which can have different effects in different MS. On what rationale is telling countries what they should or should not do based if we are uncertain about the outcome? There is a fine line here between reforms that are 'nice to have' and 'need to have' (Gros, 2015). The uncertainty on spillovers was recognized in a Council evaluation of a pilot exercise in 2013. In 2013 the Council started with discussing ex-ante economic reform plans to include the European dimension in national economic policy making. The evaluation shows that identifying potential spillover effects proves to be very difficult and it suggests that large spillovers are not a frequent feature of reforms (Council, 2014).

Knowledge and prediction of economic outcomes represents a major challenge in economic governance. For example; at the outset of the crisis nobody expected that European public finances would become a problem. The Commission even declared that structural deficits were at the lowest level on record since the early 1970s (EC, 2008: 37). However, today's governance system represents a far more holistic and comprehensive approach to monitoring economic shocks based on a large number of indicators and thresholds and a larger involvement of experts. In the new framework macroeconomic, financial, and fiscal risks associated with the expansion in external imbalances, credit growth, sectoral debt levels, and housing prices are all taken into account in assessing Member States' fiscal policies. Finally, it is important to bear in mind that politics is seldom about dealing with certainties. Though, uncertainty of economic outcomes is important in the debate on how far the Semester can limit the scope for nationally idiosyncratic policy, even if MS have signed on to this themselves.

The Semester mechanism has far from consolidated and should be understood as a process of constant change, rather than in static terms. In analyzing the CSRs, Bekker finds a tendency for them to become more numerous, relatively uniform and highly prescriptive (2013). Zeitlin and Vanhercke find that the 2012 Semester cycle catalyzed a push back by MS against the Commission’s increasingly prescriptive approach to the CSRs, along with its reluctance to deliberate over proposed amendments with national representatives, which led to a substantially revised procedural framework for the 2013 cycle (2014). In the 2015 cycle the CSRs are less numerous and detailed, which according to the Commission should create a sense of urgency for implementation by focusing on priorities only (EC, 2015). Commission official DeRoose confirms that there is still a lot of discussion between MS and DG ECFIN on the right application of the Semester, the content of the CSRs and the interpretation of all the data (2015). The analysis of Schout and Mijs finds that even within the Commission several high-ranking officials describe the process both within the Commission and between the Commission and MS as involving a high degree of political bargaining (forthcoming). The Semester is sometimes described as ‘governing by the rules and ruling by the numbers’ (Schmidt, 2014), but should rather be understood as an incremental process involving adaptation, discussion, negotiation and learning. Such factors should be taken on board when assessing the rigidity with which the framework should be implemented.

While taking note of the innovations in the Semester, all in all a first big challenge which can be identified is how to ensure the framework sufficiently addresses the difficulties encompassed with a high degree of differentiation and uncertainty. This results in the following empirical and normative research questions:

- How does decision-making in the Semester work? Which actors are involved? How uniform and prescriptive are the recommendations? What room do they leave for national implementation pathways? To what extent does the process involve mutual learning as well as peer-pressure?

- What design features for the governance framework can sufficiently contribute to reducing uncertainty on economic outcomes? How prescriptive should the CSRs be? How can credibility of CSRs be increased?

Reflections on enforcement

Despite improved policy coordination, fiscal and economic policies largely remain national prerogatives. The effectiveness of the new arrangements is not established yet, and will crucially depend on the implementation in practice. Where rules are hard to enforce with legal mechanisms, they rely on credibility (as discussed above) and a political commitment towards recognizing and implementing them. The new framework should be seen in light of the vast increase of risk sharing that has occurred in recent years, such as with the introduction of the ESM. As a consequence interdependence and MS interest in the performance of each other's economies has increased. Vijlbrief, who has a long history of involvement in Euro group and ECOFIN meetings recently confirmed that peer pressure has increased and that discussions on implementation of CSRs have gotten a lot tougher over the past few years.[5] Additionally, it could easily be argued that naming and shaming has increased, with e.g. Italy's debt level, France's state of reform and Germany's level of domestic investment now receiving more European-wide media attention.

On the other hand a recent EP study found that only 9% of CSRs was being fully implemented in 2014 and on almost half of CSRs there was no or limited progress (EP, 2014). Several MEPs (mostly ALDE and EPP) therefore warn for the lack of implementation of CSRs and call for the CSRs to be more binding. [6] While the Commission considers the implementation rate to be much higher (which again is proof of the multiple interpretations that can be applied to terms like 'implementation' of structural reform) (see Zeitlin & Vanhercke, 2014: 56), the criticism on a lack of implementation seems widespread. Pisani-Ferry as one among many voices argues that the recent innovations in economic governance

[5] H. Vijlbrief comments at an expert event on Economic Governance on 29th January 2015, De Balie, Amsterdam.

[6] European Parliament. Plenary session 16-12-2014: *Economic governance review of the 6-pack and 2-pack regulations*

have only added complexity to an already Byzantine architecture of procedures, while adding little effectiveness. The EU has a strong hand when a country is in need of financial assistance, but otherwise it can do little more than offer counsel (2015). A recent IMF study calls on the Commission to come up with proposals for greater automaticity in enforcement and a more credible set of sanctions to ensure compliance (IMF, 2015). The ECB's Draghi continues to warn for the lack of structural reform in the EU (Draghi, 2015). While others have suggested that it might make more sense to start promoting the implementation of structural reform by funding parts of the initial costs that accompany them, rather than threatening with sanctions (see e.g. Enderlein & Fritz-Vannahme, 2014). While toughening the sanction regime runs into earlier mentioned problems, creating incentives for implementation of CSRs would require a type of budgetary capacity, which is unlikely to find sufficient support in the Council in the short term (Spiegel, 2015). On the other hand there seems to be movement in this direction. In the new Structural Funds Regulation, MS have to explain how their plans contribute to implementing the CSRs and the Commission has the right to request a reprogramming of the plans to ensure that they respond to existing or new CSRs (Regulation No. 1303/2013). For now the focus of the Commission seems to be to simplify[7] the Semester in order to make it more visible and easier for national leaders in applying the recommendations.

This brings us to the following research question:

- How effective are current mechanisms in promoting the implementation of CSRs?

Reflections on legitimacy

While the mechanism of the Semester might reflect soft law architecture it can still be considered as quite pervasive and certainly has moved beyond the broader policy suggestions of the BEPGs. The Semester has an influence on how budgetary policy is planned, approved, carried out, and monitored. Similarly the recommendations touch upon key issues of national sovereignty. For example, in 2014 France received a recommendation to "take steps to reduce significantly the increase in social security spending as from 2015 as planned, by setting more ambitious annual healthcare spending targets, containing pension

[7] In a speech Commission President Juncker admitted that simplification is indeed the goal, while describing the Semester as a *gas factory, which nobody really understands.* J.C. Juncker, Speech at the EP Interparliamentary meeting on the European Semester Cycles 2014 and 2015. 3 February 2015.

costs, and streamlining family benefits and housing allowances." Additionally, the Semester is concerned with a high degree of qualitative analysis of reform plans and data by the Commission, combined with the flexibility in applying the rules and the use of ambiguous concepts, this provides the Commission with ample space for discretionary decision-making.

Criticism of the lack of legitimacy in the new economic framework has thus been fierce. Scharpf for example argues that the institutional setting of the euro provides near-perfect protection against the interference of input-oriented political processes and of democratic accountability to the constituencies affected (Scharpf, 2013: 23). And even though the legitimacy aspect should be considered whilst taking account of the flexibility and intrusiveness arguments as described above, it can hardly be denied that the role of the EP has not been reinforced in the way those of the Commission and Council have. It has to be informed and consulted on specific occasions, it can organize hearings and cooperate with national Parliaments, but it is not entitled to take any decision in the framework of economic governance (Fasone, 2014). A number of recent EP resolutions and reports therefore call for a strengthening of the role of the EP to ensure increased democratic oversight, for example by introducing co-decision on the AGS.[8] Similarly, the inter-parliamentary forums that have been created, can be considered as a useful exercise of exchange of information, but still go a long way from being effective mechanisms for accountability (see e.g. Kreilinger, 2015).

Legitimacy could also be conceived of in a more functional understanding of the concept. Legitimacy is not only about parliamentary oversight, but also about balancing the national and supranational interest, adhering to principles of good governance, putting constraints on the EU's powers and respecting legitimate diversity. So far the reflections in this paper have focused mostly on the challenges in macroeconomic and fiscal governance at the

[8] See e.g. EP (2012) Resolution of 20 November 2012 with recommendations to the Commission on the report of the Presidents of the European Council, the European Commission, the European Central Bank and the Eurogroup "Towards a genuine Economic and Monetary Union' (2012/2151(INI)). EP report 'Constitutional problems of a multi-tier governance in the European Union', 10-07-2013. EP report 'On strengthening European democracy in the future EMU' 10-06-2013. Draft EP report ' On the review of the economic governance framework: stocktaking and challenges' (2014/2145(INI)), 02-02-2015. EP Draft Committee on Constitutional Affairs Opinion AFCO 'on the review of the economic governance framework: stocktaking and challenges' (2014/2145(INI))

European level. But as discussed on page 3 and 4 the Six-Pack also introduced a new quality framework for national economic and fiscal oversight. Focusing on this national level of economic and fiscal oversight and the relation between the national and European level provides for an interesting dimension in the legitimacy versus effectiveness debate. Full implementation of directive 2011/85/EU on national budgetary frameworks with European quality checks and benchmarks on the national level and further building towards an effective model of interaction between the national and European level could in theory provide for sufficient safeguards to limit discretionary decision-making at the European level. This would entail that European-level coordination would complement the national framework. Thus moving towards a decentralized macroeconomic and fiscal monitoring framework, checked for quality and debated at the European level. Consequently, peer-pressure from the European level would only be necessary where national pressure is failing and when there is a high degree of certainty on the spillover effects caused by national economic policy.

The legitimacy debate is interlinked with the above-described reflections: the more prescriptive and tougher the economic regime is, the more legitimacy problems it creates. One can conceive of the legitimacy debate in various ways, one would be to strengthen input legitimacy by for example increasing the role of parliaments; another would be to look at other principle-agent relations by for example limiting the direct impact of the Semester on national policy-making by further decentralizing the monitoring system. This results in the following research questions:

- Which mechanisms of accountability in the Semester can be identified? And how effective are they in increasing the legitimacy of the Semester?[9]

Final reflections

[9] Legitimacy is in essence a normative and multi-dimensional concept. Normative legitimacy based on a set of theoretical criteria is difficult to apply since the Semester includes a complexity in organizational relations that transcend a single theory of compliance and control. Rather the term legitimacy is used empirically, broadly meaning in this sense: the acceptance by the end-user of the product (national policy makers).

The Semester can be seen as a sort of intermediate framework between fast- and slow-burning crises. As an early warning mechanism it aims to detect and prevent the building up of macroeconomic and fiscal imbalances in MS to prevent them from falling under the more coercive regime of the Economic Adjustment Programs, such as with Portugal, Cyprus and Greece. At the same time, a thorough analysis of the Semester could provide for some useful insights on the debate on how EMU governance should evolve, whether by restoring the credibility of the no-bailout rule complemented by a sufficient Banking Union or by deepening integration and developing types of economic shock absorption capacity or other elements of a fiscal union,[10] or third alternatives. Each depends to a certain degree on the credibility of the EU's economic governance arrangements. One final comment that is relevant for the debate on the longer-term viability of the EMU is the fact

The final research question that can be identified is the following:

- What lessons can be learned from analyzing the European Semester for the long-term viability of the EMU?

Conclusion

With the European Semester for macro-economic and fiscal monitoring the EU, with a long history of being mainly a regulatory force in the internal market, has set a new step towards the dimension of being a stabilization force (whether successful or not). But while the EU has quite a strong track record in managing market externalities, the management of economic policy externalities presents some challenging dilemmas. The Semester can be seen as an early warning mechanism to prevent MS from being subject to the more coercive approach for MS under financial assistance (fast-burning crisis) and is an important framework to study in the discussion on the longer-term viability of the EMU (slow-burning crisis). This research memo has argued that the Semester should be studied as a process, stemming from the former SGP and BEPGs, having received some important innovations during crisis years and currently still evolving. This note has furthermore argued that most integration theories fall short of explaining the full set of interactions associated with the Semester,

[10] Another point that has not been fully raised in this research note is the fact that the Euro crisis showed that many asymmetries and imbalances in the Euro zone are cross-country rather than intra-country. Stabilization efforts at the national level can have limited effect if the imbalances are build up by a group of MS or can be seen as systemic, such as trade imbalances between North and South. These problems are creating strong pressures for a Eurozone-wide counter-cyclical capacity.

rather it should be studies as a hybrid governance framework. Additionally the Semester provides for opportunities of enhanced monitoring, policy dialogue and peer-pressure, but more coercive tools such as financial sanctions will be difficult to apply. Finally this note has shed some light on different effectiveness versus legitimacy trade-offs and challenges in the Semester. These concern the identification of spill-over effects and uncertainty in identifying potential crises, the perceived lack of implementation of CSRs and finally the overarching question of how the legitimacy of the Semester can be increased.

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