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ON THE EFFECTIVENESS AND LEGITIMACY OF EU ECONOMIC POLICIES

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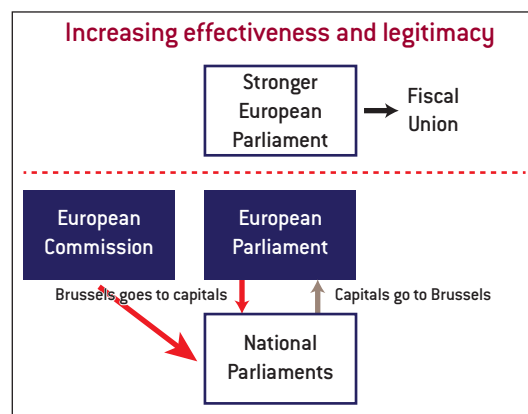
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THE ISSUE For markets, European economic governance faces a crisis of policy effectiveness, while for citizens the European Union faces a democratic legitimacy crisis. The introduction of the European Semester economic policy surveillance system has not resolved these problems. Policy guidance deriving from the Semester is not focused enough on areas of significant spillovers and on problem countries, and national compliance is often procedural rather than actual. This brings into question both the Semester's effectiveness and the democratic legitimacy of the EU's new intervention rights, which allow intrusion into national policy-making.

POLICY CHALLENGE

The European Semester cannot be effective if it is not legitimate. Legitimacy ultimately comes from national parliaments that vote on budgets and on financial, labour and product market reforms, but national parliaments are insufficiently involved. There are three options that could reduce the tension between the EU level and the national level over the legitimacy of the European Semester, while increasing its effectiveness: (i) *Brussels goes to capitals*: the direct presence of European institutions in national

parliaments and the European Parliament acting as a watchdog; (ii) *Capitals go to Brussels*: greater presence of national parliaments at European level; (iii) a *new treaty* creating a soft political union with some fiscal capacity and a real shift in decision-making authority to the EU.



Source: Bruegel.



HUGE DEBTS, INEFFICIENT LABOUR MARKETS, fragmented, poorly capitalised banking systems: these major problems that the European Union faces are a testament to the failure of its crisis-prevention system. Many of the most difficult problems that the EU must resolve if the euro-area crisis is to be overcome, such as macroeconomic imbalances, were not the main focus of the Maastricht Treaty, which created the euro. For example, the EU system of economic governance did not criticise private-sector imbalances prior to the crisis, and even considered them a sign of the success of the monetary union¹. At the micro level, the EU's 2000-10 reform programme, the Lisbon Agenda, failed to spur meaningful change. These failings mean that for markets, European economic governance is ineffective, while in the eyes of many citizens the EU faces a democratic legitimacy crisis.

Recognising the failure of the Maastricht framework, a reform of EU economic governance started in 2010. One of the most notable changes was the introduction of a procedure under which the EU will provide member states with policy guidance before national budgets are passed and reforms decided. The goal of this procedure, which is known as the **European Semester**, is to ensure that national priorities do not conflict with policies agreed at EU level but rather support EU objectives. Since 2011, the Semester has been combined with tougher regulations in the areas of structural and fiscal policy.

The European Semester may be regarded as an attempt to shift the distribution of power between the EU and the national level without altering the Treaty. It is the stretching of EU intervention rights to the maximum without a formal devolution of national sovereignty. This has led to tension between the EU and its member states and concerns about the democratic legitimacy of the new economic governance framework. One example stems from the first Semester cycle in 2011 when the draft recommendations published for each country by the European Commission were to some extent revised by member state representatives sitting in the EU Council. Moreover, national authorities, which ultimately provide legitimacy because they have been put in place by their citizens, do not always implement the EU recommendations. The European Semester's effectiveness has therefore been limited. Greater use of binding regulation is a way to increase effectiveness because member state compliance can be enforced. But the consequence is that the question of how to achieve legitimacy at the EU level becomes burning.

This is particularly evident in the case of financial assistance. The conditionality now in place for Ireland, Greece, and Portugal is intrusive: it forces change in domestic policies. In principle, it makes European policy making more effective. But democratic legitimacy in the EU mostly derives from the Council, which – out of a position of financial strength – negotiates financial assistance via the troika of the

Commission, International Monetary Fund and European Central Bank with the member state concerned. The member state provides its share of legitimacy with a memorandum of understanding out of a position of weakness. National parliaments, however – let alone citizens – have only a limited influence over the outcome.

As the third European Semester cycle is about to start, this Policy Brief assesses its effectiveness and legitimacy focusing on recent reforms. We provide suggestions about how the tension between national sovereignty and the need for stronger supranational powers can be resolved.

1 THE EUROPEAN SEMESTER

The European Semester is a framework to improve economic policy coordination in the EU. It has been in place since January 2011. It was institutionalised in December 2011 with the approval of a set of laws designed to strengthen economic coordination – the so-called six pack (see Box 2)². Enhanced EU coordination of economic policies is not a new idea. It featured prominently in the Delors Report (1988) and was proposed again in the Sapir Report (2004). But the European Semester defines for the first time the procedural details. The core idea is for the EU to provide annually early policy guidance to EU member states, and for the member states to take on board this guidance to prepare fiscal and other reform plans (Box 1).

The European Semester changes EU policy coordination in a

1. European Commission (2008), 'EMU@10: successes and challenges of Economic and Monetary Union', *European Economy* 2, page 21.

2. A detailed study of the European Semester can be found in Hallerberg, Marzinotto, Wolff (2012).



number of major respects. Firstly, the European Commission defines a list of policy priorities in the Annual Growth Survey (AGS) well before national governments have started preparing draft budgets for the following year. EU member states are obliged to take the AGS into account when drafting Stability or Convergence Programmes and National Reform Programmes. The new approach to policy coordination also gives the European Commission increased intervention rights in terms of both the areas in which the Commission may intervene, and the stringency of the intervention (see Box 2). The Commission's role is strengthened relative to the EU Council, which in some areas can now only oppose a Commission recommendation to impose sanctions on non-performing member states, rather than being required to approve it³. The European Semester also changes EU policy coordination in that fiscal and structural reforms are considered jointly⁴.

The European Parliament fought – rightly – for a stronger role in the European Semester procedure, and secured the right to Economic Dialogues (introduced with the six

BOX 1: THE EUROPEAN SEMESTER TIMELINE

The European Semester begins with the publication by the European Commission of the Annual Growth Survey (AGS), which is a list of general policy priorities for the EU and its member states⁵.

The EU Council (grouped in different formations) and the European Parliament debate the AGS until March, when the spring European Council formally endorses it.

Following endorsement by the Spring European Council, EU member states must take EU policy guidance into account when drafting their Stability or Convergence Programmes (SCPs) and National Reform Programmes (NRPs), both of which they must submit to the Commission by 30 April each year⁶.

The European Commission evaluates national plans to ensure that proposed measures respect the priorities and objectives identified in the AGS. Around the end of May, the Commission publishes its own assessment of national fiscal and structural plans and releases both country-specific recommendations and euro-area recommendations.

The Council then approves draft recommendations, the June European Council endorses them, and finally the Council publishes the country-specific recommendations, which are binding on EU member states.

The six pack allows the European Parliament to make use of the Economic Dialogue instrument to engage in a discussion with EU institutions and national representatives on issues relating to the European Semester – whether concerning the Commission's AGS or the country-specific recommendations or the national implementation of the recommendations – at almost any point in time throughout the Semester process (see Table 1).

pack, see Box 2). These allow the European Parliament to hold discussions with the other EU institutions and with national representatives on economic issues, thereby introducing an element of parliamentary accountability.

Table 1: European Semester timeline

	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July
European Commission	Adoption: AGS						Adoption: CSRs/ EARs		
EU Council	Debate and orientations on AGS							Finalisation and adoption of CSRs and EARs	
European Parliament	European Dialogue								
European Council					Endorsement of AGS			Endorsement CSRs/ EARs	
Member states			National Parliaments discuss SCPs and NRPs			Submission: SCPs/NRPs			

Key: AGS = Annual Growth Survey; CSRs = country-specific recommendations; EARs = euro-area recommendations; SCPs = Stability and Convergence Programmes; NRPs = National Reform Programmes. Source: Bruegel.

3. At the end of the European Semester, each country receives specific recommendations. The Commission monitors Member State progress in the implementation and can propose sanctions for non-compliance. Sanctioning applies only to the failure to bring the fiscal deficit below 3 percent of GDP or to correct large macroeconomic imbalances. There is no sanctioning of more structural interventions in labour and product and service markets.

4. National Reform Programmes are submitted at the same time as Stability or Convergence Programmes. The idea is that the Commission should do a joint review of both the macro and micro economic policies the Member State government is proposing.

5. Formally, the AGS is based on the EU2020 strategy progress report, the Macroeconomic Report and the Joint Employment Report.

6. The two pack legislative proposal suggests that the submission of national documents is anticipated to 15 April in the case of euro area countries.



2 EFFECTIVENESS

A change in EU economic governance will be effective if it addresses the short-term crisis or makes crises less likely in the long-term. The European Semester will be effective if it reduces adverse spillovers between member states and discourages countries from implementing policies that exacerbate existing crises or increase the probability of future crises. On reducing adverse spillovers, it is questionable if European Commission and Council recommendations focus on the policies with the greatest relevance for the monetary union. An analysis of EU recommendations to member states under the European Semester (the analysis can be found in Hallerberg et al, 2012) shows that references to the impact of policy measures on the EU as a whole, or the incorporation of a quantification of potential spillover effects are quite rare⁷.

which is an interesting case because its policy decisions are likely to generate spillovers, because of its size. Germany enjoys a large current account surplus. One would expect a policy discussion about if and how this surplus could be reduced as part of a broader effort to rebalance the euro area. The Council recommendations to Germany do not address the 'surplus problem' but look at the conduct of sound fiscal policy. Recommendations include the full implementation of the debt brake rule⁸ and increased spending on education and research; the need to address structural weaknesses in the financial sector, and of state-level banks in particular (Landesbanken); the reduction in the country's high tax wedge, which penalises employment creation; and reform of the energy sector. While each recommendation might be laudable in its own right, the link to the recession in Europe and the rebalancing of the euro area is not at all evident.

member states. In the recommendations to Italy, the wording on structural reforms to improve competitiveness is extremely weak. The recommendations do not clearly link domestic policy reforms with the need to reduce negative spillovers at European level. This is both a procedural and a substance problem. Procedurally, policy recommendations are not justified by an EU or euro-area logic but are rather a mix of different considerations relating to broader goals. On substance, many recommendations appear to be more important from a domestic than a European point of view.

To be fair, the EU has not completely ignored the euro-area dimension and the importance of spillover effects for different countries and policy areas. One indication of this is that the European Commission and Council issue not just country-specific recommendations but also separate recommendations to the euro area. Still, this seems like an empty exercise. It is not clear who

An illustration comes from the recommendations for Germany,

Similar examples exist for other

BOX 2: THE SIX PACK

The European Semester builds on Articles 121 and 148 of the Treaty on the Functioning of the European Union, according to which EU member states are required to coordinate their economic and employment policies so that the correct functioning of the monetary union can be secured. The six pack, a package of six laws in force since December 2011, codifies the European Semester, clarifying its constituent parts, the stakeholders and their involvement in the process.

The six pack is particularly important for the operation of the Semester in a number of ways. First, it introduces the Macroeconomic Imbalance Procedure (MIP), by which macroeconomic imbalances other than fiscal imbalances are made subject to sanctions. The Alert Mechanism Report (AMR) is the instrument to detect those countries where a more thorough investigation in the MIP is warranted.

Second, the six pack changes some of the voting modalities thereby strengthening the role of the Commission relative to the Council.

Third, the six-pack introduces the Economic Dialogue, which allows the European Parliament to more strongly than before question the other EU institutions and to invite national government representatives to hold them to account for their actions.

7. One other related issue is that EU recommendations so far lack not only a clear identification of spillovers in the euro area but also visible prioritisation both across countries and across policy areas. All countries receive their respective 3-5 policy recommendations with essentially similar urgency.

8. The debt brake rule is a balanced budget provision introduced in Germany in 2009, which implies that from 2016 onwards the Federal Government cannot run a structural deficit of more than 0.35 percent of GDP and from 2020 the states (Länder) must have a balanced structural budget.



the euro-area recommendations are addressed to and who is supposed to implement them. Euro-area considerations should not be treated in a separate document, but should cut across all country-specific recommendations for euro-area countries.

Once adverse spillovers are effectively identified and possibly even quantified, there remains the problem of domestic policy implementation. The evidence collected by Hallerberg *et al* (2012) for a sample of six EU countries indicates that there is a problem in domestic implementation. More precisely, EU recommendations were found to have not altered dramatically the national process of policy formulation, especially when the suggested reforms are likely to erode rents and dominant positions in product and service markets⁹.

3 LEGITIMACY

The problem of the legitimacy of the new economic governance system is directly linked to its effectiveness. Two recent reports discuss the issue. In the so-called *Report of the Four Presidents* from June 2012, the authors call for more involvement of the European Parliament and national parliaments to strengthen “democratic legitimacy and accountability”. The *Report of the Foreign Ministers* three months later similarly focused on the same sets of institutions¹⁰.

But what is democratic legitimacy? Since at least Weiler *et al* (1995), there has been a growing debate about a ‘democratic

deficit’ in Europe. For Scharpf (1999), it is important to consider both *input legitimacy* and *output legitimacy*, and we will use that template here. Input legitimacy is government by the people. For this to exist, the voters have to participate. In this respect, the EU has several widely recognised flaws, as many academic and media commentators have noted¹¹. Member states, rather than the people themselves, appoint EU commissioners. The main representative body is the European Parliament, but participation in European parliamentary elections, has dropped progressively since direct elections were introduced in 1979. Academic work suggests that people often vote in such elections based on their views of their current government, not on the basis of European political developments, though there is some evidence that this might be starting to change¹².

Scharpf’s definition of output legitimacy is democracy for the people. This is harder to judge, but again there are institutional prerequisites. There should be electoral accountability — it should be possible for the public to remove non-performing policymakers. Follesdal and Hix (2006) fault the EU especially on this account: it is not possible for voters to remove an unpopular commissioner. Scharpf (1999) also wants independent expertise that is meant to encourage outcomes that are good for the EU population more generally. On this count, the European Central Bank and the EU Court of Justice are effective. Policies that improve the welfare of all citizens

are also output-legitimate in Scharpf’s definition. In the current context characterised by significant imbalances the definition of the general welfare of all citizens is complicated and makes the concept of output legitimacy less relevant than that of input legitimacy. Our focus is thus on input legitimacy and on the aspect of output legitimacy that deals with the capacity of European voters (or their legitimate representatives) to hold EU institutions to account.

3.1 The role of the European Parliament

The Treaty on the Functioning of the European Union gives only limited authority to the European Parliament in the exercise of economic policy coordination. The Parliament has an information right under macro-economic surveillance (Articles 121 and 126 of the Treaty). More specifically, the EU Council President and the Commission must report to the European Parliament on the results of the macro-economic surveillance exercise and the approved EU recommendations. The European Parliament is thus informed but is has no power to change recommendations relating to economic policy coordination in the EU.

The situation has slightly improved since the adoption of the the six pack and the introduction of the Economic Dialogue (see Box 2). The European Parliament can now step into the Semester on its own initiative, at almost at any point in the procedure, whether to discuss the AGS after the spring European Council,

9. The German case demonstrates that Member State governments generally ‘implement’ recommendations they were already doing anyway and ignore recommendations that would involve truly new reforms.

10. Van Rompuy, Herman (2012) and Future of Europe Group (2012).

11. A good press review is ‘The eurozone: an ever-deeper democratic deficit’, *The Economist*, 26 May 2012.

12. At the same time, there is at least some hope that this may be evolving—in a recent special issue of *Electoral Studies*, which analysed a set of data from the 2009 European Parliamentary elections, there is some evidence that in Member States where there was a lot of coverage of European issues there was also voting more along European instead of national lines. See *Electoral Studies*, March 2011, vol 30 (1), edited by Sara Hobolt and Mark Franklin.



or in reaction to the final country-specific recommendations. It still cannot change recommendations. Yet, while such involvement does not come with any decision-making rights, it still represents an instrument to exercise moral suasion and to hold EU institutions to account.

3.2 The role of national parliaments

The budget is the most important part of the parliamentary decision-making power in each country. Structural reforms in terms of labour market laws, product market policies and competition policies are also central elements of parliamentary decision-making processes. More intrusive EU intervention into national decision-making processes therefore raises the question of how policy outcomes are legitimised. While the European Semester assigns a weak role to the European Parliament, the Semester's legitimacy would not be an issue if there was evidence that national parliaments are truly involved in the process. To investigate this issue, in a previous project for the European Parliament, we submitted a survey to the EU27 national parliaments to determine the extent to which they discuss Stability or Convergence Programmes, National Reform Programmes and the EU's recommendations. The results presented in Hallerberg *et al* (2012) may be summarised as follows¹³.

First, only the parliaments of France, Italy, Luxembourg, Portugal, Slovakia, Spain and the United Kingdom discuss Stability

and Convergence Programmes. Where the programmes are discussed, it is mostly because the parliament is already involved in the discussion of government multi-annual fiscal plans other than its Stability or Convergence Programme. Italy and Portugal are exceptions to this: their parliaments discuss only the 'European' and not 'domestic' documents.

Second, parliamentary committees are much more involved than plenaries in the discussion of European documents. In the majority of countries both the budget and EU affairs committees discuss either Stability and Convergence Programmes (eg Finland) or National Reform Programmes (eg Cyprus, UK) or both (eg Estonia, Germany, Hungary, Italy, Latvia, Lithuania, Luxembourg, Portugal, Slovenia, Sweden).

Third, a significant number of EU countries have not discussed Council recommendations received at the end of the European Semester cycle, even if member states are indeed asked to include those recommendations in the measures listed in the national budget law for the consecutive year, and in laws on broader macroeconomic issues. Where the EU recommendations have been discussed, the debate concerned both fiscal recommendations under Stability and Growth Pact provisions, and non-binding structural reform recommendations, and were mostly dealt with by European affairs committees as if they were more a matter of the relationship with the EU, rather than being cen-

tral to citizens' welfare.

We therefore conclude that, so far, national parliaments have not sufficiently discussed and debated, let alone provided legitimacy for, the EU Council recommendations.

4 THREE WAYS TOWARDS MORE EFFECTIVENESS AND LEGITIMACY

We see three options for strengthening the democratic legitimacy, and in turn the effectiveness, of the new EU economic governance framework: (a) enhance the role of the European institutions at member state level while increasing the role of the European Parliament in holding EU institutions to account, (b) enhance the role of national parliaments at the EU level, and (c) create a legitimate political union, which would require the role and decision-making powers of the European Parliament to be enhanced in a significant fashion. All three options have in common that they attempt to improve the process of defining the common European interest, which should render the EU more effective and legitimate. The first two options could – at least to some extent – be done in the framework of the current treaties. The third option would likely require treaty changes.

4.1 Brussels goes to capitals

Input legitimacy would increase if the European Commission would have more regular contacts with national parliaments. The October 2012 visit of European Central Bank president Mario Draghi to the German Bundestag sets an

13. We received replies to our survey from all countries except Bulgaria.



example that Commissioners should follow¹⁴. One can argue, of course, that contact with the European Parliament is enough; contacts with national parliaments would be unduly burdensome in terms of time and expense. Yet the EU is by no means a self-contained mature polity, and the European Parliament is not the sole, or even the main, source of input legitimacy¹⁵. More outreach to national legislatures by Brussels would relieve national governments from being the main communication channel between the EU and national parliaments. While Hallerberg *et al* (2012) showed that many national parliaments are active and debate the national documents submitted to the EU, far fewer parliaments debate the recommendations issued by the Council. Yet, that is the stage at which concrete policy measures should be formulated and implemented by national parliaments. A stronger presence by the responsible Commissioner, for example in the form of a hearing at a number of national parliaments each year, would be a strong step towards making EU coordination more effective.

Brussels would go to capitals if the inter-parliamentary cooperation between the European Parliament and national parliaments is exploited to its full potential. The existing Interparliamentary Committee meetings¹⁶ should be used as a forum to strengthen communication channels. The meetings should be regular, open to the public, possibly even held in different capitals and include meetings with a broader group of national parli-

mentarians. These steps would also increase the visibility of the European Semester in national media.

At the same time, the European Parliament should play a greater role in holding the EU institutions to account for their decisions. The six pack has created a strong instrument for that purpose. The European Parliament should build on the Economic Dialogue to invite representatives from European institutions on a regular basis. We see at least three points in the cycle for this: i) at the beginning of the cycle shortly before the AGS is published, so that the dialogue can have an impact on the definition of early policy priorities; ii) after the publication of the AGS to assess the extent to which the European Commission has taken the Parliament's policy preferences into account; and iii) when the European Council endorses country-specific recommendations, especially if there are discrepancies between these and the initial European Commission draft recommendations. The Economic Dialogue also allows the European Parliament to invite member state representatives. This could be an effective way of increasing the visibility of European decisions at national level.

4.2 Capitals go to Brussels

A second approach consists of giving national parliaments a more explicit and direct role in the European decision-making process. The EU Treaty gives national parliaments the right to be informed about EU activities and to voice objections to EU

policies, even if this is restricted to specific policy areas (eg judicial cooperation in civil matters, see Article 12 and Protocol 1). Inter-parliamentary cooperation, mentioned in section 4.1, is the key instrument through which national parliaments engage in a dialogue with the European Parliament.

The Treaty on Stability, Coordination and Governance (TSCG), which is intended to safeguard the stability of the euro area, and was signed by EU governments with the exception of the Czech Republic and the UK in March 2012, refers to the need to involve national parliaments in the emerging system of EU fiscal governance. The aim is to create a system in which the national prerogatives in the budgetary processes can be voiced at a European level, while European commitments are effectively transmitted to the national level. The entry into force of the TSCG thus puts the spotlight on national parliaments. The question is whether this will be effective. How does the emerging model of decentralisation of fiscal policy impact on the capacity of parliaments to put a strain on national budgets?

The stringency and intrusiveness of European fiscal commitments puts in question the role of national parliaments especially in those countries where the parliament plays a strong role in the budgetary process (eg Germany and Finland). The TSCG is a genuine attempt to reinvigorate their role by setting up a fiscal governance framework with a strong centre, the European

14. See <http://www.ft.com/intl/cms/s/0/0008a432-1e01-11e2-ad76-00144feabdc0.html#axzz2BTgmxy9y>.

15. The German Constitutional Court even questioned the democratic legitimacy of the European Parliament, see <http://www.bundesverfassungsgericht.de/pressemitteilungen/bvg09-072en.html>.

16. See <http://www.europarl.europa.eu/webnp/cms/lang/en/pid/11>.



Commission, but which is at the same time decentralised, as all contracting parties commit to introduce a binding debt brake rule in their national legislation.

The advantage in terms of legitimacy from this approach is that, in the absence of a European fiscal union of some sort¹⁷, national parliaments are the legitimate representatives, especially now that taxpayers' money is used to fund financial assistance in crisis countries (see Pisani-Ferry, 2012).

4.3 Going beyond current treaties

A third option would be to create some form of political/fiscal union, which would also require increasing the role of the European Parliament in decision making. This ultimately will require Treaty changes. Within the current treaties, the European Parliament cannot change decisions taken by the Council, and it has no taxation powers. Also, national parliaments set labour

and product market laws. A Treaty change would thus be required if the European Parliament were to be granted some form of taxation power to create a sufficiently large buffer that supports countries in difficulties. A form of fiscal union could be created by providing the EU with a budget for stabilisation purposes, with decisions on spending legitimised by the involvement of the European Parliament, which would approve this budget as it does now for the EU27 budget. This type of fiscal union would raise the question of whether a split of the European Parliament into a euro-area assembly when it comes to decisions on the euro-area budget would be necessary¹⁸. While divisive, such an institutional set-up may increase the legitimacy of the EU by creating a parliamentary counterpart to the Eurogroup.

5 CONCLUSIONS

The three alternatives we envisage correspond to three different visions of Europe. The first is

about the Europeanisation of national policies, the second about the re-nationalisation of European policies and the last about a soft political union with some fiscal capacity. The first two options would be the easiest to accomplish, and they would not require any Treaty change. There is an argument to be made, however, that a jump towards greater fiscal federalism would be the most effective option for bringing an end to the current crisis, and would provide the necessary tools to fight future crises. In this case, the direct involvement of the European Parliament would also increase legitimacy.

Regardless of which path the EU decides to take, it does need to move down one of them and will probably eventually have to move to the more federal option. Markets have a point when they judge the current system to be ineffective, and citizens have reason to worry that the current system lacks legitimacy. The status quo is not acceptable on either count.

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17. For a proposal for a fiscal union in Europe, see Marzinotto, Sapir and Wolff (2011).

18. The same proposal was put forward by Angela Merkel speaking in front of the European Parliament on 7 November 2012. It was suggested by Hallerberg et al (2012).

