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How to make the European Semester more effective and legitimate?

Euro Area Scrutiny

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How to make the European Semester more effective and legitimate?

Euro Area Scrutiny

Abstract

The Commission has launched an assessment and revision of the so-called six-pack and two-pack legislative packages. This paper assesses the successes and shortcomings of the European Semester with a focus on legitimacy, effectiveness and ownership. It argues that in order to address these problems, the framework should be redesigned from a new starting point, which builds on existing divisions of competence and clear decision making structures. This would help to restore the honesty and credibility of the Semester, which should be geared at supporting accountability at the national level.

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LIST OF ABBREVIATIONS

AMR	Alert Mechanism Report
ASGS	Annual Sustainable Growth Strategy
CJEU	Court of Justice of the European Union
CSR	Country-Specific Recommendations
ESI	Emergency Support Instrument
ECB	European Central Bank
EDP	Excessive Deficit Procedure
EMU	Economic and Monetary Union
EP	European Parliament
EU	European Union
IMF	International Monetary Fund
MIP	Macroeconomic Imbalance Procedure
MTO	Medium-Term Budgetary Objectives
NRP	National Reform Program
RQMV	Reversed Qualified Majority Voting
SDG	Sustainable Development Goals
SCP	Stability and Convergence Program
SGP	Stability and Growth Pact
TFEU	Treaty on the Functioning of the European Union
UN	United Nations

EXECUTIVE SUMMARY

The Commission has launched an assessment and revision of the so-called six-pack and two-pack legislative packages. This paper assesses the successes and shortcomings of the European Semester with a focus on legitimacy, effectiveness and ownership. In particular, we identify four problematic areas that demand attention:

- the deficit of accountability mechanisms resulting from the deliberative, multi-level governance system of decision-making within the European Semester;
- the complexity of the whole framework resulting from the increased number of objectives to be considered under a rule-based system;
- the pernicious effects of enforcing policy decisions through sanctions for the honesty of allegedly technical assessments; and
- the specific voting rule (reverse qualified majority voting) according to which some decisions are to be adopted.

It argues that in order to address these problems, the framework should be redesigned from a new starting point, which builds on existing divisions of competence and clear decision making structures. The new European Semester should build on four elements:

- *Restoring the honesty and credibility of the Semester.* Under the current system, the valuable technical assessment provided by the Commission is not adequately reaching national policy-makers. This is due the need to avoid escalation of political conflicts..
- *Limiting sanctions to the bare minimum* required by the Treaties. The sanctions introduced through secondary legislation as part of the preventive arm of the SGP and the MIP should be abolished. They create unnecessary obstacles to frank and open discussion on economic policies.
- *Refraining from using the Union budget as an* additional sanction mechanism in economic governance. Incentive measures can only be used to protect Union funds when the effectiveness of Union programs is in fact being undermined.
- *Restoring the institutional roles as defined in the Treaties*: The Commission tasks should be reconsidered and limited to technical ones, reducing the political dimension of its work and restoring its technocratic quality. The Council should be reintegrated into the Semester, forced to take an active role in confirming and legitimising the Commission assessments.
- Finally, the new European Semester should *be utilised maximally to support accountability at the national level*. With its honesty restored and its analysis debated in a public and transparent manner, the Semester can help to clarify where mistakes were made and who is responsible for them.

1. INTRODUCTION

The Commission recently launched an assessment and revision of the so-called six-pack and two-pack legislative packages.[1] Introduced during the euro crisis, they modified the Stability and Growth Pact (SGP) and supplemented it with macroeconomic surveillance. They created the basis of the European Semester, under which Member States' national macroeconomic and employment policies are coordinated. In light of the current review, this study will analyse and make suggestions on how the EU's current 'rules-based' economic governance system could be made more effective and legitimate. In particular, we will make proposals on how 'political ownership' of the system could be enhanced at the EU and at the national levels.

In its assessment, the Commission recognises that the current framework has not always worked to perfection:

> *'multiple rules do not always yield the same conclusion in terms of compliance, thus requiring the use of economic judgement. In addition, the framework relies heavily on variables that are not directly observable and are frequently revised, such as the output gap and the structural balance, which hampers the provision of stable policy guidance. While the higher degree of sophistication of the SGP is meant to make the framework more adaptable to changing economic conditions, it has also increased its complexity and reduced its transparency, especially of the preventive arm. This has hampered ownership, communication and political buy-in. To some extent, these shortcomings have been addressed by the Commission through its stronger focus on the expenditure benchmark, which provides more stable and operational policy guidance and focuses on budgetary items directly under the control of the government.'*[2]

Despite these shortcomings, the global account of the Commission is largely positive. The Commission believes that 'the six-pack and two-pack reform, together with the roll out of the European Semester, have strengthened the framework for economic surveillance in the EU and euro area and guided Member States in achieving their economic and fiscal policy objectives. They have also led to a broader and more integrated approach to surveillance that better assures the overall consistency of policy advice within the European Semester'.[3]

External accounts of the track record are less generous. Observers point out how the current framework is unnecessarily complex and contains too many conflicting objectives. Financial sanctions in case of non-compliance with the EU fiscal rules framework have been politically difficult to enforce. Also, the European Parliament (EP) '[r]ecalls that the degree of implementation of the country-specific recommendations is too low; believes that the focus of the European Semester should be on national ownership; urges national and regional parliaments to debate country reports and country-specific recommendations and to engage with the relevant actors; points out that a more streamlined and more focused European Semester could increase ownership'.[4]

In the absence of a counterfactual evidence – how Member States would have conducted their economic policies in the absence of the European Semester – it is difficult to make a definitive

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[1] European Commission, *Economic governance review: Report on the application of Regulations (EU) No 1173/2011, 1174/2011, 1175/2011, 1176/2011, 1177/2011, 472/2013 and 473/2013 and on the suitability of Council Directive 2011/85/EU* COM(2020) 55 final, of 5 February 2020.

[2] European Commission, see note 1, p. 10.

[3] European Commission, see note 1, p. 16.

[4] European Parliament, *Resolution on the European Semester for economic policy coordination: Annual Growth Survey 2019* (2018/2019(INI)) of 13 March 2019, paragraph 32, available at https://www.europarl.europa.eu/doceo/document/TA-8-2019-0201_EN.pdf.

assessment of its success. The Semester has multiple objectives. It aims to ensure sound public finances through the avoidance of excessive government debt, prevent excessive macroeconomic imbalances, support structural reforms and boost investment.5 It seems clear that the framework has failed to meet many of these goals. It has manifestly failed to adjust Member States' fiscal situation in accordance with the Treaty limits, it is objectively very complicated, and it has frequently become a source of discord and even an object of ridicule for national politicians.

We believe that some EU oversight is useful to encourage States to pursue sound economic policies, but we see important shortcomings in the current framework. These shortcomings are architectural, relating to the basic aims and assumptions underlying the framework. We believe that the (relative) failure of the framework is primarily a result of its focus on rules and enforcement. The European Semester is essentially about trying to force, at the threat of sanctions, unpopular policies on Member States. We doubt that this will be successful, and the experiences from applying the framework support this conclusion. It is not likely that a minor tweaking of the internal mechanics of the Semester will result in a better outcome.

In our view, a tangible improvement would require a fundamental reorientation of the European Semester towards better co-operation and ownership at the national level. Instead of trying to outlaw bad policies, the 'new Semester' should be geared towards nurturing ownership of good policies within Member States' democratic structures. Rather than on authority and sanctions, the new European Semester would rely on dialogue and openness. It should be a visible voice of reason that supports an informed debate and gradual build-up of popular support for sound policies.

In the following, we will first outline the current Treaty and legislative framework relating to the European Semester and assess its successes and shortcomings. We then discuss the ambitions relating to legitimacy, effectiveness and ownership, and what in the current framework is particularly problematic and should be amended. We close with proposals for a 'new European Semester'.

[5] As defined on the Commission website, https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester/framework/european-semester-why-and-how_en .

2. THE DEVELOPMENT OF THE ECONOMIC GOVERNANCE AND ITS ASSESSMENT

2.1. Provisions of the Treaties on economic policy coordination

The constitutional design of the Economic and Monetary Union (EMU) is intentionally asymmetrical: at the core is the Euro and its management, which needs to be uniform and centralised. Incidentally, to avoid malfunctions, Member States' economic policies have to be aligned in support of the common currency. They remain the competence of Member States, which, pursuant to article 2(3) TFEU, are required to "coordinate their economic and employment policies within arrangements as determined by this Treaty". In addition, article 146 TFEU regards promoting employment as a matter of common concern, thus requiring Member States to coordinate their actions in this field as well. As to the meaning of the term "coordinate", article 2(5) TFEU stipulates that, "*in certain areas and under the conditions laid down in the Treaties, the Union shall have competence to carry out actions to support, coordinate or supplement the actions of the Member States, without thereby superseding their competence in these areas.*" Therefore, in these two fields, Union competence cannot be used to overtake Member State competence or to settle substantive outcomes.

The coordination arrangements are further specified in Articles 121 and 126 TFEU, describing the multilateral surveillance procedure and the Excessive Deficit Procedure (EDP), respectively. Article 121 TFEU lays down the multilateral surveillance procedure, under which the Council adopts a recommendation on the broad guidelines of the economic policies of the Member States, the observance of which the Commission monitors on the basis of information provided by the States. In the case of infractions, the Council can adopt recommendations and—as the ultimate form of peer pressure—make them public. On the other hand, the EDP (article 126 TFEU, read altogether with Article 1 of Protocol No 12) establishes limits for public deficit and gross debt (3 and 60 per cent of GDP respectively), with limited discretion and few escape clauses. The Treaty also establishes a well-defined path of escalation from a Council recommendation to non-interest-bearing deposits until the excessive deficit was corrected and eventually, in the absence of effective action, fines "of an appropriate size". The Treaties provide the possibility to adopt relevant secondary legislation to develop further these two key procedures, the EDP and the multilateral surveillance procedure, if deemed necessary (articles 121(6) and 126(14), with the possibility of adopting specific measures for euro area Member States through article 136(1) TFEU).

The Treaty leaves the responsibility for substantive choices on economic policy with the Member States. As the Court of Justice of the European Union (CJEU) acknowledged in its ruling in *Pringle*, "[a]rticles 2(3) and 5(1) TFEU restrict the role of the Union in the area of economic policy to the adoption of coordinating measures".[6] This said, due to EMU's design, national decision making on these issues must take into account implications for the whole EU. This tension has been addressed through the several incarnations of the SGP since the creation of the Euro. Secondary law has established three successive regimes of coordination (here referred to as the 'original SGP', the 'revised SGP' and the 'European Semester').

6 Judgment of 27 November 2012, *Pringle*, C-370/12, EU:C:2012:756, paragraph 64.

2.2. The evolution of secondary law in the coordination of economic policies

2.2.1. The original and revised SGP

The original SGP was composed of a European Council resolution[7] and two regulations, one developing the multilateral surveillance procedure[8] and the other one the EDP.[9] This arrangement was soon put to the test before the CJEU.[10] When for different reasons France and Germany did not observe the deficit limit of 3 per cent of GDP, the Council failed to follow the proposal of the Commission to declare that they had incurred in excessive deficits. This situation laid bare that while Commission action was based on data and figures, the actual implementation by the Council was discretionary. Member States were reluctant to sanction their peers. Hence, a mismatch between EMU's design and Member State incentives to implement the rules, in particular regarding the imposition of sanctions, was identified.[11]

Consequently, in 2005 Member States decided to amend the two regulations.[12] The aim was to minimise the number of discretionary decisions adopted by the Council by transferring to the Commission part of the required assessment on the affected Member State's fiscal position. This was also possible by adding a new, preventive layer to the SGP, until then mainly focussing on corrective measures.

The revised SGP introduced several innovations. First, the multilateral surveillance procedure was articulated through Medium-Term budgetary Objectives (MTOs) adapted to the specific features and economic contexts of each Member State.[13] Consequently, the rule requiring a budget "close to balance or in surplus" became subject to a discretionary assessment.[14] Second, the EDP redefined the notion of "severe economic downturn" as merely equivalent to negative growth,[15] which eased their justification. Third, the items that the Commission must take into consideration when assessing whether to launch an EDP against a Member State became subject to an exhaustive list of issues, including elements which "in the opinion of the Member State concerned" are relevant to justify the deficit.[16] Finally, more flexibility regarding the deadline for addressing the deficit once declared by the

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7 Resolution of the European Council on the Stability and Growth Pact of 17 June 1997 (OJ C 236, 2.8.1997, p.1).

8 Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (OJ L 209, 2.8.1997, p. 1).

9 Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ L 209, 2.8.1997, p. 6).

10 Judgment of 13 July 2004, *Commission v Council,* EU:C:2004:436, ECR I-06649.

11 As anticipated by some scholars, for instance Herdegen, M.J., 'Price Stability and Budgetary Restraints in the Economic and Monetary Union: The Law as Guardian of Economic Wisdom', *Common Market Law Review,* Vol. 35, 1998, p.31.

12 Council Regulation (EC) No 1055/2005 of 27 June 2005 amending Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (OJ L 174, 7.7.2005, p.1); Council Regulation (EC) No 1056/2005 of 27 June 2005 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ L 174, 7.7.2005, p.5).

13 Recital 5 of Regulation 1055/2005.

14 Artis, M.J., and Onorante, L., 'The revision of the Stability and Growth Pact: The Medium-Term Objective', in Simona Talani, L., and Casey, B., (eds.), *Between Growth and Stability: The Demise and Reform of the European Union's Stability and Growth Pact*. Edward Elgar, Cheltenham, 2008, pp. 170–190.

15 A severe economic downturn can be considered exceptional if it results "from an accumulated loss of output during a protracted period of very low annual GDP volume growth relative to its potential" See Article 2.2 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure as amended by Council Regulation (EU) No 1177/2011 of 8 November 2011.

16 Article 2.3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure as amended by Council Regulation (EU) No 1177/2011 of 8 November 2011.

Council was granted to Member States.[17] Although the coordination of economic policies was still considered of the essence for the stability and proper working of the common currency area, the combination of all these amendments was seen to weaken the budgetary framework. There was a move from the swift management of excessive deficits to increase Member States' reaction time when addressing the problem. This has been characterised as a switch from a "rules-based system back to a system of discretionary fiscal policy making".[18]

2.2.2. The European Semester

For many, the Euro crisis manifested the toothlessness of Europe's fiscal rules and its economic policy coordination. The remedy was to strengthen and expand the framework. Following the Commission's initiative, a six-month cycle to coordinate national structural reforms and stability and convergence programmes under a new set of macroeconomic priorities was first articulated through informal mechanisms.[19] Later, the reforms were institutionalised through several pieces of secondary legislation grouped in two packages, one from 2011 (six-pack)[20] and the other from 2013 (two-pack).[21] The objective was to ensure implementation by national authorities of guidelines and recommendations coming from the European level. The reform was partly based on regulations with article 136 TFEU as the legal basis in order to increase the enforceability of measures for those Member States in the euro area, especially through new sanctioning procedures. Measures were also taken to strengthen national budgetary frameworks, most notably through the setting up of independent fiscal institutions to monitor compliance with fiscal rules.

These measures developed the multilateral surveillance procedure far beyond measures of coordination. As aresult, the 'new measures are also increasingly mingling with matters of national competences'.[22] Secondary legislation not only regulates the Article 121 TFEU procedure in greater detail (as the legal basis provides), but also adds a number of new stages and expands and amends the roles of the EU institutions beyond those defined in the Treaty-based economic policy framework. A

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[17] Article 2.3 and Article 3.4 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure as amended by Council Regulation (EU) No 1177/2011 of 8 November 2011.

[18] Calmfors, L., *What remains of the Stability Pact and what next?* Swedish Institute for European Policy Studies (SIEPS), Stockholm, 2005, p. 68.

[19] Fasone, C., 'European Economic Governance and Parliamentary Representation. What Place for the European Parliament?', *European Law Journal*, Vol. 20, 2014, p.169.

[20] Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (OJ L 306, 23.11.2011, p. 12); Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (OJ L 306, 23.11.2011, p.25); Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area (OJ L 306, 23. 11. 2011, p.8); Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area (OJ L 306, 23.11.2011, p.1); Council Regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ L 306, 23.11.2011, p.33); and Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States (OJ L 306, 23.11.2011, p.41)

[21] Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability (OJ L 140, 27.3.2013, p. 1); and Regulation (EU) 473/2013 of the European Parliament and of the Council, of 21 May 2013, on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (OJ L 140, 27.5.2013, p.11).

[22] See S. Bekker and I. Palinkas, 'The Impact of the Financial Crisis on EU Economic Governance: A Struggle between Hardand Soft Law and Expansion of the EU Competences?', Tilburg Law Review, 17(2), 2012, 360–6. Similar findings can also be found in R. Bieber, 'The Allocation of Economic Policy Competences in the European Union', in L. Azoulai (ed.), The Question of Competence in the European Union (Oxford University Press, 2014), pp. 86–100.

new voting rule in the Council, Reversed Qualified Majority Voting (RQMV), was introduced, in accordance with which decisions are to be deemed adopted unless a majority of Member States rejects the Commission proposal. At the same time, the new legislation introduced significant legal consequences for Member States unwilling to follow the recommendations issued in the course of the procedure, through the adoption of sanctions (which Article 121 TFEU itself does not expressly provide). The legal instrument to be used in the procedure has been changed from a Council recommendation to a Council decision, which is used to establish that certain Member State measures have been insufficient or to impose interest-bearing deposits or fines.[23] This change has significant legal consequences. While recommendations have 'no binding force' (Article 288 TFEU), a Council decision is 'binding in its entirety' and can be reviewed by the Court of Justice. Hence, for example, the legality of a Council decision establishing an excessive macroeconomic imbalance in a Member State could in principle be challenged in the Court. This procural change is relevant for those parts of the European Semester that build on the preventive and corrective arms of the Stability and Growth Pact and the MIP.

These reforms are significant from a constitutional and institutional perspective. They specifically aim at affecting institutional balance and roles in the area of economic policy-making and have implications for the clarity of the division of competence between the EU and the Member States. The discretion of the Council is significantly constrained, since it is to follow the recommendation of the Commission or otherwise publicly explain its decision.[24] Further, as part of the Fiscal Compact, the euro area countries have committed to support Commission proposals in the Council, unless the qualified majority of them is against it. Hence, while the formal power of sanctioning is still with the Council, it is in reality the Commission that is in charge of all the important decisions. How the Court would interpret these changes is unclear since, thus far, this legislation has not been challenged before it. However, in general, the principle of institutional balance has been of crucial significance when evaluating what kind of procedural changes might be compatible with the Treaties. The Court has stressed that 'the rules regarding the manner in which the Community institutions arrive at their decisions are laid down in the Treaty and are not at the disposal of the Member States or of the institutions themselves'.[25] For this reason, the Court has stressed, the 'Treaty alone may empower an institution to amend a decision-making procedure established by the Treaty'.[26]

The resulting "new governance architecture for socioeconomic policy coordination in the European Union", aiming at complementing national budgetary processes, is known as the European Semester.[27] With the aim of increasing the coordination of economic policies and awareness of specific cross-border risks, the Commission and the Council now monitor each Member State's budget implementation during the previous tax year and assess its budgetary prospects for the next one(s). Hence, the European Semester integrates into a continuous policy cycle of reporting and monitoring three processes: fiscal surveillance of national budgets (preventive and corrective arms of the SGP),

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[23] See Regulation (EU) No. 1174/2011, Art. 3; Regulation (EU) No. 1173/2011, Arts. 5 and 6. The use of Council decisions is particularly prominent in the context of the Two Pack. Based on Regulation (EU) No. 472/2013, the Council also adopts implementing decisions approving the update of the relevant Member States' macroeconomic adjustment programme.

[24] Article 2a.1, second paragraph, of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure, as amended by Council Regulation (EU) No 1177/2011 of 8 November 2011.

[25] Case 68/86 *United Kingdom v Council* [1988] ECR 855, paragraph 38.

[26] Judgment of 6 May 2008, *Parliament v Council,* Case C-133/06, EU:C:2008:257 paragraphs 54–55, which concerns the use of so-called secondary legal bases.

[27] Verdun, A. and Zeitlin J., 'Introduction: The European Semester as a new architecture of EU socioeconomic governance in theory and practice', *Journal of European Public Policy*, Vol. 25, 2018, p. 137.

multilateral surveillance of macroeconomic imbalances, now complemented with a Macroeconomic Imbalance Procedure (MIP), and coordination of employment policies. In addition, the Emergency Support Instrument (ESI) Regulation[28] introduces the possibility to suspend structural and investment funds to a Member State in violation of the economic governance framework. In accordance with the Regulation, the purpose of the conditionality is "to ensure that the effectiveness of expenditure under the ESI Funds is underpinned by sound economic policies".[29]

Overall, the European Semester broadened considerably the range of situations in which the EU could interfere—through recommendations, instructions and, increasingly, even outright sanctions—in a Member State's fiscal policies throughout the policy cycle. What was initially an emergency brake, to be invoked when a Member State's policies pose a direct threat to the stability of the single currency, turned into a broad vehicle for guiding Member States towards fiscal policies deemed adequate on a continuous basis. In this regard, the framework continued the trend from a rules-based system towards increasingly discretionary co-ordination where a wide variety of exceptional circumstances, temporary factors and measurement issues have come into play.[30] Sanctions result from the breach not of a numerical limitation (as was initially the case in the original SGP), but of the discretionary assessment of the Commission regarding some concrete parameter – deficit ratio to GDP, trajectory of debt ratio to GDP, balance of payments or current account imbalances, to name a few. Increasing discretion was made very explicit in the area of fiscal policies through the adoption of the Commission's 'Flexibility Communication' on the SGP,[31] which the Council Legal Service,[32] labelled as 'illegal' since the change "violates the letter and spirit of the EU's budget rules".[33] In addition, in response to the COVID 19 crisis, the Commission has recently activated the general escape clause under the SGP. While the necessity of this measure is not in doubt, the Commission makes it explicit that no normal budgetary requirements will apply in the foreseeable future.[34] While the procedures under the Stability and Growth Pact will be formally applied, the application of the general escape clause implies that the normally applicable budgetary requirements under the Pact will not apply.

The European Semester establishes a general procedure for the monitoring and assessment of Member States' budgetary process, requesting Member States to submit their budgetary plans for monitoring purposes. The whole policy cycle at the European level starts in November, when the Commission presents its Annual Sustainable Growth Strategy (ASGS), including its view of EU policy priorities for the coming year and integrating the objectives of the United Nations (UN) Sustainable Development Goals (SDGs). Member States are invited to take into account those policy priorities when drawing up their economic policies for the coming year. In parallel, the Commission makes public its assessment of

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[28] Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347 20.12.2013, p. 320).

[29] See note 26, Recital 24.

[30] A discussion in Leino, P., and Saarenheimo, T., 'Sovereignty and Subordination: On the Limits of EU Economic Policy Co-ordination', *European Law Review,* Vol. 42, 2017, pp. 166-189.

[31] European Commission, *Making the best use of the flexibility within the existing rules of the Stability and Growth Pact,* COM(2015) 12 final/2 of 10 February 2015. Revised by European Commission, *On the review of the flexibility under the Stability and Growth Pact,* COM(2018) 335 final of 23 May 2018.

[32] Council of the European Union, *Opinion of the Legal Service,* 7739/15 of 7 April 2015.

[33] Financial Times, 'Leaked legal opinion: EU too loose with budget rules?', 4th May 2015, available at https://www.ft.com/content/6d5874a4-490b-3988-a55b-79ce30f8fe67.

[34] European Commission, *On the activation of the general escape clause of the Stability and Growth Pact* COM(2020) 123 final of 20 March 2020.

potential economic imbalances affecting a Member State, the Euro area or the whole Union in an Alert Mechanism Report (AMR). This document compiles the results of a scoreboard of indicators and launches the annual cycle of the MIP. In February, the Commission publishes country reports assessing Member States' progress in implementing Country Specific Recommendations (CSR) and, for the first time in 2020, monitoring their advancement towards the SDGs.[35] For the elaboration of these reports the Commission not only employs 'EU Semester officers' placed at EU representations, but also builds its assessment on a number of exchanges with national institutions and stakeholders.. These reports include analyses of the eventual spill-over effects of national policy proposals within the framework of the MIP and, if the Member State at hand is experiencing imbalances, the corresponding In-Depth Review (IDR) is also considered. In March, the European Council debates the ASGS, sets out overall policy guidelines, and adopts conclusions. In April, national governments must submit their policy plans, including among other documents Stability and Convergence Programmes (SCP) outlining the Member States' medium-term budgetary strategy, as well as National Reform Programmes (NPR) outlining Member States' structural reform plans and focused on promoting growth and employment. In May, the European Commission evaluates national policy plans and presents draft CSR, which are discussed and agreed by the Council in June and endorsed by the European Council. During this process, Member States are also offered an opportunity to comment on the draft. The process is confidential. In July the Council adopts the CSRs, and Member States are invited to implement them. After that, Member States proceed with the elaboration of their draft budgetary plans according to their national procedures. By the 15th of October they must submit them to the Commission for it to adopt an opinion before the end of November, for a discussion by the Eurogroup. In case of a risk of a serious non-compliance with the rules, the Commission can request amendments to the budgetary plan.

The role of the EP in the European Semester is modest. It is involved as a co-legislator in establishing the legal framework under Article 121(6) TFEU, but it is not involved in its implementation, nor do the Treaties allocate it any such role. It discusses the ASGS and may publish its own initiative report. It also issues an opinion on employment guidelines, and is involved in the Semester through the economic dialogue. The EP may invite the President of the Council, the Commission and, where appropriate, the President of the European Council or the President of the Eurogroup to discuss issues related to the European Semester. However, the most important role for the EP could be through holding the Commission accountable for the political choices it makes in implementing the framework. In reality, this is not going to be simple, as the accountability mechanisms available for the Parliament are not well suited for the kind of complex policy questions that the Semester entails.[36]

Since the introduction of the European Semester, various proposals have been made to further broaden its scope and to create new incentives for Member States to comply with the recommendations. The Five Presidents' Report suggested that the right to benefit from certain Union programmes should be "tightly linked to compliance with the broad EU governance framework and to

[35] European Commission, *2020 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176(2011)*, COM(2020) 150 final, of 26 February 2020.

[36] There have been some cases where the European Parliament has played an influential role in matters linked to the Semester. In fall 2016, the European Parliament managed to stall the process of *de facto* sanctioning Spain and Portugal for lack of effective action to correct excessive deficit. It did so through suspending their access to the Structural and Investment Funds. For this, the European Parliament used highly effectively its right to invite the Commission to "structured dialogue". The dialogue turned to be a protracted one, and kept the process in limbo until the two countries managed to take satisfactory measures to correct their deficits. See European Parliament, *Structured Dialogue with the Commission on suspension of European Structural and Investment Funds to Spain and Portugal* PE 587.360, 2016, available at: https://www.europarl.europa.eu/RegData/etudes/IDAN/2016/587360/IPOL_IDA(2016)587360_EN.pdf.

progress in converging towards … common standards”.[37] The Report placed a great deal of emphasis on stronger coordination of structural reforms, which it defined as “reforms geared at modernizing economies to achieve more growth and jobs”, including “both more efficient labour and product markets and stronger public institutions”. It envisaged moving towards a “more binding” process of structural convergence and common standards for “labour markets, competitiveness, business environment and public administrations, as well as certain aspects of tax policy”. It later proposed that such reforms could receive support from the new Budgetary Instrument for Convergence and Competitiveness for the euro area, now replaced by the new proposal for a Regulation establishing a Recovery and Resilience Facility.[38]

The vision embodied in such plans would entail a tangible shift in economic policy powers. While Member States would still have the formal right to adopt the budgetary or legislative measures needed to comply with EU recommendations, they would do so subject to the Commission’s prerogative to sanction or reward their actions. Depending on the amount of money at stake, this may or may not be decisive for the decision, and a Member State would always have the option to ignore the recommendations and bear the financial consequences. If conditionality is, in principle, accepted as a way for the EU to influence decisions beyond its formal competence, then the door is open to increasing the sanctions until they definitely become decisive. At that point, one needs to ask whether these policies would genuinely remain within the national competence.[39]

2.3. Assessments of the European Semester

In her political guidelines, Commission President Ursula von den Leyen pledged for deepening the EMU, namely through making full use of the flexibility allowed within the SGP, refocusing the European Semester to integrate the United Nations Sustainable Development Goals and granting the EP a louder voice on economic governance.[40] In its review of the economic governance framework,[41] the Commission praises the “more integrated approach to surveillance that better assures the overall consistency of policy advice within the European Semester”, as well as the general contribution of the European Semester to “achieving the Union’s strategy for growth and jobs” and to reducing the temporary divergence between Member States with financial stability difficulties and the rest of the euro area.[42] It nevertheless acknowledges that in general, fiscal rules are complex in excess and, that “the MIP has been more successful in reducing current account deficits than it has been in reducing persistent and large current account surpluses”, and that “the traction of policy recommendations is suboptimal and has been declining over time as the momentum for the reform has faded”.[43]

Other assessments are not so indulgent with the effectiveness of the European Semester, whose output has been rather modest, especially among countries with excessive imbalances. For instance, Bofinger assessed the European Semester as having been ‘a complete failure’.[44] Claeys and others found that

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[37] European Commission, *The Five Presidents’ Report: Completing Europe’s Economic and Monetary Union,* Brussels, 2015, p.15.

[38] European Commission, Proposal for a Regulation establishing a Recovery and Resilience Facility, COM (2020) 408 final, of 18 May 2020.

[39] Leino-Sandberg, P., and Saarenheimo, T., ‘Fiscal stabilisation for EMU: managing incompleteness’, *European Law Review,* Vol. 43, 2018, pp. 623-647.

[40] Ursula von der Leyen, *A Union that strives for more: My agenda for Europe*, *Political Guidelines for the next European Commission: 2019-2023*, Brussels, 2019, available at https://ec.europa.eu/commission/sites/beta-political/files/political-guidelines-next-commission_en.pdf .

[41] European Commission, see note 1.

[42] European Commission, see note 1 p. 16.

[43] European Commission, see note 1 p. 17.

[44] Bofinger, P., ‘The way forward: Coping with the insolvency risk of member states and giving teeth to the European Semester’ in Baldwin, R. and Giavazzi, F., (eds), *How to Fix Europe’s Monetary Union: Views of Leading Economists*, CEPR Press, London, 2016, p. 227.

the 'European fiscal rules are barely implemented' and that 'the threat of sanctions is not credible'.[45] Efstathiou and Wolff consider that the 'overall implementation of recommendations by EU countries has worsened in the last few years, in particular when it comes to recommendations addressed to countries with excessive macroeconomic imbalances'.[46] All indicators coincide pointing out that implementation remains meagre.[47] The European Court of Auditors has criticised in particular the way the Commission had used its discretion in finding that '[w]hat has been lacking is consistency and transparency in the application of those rules; the Commission does not adequately record its underlying assumptions or share its surveillance findings for the greater benefit of all Member States'.[48] It believes that cooperation with independent fiscal institutions should be strengthened and points out that their interpretation of the rules often diverges from that of the Commission.[49] The European Fiscal Board finds that medium-term fiscal planning has not improved while fiscal surveillance has become increasingly bilateral. It also considers that the current framework is unnecessarily complex and contains too many conflicting objectives. Furthermore, it confirms that financial sanctions in case of non-compliance with the EU fiscal rules framework have been politically difficult to enforce.[50] The IMF agrees with the negative accounts, regretting that '[c]ompliance with the 2018 Country-Specific Recommendations (CSR) under the European Semester continues to disappoint'. In its view '[C]ompliance with the fiscal rules has been weak and enforcement has become increasingly discretionary'.[51]

Against this rather fundamental criticism, it is notable that the Commission review builds on the foundation of the current European Semester, without questioning its key choices. It continues to define the issue as one of effective enforcement, where the available tools consist of pecuniary sanctions, reputational costs and "positive incentives". It seeks to assess how the framework should be improved to ensure sustainable public finances in all Member States and wonders about the appropriate role for the EU surveillance framework in encouraging Member States to undertake key reforms and investments. It admits that a 'simpler framework and implementation could contribute to increased ownership, better communication, and lower political costs for enforcement and compliance'. What it does not embark on is a serious evaluation of the foundational assumptions of the Semester.

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45 Claeys, G., Darwas, Z., and Leandro, Á., 'A proposal to revive the European fiscal framework', *Bruegel Policy Contribution,* Iss. 2016/07, 2016, available at: http://bruegel.org/wp-content/uploads/2016/03/pc_2016_07.pdf.

46 Efstathiou, K.,and Wolff, G.B., 'Is the European Semester effective and useful?', *Bruegel Policy Contribution,* Iss. 9, 2018, available at: https://www.bruegel.org/wp-content/uploads/2018/06/PC-09_2018_3.pdf.

47 In 2019 just 1.1% of the proposals were fully implemented by Member States, while in 60.2% of them there were limited or no progress at all. Even more telling is the analysis of the historical data, showing a sustained and consistent trend towards an increase of disregarded proposals (from 29.0% in 2012 to the 60.2% of 2019). When considering proposals substantially implemented (from 11.6% in 2012 to 1.1% in 2019) or at least showing some progress towards the objectives (from 59.4% in 2012 to 38.7% in 2019) the historical record does not provide further reasons for optimism. See, European Parliament, *Country-specific recommendations: An overview – September 2019,* PE 624.404, at p.7, available at https://www.europarl.europa.eu/RegData/etudes/BRIE/2018/624404/IPOL_BRI(2018)624404_EN.pdf; and European Parliament, *Implementation of the 2019 Country-Specific Recommendations*, PE 624.400, available at https://www.europarl.europa.eu/RegData/etudes/ATAG/2020/624400/IPOL_ATA(2020)624400_EN.pdf.

48 European Court of Auditors, *Further improvements needed to ensure effective implementation of the excessive deficit procedure* Special Report No 10/2016 of 19 April 2016 p. 12.

49 European Court of Auditors, *EU requirements for national budgetary frameworks: need to further strengthen them and to better monitor their application*, Special Report No 22 /2019 of 4 December 2019.

50 European Fiscal Board, *Assessment of EU fiscal rules with a focus on the six- and two-pack legislation* of 11 September 2019, available at https://ec.europa.eu/info/sites/info/files/2019-09-10-assessment-of-eu-fiscal-rules_en.pdf

51 International Monetary Fund, *Euro Area Policies: 2019 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Member Countries* IMF Country Report No. 19/219 of 20 June 2019, p. 38.

3. INTERRELATION BETWEEN LEGITIMACY, EFFECTIVENESS, AND POLITICAL OWNERSHIP OF ECONOMIC POLICY DECISIONS

The discussion on the democratic legitimacy of the European Union is a quarter of a century old, but it has entered the EMU agenda only recently. Even then, its entrance has been perfunctory and shallow. The Five Presidents' Report recognises that 'Greater responsibility and integration at EU and euro area level should go hand in hand with greater democratic accountability, legitimacy and institutional strengthening', but their practical suggestions in this regard are modest. It proposes more opportunities for dialogue and interaction with the EP and national parliaments in the context of the European Semester and stresses that 'national Parliaments should be closely involved in the adoption of National Reform [NRP] and Stability [SCP] Programmes'. For the Five Presidents, legitimacy is about 'better sharing of new powers and greater transparency about who decides what and when. Ultimately, this means and requires more dialogue, greater mutual trust and a stronger capacity to act collectively.'[52] More recently, the Commission ASGS stressed,

> *Economic governance and democratic accountability must go hand in hand. The European Parliament should have a stronger voice on the EU economic governance. To this end, the Commission will engage in a dialogue with the European Parliament on how to make this operational going forward. As a first step, Members of the Commission in charge of economic matters will come to the European Parliament before each key stage in the European Semester cycle. This enhanced democratic accountability of the European Semester should help to enhance ownership and therefore reform implementation. More broadly, the Commission will continue the dialogue with Member States, and invites the Member States to involve national parliaments, social partners and all other relevant stakeholders.*[53]

This passage reflects a laudable ambition. We agree that economic governance should be built on strong foundation of democratic accountability. We also agree that the EP should have more opportunities for dialogue and a greater say in determining how the Semester is run. However, we do not think this alone would do much to remedy the shortage of legitimacy and democratic accountability. And we do not think it is useful for the Union to advise Member States on how to organise relations between the different branches of their government or with other stakeholders. We agree that national parliaments play a key role in legitimising economic policies. They are the body that will, in the end, have to legislate the measures that the Semester puts forward. And with all their shortcomings and dysfunctionalities, they are for most European citizens the natural mechanism for holding decision makers accountable. But to harness their legitimacy resources in support of the Semester, there needs to be much more than just dialogue.

Legitimacy is about the acceptance of authority and public decisions by the members of a political community, and the reasons and modalities for such acceptance.[54] Legitimacy comes, in general, in different disguises. It concerns the involvement of democratically legitimated bodies in the formation of the public decisions (input legitimacy), the extent to which these decisions deliver expected public

[52] Five Presidents' Report, see note 35, all quotes from p. 17.

[53] European Commission, *Annual Sustainable Growth Strategy 2020*, COM(2019) 650 final of 17 December 2019.

[54] Scharpf, F.W., *Governing in Europe: Effective and Democratic?*, Oxford University Press, Oxford, 1999.

goods (output legitimacy),[55] and the procedural elements of decision-making (process legitimacy).[56] For national parliaments, which consist of laymen and can make no claim to exceptional wisdom and judgment (the ingredients of output legitimacy), the variety that matters is input legitimacy. National parliaments gain their legitimacy by taking decisions, good or bad, accepting responsibility for them, and then exposing themselves to the popular verdict in elections, where they are held accountable for those decisions. Their mere engagement in dialogue will not sprinkle the Semester with the magical stardust of legitimacy, if at the same time the process is used to undermine their true sovereignty in economic policy decisions. Accountability requires clear responsibilities and transparent decision making procedures, in line with constitutional requirements, both at EU and national levels.

While the EU Treaties include various lofty proclamations about democracy, the EU's relationship to classic modes of democratic participation has always been uneasy. This makes the EU radically dependent on its political performance. Democratic procedures have often been considered a nuisance undermining efficient decision making and thus to effective delivery of the expected public goods. Within the EU, it has been rather common to succumb to "the temptation to bridge, in a technocratic manner, this gulf between what is economically required and what seems to be politically achievable, only apart from the people".[57] Majone explained how "'short-termism' and poor credibility are intrinsic problems of democratic governance" and how, for this reason, objective, technocratic agencies are best equipped to produce Pareto (non-redistributive) improvements that would win popular support in all Member States.[58] This was written at a time when the focus of the Union action was squarely on the internal market and EMU was a mere blueprint at best; in his later years, Majone has been less enthusiastic about this model of integration and particularly its application to economic and monetary integration.[59] But it is clear that the EU has indeed always been characterised by a strong emphasis on results rather than democratic accountability. Many day-to-day decisions have been delegated to non-elected professionals who are constrained by politically set mandates, but are supposed to be free from the biases and distortions of democratic and electoral politics.[60] In most cases, the natural body to which to delegate such competences has been the European Commission, around of which a plethora of new agencies has mushroomed in the last two decades.

From the viewpoint of both governance and legitimacy, the establishment of the EMU presented a new challenge for the EU. Member States agreed to assign the competence over monetary policy to the European Central Bank (ECB), an independent, expert-based agency under a mandate to deliver price stability, but they were not willing to confer to the EU parallel competences on economic policy. Instead, they chose to keep main control over these matters at the national level, while granting the Union powers to "coordinate" economic policies. The resulting hybrid governance arrangement, which later developed into the European Semester, is an anomaly among EU policy areas. In most EU policy areas, legislation is adopted by EU legislature and enforced and applied by the Members States. In

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[55] Importantly, Weber did not consider this a pure mechanism of legitimation because its reliance on specific results, while legitimacy presupposes an allegiance to the political project regardless of the concrete interest-based analysis of each actor.

[56] Schmidt,V.A., 'Democracy and legitimacy in the European Union revisited: Input, output and 'throughput'', *Political Studies*, Vol. 61, 2013, pp. 2-22; and Schmidt, V., and Wood, M., 'Conceptualizing throughput legitimacy: Procedural mechanisms of accountability, transparency, inclusiveness and openness in EU governance', *Public Administration*, Vol. 97, 2019, pp. 727-740.

[57] Habermas, J., 'Democracy, Solidarity and the European Crisis' in Grozelier, A.M., Hacker, B., Kowalsky, W., Machnif, J., Meyer, H., and Unger, B., (eds.), *Roadmap to a Social Europe*, (Social Europe, 2013, p. 6.

[58] Majone, G., 'The Rise of the Regulatory State in Europe', *West European Politics,* Vol. 17, 1994, p. 77.

[59] See, for example, Majone, G., *Europe as the Would-be World Power: The EU at Fifty*, Cambridge University Press, Cambridge, 2009, and, especially, *Rethinking the Union of Europe Post-Crisis: Has Integration Gone Too Far?*, Cambridge University Press, Cambridge, 2014.

[60] Beetham, D., and Lord, C., *Legitimacy and the European Union,* Longman, London, 1998, p. 17.

contrast, economic and employment policies, which fall under the Economic Semester, are neither shared EU competencies nor an exclusive competence (like monetary policy), but instead belong to the national competence. Hence, the EU cannot directly legislate policies in these areas.

The Member States' reluctance to relinquish control over their economic policies is not difficult to understand. Unlike monetary policy, which by the time of the signature of the Treaty of Maastricht had already been delegated to experts in virtually all developed countries, economic and budgetary policies everywhere remained at the heart of political decision making. Budgets have massive importance in democracies. In any national parliamentary elections, economic and fiscal policies form the hard core of campaign platforms and provide the democratic process a large part of its content. Key economic and fiscal policy choices touch upon fundamental questions of both a constitutional and democratic nature. They deal with trade-offs between equality and efficiency, between protection and flexibility. These are the most fundamental matters of politics; they involve the key societal choices that form the primary dimension of political organisation. In a democratic society, decisions regarding these choices are contested and legitimised through democratic elections and cannot be delegated to expert bodies.[61] In the words of the German *Bundesverfassungsgericht*, "revenue and expenditure including external financing and all elements of encroachment that are decisive for the realization of fundamental rights" belong to the "essential areas of democratic formative action". These belong to the national sphere in the EU and hence the room for the constitutionally accepted transfers of power is limited.[62] For many Member States, this means that to preserve the democratic nature of decision making the central role of national parliaments in the formulation of these policies must be protected.[63]

Against this reality, the fact that the Member States only gave the Union the power to coordinate is understandable, but as a compromise, it was an awkward one. Even if the EU recommendations truly paved the way to far better economic policies – a bold proposal as such – would it justify undermining the national parliament's right to decide in a field that is so central to the Member States' democratic process? And if not, how can Union oversight be organised so that it avoids doing that?

As demonstrated above, the implementation of the EU recommendations has been weak, and the mainstream diagnosis of why this is so is the lack of national ownership. Thus, the solution is to encourage national actors to gain political ownership over the EU-recommended measures. 'Stronger national ownership should lead to better enforcement of commonly agreed rules, regardless of economic conditions and remove the perception that rules are hierarchically imposed.'[64] But "ownership" is not standard terminology in constitutional studies or political science, so what is it actually?

In this discussion, ownership is understood as the belief in and acceptance of EU rules and recommendations by national governments and parliaments and, ultimately, the voters they are accountable to. This includes "internalisation of the spirit of EU's fiscal rules into the national budgetary

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[61] Leino-Sandberg, P., & Saarenheimo, T., 'Discretion, Economic Governance and the (New) Political Commission' in Mendes, J., (Ed.), *EU Executive Discretion and the Limits of Law*, Oxford University Press, Oxford, 2019, pp.132-154.

[62] Judgment of 30 June 2009, *Bundesverfassungsgericht*, No.2 BvE 2/08, (Lisbon) paragraphs 244, 249.

[63] For example the Finnish Parliament has stressed that economic policy needs to be examined in a much broader legal and political approach, taking into account its effects on citizens and their rights and the requirements set by democratic legitimacy: "the principles of democracy require that member states retain their primacy in economic policy". Parliament of Finland, *Statement of the Grand Committee of the Finnish Parliament to the Council of State*, 4/2012 vp available at https://www.europarl.europa.eu/meetdocs/2009_2014/documents/econ/dv/finland_/finland_en.pdf.

[64] Alcidi, C., and Gros, D., *'How to strengthen the European Semester?' Research Report* No. 2017/15, December 2017, CEPS, available at https://www.ceps.eu/wp-content/uploads/2017/12/RR2017_15_CAandDG_EuropeanSemester.pdf.

process".[65] The roots of the concept can be traced to IMF adjustment programs, where the debtor government is expected to implement a set of policies that it may find extremely unattractive. This often resulted in poor program performance and serious damage to the IMF's standing in those countries. The IMF eventually concluded that the success of its programs depended crucially on "ownership". If the debtor government and its people were fundamentally hostile to the required policies, they were unlikely to be effectively implemented and, as a result, the programme was likely to fail.[66]

The IMF experience holds useful lessons for the Semester. First, it is worthwhile to ask, why is Member States' ownership of EU recommendations weak? Commission's recommendations map the path to objectively better economic policies and hence better wellbeing for the people, then why are they not immediately embraced by the Member States and implemented without objection? We would claim that national governments' failure to implement EU recommendations is seldom, if ever, because of the complexity of the framework or other similarly superficial reasons. In general, it is because the recommendations tend to target policies that are unpopular among the electorate and hence politically difficult to implement – in particular if they require the adoption of legislation. This is the nature of economic-structural shortcomings in democracies: they exist and persist because, and as long as, there is not sufficient popular support for fixing them. The former president of the European Commission, Jean-Claude Juncker, phrased it succinctly: "We all know what to do, but we don't know how to get re-elected once we have done it."[67] This is the first lesson. Creating ownership is not about convincing key ministers or the government or even the parliament. It is about building sufficient support for the policies among the people to whom the political actors are accountable.

The current EU economic governance framework relies on governance by experts, authority and sanctions. The need to guarantee the alignment of all Member States to the requirements of the single currency has promoted a *top-down* rationale concerned about the effectiveness of the Euro system,[68] encouraging Member States to internalise certain fiscal policy solutions, incentivised by the threat of sanctions. The system seems to put all the weight on the transfer ideas from the supranational to the national level instead of allowing national institutions to determine their own priorities. As a result, the agency of national parliaments over the decisions on these matters has been lost, leading to a critical flaw on the *bottom-up* legitimation mechanism on which the European political system crucially relies. With emphasis on "compliance" (essentially the polar opposite of "ownership"), it is as if the framework had been designed to minimise national ownership and to make European recommendations look like something imposed from the outside by someone with limited democratic legitimacy. The situation is essentially identical to the one faced by the IMF two decades ago. The result also looks similar: poor record of implementation, frequent standoffs, alienated citizens (particularly in the crisis-hit countries) and the emergence of reactive political movements that have sought to capitalize the situation through anti-European platforms. We believe that in order to address these problems, the framework

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[65] Schlosser, P., *Europe's New Fiscal Union*, Palgrave Macmillan, Basingstoke, 2019, p. 53.

[66] Boughton, J.M., 'Who's in Charge? Ownership and Conditionality in IMF-Supported Programs', *IMF Working Papers* WP/03/191, International Monetary Fund, 2003, available at https://www.imf.org/en/Publications/WP/Issues/2016/12/30/Who-s-in-Charge-Ownership-and-Conditionality-in-IMF-Supported-Programs-16796.

[67] The Economist, *The Quest for Prosperity,* Special Report of 15 March 2007. For a discussion, see Buti, M., Turrini, A., Van den Noord, P., and Biroli, P., *Defying the 'Juncker Curse': Can Reformist Governments be Re-elected?* European Commission Economic Papers, 324, Brussels, May 2008, available at https://ec.europa.eu/economy_finance/publications/pages/publication12586_en.pdf.

[68] The concept of *efficiency*, originally stemming from economic sciences, in policy-making refers to the time and effort spent in the process of adopting a concrete policy decision. In particular, efficiency requires an outcome to be pre-determined and, with that objective in mind, tries to accomplish it in the shortest time and using the lesser amount of resources.

should be redesigned from a new starting point, which builds on existing divisions of competence and clear decision making structures.

4. SCRUTINISING THE EUROPEAN SEMESTER: CURRENT CHALLENGES TO LEGITIMACY, EFFECTIVENESS AND POLITICAL OWNERSHIP OF ECONOMIC POLICY DECISIONS IN THE EU

4.1. Multi-level governance

Proper democratic accountability requires that voters have a reasonably clear idea of who is responsible for the policy decisions that matter to them and, come election time, can join their forces to "throw the rascals out" if the decisions are not to their liking. The formal constitutional design of EMU was relatively unproblematic from this viewpoint. The responsibility for economic policy decisions was clearly with the Member States and the Union powers were, for the most part, limited to non-binding recommendations. Democratic accountability operated unambiguously at the national level.

The European Semester changed this. With its wider scope, stronger sanctions and focus on enforcement, it marked a departure from this formal constitutional design. It created a system where responsibility for decisions becomes blurred and ownership of policies dissolves.

The Semester recommendations are prepared through an opaque process not subject to democratic control. Early political discussions, notably by the Eurogroup, may provide some horizontal guidance, but the country-specific applications are prepared very much in dialogue among career civil servants. The pen is held, naturally, by the Commission, where the country desks build a picture of the policy needs of each Member State based on the countries' formal submissions, national policy announcements, research and media coverage. The number of officials for each country desk is relatively small in comparison with the analytic and operational capacity of Member States' administrations. During the course of their preparation, the Commission normally visits the Member States and in general consults with key national officials. The nature and depth of these contacts, and their influence on the outcome, depend on many factors, such as the personalities of the individuals and, undoubtedly, also the size and insistence of the Member State in question.

On the basis of these consultations, the draft recommendations are modified and calibrated to the political situation of the Member State in question, and when the College eventually adopts the Commission recommendations, they are already a compromise. The outcome may not always be welcome by each Member State, but it seldom comes as a complete surprise. The recommendations are then debated by Member State representatives, within the Council structures. This gives another opportunity for Member States who have not been able to persuade the Commission, to build alliances and influence the outcome. The participation of Member States in the formulation of the recommendations is intended to offer them broader legitimacy. But it also has another consequence: it changes the nature of the recommendations from independent policy advice to something more political.[69]

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[69] An earlier EGOV study points out how 'EU policy recommendations clearly differ from policy advice provided by independent institutions such as the OECD or IMF. Member States play a fundamental role at the EU level in designing and applying the common economic governance framework: they co-decide the relevant legislation (i.e. the SGP and the MIP), adopt policy recommendations under the European Semester, and coordinate their policies in the Eurogroup and the Council' See, European Parliament, *The European Semester for economic policy coordination: A reflection paper*, Brussels, 2019, p. 36, available at https://www.europarl.europa.eu/RegData/etudes/STUD/2019/624440/IPOL_STU(2019)624440_EN.pdf

On the whole, the process is a hybrid construction with many technocratic elements, some quasi-political elements, and very little transparency. There is no telling when and by whom different elements have entered the recommendations, or whether they reflect the Commission's own analysis or were included at the request of the Member State in question. It is clear that the process is not about the Commission dictating policies to Member States. On the contrary, it is very much a process of dialogue, where the Commission listens carefully and, in most cases, adapts the outcome to avoid confrontations. But while this is a good thing from the viewpoint of maintaining amiable relations within the Union, it is not conducive to clear lines of accountability. Formally, these are Union recommendations, but with fingerprints often all over the final product, the Member State can hardly claim innocence. As a result, this is not a technical process building on outside expertise, but a highly political exercise. However, it is not conducted by people with democratic mandates, but by technocrats, in a process that is highly untransparent.

Under the European Semester the national economic and budgetary procedures have become entangled in a continuous multi-level policy cycle that "never crystalizes (…) into a 'once and for all' agreement".[70] With a complicated process with overlapping competences, where the formal adoption of budgets remains national but key parts of its substantive content are determined at the European level, it is not easy to determine who should be considered responsible, and hence be held accountable, for the outcomes.[71] This opaqueness can provide national governments convenient cover to externalise responsibility for unpopular decisions to the Union. In case policies backfire, it can also provide a get-out-of-jail-free-card, in the sense that formal compliance with the EU rules in the run-up to can be invoked as evidence that the difficulties faced by a country are not of its own making.[72] Conversely, if, in a rare case, a recommendation truly originates from the Union, and a Member State implements it only out of obedience, then there is really nobody at the European level to be held accountable.

4.2. Complexity

Much of the discussion around the coordination framework, both in policy circles and in academic fora, has focused on its complexity, particularly with regard its fiscal dimension. Practically everyone agree that the Stability and Growth Pact has grown too complicated. This includes the Commission:

> *"This complexity results from the framework pursuing multiple objectives and the need to cater for a wide variety of evolving circumstances, including by the use of flexibility, in a context of divergences of views among Member States. It is reflected in a very detailed codification, encompassing several operational indicators of which a number are non-observable and frequently revised, as well as a variety of escape clauses. As a result, the fiscal rules have become less transparent, hampering predictability, communication and political buy-in".* [73]

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[70] Dawson, M., 'The Legal and Political Accountability Structure of 'Post-Crisis' EU Economic Governance', *Journal of Common Market Studies*, Vol. 53, 2015, pp.976-993, p. 982.

[71] Crum, B., 'Parliamentary Accountability in Multilevel Governance: What Role for Parliaments in Post-Crisis EU Economic Governance?', *Journal of European Public Policy*, Vol. 25, 2018, pp. 268-286, p. 276.

[72] The get-out-of-jail-free-card was in frequent display during the Euro crisis.

[73] European Commission, see note 1 p. 17.

We agree. The fiscal framework is extraordinarily complicated, which not only muddles the political discussions but also creates a fragile basis for enforcement. We also agree with the Commission's account of how things came to be this way.

Complexity is, as the Commission indicates, an unavoidable consequence of the increased ambitions of the fiscal framework. As long as the framework's focus was narrow, to prevent Member States from pursuing blatantly unsustainable fiscal policies, it was possible to encapsulate it in a reasonable manner in two numerical limits. Yet, even with its narrow focus, the flip side of simplicity turned out to be roughness. The framework was frequently criticised as arbitrary, most famously by no other than the Commission President.[74] With its successive revisions, the fiscal framework was tasked to serve increasingly sophisticated goals. As it stands now, the framework is supposed to ensure optimal stance of fiscal policy throughout the economic cycle, taking into account a substantial number of special factors.

This is an inherently complex task. It is a multidimensional dynamic optimisation problem subject to a great variety of constraints and uncertainties. It simply cannot be encapsulated within a simple and transparent set of rules.

We cannot but agree on the desirability of simplifying the framework. Yet, it is important to understand that this is only possible if, at the same time, either its level of ambition is lowered or, alternatively, the philosophy of a rules-based system is abandoned in favour of a discretionary one. We suspect that Member States will not be willing to substantially expand the Union's discretion in imposing sanctions on them, so the only plausible route towards a simpler framework seems to be through narrowing down the tasks it is expected to serve.

4.3. Sanctions

One key issue that needs to be addressed in the review of the Semester is the use of sanctions. Sanctions are a key part of the system and, next to the expanding scope and depth of the framework, increasing the availability of sanctions has been a defining trend in the evolution of the economic coordination framework.

The Treaties mention sanctions only in the context of the Excessive Deficit Procedure. In case there has been no effective action in response to its recommendations by the Member State in question, the Council may decide to make its recommendations public. Following this, Article 126(11) TFEU seems to provide an exhaustive list of four possible measures that may be considered as sanctions in the case of a Member State's failure to correct excessive deficit. The Council may decide:

> - to require the Member State concerned to publish additional information, to be specified by the Council, before issuing bonds and securities,
> - to invite the European Investment Bank to reconsider its lending policy towards the Member State concerned,
> - to require the Member State concerned to make a non-interest-bearing deposit of an appropriate size with the Union until the excessive deficit has, in the view of the Council, been corrected,
> - to impose fines of an appropriate size.

[74] "I know very well that the stability pact is stupid, like all decisions which are rigid", Romano Prodi, *Le Monde*, 17 October 2002.

Yet, additional sanctions were created, mostly as part of the six-pack, for the EDP. In addition, the possibility of sanctions was introduced in the preventive arm of the SGP and in the Macroeconomic Imbalances Procedure, which are based on the Union's powers to give recommendations and that therefore are supposed to be non-binding. Most of the additional sanctions are based on Regulation No. 1173/2011, which sets out a system of sanctions for enhancing the enforcement of the preventive and corrective parts of the SGP in the euro area and adds various new stages to Article 126 TFEU. Regulation No. 1174/2011 lays down a system of sanctions for the effective correction of excessive macroeconomic imbalances in the euro area – a procedure that is entirely unknown to the Treaties.

Apart from the explicit sanctions, the Union also created sanctions under a different disguise. Framed as "measures linking effectiveness of ESI Funds to sound economic governance", the Common Provisions Regulation 1303/2013 introduced the possibility, in case of transgressions against the coordination framework, to suspend the access of a Member State to the Structural and Investment Funds.

Most of the criticism relating to sanctions has been about their non-use. So far, no sanctions have ever been imposed on a Member State for not following policies prescribed by the fiscal or economic governance framework.[75] To many, the problem seems to be just the weakness of the Commission in face of political pressure,[76] prompting calls for delegation of the powers to interpret the SGP provisions to an independent expert body.[77]

To us, the Commission's unwillingness to impose sanctions is understandable, for reasons discussed in Section 3. When a government fails to follow the rules or recommendations of the economic governance framework, it is usually not for negligence but for very logical reasons. It may not have the parliamentary support for the recommended policies, or it may have just won elections on the grounds of a policy program which it now feels obliged to implement. Almost always, the policies in question tend to be unpopular among the voters. Trying to force a national government, in highly political matters, to follow certain paths of action upon the threat of financial sanctions would almost certainly result a highly visible and embarrassing clash of authority. The stricter the application of sanctions, the more likely it will feed discord, play into the hands of anti-European forces in the Member State, and further undermine the EU's authority in these matters.[78] The pressure on the Commission to solve the situation by forbearance and interpretation is tangible.

One unfortunate victim of the sanctions has been the honesty of the economic assessments of the Semester. In the case that an honest assessment of a Member State's policies risks triggering an escalating and hard-to-stop procedure leading to sanctions, more often than not, it is the honesty of the assessment that will give way. Even when Member States have exceeded the respective thresholds, the overall assessment of the Commission finally avoided sanctions. When applying this method, an embarrassing clash of authority may be avoided. At the same time, an opportunity for an objective and authoritative review of the quality of Member State economic policies is lost. We believe that, in the

[75] While no sanctions have been imposed for non-observance of fiscal or economic policy recommendations, they have been imposed, under a different but related framework, for failure to implement European rules on statistics collection. In 2015, Spain was fined for providing inaccurate statistical information on the public finances of Comunidad Valenciana, one of its Autonomous Communities. Similarly, in 2018, Austria was fined for misreporting debt data in Saltzburg state.

[76] The Financial Times, *European Commission lambasted on policing of national budgets,* 14 June 2016 available at https://www.ft.com/content/24575aee-320d-11e6-ad39-3fee5ffe5b5b; The Irish Times, *EU worried Commission not applying budget rules equally,* 14 June 2016, available at https://www.irishtimes.com/business/economy/eu-worried-commission-not-applying-budget-rulesequally-1.2684196.

[77] This is discussed further in Leino and Saarenheimo (2017), see note 28 p. 182.

[78] Leino-Sandberg and Saarenheimo (2018), see note 36 p. 645.

absence of sanctions, the frankness of the assessments and discussions that form the economic policy coordination would be greatly improved.

The growing recognition that the present system of sanctions is not working well has led to various suggestions for improvement. One was mentioned above, namely the proposal to delegate the powers of interpret the rules to an independent expert body, usually a fiscal council consisting of academic economists. If ever implemented, this experiment would be very likely to fail. First, having to bear the responsibility for decisions which may affect millions of people is a heavy burden for anyone, very different from the normal academic work, and it seems unlikely that a group of academic economists is better prepared to succeed in that task than the Commission. Second, it is almost certain that the selection of the members of this group would become a hard-fought political battle, where the backgrounds and the leanings of potential members would be carefully screened. Finally, from a governance viewpoint, it is almost inconceivable to give that much power to an unaccountable body of technocrats. An expert body can only play an advisory role, and the European Fiscal Board seems to be already fulfilling that role quite well.

Another increasingly popular suggestion, also raised by the Commission in its review, is to move the emphasis from pecuniary sanctions to "positive incentives", that is, greater linking of EU funds to reforms and compliance with the Semester. The thinking is that by offering rewards rather than sanctions, the discussions on rules and recommendations would turn less toxic. Such thinking has already been reflected in the Commission's proposal for a Reform Delivery Tool[79] which later morphed into the Budgetary Instrument for Convergence and Competitiveness[80] and the Recovery and Resilience Facility.[81] It is closely related to the macroeconomic conditionality in the EU cohesion funds.

In our view, this idea is misguided. As anyone involved in the negotiations on the EU's Multiannual Financial Framework knows, for Member States, EU funds are not rewards but entitlements. This was amply demonstrated by the 2016 episode of flirting with the suspension of cohesion funds to Spain and Portugal. The Council agreed with the Commission's finding that Spain and Portugal had failed to take effective action in response to the Council's EDP recommendations, which for the first time triggered a sanctions process. Some weeks later, fines were determined and, at the same instance, immediately cancelled.[82] The threat of losing something that was perceived rightfully theirs was received very badly in the countries, and the ensuing discussion was every bit as toxic as in the context of pecuniary sanctions.

Apart from likely being ineffective, the idea of positive incentives is problematic from the viewpoint of distribution of competences. Linking the availability of EU funding to policies that are in national competence provides an indirect way for the Union to exercise power in areas where it lacks formal competence. Depending on the amount of money at stake, Union incentives may or may not be decisive for Member State decisions. Yet, to the extent the incentives are effective in guiding Member States' policy choices, they raise difficult questions about accountability and the Treaty-defined limits to Union powers.

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[79] European Commission, *Proposal on the establishment of the Reform Support Programme,* 2018/0213 (COD) COM(2018) 391 final of 31 May 2018.

[80] European Commission, *Proposal on a governance framework for the budgetary instrument for convergence and competitiveness for the euro area*, 2019/0161 (COD) COM(2019) 354 final of 24 July 2019.

[81] European Commission, *Proposal for a Regulation establishing a Recovery and Resilience Facility,* COM (2020) 408 final, of 18 May 2020.

[82] Council Implementing Decision (EU) 2017/2350 of 9 August 2016 on imposing a fine on Portugal for failure to take effective action to address an excessive deficit (OJ L 336, 16.12.2017, p. 24); and Council Implementing Decision (EU) 2017/2351 of 9 August 2016 on imposing a fine on Spain for failure to take effective action to address an excessive deficit (OJ L 336, 16.12., p. 27).

4.4. Reverse qualified majority voting

Another innovation of the Six-pack was the introduction of the reverse qualified majority voting rule in many key decisions of the Semester. This meant that, for a Commission proposal on, for example, the existence of excessive deficit in a Member State to be approved by the Council, it only needed the support of a blocking minority of Member States, instead of qualified majority as before. The explicit purpose was to 'reduce discretion in enforcement'.[83] This change was motivated by the belief that, in the effective enforcement of the fiscal framework, it were the Member States that were the weak link, liable to frustrate the Commission's efforts to uphold the rules. From a legal viewpoint, it was a neat trick, changing the institutional power balance in a key Union process without having to resort to a Treaty change.

This change was further supplemented by the euro area Member States committing, as part of the Fiscal Compact,[84] to support Commission proposals in the Council, unless there is a qualified majority amongst themselves in opposing it. Hence, in the final count, it now only takes the support of a qualified minority of the *euro area Member States* to have a Commission proposal approved.

The believe in the Commission's superiority in upholding the fiscal rules was no doubt informed by highly public episode of the Council voting down in 2003 the Commission proposal to put Germany and France in the EDP. The analytical basis of this belief was shallow, and we believe events since the change have proved it wrong. While the Council has, as expected, approved every Commission proposal under the fiscal framework ever since, the main consequence of the change was to move the weak link from Justus Lipsius to Berlaymont. Institutional roles have changed, but the enforcement of the framework has not improved.

We do not think there is anything inherently strong or weak either in the Council or the Commission. The real issue is the one described above in section 3: that the key decisions under the Semester, particularly those involving or foreshadowing sanctions, are very difficult decisions and a heavy burden for whoever is tasked to take them. Everyone involved would rather have someone else taking the decision and bearing the responsibility.

With the move to the RQMV, the Council, for all practical purposes, externalised itself from the enforcement of the Semester. Although Commission technically still needs the support of a number of number of Member States, in reality, this is a non-issue. Following their commitment (as part of the Fiscal Compact) to support Commission proposals, Member States have been all too happy to place the burden on the shoulders of the Commission and relegate themselves into the role of a rubber stamper. The key result of the change was to turn much of the Semester into a bilateral exercise. Key policy discussions now take place solely between the Commission and individual Member States, while at the Eurogroup and the Council there is very little substantive discussion. Any kind of peer pressure among the Member States is more or less absent.

We believe the RQMV was a misguided change. It was born out of a vision centered around enforcement of rules rather than around open and honest discussion about good economic policies. Motivating Member States to follow good economic policies is not about blind enforcement of rules, it is about arguments, persuasion and visible peer pressure, which hopefully over time will help to build broad support for those policies at the national level. We believe that, by essentially taking the Council

[83] European Commission, *Proposal on the effective enforcement of budgetary surveillance in the euro area*, COM/2010/0524 final of 29 September 2010.

[84] The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

out of the picture and by forcing the Commission alone to carry the burden, the RQMV weakened rather than strengthened the Semester.

5. TOWARDS A STREAMLINED, LEGITIMATE, AND EFFECTIVE EUROPEAN SEMESTER: SPECIFIC REFORM PROPOSALS

We believe that any shortcomings of national economic and fiscal policies in the EU should not be seen as a failure of the European Semester. Rather, it should be understood that any such shortcomings reflect dysfunctionalities of national political systems; either a failure of the political class (and the media) to communicate to the electorate what policies are in the nation's long-term interests, or a failure of the electorate to hold the decision-makers accountable. The European Semester will not provide a miracle cure to this problem.

Perhaps trivially but nevertheless importantly, one should also keep in mind that there is no objective, value-free definition of what constitutes good economic policies. There is a minimal set of features that would seem obvious part of any good policies, such as the numbers adding up and certain basic rights not being violated, but even within these basic features there still remains a wide range of viable and very different policy choices. The choice between these is not a technocratic task, nor is it a task for the Union and the Economic Semester. It is an ideological and value-dependent task that belongs to the national electorates. Whatever the future form of the European Semester, it should steer clear from those ideological choices.

We believe that the European Semester would benefit from a complete overhaul, from its philosophical foundations up. The premise that the Union could, with sanctions or money, coerce Member States to follow good economic and fiscal policies, would be dropped. The Semester would be based on clear respect for the Treaty-assigned competences in economic and fiscal policies. It would recognise that, although national economic policies entail cross-border externalities and that it would therefore be mutually beneficial to coordinate those policies within the EU, ultimately the policy choices are for the national democratic bodies of each Member State. Any turn towards better economic policies can only be sustained if it enjoys a sufficient electoral support. The idea of sanctioning (or "incentivising") Member States on their democratic choices, or in any way providing the Union powers to interfere in those choices with means other than good arguments and persuasion, would be dropped. Efforts would be redirected to ensuring transparent scrutiny of national economic policies and thereby facilitating a gradual strengthening of a responsible political culture in all Member States.

We realise that such a radical overhaul is likely not to be realistic at this point, so here we will concentrate on more modest and incremental recommendations.

The first, crucial, step is to *restore the honesty and credibility of the Semester.* This is not criticism of the Commission. Almost all of the analysis that goes into the Semester is solid and useful. It should be widely read, which it unfortunately is not, at least not among the electorates. Instead, what is widely publicised and read are the Commission's final, categorical compliance assessments, and those have, in many high-profile cases, been held back by the desire to avoid escalation and hence have been less than fully honest. The Commission must be able to call spade a spade, without triggering counterproductive escalation.

Second, and as direct consequence of the first, *sanctions should be paired back to the bare minimum* required by the Treaties. In particular, the sanctions introduced through secondary legislation as part of the MIP and of the preventive arm of the SGP should be abolished. Their legal base is questionable, they have proven unusable, and they undermine national competences and mechanisms of democratic accountability in economic and fiscal policies. We simply see no benefit to be derived from them, but we see a clear cost in terms of raising the stakes and hence creating unnecessary obstacles

to frank and open discussion on economic policies. Instead, procedural escalation could be used, aimed at forcing Member State governments to justify their choices in public.

Third, to ensure the legitimacy of union actions and to respect the national policy competences, the *linking of the economic governance framework to the Union budget should not be used as an additional sanction mechanism*. It should be clear that this link is there not to incentivise Member States to follow particular policies but only to protect Union funds, and it should only be invoked in face of clear and concrete evidence that the effectiveness of Union programs is in fact being undermined. Instead, the Commission could actively and publicly offer technical support to Member States with a view of addressing identified problems.

Fourth, the *new European Semester should restore the institutional roles as defined in the Treaties*: The Council decides, the Commission prepares and provides expertise. The Commission tasks should be reconsidered and limited to technical ones, reducing the political dimension of its work and restoring its technocratic objectivity. The Council should be reintegrated into the Semester, forced to take an active role in confirming and legitimising the Commission assessments. In case the Council found itself unable to do so – which might well happen – this would happen openly and transparently, with both sides of the argument spelled. Such institutional dispute – the Council failing to confirm Commission assessment – would essentially guarantee media attention and thus facilitate open debate an peer pressure.

Finally, aided by all these changes, the new European Semester should *be utilised maximally to support accountability at the national level*. With its honesty restored and its analysis debated in a public and transparent manner, the Semester can help to clarify where mistakes were made and who is responsible for them. In this work, the Semester should be complemented by the rest of the Union toolbox: the budgetary framework directive, which should uphold the transparency of budgetary practices, accurate statistical information supervised by the Eurostat, and national independent expert bodies such as the national fiscal institutions and productivity boards.

Fixing deep-seated dysfunctionalities of national political systems is not going to happen fast. Democratic systems will continue to suffer from short-termism and sometimes make plain irrational decisions. But democracies mature and learn to control those tendencies. With time and perseverance, the Semester can be a valuable component in facilitating this process.

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The Commission has launched an assessment and revision of the so-called six-pack and two-pack legislative packages. This paper assesses the successes and shortcomings of the European Semester with a focus on legitimacy, effectiveness and ownership. It argues that in order to address these problems, the framework should be redesigned from a new starting point, which builds on existing divisions of competence and clear decision making structures. This would help to restore the honesty and credibility of the Semester, which should be geared at supporting accountability at the national level.

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