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The European Semester: only a first step

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Introduction

In 2010 the euro faced a public debt crisis which was largely the result of the global financial crisis. Public debts and deficits both increased as a consequence of recession-related factors: the transfer of private debt to the state (mainly due to the public commitment to save the banking system), a fall in tax revenues because of higher unemployment and increased public spending due to automatic stabilisers. But the euro crisis was also a result of certain weaknesses in the Economic and Monetary Union (EMU), and of structural problems in eurozone countries (in particular, gaps in competitiveness between them). The crisis thus proved right those who, for over a

decade, have called for a genuine economic pillar within EMU. It highlighted the gaps in the coordination and surveillance of eurozone economic policies, and demonstrated the interdependence of the countries which share the single currency.

In this context the EU needed a response to the urgency of the sovereign debt crisis. It adopted a package of aid to Greece and a mechanism aiming to guarantee eurozone stability. Alongside this short-term action there was debate on reform of European economic governance, fed by the European Commission and proposals of the task force chaired by Herman Van Rompuy. From this debate was born the idea of a "European Semester". This brief outlines the content and the procedure of this new feature of post-crisis economic governance, and discusses several important new issues surrounding it. The European Semester represents a step forward in European economic governance. It is nonetheless insufficient if the EMU is to have the economic pillar it needs.

The European Semester: content and procedure

The European Semester brings innovations in the content of the coordination of EU economic policies and represents an important step forward for the procedure of European economic governance.

Following the decision by Heads of State or Government to pursue coordination of national structural reforms, the public debt crisis has demonstrated the need to strengthen budgetary surveillance and to add a new component to economic policy coordination: surveillance of macroeconomic imbalances.

Using the lessons from the crisis, the European Semester includes three components of economic policy coordination:

- Structural reforms, within the framework of the Europe 2020 Strategy. This strategy, adopted in June 2010, outlines a vision of the type of growth desired in the EU: smart, sustainable and inclusive. It sets out five objectives for the EU and member states to reach by 2020. At EU level, action includes the implementation of flagship initiatives, while member states must present their structural reforms as part of their National Reform Programme.
- Budgetary surveillance, in the framework of the Stability and Growth Pact. The Pact has been strengthened, both in its preventative and corrective aspects. In addition, a number of rules concerning national budgets have been created, relating in particular to accounting, statistics and planning.
- Surveillance of macroeconomic imbalances. This is a new component of economic policy coordination. The crisis made clear that the macroeconomic imbalances which have emerged between countries – in particular the major and persistent gaps in competitiveness – are seriously harmful to the euro. A new procedure including a scoreboard of indicators (the current-account balance and private debt, for example) is therefore in place in order to prevent and correct EU macroeconomic imbalances.

In terms of procedure, the European Semester introduces two innovations.

The first is the synchronisation of different procedures. Before the crisis, coordination of structural reforms (as part of the Lisbon Strategy) and budgetary surveillance followed two separate procedures with different calendars. One idea at the heart of the new phase of EU economic policy coordination is thus to create a synergy at national level between structural reforms and budget priorities, by synchronising the submission to the Commission of National Reform Programmes (NRPs) and Stability and Convergence Programmes (SCPs), plus their annual reports. In synchronising at EU level the assessment and coordination of these policies, the aim is to help member states to pursue their shared objectives more effectively than before.

The second innovation is the reversal of the time framework for coordinating national economic policies. Up until now there has been ex post coordination of member states' structural reforms and budgetary priorities. From now on, in the framework of the European Semester, the coordination will be ex ante: the policy direction of the European institutions will be decided before the drawing up of the NRPs and SCPs and before the adoption of national budgets.

The European Semester will therefore take place from January to July each year. The first was launched on 12 January 2011, with the publication of the European Commission's "Annual Growth Survey". Presenting the report, President Barroso declared that the European Semester marked a "new phase in European governance", putting an end to the "gentlemen's agreement" of the Stability and Growth Pact, which allowed a blind eye to be turned to public deficits.

It is important to note that at the time of the European Semester's launch the Commission's six legislative proposals (on strengthened surveillance of budgets and macroeconomic imbalances) were still the subject of negotiations within the Council and the European Parliament.

In parallel to these ongoing negotiations, the European Semester continues apace. The spring European Council will adopt the strategic policy orientations for the finalisation of the SCPs (budgets) and NRPs (structural reforms). In April member states will submit these programmes to the European Commission, which will present its assessments of them within two months, along with recommendations by country. These will in turn be debated within the various formations of the Council before being adopted by the June European Council. In July, finally, the ECOFIN Council and the European Council will present the recommendations on member states' budgets before these are submitted to national parliaments.

A semester straddling the EU27 and the EMU17

The European Semester is a cycle of economic policy coordination between the 27 members of the EU. The crisis having highlighted the need to strengthen economic policy coordination within the EMU, member states decided to create a procedure for ex ante assessment of structural reforms, budget plans and macroeconomic imbalances at the level of the EU27. This was somewhat surprising, since the eurozone countries have more important obligations (and benefits) than non-euro EU members. Both cause and consequence of the crisis can be found at the heart of the eurozone: the shock to the public finances put the single currency's stability at risk. Furthermore, the short-term solution to the crisis was provided in great measure by the eurozone countries through the creation of the European Financial Stabilisation Facility. The long-term response to the eurozone's problems must also focus on the eurozone members.

The new surveillance procedures for budget deficits and macroeconomic imbalances proposed by the Commission nonetheless include measures designed exclusively for eurozone countries. While the preventive arm of these procedures applies to the EU 27, the corrective part is reserved for the eurozone.[1] We therefore have a situation where economic policies are coordinated by the EU 27 but sanctions apply only to eurozone members. This does not seem the best way to highlight the closer links which bind countries sharing a currency. The eurozone needs a stronger capacity to prevent and manage crises, with more binding instruments. But for this to happen the EMU needs a genuine economic pillar – which means action by 17 and not 27.

The proposal by Germany and France presented at the European Council of 4 February is a step in this direction, even if its content must be debated. The question we need to ask is why it was necessary to strengthen economic coordination within the 27 before the 17. This leads to a system which is complicated in terms of methods, instruments and participants. On the one hand we have a coordination cycle for the whole EU – the European Semester – which follows the community method and allows for sanctions on eurozone countries; and on the other, a future "competitiveness pact" aimed at the 17 or more (once it is open to all member states) which uses the intergovernmental method and relies on peer pressure for enforcement.

In decisions concerning this competitiveness pact and the new European Stability Mechanism post-2013 it is essential to retain some coherence in the reforms by using the community method, as was the case for the reform of European economic governance in the last few months.

1. There is an exception in the preventive arm of the reformed Stability and Growth Pact: the obligation to make an interest-bearing deposit in cases of imprudent budget policy would only be imposed on eurozone countries.

A semester excessively focused on sanctions

The sanctions proposed by the European Commission for member states which do not follow their SCPs include two innovations not featured in the original Pact.

First, the Commission wants to make triggering of sanctions more automatic, in order to avoid a reprise of the 2003 situation. It proposes that sanctions be adopted except if the Council votes against by qualified majority. The "reverse voting mechanism" would make it more difficult for the Council to oppose the application of sanctions.

Second, the sanctions take on a graduated aspect, the objective being to intervene as far upstream as possible. In practice, an initial interest-bearing deposit would be imposed in cases of particularly imprudent fiscal policy, under the preventive arm of the pact. If an excessive-deficit procedure is triggered, the member state in question must make a non-interest-bearing deposit, which in the last resort may be converted into a fine.

Nonetheless, these sanctions have still not been formally adopted by the Council and the Parliament. Although the idea of gradual financial sanctions does not seem problematic, there are differences over how automatic the sanctions should be. The European Parliament currently seems favourable to the reverse voting mechanism, but an agreement has not yet been reached. Within the Council, an agreement on the Commission's proposal looks more difficult, given the 18 October Deauville declaration in which Nicolas Sarkozy and Angela Merkel advocate qualified-majority and not the reverse voting mechanism for the Council's decision to impose sanctions. This Franco-German position could hinder the European Council's objective to reach an agreement on the legislative package by June 2011. Its quick adoption would however take the focus off sanctions, the semester's relevance being more preventative than corrective.

Despite being stronger, it is not clear that the new sanctions are more convincing. For instance, it will be difficult to impose sanctions on a state which has asked for aid from the European Financial Stabilisation Facility (EFSF). The sanction would cancel out a part of the EFSF aid, even though this aid is already conditioned on high interest rates and commitment to fiscal consolidation – a sort of supervision of the national budget. The European Semester does not take account of member states' potential recourse to the EFSF or the possible consequences of this. For example, the level of sanctions might be modulated in accordance with the member state's demand to seek assistance from the EFSF.

Similarly, the semester is cruelly lacking in incentives, relying above all on a combination of ex ante surveillance and sanctions. The sanctions mechanism should probably be counterbalanced by the possibility of "awards" for countries which respect the commitments laid out in their Stability and Convergence Programme. Such incentives could take the form of privileged access to EU funds (for research funding, for example) or to European infrastructure loans under a future EU funding instrument such as euro bonds.

A semester for stability but also for growth

The European Semester aims not only to ensure the financial stability of the EU but also to stimulate growth, by means of the reforms set out in the Europe 2020 Strategy. In practice, however, the second objective has been somewhat obscured by the first.

The Europe 2020 Strategy is the successor to the Lisbon Strategy, whose results were disappointing. Lisbon was the EU's first growth strategy, and as a first experiment it had several weaknesses, relating both to its defined aims and priorities and its implementation. Criticisms included a lack of appropriation and thus commitment on the part of actors, and an insufficiently binding implementation method (the open method of coordination and peer pressure). The inclusion of Europe 2020 within the European Semester is aimed at addressing these weaknesses, by strengthening appropriation of the strategy and its implementation.

Nevertheless, the fact that debate on fiscal consolidation has overshadowed that on growth stimulation means there is a risk of the European Semester obscuring Europe 2020. And yet Europe

2020 is essential as a gauge of the growth model desired by the EU, which in turn is the only possible response to the financial, economic and social difficulties experienced since 2008. Without such a vision no amount of budgetary surveillance, be it ex ante or ex post, will produce a sufficient outcome, and the risk is of economic debate being confined to budget rules.

The Europe 2020 Strategy provides a framework for national economic policy as a means of boosting the EU's economic potential. It should be the focus for analyses of macroeconomic imbalances, and serve as a guide for correcting these imbalances at national level. Implementing the Europe 2020 Strategy will strengthen member state convergence and EU competitiveness, the two prerequisites for a reduction of imbalances within the euro zone.

The Europe 2020 Strategy and its national translation, the NRPs, must not have a secondary role during the European Semester. The semester must comprise three pillars of equal importance. Even if member states' priority today is to put their public finances in order, it is essential not to forget the role of growth in the reduction of debt as a percentage of GDP.

In addition, the new instruments currently being negotiated must work to stimulate growth. As Tommaso Padoa-Schioppa said of this post-crisis period, "The EU member countries need both budget austerity and support for growth at one and the same time. The key concept should be that member states must devote their energies to fiscal consolidation, while the EU must focus on supporting growth"[2]. The eurozone should therefore create not only a stability instrument for financing public debt, but also an instrument for funding pan-European infrastructure projects. This could be done by means of euro bonds, as proposed by the Monti report on the Single Market.

A semester with participation by actors in the economic debate

This new phase of economic coordination should not limit itself to the confines of EU institutions. For this initiative to be a success it is fundamentally important to count on the ownership and the commitment of the various actors.

Special attention must be paid to national parliaments. This new phase of coordination is an opportunity to make these parliaments more involved in European affairs, by helping them out of their excessively national economic framework. Such an outcome is indispensable if the decisions and recommendations of the European Semester are to be greeted favourably and not seen as unwelcome interference in national economic policy by EU institutions. In particular national parliaments will need to debate the NRPs and SCPs while taking into account the recommendations coming from Brussels, before these programmes are sent by national governments to the European Commission.

The European Semester also affects areas of particular interest to workers and employers. The SCPs have an impact on public spending, including on social policy, and the NRPs involve elements of the European social model, including social protection, job contracts and wages.

It is therefore vital to involve European social partners in the issues dealt with by the European Semester. The European social partners should be consulted and given the opportunity to provide feedback on the recommendations made to member states concerning the NRPs and SCPs. European social dialogue was a major pillar created alongside the EU's economic and monetary integration. It is important that it be allowed to be an actor in the EU project. Labour and competitiveness reforms should be included in the European Social Agenda with a view to achieving Europe-wide agreements. These issues cannot be dealt with by governments or EU institutions only. Revitalisation of the European social dialogue remains as important as ever, both for the sake of democracy and for the proper functioning of the social market economy.

2. *From the Crisis to a European Economic Strategy: A Conversation with Tommaso Padoa-Schioppa on the Eve of the June 2010 European Council.*

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Conclusion

The European Semester aims to improve fiscal and macroeconomic stability, and to boost implementation of the Europe 2020 Strategy. These steps are important to help end the euro crisis and bring a return to growth. But the semester remains too complex (straddling the EU 27 and EMU 17), too focused on sanctions (and not enough on incentives) and insufficiently open to participation by a variety of actors – including national parliaments and European social partners. The semester is however only one initiative, and other priorities have today been clearly identified. They relate to the current debate on European economic governance, and invite us to sketch out a positive future for Europeans – one which reconciles necessary austerity with support for growth and jobs.

As Tommaso Padoa-Schioppa demanded in December 2010, "The European Council should complete the 'stability part' of its programme and open the 'growth part', by acknowledging that without growth no stability is really possible"[3] ■

3. *Closing the year, closing the crisis? A Conversation with Tommaso Padoa-Schioppa on the eve of the December 2010 European Council.*

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