



Project no. CIT1-CT-2004-506392

NEWGOV **New Modes of Governance**

Integrated Project
Priority 7 – Citizens and Governance in the Knowledge-based Society

Policy Memorandum on Emergence and Evolution of Economic Policy reference number: 01/D27

Due date of deliverable: January 2006
Actual submission date: 20 March 2006

Start date of project: 1 September 2004

Duration: 48 months

Organisation name of lead contractor for this deliverable:
University of Cologne, Udo Diedrichs

Project co-funded by the European Commission within the Sixth Framework Programme (2002-2006)		
Dissemination Level		
PU	Public	X
PP	Restricted to other programme participants (including the Commission Services)	
RE	Restricted to a group specified by the consortium (including the Commission Services)	
CO	Confidential, only for members of the consortium (including the Commission Services)	

Summary

The analysis of key problems in economic governance in the EU hints at some fundamental difficulties that will probably not be solved by minor institutional or procedural reforms. Instead, a general approach would be necessary aiming at addressing the very nature and architecture of economic governance in the EU.

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I. Short Analysis of Key Problems in EU Economic Governance

1. Economic governance in the EU: under pressure

The emergence and evolution of economic governance in the EU has been following different paths and logics. Starting with the original Treaties, there has always been a degree of economic policy shaping at the EU level, particularly in those areas with distributive or redistributive effects upon the national economies (agriculture, structural policy). In the 1990s the fabric of economic governance in the EU has received a push by the creation of Economic and Monetary Union, which led to the revitalisation of economic coordination, but also to the establishment of new forms of coordination in fiscal policy, trying to supplement the rather rigid provisions on monetary policy by improved efforts for an effective economic policy in the EU. These endeavours followed the prime intention of stabilising monetary union, which in the long run would require a more homogeneous economic policy, but also served to improve the overall policy effectiveness of the EU. The underlying dynamics may be termed as a spill-over from monetary policy to broader areas of economic policy. EMU has beyond doubt been the major catalyst, but also the key problem to economic governance in the European Union.

With the Lisbon strategy adopted in spring 2000 a new impetus in economic governance became visible, combined with an innovative – although not totally new – procedural model. The open method of coordination was widely regarded as an adequate way of entering in EU policy-making without using the classical orthodox set of institutional and procedural provisions. At the same time, the ‘finalité’ of economic governance was redefined, becoming henceforth a tool for turning the Union into “the world’s most competitive economy” (European Council 2000).

So far, expectations have been frustrated in three ways: 1. the output of economic governance in the EU has been poor; Lisbon seems to have moved away beyond reach; 2. the hailed method of coordination as a tool for achieving efficient and effective policy-making has become a source of disappointment; 3. the link between the different areas of economic governance: multilateral surveillance of economic policy; fiscal policy coordination; and employment policy has so far been rather weak, hinting at crucial difficulties in shaping a coherent and consistent framework for economic governance in and for the European Union.

In reaction to the unsatisfactory results, the European Council and the Commission tried to relaunch economic governance in the EU by injecting new life to the Lisbon Strategy, and by reforming the coordination cycle for the broad economic guidelines and for employment policy. Henceforth, there would be an “integrated guidelines package” for three years including both the economic and employment area.¹ In April 2005, the Commission submitted the first package, on the basis of which the Member states have set up national reform programmes (European Commission 2005). These will be followed by national implementation programmes in the following years.

In this document, the Commission starts by presenting a sober and critical diagnosis of the record so far; a number of trends and developments are mentioned:

- a slowdown of economic growth since the second half of 2003 has been observed;

¹ “Commission tables 3-year blueprint for growth and jobs”, Press Release, Rapid, Reference: IP/05/414, Date: 12/04/2005.

- this has been accompanied by a slow decrease in unemployment rates; in 2006, the expectation was at about 8,7% of unemployed in the European Union;
- as explanations for the poor economic showing, the low amount of labour input and the low level of productivity growth, declining for more than a decade, have been identified as key explanatory factors. Lacks in business investment, in technological progress and innovation and in Information and Communication technology diffusion account to a large degree for these deficits.

Thus, the new start for the Lisbon strategy for creating growth and employment will focus on the promotion of a knowledge-based society, relying on human capital, education, research and innovation policies (European Commission 2005). What follows in the Commission document is however a menu of well-known items and rather conventional wisdom, where the Member States are addressed in general ways, without going into details of which country is doing better or worse than others. In this regard, the streamlining of the economic and employment policy coordination processes have led to a pleasant diffusion of contents, where national performance is not presented in an identifiable way.

In fiscal policy, the reform of the Stability and Growth Pact has also taken pressure from the Member states, as the strict conditions for fulfilment of the stability criteria have been smoothed and watered down, without however, giving up totally the underlying rigid framework, allowing for sanctions in case of durable and persistent deviation by member states. These adjustments were owed to the fact that some key member states like Germany and France had since 2002 constantly revealed excessive deficits of more than 3% GDP. The Stability and Growth Pact did not seem to work efficiently under conditions of weak economic performance in the member states: “[...] the simple and straightforward system of fiscal policy coordination, which was established under a stable and predictable economic environment in the mid-1990s, was no longer functioning as planned under the changed and uncertain circumstances in EMU in the 21st century [...]” (Kaarlejärvi 2005: 262).

Thus, all variants of economic governance have been subject to reforms in recent years and are still under heavy discussion as to their optimal form and modes. The reform debate will not stop with the possible failure of the Constitutional Treaty, but it might follow new directions in the coming years.

2. The debate on economic governance: criticism, suggestions and visions

According to Schelkle (2005), the institutional architecture of economic governance reveals some major problems: “[...] economic governance in the EU as a whole and in EMU as its most fully developed part does not follow the functionalist script. This script assumes that the levels of central and local government with executive competencies are clearly separated, these government functions neatly differentiated, and the set of policies to fulfil them given. Multi-level governance in the EU violates each of these assumptions [...]” (Schelkle 2005: 6). The fuzzy and complex mix of competencies, capacities and responsibilities has caused major difficulties for fiscal policy coordination to work effectively.

Criticism also hints at the vagueness of the open method of coordination as a major drawback and a source of confusion and lacking activist: “open coordination – which was presented as a method ‘designed to help the member states to progressively develop their own policies’ in the March 2000 Presidency Conclusions – is too ‘open’ in many ways, with significant consequences for its effectiveness: a concept that is so vague and malleable is difficult to translate into actual policymaking, especially within an already very complex system like the European Union. Thus, the most important challenge confronting open coordination involves

the establishment of a common understanding of its objectives and main features” (Metz 2006: 1-2). Metz (2005; 2006) identifies major weakness in coordination in a number of items:

- lacking consensus on the objectives of coordination;
- missing criteria for the application of coordination in different policy fields;
- poor commitment by member states;
- insufficient democratic legitimacy;
- increased heterogeneity by enlargement;
- failure of the constitutionalisation of the OMC.

In all of these fields, a counterstrategy should be developed in order to make the open method of coordination more effective; in particular, it is the member states’ level of public and political awareness that has to be raised (Metz 2006).

In fiscal policy also, the picture is rather mixed. From the very start already, a part of the economic community had attacked the SGP due to a perceived lack of consistency and frail rules (Eichengreen and Wyplosz, 1998). It is also stressed by some authors that results from the stability and growth pact have to be viewed in a differentiated manner, as national level outcomes have been quite heterogeneous (Buti and Pench 2005); some authors recognise that the SGP has indeed helped to establish a "stability culture" (Sapir et al. 2004), while on the other side, a "loss of credibility" generated in particular by an "amputation of the dissuasive arm of the pact" as a result of the suspension of the excessive deficit procedure in the cases of France and Germany has been observed (Buti and Pench 2005: 1026). Thus, rule application in this field of coordination has been viewed as rather frail and inconsistent. A broad range of contributions has been devoted to these weaknesses and failures, addressing the presumed crisis of the SGP.

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Within the debate on the reform of the SGP, several schools of thought can be identified: the first approach sticks to the pact which is regarded as basically sensible and feasible; the problems are with the member states, who should solve their budgetary difficulties; a second approach is the radical opposite, i.e. the plea for abolishing the SGP, due to the unsolvable internal difficulties; a third set of proposals pleads in favour of reforming the SGP, in particular by sticking to the objectives, but modifying the rules, and a last strategy would consist in a pragmatic muddling through, changing not the rules, but their interpretations, and to smoothly adjust to the needs of daily economic and political needs (Coeure and Pisani-Ferry 2003: 7ff.).

The balance between long-term fiscal stability and short-term flexibility in fiscal policy appears as a core problem (Fatás, von Hagen, Hughes Hallot, Strauch and Sibert 2003). The lack of fiscal discipline among the member states and the blunt instruments to enforce obedience has radically changed the appreciation among the expert community.

Beneath those contributions that consider a modification of fiscal policy coordination and the SGP in particular, there is a group of researchers advocating a total break-up of the SGP (En-

derlein 2004). The death of the pact has become a regular subject of political and scientific debate: "Therefore, new forms of democratic legitimacy are needed that intergovernmental coordination cannot produce" (Collignon, 2001: 30), e.g. by strengthening the role of EU institutions (in particular the Commission, the EP and the Council), by more neatly separating the national and European competencies and by differentiating between different levels of budgetary decision-making, with the effect of creating a democratic dialogue about policy objectives in a multi-level context (Collignon, 2001: 30ff.) A divergent approach is followed by Enderlein who pleads for totally abandoning the SGP as a whole and strengthening instead softer forms of coordination, e.g. in the framework of the Broad Economic Policy Guidelines (Enderlein 2004).

Economic governance in the EU has come under pressure, the need for reform seems evident. Whether the measures taken so far will suffice for making the institutional and procedural provisions more efficient and the performance more effective remains however doubtful. In the following part, a number of policy options and recommendations will be presented for a long, medium and short-term strategy.

II. Policy Options and Recommendations

1. Insufficient Reforms so Far

In the first place, it is important to develop a realistic vision of what is politically possible and what is not. The reform of the broad economic policy guidelines and the employment policy guidelines so far are insufficient, as they do not touch the core of the problem. Neither a multi-annual framework nor the insertion of both guidelines into a single document will solve the underlying structural deficits. What is needed is therefore a debate in the EU about the level of ambition and of expectation in economic governance. Reading the texts, little innovation or reform become visible. Thus it does not depend primarily on the timeframe whether coordination will work. Instead, the member states should be clear about why they need coordination, and what for they need it. If the results are not convincing, the EU should be ready to give up coordination in these areas or to organize flexible groups of coordination among countries with similar profiles in expectations, capabilities, and political will.

2. Corrections should not be a taboo: Lisbon as a long term vision

The Lisbon objectives, as far as can be said after 5 years, will probably not be achieved. Therefore, it would be damaging to stick to these elements, and thus produce a new source of frustration and disappointment. Instead, The EU should as early as possible try to redefine the targets and to adjust them to the possibilities of the EU. More modesty is required, coupled with a more pragmatic approach in making smaller, but concrete steps forward.

Too many coordination procedures may have been installed so far, so that a reduction in the number and size of these methods will be necessary. The EU should not regard this as a sign of weakness or failure, but of a realistic adjustment. Public attention for such steps will probably be weak anyway.

3. Fiscal Policy: Make the Hard Choices

The fiscal policy coordination process, in particular through the Stability and Growth Pact, should be fundamentally reviewed. The link between coordination and a strict framework for implementation including sanctions does not hold. The application of sanctions requires a rigid procedure including supranational institutions, and not a per-to-peer process among

member states unwilling to create cases of precedence that could one day fall back on them. Thus, the fiscal policy framework should be split, including a coordination cycle following the familiar patterns, and on the other hand a separate procedure triggered and dominated by the Commission for sanctions, which only may be suspended if a reinforced qualified majority of the member states votes against it.

4. Economic Governance and Legitimacy: No Need for Exaggeration

Expectations towards a more democratic and legitimate policy-making in the areas of economic governance should not be overstated. These fields will never respond to a mass audience, nor will the European public be eager to deal with economic governance in detail. Therefore, the EU should not try to invest amounts of resources into public campaign for information or exchange. What seems to be more important is to address specific audiences in each policy area, where a variety of organisations, associations, and experts are committed to issues of interest to them. Furthermore, the role of the European Parliament should be strengthened as a forum of debate and critical reflection of the EU's major monetary, fiscal economic policy options and developments. The parliamentary responsibility of the ECB could be strengthened without impairing autonomy in a too extreme measure, by enhancing and specifying reporting duties and personal appearances at committee and plenary levels.

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