NewGov
NEW MODES OF GOVERNANCE PROJECT
Policy Brief #05
Winter 2007/2008

How effective are new approaches to economic governance? The re-launched Lisbon Strategy and the revised Pact

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The economic and monetary union in Europe is a grand laboratory for new approaches to economic governance. The Lisbon Strategy and the Stability and Growth Pact (SGP) are show cases for these new approaches. But have these innovations achieved their declared goals? Both were reformed in early 2005, the Lisbon Strategy in February and the Pact in March. That changes were deemed necessary indicates that not all was well with these new approaches. Even worse, the changes were greeted with a barrage of criticism. This policy brief first examines what effectiveness of economic governance might mean. It then analyses how the reforms have affected the 'bindingness' of these policy processes and concludes that the SGP has potentially become more effective but not the Lisbon Strategy. Finally, it is argued that the reforms represent a shift in the underlying philosophy and practice of economic governance in the EU.

1. Effectiveness of new approaches to economic governance

A seemingly straightforward way of evaluating the effectiveness of a government is to ask whether it achieves its declared goals. But in the case of dynamic growth or sustainable public finances it may not be all that easy to assess to what extent the government is responsible for meeting or missing these goals. After all, there is a private commercial sector which may be more or less innovative and entrepreneurial and a world economy that may be more or less favourable to national growth. In the case of public finances, each government that comes to power has certain parameters to reckon with, such as a legacy of previous administrations' debt management and of accumulated social entitlements that cannot be easily undone within one or two terms in office. Thus the assessment of a government's effectiveness is a matter of legitimate political debate rather than of straightforward impact assessment. These arguments apply *a forteriori* to the EU where there is not one government. The interdependent governance of member states and the European level makes it quite difficult to identify the source of policy (in-)effectiveness.

It may be more sensible to assess effectiveness in the sense of the 'bindingness' that the EU's approach to economic governance is able to project on the national administrations that are supposed to coordinate their policies. Correspondingly, the literature has used the simple distinction between soft and hard law to distinguish new and old modes of governance. Soft law stands for codified policy processes that create a sense of moral obligation and are enforced by 'naming and shaming' (Hodson and Maher 2001). This translation of effectiveness into hardness implies, however, that the only effective instruments are legal ones. This is questionable as the emerging research on compliance suggests: hard law may not be all that hard because implementation can be shallow (Falkner et al 2005). Moreover, legal obligation is not the only way of creating binding agreements. European integration could hardly have proceeded thus far if it had to be pushed by the Court all along.

Following Abbott et al (2000), we can see that obligation is only one dimension of binding agreements in international law; delegation and precision being at least two others. *Obligation* refers to the commitment arising under the rules, procedures and discourse of international agreements. As already indicated, the new modes of governance under consideration here create only moral obligation, even though the Excessive Deficit Procedure (EDP) was meant to back up the Pact rules by pecuniary sanctions. *Delegation* refers to the possibility of empowering a third party to monitor the agreement (operative delegation) and resolve conflicts (adjudicative delegation). In the case of new modes of governance, delegation was originally analogous to diplomacy among equals, ie sovereign governments, but the Commission, Eurostat and various committees have gained in status over time, both in the Lisbon Process and in fiscal surveillance. Finally, the dimension of *precision* refers to the rules that specify what is expected from the parties under what circumstances, both in terms of goals and means to achieve these goals. New modes of governance tend to address a complex set of goals and are therefore less precise. However, detailed benchmarking and the search for best practice, if successful, makes them more specific and thus precise as regards the means to achieve or to balance various goals.

NEWGOV Policy Briefs

NEWGOV Policy Briefs are produced by the Integrated Project "New Modes of Governance – NEWGOV". The pan-European project examines the transformation of governance in and beyond Europe by mapping, evaluating and analysing new modes of governance. It is funded by the European Union under the Sixth Framework Programme from 2004 up to 2008. NEWGOV includes 24 projects and 3 transversal task forces and has more than 100 participating researchers from 35 institutions in Western and Eastern Europe.

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2. The effectiveness of the Lisbon Strategy and the Stability Pact

Those who believe in outcome indicators should welcome the 2005 changes introduced in the Lisbon Strategy and the Stability Pact. The goal of the Lisbon re-launch was an emphasis on the creation of 'more and better' jobs. Between 2002 and 2004, the employment rate for persons of working age (15-64) stagnated at around 64% in EU-15 (at below 63% in EU-27). It accelerated to 66% in EU-15 by 2006 (64% in EU-27), closer to the 70% target. The improvement in the female employment rate was particularly impressive, reaching 58% in EU-15 (57% in EU-27) in 2006, fairly close to the 60% target for 2010. The employment rate for older workers (55-64) is still about 5% (6.5% for EU-27) off the target of 50% in 2010. Employment growth took place against the backdrop of a 1.6% rise in overall labour productivity which is around the long-term trend, after a low of below 1% growth in 2001-2003.

The goal of the Pact revision was to ensure the long-term sustainability of public finances by reducing the debt dynamic generated by the anticipated rise in age-related spending for decades to come. The cyclically adjusted deficit of the Euro area stood at around 2.6% between 2001 and 2004, while it dropped to below 2% in 2005 and to 0.7% in 2007. All countries, with the exception of Austria and Belgium, have improved their fiscal balances after the reform of the Pact, and even these countries are close to balance. After the revision, the excessive deficit procedures have been closed for four Euro area members. Only Portugal and Italy still have an ongoing procedure under Art.104 (the deadline for correction has passed in the case of Italy).

Improvements in performance post-reform have not convinced the sceptics, for good reason. As long as we do not understand why and how these reformed processes should have more impact on policymakers now, it is problematic to argue that the changes really made a difference. So how have the changes affected the three dimensions of bindingness?

- In terms of obligation, the Lisbon re-launch did not bring any significant changes. This is what the proponents of structural reform noted and deplored. The Pact revision meant that a formally high to medium degree of obligation under the original framework was 'watered down' to medium to low obligation. The EDP now allows for exceptions and postponements, from systemic pension reforms to a drawn-out period of low growth. However, after the revision, every country that broke the 3% threshold was put into an EDP: there were no more suspensions.

- In terms of delegation, the 'streamlining' of the Lisbon Strategy has elevated the role of the ECOFIN Council, which contributes to making it more binding. Economics and Finance ministers can be expected to be hard-nosed monitors of social policy, with an orientation towards fiscal and economic surveillance. Similarly the DG for Economic and Financial Affairs has given itself more of a role and DG Employment has been sidelined. The Pact has been considerably strengthened in this respect, and now has a high degree of delegation in monitoring and medium in conflict resolution. The Commission has now a right to give 'early policy advice' and, thanks to a new statistical Code of Conduct, Eurostat can act as an independent auditor. The Court confirmed, in its 2004 ruling that triggered the revision, that the Commission has the sole right of initiative, now in fact an obligation, to consider the opening of an EDP whenever a government comes within the excessive deficit limit.
- In terms of precision, the re-launch of Lisbon brought hardly any changes. The focus on employment goals ('more and better') should have meant somewhat more precision in goals. But this was undermined by the Integrated Guidelines due to the streamlining with the BEPG. The annual joint report on governments' national reform programmes still comments on everything, from fiscal and ecological sustainability to employment quantity and quality. As regards the means, the medium degree of precision that originally manifested itself in the search for best practices has been replaced by four priority areas that are in place for a whole policy cycle of three years (and will not be changed for 2008-10). The revised Pact, by contrast, has become less precise as regards its fiscal goals, by providing room for structural reforms, yet has gone from a low to a high degree of precision in the application of the means to achieve goals. Governments in breach of the fiscal rules must now make a 'minimum fiscal effort' of reducing the cyclically adjusted deficit by 0.5%. The reporting requirements under agreed methods have been vastly increased, eg administrations have to calculate Sustainability Indicators for their age-related spending.

My conclusion is that the Lisbon re-launch did not really bring about a change in governance that would make it more binding. Even the shifting of peer review partly or wholly into the ECOFIN Council is unlikely to make much difference – except for alienating the social policy stakeholders of the Strategy – if it is not combined with more precise or obligatory instructions for the Council to deliberate on. In the case of the Pact, strengthening the monitoring role of the Commission and Eurostat together with more precise instructions of what

Further reading

This policy brief is based on research carried out within the NEWGOV project no. 19a on "New Approaches to Economic Governance in the EU (ECONPOL)", led by Waltraud Schelkle and Iain Begg. How economic policy is developed, legitimised and conducted in the economic and monetary union is central to the governance of the Union. The project' starting point is that, from the perspective of economic management, the policy system will not only require the bringing together of different actors (local, national and supranational, on the one hand; private and public, on the other), but also a reweighting of the policy instruments. The EMU policy system has to be analysed as a profound regime change which, in turn, has far-reaching implications for the 'demand' for governance, as well as how it is 'supplied'. The project explores these issues from both theoretical and empirical perspectives and will provide a political economy input into the overall project.

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Treasuries have to do in order to comply with the fiscal rules seems to be a potentially effective re-combination of the elements that make for binding agreements. Regulation of fiscal administrations has largely replaced the pretence of coordination between governments, potentially empowering the fiscally minded parts within governments.

3. The ongoing debate

The debate on the effectiveness of new approaches to economic governance touches on the more fundamental issue of what role governments should play in economic policy.

The governance framework of EMU before the reforms was based on a 'Dr Jekyll and Mr Hyde' view of government. While government is Mr Hyde and must be restrained when it comes to macroeconomic policymaking, it should turn itself into Dr Jekyll when it comes to microeconomic reforms to improve incentives for growth and innovation. Obviously, the original Pact was based on a Mr Hyde view of government that cannot be easily reconciled with the demands on Dr Jekyll requested by the Lisbon agenda. The shift that has taken place with the revisions is that there is now a role for Dr Jekyll in fiscal surveillance, as an enlightened regulator who is sensitive to reform needs while protecting future generations against exploitation by the present. Alas, Dr Jekyll's new job has rendered him rather less useful for the Lisbon Strategy.

The re-launch of the Lisbon Strategy alienated the stakeholders of what was originally perceived as a social policy coordination process complementing microeconomic and fiscal policy processes. Streamlining the Strategy with economic policy coordination and subordinating it to peer review in the ECOFIN Council was meant to give it more political salience, but is likely to weaken it. Economics and Finance ministers are reluctant to step on the toes of their colleagues in the social policy ministries, partly because the latter are often quite powerful ministries and partly because this could trigger the formation of a wider opposition against 'the diktat of the fiscal'. DG Ecfin, also empowered by the re-launch, is not seen as a potential ally but as a technocratic adversary in those parts of national administrations that are responsible for structural reforms. Thus, instead of giving it a new lease on life, the Lisbon Process seems to have been suffocated by the overwhelming detail of indicator comparisons and benchmarks, easily ignored by those who are interested in or responsible for social policy domestically.

The match between actors and audiences of the policy process, delegation and precision is now more congenial in fiscal surveillance. Governance through the revised Pact operates analogous to comitology, through self-regulation by 'experts' and 'giving reasons requirement'. The locus of self-regulation has shifted to deliberation between Treasuries, monitored by the Commission and Eurostat, thus avoiding a stand-off in the Council that the Commission is bound to lose. The precisely defined exceptions and country-specific circumstances that can be put forward do not allow for any other plausible excuses, as interview partners from member state Treasuries repeatedly pointed out. Far from meaning a 'watering down', the new framework extends the 'EU regulatory state' (Majone) into fiscal surveillance by effectively mobilising the Dr Jekylls, the supposedly enlightened technocrats, within the governments of member states (Schelkle forthcoming).

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