

# Macro Coordination under the European Semester

To reinforce ex ante coordination of EU Member States' economic and fiscal policies, a new monitoring cycle has been introduced: the "European semester" – a six-month period every year during which national budgetary and structural policies will be reviewed to detect any inconsistencies and emerging imbalances while major budgetary decisions are still under preparation. Technically, the European semester brings together various procedures for economic policy coordination, based primarily on Article 121 (and to lesser degrees on Articles 126, 136 and 148) of the Treaty on the Functioning of the European Union. Specifically, the reform reinforces the preventive arm of the Stability and Growth Pact, introduces a new procedure for addressing macroeconomic imbalances, and places greater emphasis on monitoring the national fiscal frameworks, identifying macrostructural growth bottlenecks and detecting macrofinancial risks in the Member States. National fiscal and economic policies will be monitored in a coordinated and integrated manner rather than separately, and national policies will be aligned with integrated guidelines. The new approach is also intended to facilitate joint discussion of important economic policy priorities at EU level, thereby ensuring complementarity of national economic policy plans through policy guidance before Member States finalize their budgets for the following year. The results of such discussions and the definition of economic and fiscal policy priorities will then be effectively reflected in national policymaking, particularly in national budgets and structural reforms. The European semester thus follows an integrative approach that moves toward comprehensive, country-specific economic surveillance, in some cases with the possibility of imposing corresponding sanctions, which is in marked contrast to the "open method of coordination" used under the Lisbon agenda. Upon implementation of the "six-pack" of economic governance rules in January 2012, the already stringent monitoring requirements will be tightened even further.

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The global financial and economic crisis, along with the European debt crisis that followed in its wake, have prompted a rethinking of the existing economic policy surveillance mechanisms in the EU and the euro area. Since those approaches suffered from obvious shortcomings in economic policy coordination, governance reform became the top priority for the near term. The European Commission's legislative proposals of September 29, 2010, coupled with the results delivered by a task force<sup>2</sup> chaired by the President of the European Council, paved the way for a comprehensive redesign of the tools applied by the EU to reinforce

the Stability and Growth Pact (SGP), i.e. to ensure sound fiscal policy and prevent macroeconomic imbalances.

The new strategy is centered on enhanced, integrated surveillance of fiscal policies, macroeconomic management and structural reforms, which marks a clear step away from the earlier "open method of coordination" as enshrined in the Lisbon strategy, in favor of comprehensive, country-specific monitoring. Integrated surveillance (which also comes with an extended range of sanctions) is to ensure the prevention or correction of macroeconomic imbalances that might jeopardize financial and price stability in

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<sup>2</sup> See the task force report of March 2010.

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the euro area and the EU, as well as the prevention or correction of insufficient competitiveness and growth bottlenecks. Technically, the new approach is a cornerstone of the recently implemented European semester – a six-month period every year during which Member States’ budgetary and structural policies will be reviewed while major budgetary decisions are still under preparation. Notably, the SGP, which is the centerpiece of the European fiscal framework, will be strengthened progressively by focusing not only on public deficit but also on trends in public debt as well as the dimensions and dynamics of public spending. In addition, the euro area countries and several other EU Member States<sup>3</sup> adopted a complementary agenda of additional reforms – the Euro Plus Pact – in spring 2011 as a further means to improve competitiveness, employment, long-term sustainability of public finances and financial stability.

EU governance has been reformed on a number of levels. First, by introducing the European semester, the EU’ economic and fiscal policy surveillance measures will be synchronized with national budget procedures, thereby facilitating a better integrated and more effective policy coordination at the European level. Specifically, the preventive and dissuasive arms of the SGP will be strengthened, and monitoring of national fiscal frameworks reinforced. Second, in addition to budgetary surveillance, procedures for monitoring macroeconomic imbalances will be introduced. An alert mechanism based on a scoreboard of specific indicators, coupled with a more stringent surveillance mechanism, will allow timely intervention to prevent or correct such imbalances, especially unsustainable

debt positions in the private and public sectors, in the financial sector and vis-à-vis non-EU countries. Third, the EU-wide surveillance of structural reforms in the Member States aims at making tangible progress toward achieving the Europe 2020 strategy’s objectives of smart, sustainable and inclusive growth (Auböck et al. in this issue). Finally, the temporary crisis management solutions are to be replaced by a permanent crisis management tool for safeguarding financial stability in the euro area as a whole: the European Stability Mechanism (ESM) (Nauschnigg and Schieder in this issue).

The reform was implemented, among other things, through six legal instruments (collectively known as the “six-pack”), four of which deal with fiscal issues, including an extensive reform of the SGP (Holler and Reiss in this issue), while two new regulations govern procedures aimed at identifying and effectively addressing macroeconomic imbalances emerging in the EU and the euro area (Essl and Stiglbauer in this issue). One primary motive behind the reform of economic and fiscal policy governance is to put “more teeth” into the regulatory mechanism by ensuring that deviations from fiscal rules will automatically trigger sanctions. For this reason, the implied changes to the SGP and implementation of the two new regulations dealing with macroeconomic imbalances will be accompanied by markedly stronger enforcement mechanisms.

This article describes the new coordination and governance structure under the European semester. The first section presents the pillars and principles of macro coordination in the EU and euro area established under the Treaty on the Functioning of the Euro-

<sup>3</sup> Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania.

pean Union. Section 2 examines the substantive and economic policy priorities that support the procedural framework of the European semester. Section 3 illustrates the actual timing of the European semester against the backdrop of the initial six-month cycle implemented from January to June 2011. The final section offers an initial assessment of the effectiveness of this new institutional process.

## 1 Principles of Macro Coordination under the Lisbon Treaty

The Economic and Monetary Union (EMU) has now been in effect for more than 12 years. Since the single currency was launched, the number of euro area Member States has increased from 11 to 17.<sup>4</sup> The Lisbon Treaty brought only slight changes in the basic concept of EMU. The fact that the achievement of economic and monetary union is one of the objectives laid down both in Article 3 of the Treaty on European Union (TEU) and Title VIII of the Treaty on the Functioning of the European Union (TFEU) shows the strong link between economic and monetary policy decisions. Regarding the concepts behind “economic union” and “monetary union,” however, marked asymmetry exists with respect to the exercise of powers among the Member States. Monetary union is characterized by the single currency, free movement of capital and a common monetary policy aimed at maintaining price stability. Institutionally, it is evidenced by the independent European Central Bank (ECB) and the European System of Central Banks (ESCB). As defined by Articles 119 and 120 TFEU, economic union is based on economic policy coordination (which fundamentally has remained within the

national jurisdiction), the internal market concept and the definition of common economic policy objectives for the European Union and its Member States (e.g. Häde, 2011). Articles 119 and 120 TFEU stipulate that the guiding principles of EMU are an open market economy with free competition, stable prices, sound public finances, stable monetary conditions and a sustainable balance of payments. In brief, those principles represent the macrofinancial prerequisites to, or restrictions on, the economic and fiscal policies of the Member States and the European Union to ensure that the monetary union remains focused on delivering (price) stability.

### 1.1 Salient Principles of Macro Coordination

- *Imposing “market” discipline on Member States’ fiscal policies:* Article 123 TFEU bars the Member States’ national central banks from directly financing public sector debt, public undertakings and other bodies governed by public law, with the exception of credit institutions. As a result, the purchase and sale of government securities by national central banks is possible only through the secondary market to ensure that such activities are subject to market valuation. Furthermore, Article 124 TFEU prohibits measures (e.g. preferential interest rates) providing the public sector with privileged access to financial institutions, while Article 125 also prevents the Union and Member States from assuming the public debt of another Member State (“no bailout” clause).

<sup>4</sup> Belgium, Germany, Estonia, Finland, France, Greece, Ireland, Italy, Luxemburg, Malta, Netherlands, Austria, Portugal, Slovakia, Slovenia, Spain and Cyprus.

- *Increased commitment of national budget policy to fiscal rules* to ensure adherence to sound fiscal policy and long-term sustainability of public finances by imposing quantitative restrictions in the form of ceilings on general government budget deficits and the Member States' gross public debt ratio. The preventive arm of the SGP (Regulation No 1466/97 as amended by Regulation No 1175/2011<sup>5</sup>) is intended to make Member States pursue a prudent fiscal policy aimed at building up the financial buffer necessary to ensure that automatic stabilizers can work to their full potential and preventive countermeasures can be adopted in the event of a severe economic crisis. The excessive deficit procedure (EDP) anchored in Article 126 TFEU and specified in further detail by Regulation No 1467/97 as amended by Regulation No 1177/2011<sup>6</sup> sets out the criteria for identifying the existence of an excess deficit, specifies the requisite measures and time limits for corrective action and stipulates the sanction mechanisms to be applied to euro area countries – and much less substantially to EU Cohesion Fund countries – in instances of nonadherence to the prescribed fiscal governance rules. For the future, said regulation also mandates stricter surveillance of debt levels and their development, which, according to the EDP, carries about the same weight as an excessive budget deficit. The changes to the preventive and dissuasive components of the SGP will be supplemented by a new set of gradual financial sanctions for euro area countries based on Article 136 TFEU and Regulation No 1173/2011.<sup>7</sup> To ensure enforcement, a “reverse voting procedure” is envisaged when imposing such sanctions: a sanction proposed by the European Commission will be deemed automatically adopted unless voted down by a (qualified) majority of the Council.
- *Stronger obligation of Member States to reduce excessive macroeconomic imbalances* by means of a new procedure based on Articles 121 and 136 TFEU (excessive imbalances procedure – EIP), which also provides a basis for imposing financial sanctions on euro area countries. As of 2012, the new surveillance mechanism specified by Regulations No 1174/2011<sup>8</sup> and 1176/2011<sup>9</sup> is intended to prevent the accumulation of excessive debt in the private sector, the financial sector or vis-à-vis foreign countries, a lack of competitiveness and excessive increases in the prices of real and financial assets throughout the euro area.
- *Implementing a permanent financial crisis resolution mechanism* for EU

<sup>5</sup> 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.

<sup>6</sup> 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.

<sup>7</sup> Council 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.

<sup>8</sup> Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic balances in the euro area.

<sup>9</sup> 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.

Member States and euro area countries. Based on Article 143 TFEU for non-euro area countries and Article 122 TFEU for cases of extraordinary situations, tools to counteract financial crises were created as debt crisis worsened in the peripheral countries of the EU and the euro area. Such tools include the EFSM<sup>10</sup>, a temporary rescue fund which, although technically available to all EU Member States, focuses on the euro area. In addition, the members of the euro area, jointly with the IMF, implemented bilateral credit facilities for Greece and also created the EFSF<sup>11</sup> as a temporary vehicle for providing financial assistance to euro area countries facing liquidity problems. A permanent crisis management tool for the euro area – the ESM<sup>12</sup> – will be implemented as of June 2012 based on the new – yet to be ratified – Article 136(3) TFEU.

- *Strengthening the integrated economic policy surveillance of the Member States:* While under the Lisbon agenda, the key focus of economic policy governance used to be on the analysis of enforced/implemented measures and their impacts, the aim of the European semester is to reinforce coordination ex ante during the policymaking process.

## 2 Objectives and Content of the European Semester

### 2.1 Objectives

In March 2010, the European Council adopted the Europe 2020 strategy that replaced the Lisbon Agenda for Growth

and Jobs.<sup>13</sup> The objective of Europe 2020 is to achieve smart, sustainable and inclusive growth by the year 2020. To realize that objective, ten integrated guidelines were adopted on the basis of the broad economic policy guidelines pursuant to Article 121(2) TFEU and the employment policy guidelines rooted in Article 148 TFEU, which also contain five EU-wide headline targets: employment, R&D, education, the environment and the fight against poverty.

The economic and debt crisis had also made it apparent that the Europe 2020 strategy would have to be based on a more effective framework than its predecessor – a challenge being addressed through implementation of the European semester. Thus, the instrument of *macroeconomic surveillance* has been reformed to ensure a stable macroeconomic environment conducive to growth. In line with the Europe 2020 integrated guidelines (guidelines 1 to 3), macroeconomic surveillance covers the economic policy areas under national jurisdiction that might influence macroeconomic imbalances, macrofinancial risks and the competitiveness of a national economy. As it is based on the synchronized assessment of Member States' structural policies, the respective macroeconomic surveillance addresses not only the direct impact of structural measures, but also their spillover effects on other Member States and the European Union as a whole. By extension, the *surveillance mechanism of the SGP* will be reinforced, primarily to support fiscal adjustment measures in the pre-

<sup>10</sup> European Financial Stabilisation Mechanism.

<sup>11</sup> European Financial Stability Facility.

<sup>12</sup> European Stability Mechanism.

<sup>13</sup> See European Council (2010). *Conclusions of the European Council of March 25/26. EUCO 7/10.*



ventive arm, thereby ensuring the long-term sustainability of public finances.<sup>14</sup>

The European semester aims at enhancing ex ante coordination of the economic and fiscal policies of the Member States and the Union by aligning the different strands of economic policy coordination. As a result, national fiscal and economic policies will be monitored in a coordinated and integrated manner rather than separately, and national policies will be aligned with integrated guidelines. This approach ensures that important economic policy priorities will be discussed jointly at EU level and that structural and fiscal policy reforms are compatible with the underlying policy stance. Similarly, complementarity of national economic policy plans will be ensured at European level through policy guidance before Member States finalize their budgets for the following year. The results of such discussions and fiscal and economic policy priorities will then be effectively reflected in national decision-making, particularly in national budgets and structural reforms, so that national and European efforts can be aligned in a manner designed to foster growth and stability and monitor progress over time. The European semester thus covers all the essential elements of economic policy coordination and surveillance, including strategies to ensure fiscal discipline and macroeconomic stability, and to promote growth in line with the Europe 2020 strategy. The first European semester was launched in January 2011.

Under the new macroeconomic policy framework, the governance and monitoring procedures established under

the SGP and the Europe 2020 strategy will be synchronized and coordinated, while preserving their respective underlying legal principles. Assessment of the Member States' Stability and Convergence Programmes (SCPs) and their National Reform Programmes (NRPs), as well as adoption of the resulting Council recommendations will take place simultaneously and in a single instrument, leading to coherent and consistent integrated policy recommendations on cross-cutting issues. The benchmark for the assessments consists of the European Council's economic and fiscal policy orientations for implementing the Europe 2020 strategy and for establishing and ensuring sound public finances, which are provided in the European Commission's Annual Growth Survey.

The country-specific recommendations issued by the Council, which will be incorporated in the formulation of the national budgets for 2012 and provide ex ante guidance to Member States for configuring their employment and structural policies, are based on Articles 121 and 148 TFEU. Furthermore, in the context of correcting macroeconomic and budget imbalances as well as excessive spending patterns, the Council recommendations also provide a basis for further procedural steps.

## **2.2 Substantive Priorities of Macro Coordination**

### **2.2.1 Enhancing the Preventive Arm of the SGP**

The reform detailed in Regulation No 1466/97 as amended by Regulation No 1175/2011 does not affect the central elements of the preventive arm of the

<sup>14</sup> For the euro area, a horizontal assessment of the members' fiscal stances is performed on the basis of their national stability programs and the forecasts of the European Commission. Special consideration to the aggregate stance should be given in cases where extensive fiscal policy measures of individual Member States are likely to produce spillover effects on other Member States.

SGP since it does not change the medium-term objective (MTO) for the Member States' budgetary positions of "close to balance or in surplus," nor the requirement to submit annual SCPs. The minimum requirement for a structural adjustment of 0.5% of GDP (if the MTO has not been met or violated) likewise remains unchanged, as does the surveillance process itself. The Member States annually submit their SCPs to the Commission where they are assessed. On the basis of this assessment, the Commission then issues a recommendation on each SCP. The reform of Regulation No 1466/97 does introduce a new element, however: if a euro area country fails to comply with previous Council recommendations under the preventive arm, the (Ecofin) Council can impose financial sanctions on that country in the form of interest-bearing deposits. This measure would be utilized particularly in cases of non-compliance with the new expenditure rule or in instances where significant deviations from the adjustment path to reach the MTO are not countered with sufficient fiscal adjustment measures specified in a Council recommendation. Such financial sanctions are initiated through a two-stage process based on the reverse majority voting mechanism (a sanction proposed by the European Commission will be deemed automatically adopted unless the (Ecofin) Council, by qualified majority, decides to reject the proposal in a second step).

The Council recommendations thus have the main purpose of determining whether:

- *A corrective action plan is sufficient to eliminate an excessive deficit that has been identified; in other words, whether the proposed reform measures are adequate and specified in sufficient detail or if further*

adjustment is required, for instance in cases where country-specific economic conditions and circumstances have changed. The procedure to be applied in cases of excessive deficit is specified in Regulation No 1467/97. If financial assistance has been granted, the procedure will follow the course prescribed by the structural adjustment program, which means that no specific recommendations will be issued. Finally, the Council recommendations also serve as a basis for financial sanctions to be imposed against euro area countries on the basis of Articles 126 and 136 TFEU.

- *A risk of excessive government deficit pursuant to Article 126 TFEU exists because:*
  1. *Excessive deviations from the required adjustment path to reach the MTO or from the MTO itself (0.5% of GDP in one year or 0.25% of GDP in two consecutive years) have occurred. In this case, Regulation No 1173/2011 based on Article 136 TFEU authorizes the Council to impose sanctions on euro area countries in the form of interest-bearing deposits that equal 0.2% of GDP.*
  2. *The new expenditure rule is not followed. If public spending (not including interest and EU expenditure and unemployment benefits that depend on cyclical developments) exceeds the country's potential GDP growth rate by 0.5% in one year or 0.25% of GDP in two consecutive years, the new Regulation No 1173/2011 similarly enables the Council to sanction euro area countries by requiring them to pay 0.2% of their GDP into an interest-bearing deposit.*

- The fiscal policy, given the effects of cyclical conditions on public spending, is sufficiently ambitious to ensure the *quality and sustainability of public finances*. Council recommendations made in that regard do not trigger any financial sanctions.

### 2.2.2 Preventive Arm to Address Macroeconomic Imbalances

The European semester also includes a preventive pillar embodied in a procedure to address macroeconomic imbalances, the details of which are specified in Regulation No 1176/2011. That feature is intended to reduce competitive deficiencies, asset price bubbles and debt positions in the private, public or financial sectors that might become unsustainable in the long term and could eventually lead to liquidity or solvency problems in the Member States, especially within the euro area. At the insistence of the European Parliament, real economic indicators, such as unemployment and productivity gains, will also be given greater weight in the analysis. The assessment of these factors by the European Commission and the Council (in its Ecofin and EPSCO configurations) will be based on information provided by the Member States in their NRPs and SCPs.

One purpose of the preventive arm is to facilitate the in-depth analysis of Member States' macroeconomic performance by the European Commission as part of its "alert mechanism." The cycle of analysis will be launched at the start of the European semester with the presentation of a scoreboard consisting of ten headline indicators intended to identify specific macroeconomic imbalances that might emerge in a national economy. The scoreboard, along with the findings for each Member State, will be published somewhat later than the European Commission's Annual

Growth Survey (AGS), accompanied by a full economic reading of the results by the Commission. That initial analysis will then be comprehensively discussed within the Council so that subsequently (next in spring 2012), a more in-depth review followed by an exhaustive dialogue with the Member States will occur, which may include review missions conducted by the Commission to assess and verify the country-specific circumstances and requirements. At the conclusion of the European semester and during the assessments of the Member States' SCPs and NRPs, the European Commission will have the following options for its further course of action:

- No proposal for a Council recommendation since no material risks of macroeconomic imbalances were identified.
- Recommendation to the Council to adopt the necessary preventive recommendations to the Member State based on Article 121(2) TFEU in the context of the integrated country-specific surveillance protocols carried out annually.
- Recommendation based on Article 121(4) TFEU for the *opening of an excessive imbalances procedure* (EIP), which establishes the corresponding corrective action plan with specific deadlines or provides for sanctions based on Article 136 TFEU (as specified in Regulation No 1174/2011, in the form of an interest-bearing deposit which may be converted into an annual fine of up to 0.1% of GDP) if no adequate adjustment program is presented.

### 2.2.3 Structural Reforms to Eliminate Growth Bottlenecks

The Lisbon agenda was conceived to increase growth and employment in the EU and make the EU the world's



most dynamic economic region by 2010. However, that objective was not achieved, in part because of governance problems and a failure to implement structural policy reforms and initiatives both in the Member States and at the EU level itself. Concerns over shortcomings in economic policy governance prompted calls for a stronger national and EU-wide commitment to implementing the framework of structural reforms required under the new Europe 2020 Strategy.

As early as June 2010, the Ecofin Council specified a series of five growth bottlenecks for each Member State<sup>15</sup> and the euro area as a whole in the context of its broad economic policy guidelines. In May 2011, the Employment, Social Policy, Health and Consumer Affairs Council (EPSCO) followed by outlining a number of national bottlenecks to growth and jobs<sup>16</sup> in its guidelines for the Member States' employment policies, which ultimately provided the guiding principle behind the country-specific Council recommendations issued in June 2011. Overall, these recommendations provided for substantially streamlined regulatory arrangements and in some cases also included different focuses for different countries (section 3). However, contrary to the Council recommendations regarding fiscal policy or macroeconomic imbalances, no financial sanctions can be levied in the event of inadequate implementation. Success is to be ensured solely on the basis of national ownership, benchmarking and peer pressure as well as an exchange of best practices.

#### 2.2.4 Monitoring of Macrofinancial Risks

Systemic risks in the financial sector are monitored primarily by the European Systemic Risk Board (ESRB), which acts independently from the European semester. The ESRB can issue recommendations to the (Ecofin) Council or individual Member States and demand corrective actions; however, such recommendations are not legally binding. In any case, the results of the ESRB's analyses may be incorporated into the framework of macroeconomic coordination by:

- Issuing a council recommendation based on Article 121(2) TFEU if insufficient financial market stability constitutes a growth bottleneck, or considerable macrofinancial risks lead to misallocations of capital in the financial sector.
- Identifying excessive macroeconomic imbalances in the financial sector in the context of a Council recommendation based on Article 121(4) TFEU if considerable macrofinancial risks have been revealed in the financial sector due to certain circumstances such as excessive bank indebtedness.

#### 2.2.5 Strengthening National Fiscal Frameworks

In future, the EU will also pay significantly more attention to the national fiscal frameworks, thereby supplementing the framework of economic governance provided under the SGP. National fiscal rules and institutions, as well as efficient and effective budget surveillance are intended to prevent fiscal policy decisions from being based solely

<sup>15</sup> For Austria: Budgetary consolidation, improvement of the fiscal equalisations system, more effective R&D and a better educational system, financial stability, higher rates of labor force participation among the elderly, unskilled and women, and structural reforms to increase internal demand.

<sup>16</sup> For Austria: Barriers to the job market for the elderly and unskilled, high taxes on labor, insufficient supply of education, disadvantages for women on the job market.

on short-term considerations and to effectively incorporate medium- and long-term trends along with the associated fiscal and economic policy challenges into economic policymaking. This set of tools is aimed at preventing or correcting macroeconomic imbalances such as unsustainable debt dynamics, high levels of implicit financial liabilities or budget structures that are not conducive to growth.<sup>17</sup> Integration into the European semester occurs along two tracks, and the information underlying the assessment of national fiscal frameworks is generally contained in the countries' SCPs. Specifically, the recommendations relate to:

- Failure to meet the minimum standards stipulated by Directive 2011/85/EU<sup>18</sup>, which will be applicable to all Member States as of 2013 and establishes minimum quality standards for the system of national accounts and fiscal statistics, a cautious approach to economic and budgetary forecasts, strong country-specific numerical fiscal rules and medium-term budget (expenditure) frameworks, transparency in public budget statistics and coverage of all subsectors of general government in the national fiscal frameworks.
- Moving in the direction of countries whose national fiscal frameworks serve as benchmarks. The procedure is based on changes effected through peer pressure, although any weaknesses that have been identified will, at a minimum, appear in reports submitted to the (Ecofin) Council

and may lead to a Council recommendation based on Article 121 TFEU (pending the effective date of Directive 2011/85/EU).

The *Euro Plus Pact*, which was signed by the euro area Heads of State or Government on March 11, 2011, is also embedded in the European semester. Under this complementary agenda, the members of the euro area and six other non-euro area economies agreed on a set of concrete national actions which are to be achieved within the near future. The enforcement and implementation of these measures builds on the “open method of coordination” and thus relies on informal and independent procedures, but since the relevant actions are listed in the NRPs (as an annex in the Austrian case), they are also included in the individual country-specific surveillance programs.

### 3 Timetable and Governance Architecture of the European Semester

The first European semester was launched in January 2011 with the presentation of the European Commission's initial Annual Growth Survey (AGS), which assesses the main economic and social challenges to be addressed by the EU. In that survey, the European Commission specified the priority actions to be taken in three main areas: public finances, structural policy and growth-enhancing measures.<sup>19</sup> The European Council discussed the AGS at its meeting in March 2011 and essentially established or supplemented its policy orientations on the

<sup>17</sup> See also Haberfellner and Part (2009).

<sup>18</sup> Council Directive 2011/85/EU of 8 November 2011 on requirements for budgeting frameworks of the Member States.

<sup>19</sup> The AGS proposes ten priority actions that are pivotal to strengthening the EU's economic recovery, keeping pace with the EU's main competitors and preparing the EU to move toward its Europe 2020 objectives: (1) rigorous consolidation of public budgets; (2) correcting macroeconomic imbalances; (3) ensuring the stability of the financial sector; (4) making work more attractive; (5) reforming pension systems; (6) getting the unemployed back to work; (7) balancing security and flexibility; (8) tapping the potential of the single market; (9) attracting private capital to finance growth; and (10) creating cost-effective access to energy.

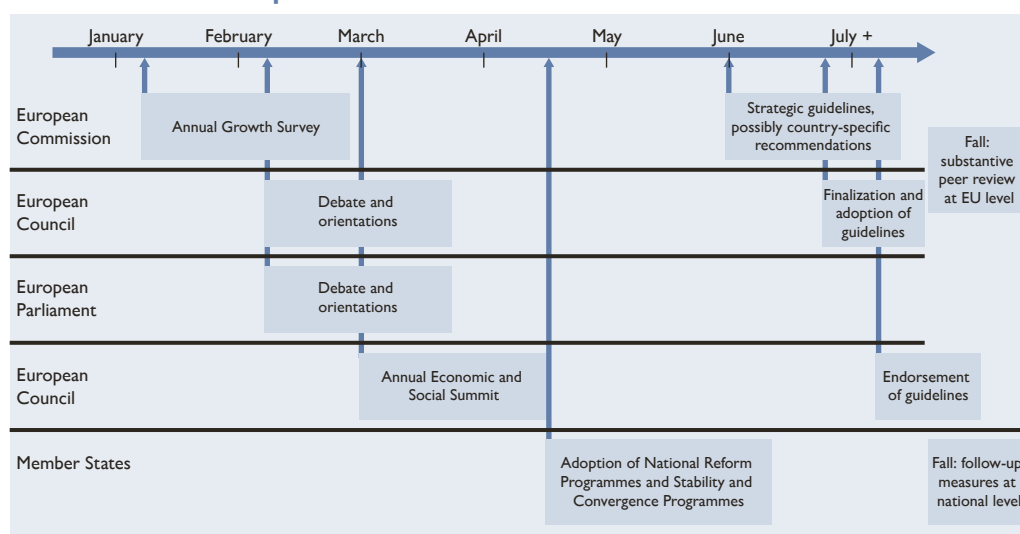
basis of the proposals contained in the survey. Those orientations aim at the effective implementation of the Europe 2020 Strategy and ensuring a sustainable fiscal policy. Based on the findings of the AGS and the orientations derived therefrom, the Member States were given until the end of April 2011 to present their SCPs, reporting on their budgetary positions and medium-term budget objectives, and their NRPs, outlining actions to promote growth and employment and measures to achieve the objectives of the EU 2020 strategy.<sup>20</sup>

The European Commission assessed the programs submitted by the Member States based on the respective legal jurisdictions and presented an integrated set of recommendations for each Member State in early June 2011.<sup>21</sup> In total, the Commission issued 27 sets of “recommendations for a Council recommendation” to the Member States and one recommendation for the euro area as a whole. Those recommendations, which

are concrete, targeted and measurable, concentrate on the key priorities to be addressed during the following 12 to 18 months. This reflects a deliberate choice to focus on the most pressing challenges and what can realistically be achieved in that time frame, taking into account the specific circumstances of each Member State.<sup>22</sup> Subsequently, based on the different areas of responsibility, the recommendations were discussed by the Alternates of the Economic and Financial Committee (EFC), in the Economic Policy Committee (EPC) and in the Employment Committee (EMCO). The drafts were then reviewed and finalized by either the EFC or the Committee of Permanent Representatives of the Member States (COREPER), depending on whether they referred to Article 121 or Article 148 TFEU. As a result, the recommendations cover a broad range of economic policy issues including public finance (budget consolidation, long-term sustainability, fiscal

Chart 1

### Timeline of the European Semester



<sup>20</sup> Greece and Portugal did not formally present any stability programs. Their fiscal policy priorities will be discussed on a regular basis during the follow-up to the assistance programs.

<sup>21</sup> The Council may direct only a single set of recommendations to each Member State.

<sup>22</sup> For Member States receiving financial aid, the European Commission has chosen to make only one recommendation: that they implement their commitments on schedule.

framework, quality of structures), financial market stability, employment and labor market policy, wage policy, product markets, educational policy, research and development, and environmental and social affairs. In June 2011, the Council, via its configurations Ecofin and EPSCO, endorsed the final versions of the country-specific recommendations to be submitted to the European Council later that month. Following endorsement by the European Council, the country-specific recommendations were ultimately adopted by Ecofin and EPSCO in July 2011. By the second half of 2011, the recommendations, which

are also intended as triggers for further growth-stimulating economic policy measures, had to be effectively reflected in Member States' national budget proposals, which are generally presented and adopted in the fall.<sup>23</sup>

#### 4 Evaluation and Findings of the First Coordination Cycle

The requirement for Member States to submit their SCPs to the European Commission for assessment has not changed under the European semester, although the content of the SCPs has been streamlined and their timing has been adapted to fit the new cycle of the

Box 1

#### The Recommendations of the Council for Austria

*The Council recommends that Austria take action to:*

- Accelerate the correction of the excessive deficit, which is planned mainly on the expenditure side, thus placing the high public debt ratio on a downward path, taking advantage of the ongoing economic recovery, in order to ensure an average annual fiscal effort of 0.75% of GDP from 2011 to 2013, in line with the Council recommendations under the excessive deficit procedure. To this end, adopt and implement the necessary measures, to include the subnational level.
- Specify measures as needed to ensure adequate progress towards the medium-term objective in line with the SGP after correction of the excessive deficit. Take steps to further strengthen the national budgetary framework by aligning legislative, administrative, revenue-raising and spending responsibilities across the different levels of government, particularly in the area of health care.
- In consultation with the social partners and according to national practices, take steps to further limit access to the current early retirement scheme for people with long insurance periods and take steps to reduce the transition period for harmonization of the statutory retirement age between men and women to ensure the sustainability and adequacy of the pension system. Apply stringently the conditions for access to the invalidity pension scheme.
- Take measures to enhance participation in the labor market, including the following: reduce, in a budgetary neutral way, the effective tax and social security burden on labor, especially for low- and medium-income earners; implement the National Action Plan on the equal treatment of women and men in the labor market, including improvements in the availability of care services and all-day schools to increase the options for women to work full-time and in the high gender pay gap; take steps to improve educational outcomes and prevent school dropout.
- Take further steps to foster competition, particularly in the services sectors, by relaxing barriers to market entry, removing unjustified restrictions on some professions and enhancing the powers of competition authorities; accelerate adoption of the outstanding “horizontal law” to implement the Services Directive.

<sup>23</sup> In the course of the European semester 2012, national progress will be evaluated based on the 2012 SCP and NRP assessments.

European semester. This enables the Member States to take the Council's recommendations into account in their upcoming budget planning decisions for 2012, thereby adding an *ex ante* dimension to economic policy coordination and surveillance in the EU. Prior to implementation of the European semester, the focus was on *ex post* assessment of the measures proposed by the Member States in their SCPs and NRPs. By allowing for a synchronized and coordinated assessment, the new integrated approach has essentially paved the way for coherent and consistent recommendations on economic and fiscal policy to be issued to the Member States. This means that the EU dimension can be embedded in national policymaking *before* decisions are made, thereby allowing the EU to take stock of Member States' national efforts and decide on complementary actions to be taken at EU level, for instance in the context of the Europe 2020 flagship initiatives.

According to the European Commission's analysis (COM(2011) 400 final), the European semester 2011 was successful in that the national policy programs presented by many Member States are in line with the overall objectives of EU. The measures proposed in those programs provide a good "starting point for sustaining Europe's recovery, for addressing fiscal challenges and for driving more ambitious reforms at national level." The Commission also noted that Member States had largely sought to reflect the focal points of the AGS in their national efforts and further stated that the adoption of national targets would demonstrate that – with a few exceptions – there was a significant degree of commitment to the goals of the Europe 2020 strategy.

However, after assessing the Member States' programs, the Commission also found that the reform plans were often not sufficiently ambitious. Specifically, many of the commitments were formulated vaguely and abstractly (as had been the case previously in the SCPs and NRPs) and thus lacked the capacity to drive forward the necessary budget consolidations and structural reforms required to allow the EU to meet its headline targets by 2020.<sup>24</sup>

Clearly, the European semester is a highly complex and ambitious governance method that requires a great deal of time and coordination. Through comprehensive, transparent and timely support of policymaking in the EU and the Member States, the European semester is intended to facilitate more consistent and better coordinated economic and fiscal policymaking. However, those objectives can only be achieved if the Member States actually contribute to macro coordination by assuming ownership and deciding collectively on the key policy orientations to be implemented on the basis of the Council's recommendations. Since this would almost necessarily restrict national policymakers' freedom of action in favor of the interests of the European Union as a whole, the success of this course of action – as measured by the meta-objectives underlying the procedural reforms – seems questionable. The experiences with the initial "run-through" of the European semester have made it very obvious that procedures need to be streamlined and that cumbersome bureaucratic efforts must be reduced at both the EU and national levels. In addition, the first six-month cycle has shown that the time frames allotted to the coordination processes require rescheduling, and that the European

<sup>24</sup> This indicates that some countries have not yet altered their past behavior despite introduction of the European semester.



Commission must be given sufficient time to accomplish a thorough assessment of the reform programs presented by the Member States in order to make the coherent and consistent recommendations expected.<sup>25</sup> In sum, it will be impossible to conclusively evaluate whether the first European semester has achieved success until the measures

adopted in the second half of 2011 have been analyzed. Furthermore, adoption of the “six-pack” set of legislative measures will likely change the entire dynamics of the European semester by adding financial sanctions to the preventive arm of the SGP and launching the new procedure to address macro-economic imbalances in January 2012.

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