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On the limits of EU economic policy coordination

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Abstract

Successive EMU roadmaps have presented the expansion of EU controls over Member States' economic policies as an integral part of monetary union, vital to its survival. Possible alternatives have been hardly discussed. In this contribution we trace the evolution of the EU economic policy coordination framework from a relatively narrow, rules-based exercise into a largely discretionary process that reaches even the most politically salient areas of the Member States' economic policies. We then discuss how the extensive coercive powers the EU formally possesses have turned out to be difficult to use in practice. This reflects the fundamental limits of the EU's legitimate use of power over its Member States, set by its current level of political and cultural integration. To have a chance of success, further designs EMU need to respect these limits.

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1. Introduction

Some say we need a government of the euro. Others say we need more discipline and respect of the rules. I agree with both: we need collective responsibility, a greater sense of the common good and full respect and implementation of what is collectively agreed.

(President Juncker, State of the Union, Sept 2015)

The discussions on the future design of the EMU have been characterized by a sense of inevitability. The title of the Five Presidents' Report on "Completing Europe's Economic and Monetary Union" published in June 2015¹ illustrates this: EMU remains incomplete, and to complete it, Member States need to subjugate key parts of their economic policies to the oversight of the EU ("pool" their sovereignty). Yet the (poorly defined) quasi-federative vision that underlies such "complete" EMU is unique. Existing monetary unions do not rely on extensive set of controls by a higher level of government over the lower one.² In some federations, there are no central controls on the state policies, while in others there may exist limited restrictions on state borrowing. The comprehensive scrutiny of fiscal and macroeconomic policies that the EU framework entails seems to be completely unique. The fact that the vision lacks an empirical precedent makes the confidence with which it has been promoted all the more remarkable. If subordination of economic sovereignty truly is the prerequisite for a stable monetary union, why is it not observed elsewhere? So far, possible alternatives have been hardly discussed at all. Yet, such must exist, as the many successful monetary unions (mostly federations) around the world demonstrate.

The desire to constrain Member States' economic policies stems from the externalities that sharing a currency entails. The preparatory work leading to the establishment of the EMU was always keenly concerned about such externalities. The *Delors Report* found that "... uncoordinated

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¹ *The Five Presidents' Report: Completing Europe's Economic and Monetary Union*, 22 June 2015.

² Fiscal restrictions on the state level, when they exist, tend to be centrally set mainly in unitary countries, while in federations, such constraints are typically self-imposed. L. Eyraud and R. Gomez, *Constraints on Subnational Fiscal Policy*, In *Designing a European Fiscal Union: Lessons from the Experience of Fiscal Federations*, edited by C. Cottarelli and M. Guerguil, Routledge. London: Routledge, 2014. See also B. Eichengreen and J. von Hagen, "Fiscal Policy and Monetary Union: is there a Tradeoff between Federalism and Budgetary Restrictions?", NBER Working Paper 5517, 1996.

and divergent national budgetary policies would undermine the monetary stability and create imbalances ... in the Community,” Hence, “[i]n the budgetary field, binding rules are required.”³ The Maastricht Treaty reflected these concerns. It provided the EU with relatively strong powers to interfere to prevent unsustainable fiscal policies, but in other fields of economic policy, the EU’s formal powers were essentially limited to issuing opinions. The ultimate responsibility for economic policies remained with the Member States,⁴ as did the ultimate responsibility of their creditworthiness, as codified in Article 125(1) TFEU, the famous “no-bailout” clause.

While the existence of externalities was recognized, the euro crisis showed that their extent was badly underestimated. With the rapidly increasing cross-border mobility of most types of financing, externalities within the monetary union had extended far beyond the simple fiscal-monetary interplay into the stability of the highly interconnected financial system. During the crisis, capital surged out of the fragile financial systems into those considered safe. The Eurosystem, attempting to preserve the singleness of monetary policy across the euro area, had little choice but to finance the capital flows. Through central bank operations it essentially converted private cross-border exposures into official ones. Through this process, the cost of the crisis was effectively mutualized, initially via the books of the Eurosystem (the TARGET balances⁵), later to be replaced by official loans from the Member States and the newly established intergovernmental financial assistance vehicles.

The crisis reflected a global failure of financial regulation, but its euro-area specific manifestation was diagnosed as a governance failure, caused by bad fiscal and macroeconomic policies of Member States, which the Maastricht framework had failed to control.⁶ In response, the crisis years saw a frantic effort to strengthen the coordination framework. The two and six-pack regulations and the Fiscal Compact already transformed the relation of the EU and its (euro area) Member State in a profound manner,⁷ and the framework still remains a work in progress. The Five Presidents’ Report maps out a plan that would bring the remaining parts of national economic policies gradually under EU control.⁸

From the outset, the successive roadmaps for the EMU have been dominated by the economics worldview. Rather than as sovereign entities, Member States have been treated as ordinary economic agents, on which the enforcement of rules and sanctions does not pose any particular

³ *Committee for the Study of Economic and Monetary Union: “Report on economic and monetary union in the European Community”, April 1989.*

⁴ See also *Thomas Pringle v Government of Ireland, Ireland and the Attorney General (C-370/12) EU:C:2012:756* at [64]. See R. Bieber, “The Allocation of Economic Policy Competences in the European Union” in L. Azoulai (ed.), *The Question of Competence in the European Union* (Oxford: OUP, 2014), pp. 86-96.

⁵ TARGET (“Trans-European Automated Real-time Gross settlement Express Transfer”) balances refer to the net position (debt or credit) of each euro area National Central Bank vis-à-vis the ECB. See https://www.ecb.europa.eu/pub/pdf/other/art3_mb201305en_pp103-114en.pdf. [Accessed 3 August 2016].

⁶ See the Four Presidents’ Report: H. Van Rompuy, “Towards a Genuine Economic and Monetary Union, Report by President of the European Council Herman Van Rompuy” (2012) EUCO 120/12, p. 3.

⁷ See e.g. P. Leino and J. Salminen, “The domestic impact of euro-crisis law” in T. Beukers, B. de Witte and C. Kilpatrick, *Constitutional Change Through Euro-Crisis Law* (Cambridge: Cambridge University Press, forthcoming 2016).

⁸ Of the five presidents, Mario Draghi, President of the ECB, has been the most vocal about the need further to share sovereignty, in particular in the field of structural reform. *Speech at SZ Finance Day, Frankfurt am Main, 16 March 2015*, <https://www.ecb.europa.eu/press/key/date/2015/html/sp150316.en.html> [Accessed 3 August 2016]. ⁹ Some exceptions exist. See, for example, B. Eichengreen and C. Wyplosz, “Minimal conditions for the survival of the euro” in R. Baldwin and F. Giavazzi (eds.), “How to fix Europe’s monetary union: Views of leading economists”, VoxEU eBook, 2016.

problems.⁹ Hence, the Delors Committee was able to talk about “binding rules” without ever asking how they are to be enforced on sovereign states. Issues such as democratic accountability, or legitimacy of decision-making, have attracted very limited attention. Although the concepts appear in the more recent EMU roadmaps, their handling has been perfunctory, without much substantive content.

To appreciate its full ramifications, it is important to understand the context in which stronger coordination of economic policies is promoted. Underlying the process of deepening the EMU is a grand north-south bargain between control and solidarity, which President Juncker also formulates in the statement quoted at the beginning of this paper. Stronger controls over Member States’ policies have always been seen as a prerequisite that allows greater mutualization of economic fortunes. So the question is not only whether coordination of economic policies in itself is beneficial, it is also whether it can provide a sound enough foundation for greater pooling of economic risks.

In this contribution, we analyze the development and functioning of the EU economic policy coordination from a legal, economic and political science viewpoint. By “economic policy coordination” we mean the framework through which the EU seeks to influence the way Member States conduct certain economic policies (fiscal, macroeconomic, structural) that formally remain mostly in national competence. There are several aspects of EMU deepening that fall outside of the scope of this paper. We do not discuss the significant steps taken in financial regulation, including the banking union. Neither do we cover proposals such as a common European unemployment insurance system or other similar proposals of the more genuinely federal nature, although to the extent their functioning relies on strict enforcement of the economic policy coordination framework, our findings may have relevance to them.

In what follows, we trace the evolution of both the formal structure and the implementation of the EU economic policy coordination framework since the introduction of the euro. We will demonstrate how it has evolved from a relatively narrow, rules-based exercise into a largely discretionary process that reaches even the most politically salient areas of the Member States’ economic policies. We will then show that while the framework formally grants the EU strong coercive powers, such powers have turned out to be difficult to use in practice. Instead of coercion, implementation has been based on persuasion and cooperation and has been highly sensitive to the political context. Our interpretation is that this reflects the fundamental limits of the EU’s legitimate use of power over its Member States set by its current level of political and cultural integration.¹⁰ We conclude with some thoughts on the alternatives for further development of the EMU.

2. Evolution of economic policy coordination in EMU: wider and deeper

The original EMU coordination framework was the result of extensive deliberations, starting with the Werner plan in 1970, finding new impetus in the Hannover Summit in June 1988, culminating in the signature of the Maastricht Treaty in February 1992 and finally refined in the Stability and

⁹ Some exceptions exist. See, for example, B. Eichengreen and C. Wyplosz, “Minimal conditions for the survival of the euro” in R. Baldwin and F. Giavazzi (eds.), “How to fix Europe’s monetary union: Views of leading economists”, VoxEU eBook, 2016.

¹⁰ For a discussion of the different understandings of the concept of political union and current institutional thinking, see A. Somek, “What is Political Union?” (2013) 14 German Law Journal 561.

Growth Pact (SGP) in 1997.¹¹ At its heart, the framework that governed the early years of EMU was quite simple and narrow in reach. The solid core of the framework consisted of the Excessive Deficit Procedure (EDP) (Article 104c TEC), which established limits for public deficit and gross debt (3 and 60 percent of GDP respectively), with limited discretion and few escape clauses. The Treaty also established a well-defined path of escalation from a Council recommendation to non-interest-bearing deposits until the excessive deficit was corrected and eventually, in the absence of effective action, fines ‘of an appropriate size’.

Beyond the EDP, Member States were only subject to soft forms of coordination. They were to ‘regard their economic policies as a matter of common concern and [...] coordinate them within the Council’. Article 103 TEC laid down the multilateral surveillance procedure, under which the Council adopted a recommendation on the broad guidelines of the economic policies of the Member States, the observance of which the Commission monitored on the basis of information provided by the States in the form of stability programmes. In case of infractions, the Council could adopt recommendations and – as the ultimate form of peer pressure – make them public.

The binding part of the original framework was therefore limited to major fiscal transgressions. The objective of the EU fiscal rules was essentially to function as an emergency brake. Only if a Member State’s public finances deteriorated so as to pose a risk to the proper functioning of the monetary union would the Union intervene. In normal situations, the day-to-day economic policy decisions were left to the Member States. By and large, the message was: “As long as you behave, your policies are your own”.

The original framework did not last long. Already in 2002, the President of the European Commission Romano Prodi famously described the EMU fiscal rules as “stupid” and “rigid”, lacking intelligence and flexibility.¹² At a purely factual level, Prodi’s assessment was accurate. The simple framework did not – and could not – prescribe the optimal fiscal response to the wide variety of possible economic circumstances. At the same time, one could argue that his criticism missed the point. It was no accident that the original rules were rigid and inflexible. The rigidity and inflexibility was a deliberate design feature intended to ensure credible, mechanistic implementation, thereby minimizing risk of political interference. The “intelligent” and “flexible” qualities were to enter the picture earlier – not in the application of the rules, but in the way Member States designed their national policies to avoid the EU fiscal rules becoming a straightjacket in the first place. Member States were expected, in good times, to ensure “*a safety margin towards continuously respecting the government's 3% deficit limit*”,¹³ thereby allowing flexible policy response to unforeseen events.

¹¹ This development has been outlined e.g. in K. Tuori and K. Tuori, *The Eurozone Crisis. A Constitutional Analysis* (Cambridge: Cambridge University Press, 2014) and in F. Snyder, “EMU Revisited: Are we making a constitution? What constitution are we making?” in P. Craig and G. de Búrca, *The Evolution of EU Law* (Oxford: Oxford University Press, 1999), pp. 417-477.

¹² Interview by A. Leparmentier and L. Zecchini, “La France sera en minorité si elle n’est pas le levain de l’Europe” *Le Monde*, 18 October 2002; available at http://www.lemonde.fr/archives/article/2002/10/17/la-france-sera-en-minorite-si-elle-n-est-pas-le-levain-de-l-europe_294558_1819218.html?xtmc=romano&xtcr=1 [Accessed 3 August 2016].

¹³ Regulation 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [1997] OJ L209/1.

The reality was of course different. Many Member States treated the Maastricht limits as policy targets in their own right, leaving little safety margin and practically no room for maneuver when the economy disappointed. When in 2003 the two largest Member States found themselves in violation of the SGP in an economic downturn, the choice was either to force those Member States – and, by implication, the whole euro area – to engage in procyclical fiscal policies, or to introduce additional flexibility in the framework. Not surprisingly, the EU chose the latter, and the two Member States were allowed to postpone their adjustment.

This well-publicized and rather embarrassing episode triggered a fundamental rethinking of the EU fiscal framework, which culminated in 2005 in the first major overhaul of the SGP.¹⁴ Only six years later, the euro area debt crisis prompted adoption of the six-pack legislation followed by the two-pack legislation two years later.¹⁵ The cumulative effect of these reforms was a fundamental transformation of the way the Union controls the public finances of its Member States.

The SGP was formally divided into the *corrective arm* (for those Member States identified as having excessive deficit) and the *preventive arm* (for those not in excessive deficit). The most significant changes concerned the preventive arm, the role of which was to guide Member States to build up a sufficient fiscal buffer during good economic times so as to allow countercyclical fiscal policy in the downturn without breaching the SGP limits. While the original SGP had left the determination and observance of such buffer to the responsibility of each Member State – with less than convincing results – the later vintages formalized its required size and gave the EU competence to enforce its fulfillment. The appropriate safety buffer was formalized in a country-specific Medium-Term Objective, defined in terms of the structural deficit.¹⁶

The economic logic of the 2005 and later SGP vintages is difficult to fault. Each new edition of the fiscal framework was more intelligent and flexible than its predecessor. Yet, what was less clearly articulated at the time of the reforms – and perhaps still remains less well understood – is that, in terms of governance and the basic objective, this development marked a stark departure from the original SGP's vision. This happened along at least two dimensions.

First, the SGP revisions broadened considerably the range of situations in which the EU could interfere – through recommendations, instructions and, increasingly, even outright sanctions – in a Member State's fiscal policies. While in the original SGP, the EU's right to interfere was limited to breaches of the well-defined Treaty-based safety limits, the newer SGP vintages granted the EU

¹⁴ Regulation 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure as amended by Regulation 1056/2005 [1997] OJ L209/6.

¹⁵ The six-pack adopted in November 2011 to improve budgetary discipline, on the one hand, and economic surveillance, on the other, includes Regulation 1175/2011 amending Regulation 1466/97 on the surveillance of member states budgetary and economic policies [2011] OJ L306/12; Regulation 1177/2011 amending Regulation 1467/97 on the EU's excessive deficit procedure [2011] OJ L306/33; Regulation 1173/2011 on the effective enforcement of budgetary surveillance in the euro area [2011] OJ L306/1; Regulation 1176/2011 on the prevention and correction of macroeconomic imbalances [2011] OJ L306/25; Regulation 1174/2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area [2011] OJ L306/8; and Directive 2011/85/EU on requirements for the member states' budgetary frameworks [2011] OJ L306/41. The two-pack includes Regulation 472/2013 on the strengthening of economic and budgetary surveillance of euro states experiencing or threatened with serious difficulties with respect to their financial stability [2013] OJ L140/1, and Regulation 473/2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the euro area Member States [2013] OJ L140/11.

¹⁶ Regulation 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies as amended by Regulation 1055/2005 [2005] OJ L174/1.

powers to interfere throughout the cycle and irrespective of whether or not the Maastricht limits were breached. This represented a fundamental change in the philosophy underlying the fiscal framework. With the successive revisions, the SGP morphed from an emergency brake, to be invoked when a Member State's policies pose a direct threat to the stability of the single currency, into a broad vehicle for guiding Member States towards good fiscal policies on a continuous basis.

Together with the beefed-up framework came new procedures to ensure its implementation. The two-pack Regulation No 473/2013 created a general procedure for the monitoring and assessment of Member States' draft budgetary plans.¹⁷ Under the new framework, Member States were to "consider their budgetary plans to be of common concern and submit them to the Commission for monitoring purposes in advance of their becoming binding" (preamble para 19). In case a draft budget deviates too much from the Council recommendations under the SGP, the Commission could request a Member State to revise its budget. The purpose was to ensure that the EU rules steer the national budgetary process in its every phase. The annual cycle of reporting and monitoring was organized as the European Semester.

The successive revisions of the SGP have also brought about a second notable, though largely unintended, trend; the *move from rules-based towards increasingly discretionary coordination*. In retrospect, this seems a rather unavoidable consequence of the much increased level of ambition. While the "rigid and inflexible" nature of the original SGP allowed, at least in principle, its mechanistic application, the much loftier goal of its post-2005 vintages – codification of good fiscal policies – necessitated a much higher degree of sophistication. By its very nature, the concept of good fiscal policies over the cycle does not lend itself to easy parameterization. The key analytical concepts of the framework – output gap and structural deficit – are unobservable and their estimates notoriously contested among economists.¹⁸ Also, a wide variety of exceptional circumstances, temporary factors and measurement issues come into play. Regulation No 1467/97 as amended by the six-pack places the Commission under an obligation to:

*give due and express consideration to any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess compliance with deficit and debt criteria [...].*¹⁹

To be sure, the EU has over the last decade made considerable efforts to formalize the handling of many kinds of circumstances. Over time, exceptions and flexibility clauses have been created at least for bad economic times,²⁰ investments,²¹ structural reforms,²² and solidarity operations.²³ In

¹⁷ Regulation 473/2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area [2013] OJ L140/11, Articles 6-8.

¹⁸ To resolve chronic differences on the measurement of output gap, a dedicated EU working group was established, see http://europa.eu/epc/working_groups/output_gaps_en.htm [Accessed 3 August 2016]. Although a common methodology has been established, the issue remains a constant object of criticism among Member States. A fundamental difficulty is that the estimate of output gap is subject to very sizeable revisions for years afterwards.

¹⁹ See Regulation 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure as amended by Regulation 1056/2005 [2005] OJ L174/5 and Regulation No 1177/2011, Article 2(3).

²⁰ Regulation 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure as amended by Regulation 1056/2005 and Regulation 1177/2001, Article 2(2).

²¹ Commission, "Commission Communication – Making the Best Use of the Flexibility Within the Existing Rules of the Stability and Growth Pact" COM(2015) 012 final, p. 7.

²² Article 5 of Regulation 1466/97.

²³ Regulation 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure as amended by Regulation 1056/2005 and Regulation 1177/2001, Article 2(3).

addition, the Commission has included the costs of refugees²⁴ and low inflation²⁵ among “relevant factors” in assessing compliance. To supplement the core of the fiscal framework in primary and secondary law, a sizeable body of soft law has gradually emerged, including Codes of Conduct, Common Understandings, Commission Communications and a thick application manual called the *Vade Mecum*.²⁶ Soft law has attempted to respond to the Member States’ wishes to have some guidance as to how the Commission intends to use its discretion.

Predictably, rather than actually settling contentious issues of interpretation, soft law has pushed the substantive decisions to the stage of implementation and buttressed the institutional position of the body – the Commission – tasked to determine what kind of meaning can be attributed to each provision in each individual case. Instead of improving the precision and predictability of the interpretations of the SGP provisions, the growing body of soft law has actually contributed to an increase in the complexity and opacity of the framework.²⁷ The result is a maze of alternative or even conflicting rules, which few understand. Due to its complexity, the application of the fiscal framework has, in practice, become an exercise of nearly unlimited discretion.

While the preventive arm of the SGP expanded the reach of EU coordination, an even clearer example of mission creep can be found outside the fiscal framework. The six-pack legislation package, apart from strengthening fiscal surveillance, also established the *Macroeconomic Imbalances Procedure* (MIP), which extended EU coordination far beyond the mere fiscal.²⁸ The creation of the MIP was motivated by the recognition that the fiscal predicament experienced by some euro countries during the crisis had originated from private sector overheating. For a while, a boom fueled by excessive buildup of private debt boosted growth and tax revenues and masked the underlying fiscal weaknesses. However, when followed by the inevitable bust, it led to financial instability and large direct fiscal costs. The conclusion was that, to be effective, the EU fiscal framework needed to be complemented by a broader framework aimed at preventing macroeconomic imbalances. That framework is the MIP.

The MIP constitutes another major milestone on the road towards a wider reach and greater discretion in EU economic policy coordination. Not only did it bring compulsion and sanctions

²⁴ Commission, “Communication from the Commission, 2016 Draft Budgetary Plans: Overall Assessment”, COM(2015) 800 final, p. 3.

²⁵ Commission, “Report from the Commission; Italy, Report prepared in accordance with Article 126(3) of the Treaty”, COM(2016) 305 final, p. 21.

²⁶ Commission, “Vade Mecum on the Stability and Growth Pact” (2016 edition), Institutional paper 021, March 2016; available at http://ec.europa.eu/economy_finance/publications/eeip/pdf/ip021_en.pdf [Accessed 3 August 2016]. For a selection of other soft-law documentation, see Commission, “Commission Communication - Making the best use of the flexibility within the existing rules of the Stability and Growth Pact” COM(2015) 012 final, “Two Pack Code of Conduct; Specifications on the implementation of the Two Pack and Guidelines on the format and content of draft budgetary plans, economic partnership programmes and debt issuance reports” of 7 November 2014 and, “Code of Conduct; Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes” of 3 September 2012; available at http://ec.europa.eu/economy_finance/economic_governance/sgp/legal_texts/index_en.htm [August 3 2016].

²⁷ L. Eyraud and T. Wu, “IMF Working Paper - Playing by the Rules: Reforming Fiscal Governance in Europe” (2015) WP/15/67; available at <https://www.imf.org/external/pubs/ft/wp/2015/wp1567.pdf> [Accessed 3 August 2016]. For analysis of the effect of soft law in other policy areas, see E. Korkea-aho, “Legal Interpretation of EU Framework Directives: A Soft Law Approach” (2015) 40(1) E.L. Rev. 70, 87; S. Vaughan, *EU Chemicals Regulation. New Governance, Hybridity and REACH* (Cheltenham: Edward Elgar Publishing, 2015).

²⁸ Regulation 1176/2011 on the prevention and correction of macroeconomic imbalances and Regulation 1174/2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area.

where there earlier was only peer pressure, it also left the reach of the new procedure essentially up to the interpretation of the Commission. The MIP Regulation No 1176/2011 defines an imbalance in a remarkably wide manner as “any trend giving rise to macroeconomic developments which are adversely affecting, or have the potential adversely to affect, the proper functioning of the economy of a Member State or of the economic and monetary union” (Article 2). There are very few significant macroeconomic phenomena that could not be said to have such a potential, through some conceivable sequence of events. Hence, in principle, the MIP opened nearly all areas of Member States’ economic policies to EU scrutiny, advice and, in case of “excessive” imbalances in a euro area Member State, even sanctions (under the Excessive Imbalances Procedure, EIP).

The MIP, by its very nature, cannot be but discretionary. Even for the comparatively straightforward SGP, the attempt to devise rules for all contingencies has proved to be nearly impossible. For the MIP, the dimensionality of the subject is far greater. There is a large multitude of conceivable macroeconomic imbalances and, since there is no simple, one-to-one mapping from macroeconomic imbalances to policy responses,²⁹ there is an even greater multitude of possible policy responses to them. Such a vast policy space simply cannot be nailed down by formal rules. The assessment has to take into account the “extremely divergent, highly contingent, and extremely variable conditions in individual member-state economies”.³⁰ To have any chance of success, the MIP “must be allowed to respond flexibly, even opportunistically and unequally to highly diverse and uncertain problem constellations”.³¹ Implementing the MIP framework is left to the Commission, which runs the alert mechanism, prepares a scoreboard to be used as a basis for assessments, undertakes in-depth reviews in conjunction with surveillance missions to the Member State when necessary, and makes proposals under the EIP.

In the area of economic governance, the context where discretion is exercised is in many ways atypical. Discretion is usually understood to exist “whenever the effective limits [on the power of a public officer] leave him free to make a choice among possible courses of action or inaction”.³² In this sense, the room of maneuver allocated to the Commission corresponds the classic definition. However, questions relating to the effective limits of discretion have usually been studied in the context of its use by public actors in relation to individuals,³³ and the possibilities of courts to monitor its use.³⁴ There is little or no research on the present subject where discretion is exercised in relation to sovereign Member States. Discretion literature is also far less concerned with the initial question of allocating power,³⁵ which for us seems to constitute one of the most urgent questions in the policy area we are examining. The EU legislature’s broad discretion to make

²⁹ While the SGP deals with issues under direct control of the government (taxes and expenditure), much of the MIP deals with private sector behavior, where the government has only indirect levers. In case of excessive buildup of private sector debt, the government can create various incentives and deterrents, but it cannot forbid private sector borrowing.

³⁰ F.W.Scharpf, *“After the Crash: A Perspective on Multilevel European Democracy”*, MPIfG Discussion Paper 14/21 (2014).

³¹ Ibid.

³² For the classic definition, see K.C.Davis, *Discretionary Justice. A Preliminary Inquiry*, Illini Books Volume 71 (Champaign: University of Illinois Press, 1971).

³³ See e.g. K.C. Davis, “Discretionary Justice” (1970) 23 Journal of Legal Education 56.

³⁴ For classic accounts, see e.g. G.E. Treves, ‘Administrative discretion and judicial control’ (1947) 10 M.L. Rev. 276, which includes a comparative analysis of the matter in the English and French legal system.

³⁵ Mendes also notes this gap in literature, see J. Mendes, ‘Discretion, care and public interests in the EU administration: Probing the limits of law’ (2016) C.M.L. Rev. 419, 426.

appropriate choices has not been questioned by the Court,³⁶ which may reflect the fact that the issue is less about formal legality than legitimacy and political acceptability.

To support the enforcement of the new, wider coordination framework, the possibility to invoke sanctions, initially foreseen only under the excessive deficit procedure of the SGP, was extended to cover also the preventive arm of the SGP and the MIP. Stronger sanctions in the fiscal field were seen as “necessary to make the enforcement of budgetary surveillance in the euro area more effective” and “enhance the credibility of the fiscal surveillance framework of the Union”.³⁷ As to the MIP, the sanctions were to incentivize Member States suffering from macroeconomic imbalances to “establish corrective plans before divergences become entrenched”, and in case of a failure to do so, “...application of the sanctions to those Member States [sh]ould be the rule and not the exception.”³⁸ It is noteworthy that unlike the EDP sanctions, which are explicitly foreseen in the Treaty, the sanctions under the SGP and MIP were established by secondary legislation under the multilateral surveillance procedure, for which the Treaty does not expressly provide such a possibility. Finally, the trend towards higher complexity and greater discretion has created an unorthodox setting for the use of sanctions. When many of the core provisions gain their interpretation only *ex post*, Member States have limited means to anticipate what is required from them to comply with the framework. Minimally, this raises questions of legal certainty and due process.

Looking into the future, these three trends – widening coverage of coordination, broadening discretion in its application, and increasing recourse to the threat of sanctions as a means of enforcement – seem destined to continue. As the procedural means of enforcing prudent fiscal and economic policies are now largely in place, the focus seems to be turning increasingly to fostering deeper structural convergence of Member States towards a free-market ideal. The Five Presidents’ Report puts a great deal of emphasis on stronger coordination of “structural reforms”, which it defines as “reforms geared at modernizing economies to achieve more growth and jobs”, including “both more efficient labour and product markets and stronger public institutions”. It envisages moving towards a “more binding” process of structural convergence and common standards for “labour markets, competitiveness, business environment and public administrations, as well as certain aspects of tax policy”.³⁹

This emphasis of the Five Presidents’ Report corresponds to the mainstream view of good economic policies, with the focus on efficiency, freedom of markets and good governance. It is also safe to say that, if it ever comes to fruition, EU coordination of structural policies will, like the MIP, be deeply discretionary. It is difficult to imagine any aspect of the policies listed by the Five Presidents that could be adequately enshrined in a set of rules, however complex.

³⁶ See e.g. *Billerud Karlsborg AB* (C-203/12) EU:C:2013:664 at [35]. See also *Afton Chemical Limited* (C-343/09) EU:C:2010:419 at [28]. See also *Gauweiler v Deutscher Bundestag* (C-62/14) EU:C:2015:400, where the matter concerned the use of discretion by the Governing Council of the ECB. The Court stressed that ‘given that questions of monetary policy are usually of a controversial nature and in view of the ESCB’s broad discretion, nothing more can be required of the ESCB apart from that it use its economic expertise and the necessary technical means at its disposal to carry out that analysis with all care and accuracy’, at [75].

³⁷ Regulation 1173/2011 on the effective enforcement of budgetary surveillance in the euro area, preamble.

³⁸ Regulation 1174/2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area, preamble.

³⁹ *Five Presidents’ Report*, p. 7.

Yet, it is in terms of its governance implications that the Five Presidents' proposal truly reaches far. First, to the extent the MIP still left some policy areas outside of EU scrutiny, the process of binding structural convergence envisaged by the Five Presidents would surely plug any gaps. But second, and even more importantly, the proposal would entail a fundamental step towards a narrowing of Member States' policy space. While much expanded, today's EU framework still remains fundamentally about preventing policies that could lead to fiscal or macroeconomic imbalances (actual or anticipated). In other words, the aim is to ensure intertemporal consistency of Member States' policies, not to define the ultimate aim of those policies. In contrast, giving the EU powers to guide Member States towards a jointly determined model of economic structures would deprive the national policy sphere from one of the most important factors defining and differentiating political ideologies: the vision of the ultimate economic model. In doing so, it would bring European coordination squarely into the distributional and rights-and-freedoms questions that have long been the heartland of political decision-making and traditionally preserved for national constituencies.

3. *Implementation and technocratic delegation*

Compared to its Maastricht roots, the current framework has already travelled a long way from its technical origins towards the political, and the future steps envisaged by the Five Presidents would continue further to the same direction. In consequence, making full use of the expanded powers would place a far heavier burden on the EU's ability to implement and legitimize its decision. One has to ask how well equipped the EU is to exercise such powers. A good place to start answering the question is to examine how the framework has been implemented so far. Since the framework underwent significant changes in 2011, it is useful to separate the discussion on the implementation to experiences before and after that year.

In the early years of the SGP, the contemporary assessment of its implementation was mixed. Morris et al. concluded that "while the original SGP did not fully attain its objectives it did have a constraining effect on fiscal policies". For any shortcomings in implementation, they attributed the responsibility to the Council, which failed to act on Commission recommendations and "did not implement the Pact in the strict manner that was necessary."⁴⁰ Joerges argues that the regime was "dependent on good economic luck and constant bargaining".⁴¹ Some years later, Schuknecht et al. found that even after the SGP was revised in 2005, implementation had remained lenient, with extensions granted and limited adjustment efforts required.⁴²

In short, these studies seemed to conclude that that blame for the deficient implementation lay with the Council. The Commission – still considered the "politically independent and neutral trustee of the European common interest"⁴³ – was by and large doing its job. The Council, being effectively influenced by national political agendas, failed to act upon its proposals. It was

⁴⁰ R. Morris, H. Ongena and L. Schuknecht, "The Reform and the Implementation of the Stability and Growth Pact." ECB Occasional Paper 47/2006.

⁴¹ C. Joerges, "The Legitimacy Problématique of Economic Governance in the EU", in *The Governance Report 2015* (Hertie School of Governance: Oxford University Press, 2015), pp. 69-93 at p. 77.

⁴² L. Schuknecht, P. Moutot, P. Rother and J. Stark, "The Stability and Growth Pact: Crisis and Reform" (2011) ECB Occasional Paper No. 129; available at SSRN: <http://ssrn.com/abstract=1791598> [Accessed 3 August 2016]. See also e.g. A. Hinarejos, *The Euro area Crisis in Constitutional Perspective* (Oxford: Oxford University Press, 2015) pp. 8-10 with further references.

⁴³ F.W. Scharpf, "Political Legitimacy in a Non-optimal Currency Area", MPIfG Discussion Paper 13/15 (2015).

therefore natural to think that strengthening the role of the Commission vis-à-vis the Council would reduce the political obstacles to strict enforcement of the rules.

Such was the thinking that underpinned the six-pack and the two-pack reforms. The former introduced the Reverse Qualified Majority voting rule – familiar from the EU trade policies – into the SGP.⁴⁴ Under the RQMV, the Commission's proposal will stand unless it is voted down by a qualified majority within the Council.⁴⁵ This was intended to make the adoption of decisions more automatic and thereby enforcement stronger.⁴⁶ Apart from boosting the role of the Commission in the enforcement of the framework, the reforms also extended the use of sanctions, as noted above. This was believed to “ensure fair, timely, graduated and effective mechanisms for compliance”.⁴⁷

Although the Commission never was a purely managerial, administrative actor free of political motives, the move to the RQMV reflected a clear intention to reduce the political element involved in the enforcement of the SGP and the MIP. As such, the 2011 reforms fell into a long tradition of de-politicization and delegation to a technocratic body, which has been the EU's standard response to problems of policy coordination and implementation. More than two decades ago, Majone, in his criticism of the discussion on EU's “democracy deficit”, proposed that the EU is, and should be, essentially a “regulatory state”.⁴⁸ In his view, “‘short-termism’ and poor credibility are intrinsic to democratic governance”, and often an objective, technocratic agency was best equipped to produce Pareto (non-redistributive) improvements that would win popular support in all Member States. In most cases, the natural body to delegate to was the European Commission.⁴⁹

Yet, there is an important difference. The policy areas that Majone uses as examples – competition and health and safety – are such where there is a reasonable basis for separating technical questions from the political ones and where delegation is the norm in most countries.⁵⁰

⁴⁴ See Regulation 1173/2011 on the effective enforcement of budgetary surveillance in the euro area, Articles 4(2), 5(2) and 6(2); Regulation 1466/97 as amended by Regulation 1175/2011, Articles 6(2) and 10(2); Regulation 1176/2011 on the prevention and correction of macroeconomic imbalances, Article 10(4); Regulation 1174/2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area, Article 3. Also the Fiscal Compact includes provisions stipulating the use of RQMV. Its use has since expanded to new policy areas, see e.g. Regulation 1303/2013 laying down common provisions on the European Regional Development Fund, etc [2013] OJ L347/320, Article 23(10).

⁴⁵ The Fiscal Compact further qualified the decision-making procedure by committing the euro countries to vote en bloc in support of the Commission, unless a qualified majority among them oppose the Commission's proposal. Treaty on stability, coordination and governance in the Economic and Monetary Union, Article 7.

⁴⁶ While the motivation behind the RQMV was clear, the preamble of Regulation No 1174/2011 was laconic in its justifications: “Commission should have a stronger role in the enhanced surveillance procedure”

⁴⁷ Preamble of Regulation 1173/2011 on the effective enforcement of budgetary surveillance in the euro area, [13]-[14].

⁴⁸ G. Majone, “The Rise of the Regulatory State in Europe” (1994) 17(3) *West European Politics* 77. See also P.L. Lindseth, “Democratic legitimacy and the administrative character of supranationalism: the example of the European Community” (1999) 99 *Columbia Law Journal* 628.

⁴⁹ G. Majone, “*The Regulatory State and its Legitimacy Problems*”, *Institute for Advanced Studies Political Science Series No. 56* (1998), p. 6. Habermas takes a far less enthusiastic view of technocratic delegation and speaks of “the temptation to bridge, in a technocratic manner, this gulf between what is economically required and what seems to be politically achievable, only apart from the people.” J. Habermas “*Democracy, Solidarity and the European Crisis*” in A-M. Grozelier et al. (eds), *Roadmap to a Social Europe (Social Europe, 2013)*, p. 6.

⁵⁰ See also P.L. Lindseth, “Comparing administrative states: Susan Rose Ackerman and the limits of public law in Germany and the United States” (1995-1996) 2 *Columbia Journal of European Law* 589, 590. The developments

In such policy areas, it is reasonable to expect policy goals to be more effectively achieved by delegating day-to-day decisions to non-elected professionals, constrained by politically set mandates, who are free from the biases and distortions of democratic and electoral politics.⁵¹ Over time, the realm of policies considered suitable for delegation expanded to cover also such major policy areas as financial supervision and monetary policy.⁵²

In contrast, the six-pack reforms took technocratic delegation far outside traditional areas and into questions where the separation of the technical from the political becomes particularly difficult or impossible. Granting a body that is not directly elected by citizens a leading role in enforcing the – still in principle, though less in practice – rules-based fiscal framework would alone be exceptional. Doing the same for the almost fully discretionary MIP was truly unprecedented. The six-pack regulations gave the Commission nearly unlimited freedom to intervene, with the threat of substantial sanctions, in a euro-area Member State's most politically salient matters of economic policy, and compel it to take decisions that its political system, left to its own devices, would be unable to take. Minimally, the six-pack reforms constituted an extraordinary experiment on the limits of delegation.

So, did the far-reaching changes introduced by the six-pack succeed in strengthening enforcement? The time span since their entry into force is too short to provide a definite answer to that question. The assessment is further complicated by the increasingly discretionary nature of the framework; that is, the effectiveness of framework now depends not only on the Member States' degree of compliance, but also on the Commission using its discretion in a manner that contributes to the attainment of the objectives of the framework. Rigorous analysis of the question goes clearly beyond the scope of this paper, but some qualitative observations can nevertheless be made.

Until very recently, no actual sanction procedure had been launched based on any part of the EU's economic policy framework. This changed in July 2016, when the Council agreed with the Commission's finding that Spain and Portugal had failed to take effective action in response to the Council's EDP recommendations, which for the first time triggered a sanction process. Some weeks later, fines were determined and, at the same instance, immediately cancelled.⁵³ Hence, so far, no country has been fined or asked to make a deposit under the SGP, no excessive imbalance has ever been identified in a Member State, and no country has had its draft budget returned for revision by the Commission.

Of course, the non-application of many of the key elements of the reforms in itself does not prove that the framework has been ineffective. Perhaps the fact that sanctions have never been used indicates that the framework is working optimally – that the deterrent of sanctions is so effective in guiding the Member States' policies that there has never been a need to resort to sanctions.

behind EU competition policy and the role of the Commission in the area are discussed in *R.D. Kelemen, Eurolegalism. The Transformation of Law and Regulation in the European Union* (Harvard: Harvard University Press 2011) pp. 152-157.

⁵¹ D. Beetham and C. Lord, *Legitimacy and the European Union* (London: Longman, 1998), p. 17.

⁵² It is against this background that the mandate of the ECB also came to be debated in the early 1990s in a number of Member States, and was ultimately accepted with reference to the ECB's narrowly defined mandate. The best-known case is *Manfred Brunner and Others v. the European Union Treaty*, *Bundesverfassungsgericht (2. Senat) 12 October 1993, Cases 2 BvR 2134/92 and 2159/92*.

⁵³ Council, "Council Implementing Decision on Imposing a fine on Portugal for failure to take effective action to address an excessive deficit" 11554/16, 5 August 2016 and Council, "Council Implementing Decision on Imposing a fine on Spain for failure to take effective action to address an excessive deficit" 11555/16, 5 August 2016.

The key question becomes whether the new framework can be considered to function to satisfaction and effectively serve the purposes for which it was created?

In its own evaluation of the post-2011 framework, the Commission finds that “the current rules are effective and generally operate to satisfaction”. According to the Commission:

*The various pieces of governance legislation have been at the core of this evolution and have significantly bolstered the existing governance setup. Overall, deficits have declined with many countries having exited the Excessive Deficit Procedure and imbalances are being corrected.*⁵⁴

External accounts of the track record are less generous. President Draghi of the ECB concludes that “fiscal rules have repeatedly been broken and trust between countries has been strained”.⁵⁵ The IMF agrees: “Under the SGP, noncompliance has been the rule rather than the exception”.⁵⁶ The European Court of Auditors finds that “[w]hat has been lacking is consistency and transparency in the application of those rules; the Commission does not adequately record its underlying assumptions or share its surveillance findings for the greater benefit of all Member States”.⁵⁷ Bofinger assesses the European semester having been “a complete failure”.⁵⁸ Since 2011, a purely mechanistic reading of the fiscal framework would have offered plenty of opportunities to escalate the procedures, possibly all the way to sanctions. Instead, the Commission chose, in each case, to use the considerable discretion allotted to it to conclude that the EU requirements had been fulfilled or otherwise avoid the application of sanctions.

Perhaps the best-publicized recipient of lenience has been France, which has been granted several extensions to its deadline for correcting its excessive deficit. In 2014, it announced that it would miss the 2015 deadline and that its budget deficit would fall below 3 percent only in 2017, with debt continuing on a rising trajectory. After discussions with the French government, the Commission announced that it had not found France guilty of “particularly serious non-compliance” – a concept to be found nowhere in the SGP.⁵⁹ When asked in an interview why the Commission had repeatedly turned a blind eye to French infractions, President Juncker’s answer was “because it is France... I know France well, its reflexes, its internal reactions, its multiple facets”. Juncker argued that fiscal rules should not be applied “blindly”.⁶⁰ One cannot help thinking that the weakness of the French government, and the risk that a harsh approach by the EU could end up benefiting the Front National, played a role.

⁵⁴ Commission, “Commission Communication – Economic Governance Review, Report on the application of Regulations (EU) No. 1173/2011, 1174/2011, 1175/2011, 1176/2011, 1177/2011, 472/2013 and 473/2013” COM(2014) 905 final.

⁵⁵ Speech by Mario Draghi, President of the ECB, Frankfurt am Main, 16 March 2015; available at <http://www.ecb.europa.eu/press/key/date/2015/html/sp150316.en.html> [Accessed 3 August 2016].

⁵⁶ International Monetary Fund, “Euro Area Policies, 2014 Article IV Consultation, Selected Issues” IMF Country Report No. 14/199, p. 93.

⁵⁷ European Court of Auditors “Further improvements needed to ensure effective implementation of the excessive deficit procedure” Special Report no 010/2016, p. 12.

⁵⁸ P. Bofinger, “The way forward: Coping with the insolvency risk of member states and giving teeth to the European Semester”, in R. Baldwin and F. Giavazzi (eds.), “How to fix Europe’s monetary union: Views of leading economists”, VoxEU eBook, 2016

⁵⁹ See the Statement by Commission Vice-President Katainen on the Draft Budgetary Plans, Strasbourg 29 October 2014, available on the Commission press releases website.

⁶⁰ See Article by F. Guarascio, “EU gives budget leeway to France ‘because it is France’ – Juncker” Reuters, 31 May 2016; available at <http://uk.reuters.com/article/uk-eu-deficit-france-idUKKCNOYM1N0> [Accessed 3 August 2016].

In the aforementioned cases of Spain and Portugal, the deviations were too large to simply paper over, yet each had a convincing political story in their defense. Spain had just had its second elections in six months after a failed attempt to form a government. Any punitive actions could have had unforeseeable consequences on the government negotiations and in the looming third elections. In Portugal, after a tough adjustment program and five years of fiscal austerity, there was a wide societal consensus against further budgetary cuts. The Portuguese Prime Minister was quoted as being prepared to go the distance to make sure that the threat of sanctions is consigned to the wastepaper basket: “They simply would not be fair”, Prime Minister Costa argued: “Everyone knows what the Portuguese people have been through in the last four years.”⁶¹ Hence, the fines were cancelled and both countries were granted extensions to their deadlines.

On the side of the MIP, the first years have seen many excessive imbalances identified and articulated in the Country Specific Recommendations, but no formal procedure has been opened under the EIP. This fact has been repeatedly lamented by the ECB: “Despite having identified excessive imbalances in five countries, the Commission is not proposing to activate the EIP...Thus, it has again decided against making full use of all available measures.”⁶² The Ecofin Council has also underlined that the “the MIP procedure should be used to its full potential, with the corrective arm applied where appropriate.”⁶³ The Five Presidents’ Report recommends that the EIP “should be used forcefully. It should be triggered as soon as excessive imbalances are identified and be used to monitor reform implementation.”⁶⁴

Despite this encouragement, rather than entering into an open conflict with a Member State, the Commission has preferred to solve problems through negotiation and interpretation. The grounds for doing so may, in each individual case, have been persuasive.⁶⁵ The hesitance to use sanctions may also relate to fears that their legal basis might not be entirely sound. After all, they are used to enforce Council recommendations on Member States – recommendations that according to the Treaty are non-binding, and according to the Court’s case law ‘are not intended to produce binding effects’.⁶⁶ Yet, when it becomes a pattern, non-enforcement of rules weakens the credibility of the whole framework.⁶⁷

In sum, there is so far little evidence that the delegation of more powers to the Commission has had a tangible effect on enforcement. Rather than making the application of rules more automatic, it seems to have transformed the Commission’s identity further towards the political.⁶⁸

⁶¹ Article by N. Donn, “Brussels threat to impose sanctions on Portugal coincides with ‘most difficult time in EU history’” *Portugal Resident*, May 12 2016; available at <http://portugalresident.com/brussels-threat-to-impose-sanctions-on-portugal-coincides-with-%E2%80%9Cmost-difficult-time-in-eu-history%E2%80%9D> [Accessed 3 August 2016].

⁶² ECB Economic Bulletin February 2016.

⁶³ Council Conclusions on Alert Mechanism Report 2016, Press release, 15 January 2016.

⁶⁴ J-C. Juncker et al. (2015), p.8.

⁶⁵ In the case of France mentioned above, demanding further fiscal consolidation would have been hugely unpopular in France and weakened the position of the incumbent moderate President relative to the anti-European political forces.

⁶⁶ See *Grimaldi (C-322/88)* at [13]: Recommendations, according to the Court, “are not binding, are generally adopted by the institutions of the Community when they do not have the power under the Treaty to adopt binding measures or when they consider that it is not appropriate to adopt more mandatory rules” and “are not intended to produce binding effects” at [16].

⁶⁷ For a discussion, see J. Snell, “The Trilemma of European Economic and Monetary Integration, and Its Consequences” (2016) 22 *European Law Journal* 157.

⁶⁸ According to Scharpf, the Commission has, to a large extent, “lost the aura of neutrality and objectivity”. F.W.Scharpf, “Political legitimacy in a non-optimal currency area”, *MPIfG Discussion Paper 13/15*, p. 23. The

Its current President (consistent with his background as the “Spitzenkandidat” for the EPP group) has been quite open about the fact:

*The Commission is not a technical committee made up of civil servants who implement the instructions of another institution. The Commission is political. And I want it to be more political. Indeed, it will be highly political.*⁶⁹

It should be no surprise that assigning the Commission increasingly political tasks will necessarily thrust political consideration into play in greater strength. It is an illusion to think that a technocratic body, when tasked with deeply political duties, could long remain a technocratic, “benevolent agent of the public good”.⁷⁰ Rather, attempting to de-politicize deeply political tasks by delegating them to a technocratic body tends to embed the technocracy with politics, transforming it into a “sham technocracy”.⁷¹ Political decisions remain political, though taken in democratically less accountable fora.

Yet faith in technocratic delegation remains strong in the EU. Rather than prompting a reassessment of the limits of the approach, the perception of an increasingly political – and hence ineffective – Commission has given impetus to take technocratic delegation one step further: delegation beyond the Commission, to an expert body created for a particular purpose.⁷² Recent years have brought many examples of such deeper kind of technocratic delegation. Many countries – including all euro area countries as part of the Fiscal Compact and the budgetary framework directive – have established independent fiscal councils to provide an independent assessment of fiscal policies.⁷³ These councils are expected to contribute to democratic accountability by equipping the public with an independent account of the government’s fiscal policy.

The Five Presidents’ Report contains further proposals of similar nature. First, it proposes the establishment of a European Fiscal Board, consisting of economic experts, to issue opinions on the application of the European fiscal framework. While the role of the Board would be advisory, the rather obvious intention is to discipline the Commission and limit its powers of interpretation. The Board, which is expected to act independently and subject to limited transparency requirements, has already been appointed by the Commission.⁷⁴

politicization of the Commission has been further strengthened by the increasingly close linkages between the Commission and the European Parliament through the Parliament’s role in the appointment procedure of the Commission (Article 17(7) TEU), and their interinstitutional framework agreement (IIA, 2010) and the ‘special partnership’ it aims to develop [2010] OJ L304/47. In addition, the Treaty stipulates that the Commission is as a body responsible to the European Parliament, which may vote on a motion of censure of the Commission (Article 17(8) TEU). This not only turns the Commission into a more political actor but also means that every move aimed at strengthening the position of the Commission simultaneously strengthens the role of the European Parliament.

⁶⁹ See J-C. Juncker, “A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change Political Guidelines for the next European Commission” Opening Statement in the European Parliament Plenary Session Candidate for President of the European Commission, Strasbourg, 15 July 2014, p. 16.

⁷⁰ Beetham and Lord (1998), p. 22.

⁷¹ See G. Davies, “Democracy and Legitimacy in the Shadow of Purposive Competence” (2013) 21 European Law Journal 2.

⁷² On this development more generally, see R.D. Kelemen and A.D. Tarrant, “The Political Foundations of the Eurocracy” (2011) 34 West European Politics 922, 924.

⁷³ Fiscal Compact, Article 3 and Article 6(1)(b) of Directive 2011/85/EU on requirements for the member states’ budgetary frameworks.

⁷⁴ The Commission acted quickly upon this proposal through Decision 2015/1937 of 21 October 2015 establishing an independent advisory European Fiscal Board [2015] OJ L 282/37, Article 2.

Second, and more boldly, the Five Presidents also seem to propose bringing technocratic delegation into the area of structural reforms. As part of their general proposal to bring structural reforms under more direct EU guidance, they recommend that each Member State establish an independent Competitiveness Authority to monitor competitiveness developments and assess progress with economic reforms. Their findings would be brought within a euro area system of Competitiveness Authorities, and the Commission would then take the outcome into account for the decisions it takes under the MIP. While the nature of such bodies would initially be advisory, the report foresees that, in the future, they would form a basis for “more binding” structural coordination.⁷⁵ President Draghi takes the idea one step further and seems to propose the creation of an independent European institution to guide Member States in the design and implementation of structural reforms.⁷⁶

The establishment of advisory expert bodies is not problematic as such. Optimally, they can support democratic accountability by equipping the public with independent accounts of the government’s policies. However, extending their role beyond the strictly advisory into the discretionary and fundamentally political judgments that increasingly form the European coordination framework would be taking technocratic delegation a step too far. We do not think that delegation to expert bodies is a durable solution to the difficulty of finding democratic acceptance to economic reforms, however beneficial those might be.

The conclusions from this section are threefold. First, implementation of the EU coordination framework has been difficult from the outset and the enforcement of even its most rules-based part has been heavily affected by political discretion. Second, the strengthening of the Commission’s role vis-à-vis the Council does not seem to have reduced the political dimension of implementation. If anything, it seems to have pushed the Commission further into the realm of politics. Third, the morphing of the EU’s economic policy coordination framework from a narrow, rules-based system for enforcing the Member States’ budget constraint into an increasingly holistic and discretionary steering of their fundamental policy choices is only going to make consistent enforcement more challenging and more political.

4. On the limits of the EU’s ability to control Member States’ economic policies

So why has effective implementation of the EU fiscal and macroeconomic framework proved so difficult? Surprisingly, in the process of extending the scope of framework and mapping the future direction of the EMU, this question has scarcely been discussed at all. Whenever concerns about the effectiveness of the EU framework have been raised, solutions have been sought from further strengthening of the EU’s powers and greater automaticity, rather than from a careful analysis of the challenges and a broader reconsideration of the locus of these powers.

In our view, the difficulties in enforcing the EU economic policy framework are not due to limitations of EU economic policy competence, nor to lack of will or courage on the part of the Commission. These difficulties are instead a reflection of the fundamental limits that the current degree of political integration in the EU imposes on the power that can be legitimately exercised

⁷⁵ See Commission, “Recommendation for a Council Recommendation on the establishment of National Competitiveness Boards within the Euro Area” COM(2015) 601 final.

⁷⁶ Speech by Mario Draghi, President of the ECB, Frankfurt am Main, 16 March 2015.

by the EU institutions. These limits are rooted deep in the culture and democratic traditions of the Member States and cannot be overcome through increased technocracy or automaticity.

Weber defines power as the probability that an actor will be in a position to carry out his will despite resistance.⁷⁷ The power of the EU in this respect remains limited.⁷⁸ In general, a political system needs to be built on the acceptance by its citizens of the different categories of rules imposed on them by different levels of authority. This acceptance builds on an assumption that the relevant authorities conduct their policies according to the right ends and procedures.⁷⁹ This kind of normative power is easier to build in the context of a nation state, with a particular cultural and historical foundation,⁸⁰ and is more difficult to build when such a context is absent.

In the case of the EU, such a foundation remains weak. The EU cannot draw on a single normative framework for its legitimacy.⁸¹ Instead of building on a strong and independent EU level normative framework, the European construction largely claims its legitimacy through national arena (legitimacy intermediation).⁸² The EU lacks a clear chain of delegation or accountability from the voters to the civil servants that ultimately implement public policy.⁸³ These shortcomings detract from the legitimacy of the EU institutions and set limits on their capacity to enforce their positions on their subjects.

In the specific case of the EU economic policy coordination, legitimization of EU decisions is further complicated by the fact that the subjects of those decisions are sovereign Member States. In fact, the mere concept of enforcing rules on sovereign states is a bit of an oxymoron. Both in jurisprudence and in political theory, sovereignty is defined by the absence of a higher authority with the power to enforce rules on the sovereign. The exercise of authority over sovereign entities always presumes some degree of acceptance by them. It is a matter of persuasion as much as enforcement.

One could of course question the extent to which Member States, particularly those that belong to the euro area, still retain sovereignty on matters of economic policy. Member States have voluntarily conferred part of their economic policy competence on the Union and, arguably, thus relinquished part of their sovereignty. Yet, this part is limited by the principle of conferral, and competences not explicitly conferred remain with the Member States, who also remain competent, by mutual agreement, to amend the Treaties.⁸⁴ In many economic policy areas where secondary legislation has granted the EU coercive powers, the basis of these powers remains contested in view of the limited economic policy competence enshrined in the Treaties. Further, each Member State retains its ultimate sovereignty: it can always choose to leave the EU and thus

⁷⁷ M. Weber, *Economy and Society* (Edited by G. Roth and C. Wittich) (Berkeley: University of California Press: 1978) Ch I: 16.

⁷⁹ W. Voermans, J. M. R. Hartmann and M. Kaeding, "The Quest for legitimacy in EU Secondary Legislation" (2014) 2 *The Theory and Practice of Legislation* 5, 12.

⁷⁹ W. Voermans, J. M. R. Hartmann and M. Kaeding, "The Quest for legitimacy in EU Secondary Legislation" (2014) 2 *The Theory and Practice of Legislation* 5, 12.

⁸⁰ Lindseth (1999), 648.

⁸¹ For a discussion, see S. Smismans, *Law, Legitimacy, and European Governance. Functional Participation in Social Regulation* (Oxford: Oxford University Press, 2004) p. 18.

⁸² F.W. Scharpf, "Legitimacy Intermediation in the Multilevel European Polity and Its Collapse in the Euro Crisis", MPIfG Discussion Paper 12/6 (2012), p. 17.

⁸³ D. Curtin, *Executive Power of the European Union. Law, Practices, and the Living Constitution* (Oxford: Oxford University Press, 2009) pp. 36-37.

⁸⁴ Article 5(2) TEU.

repatriate all competences. Even though exit from the EU is typically not a realistic threat, in many Member States anti-EU (or anti-establishment) forces have grown enough to constitute a very real constraint on the policies that the more moderate governments can implement. Appearing submissive towards the EU often carries a sizeable political cost for the government.

Against such political reality, the caution exercised by the EU institutions in enforcing the economic policy framework becomes very understandable. The recent lenience shown by the EU on the excessive deficits in Spain and Portugal is a case in point. While the two cases differ in details, they share a common characteristic: in each case a strict enforcement of the fiscal rules would have been deeply unpopular in the country and could have caused lasting damage to the popular perception of the EU.

These cases demonstrate the present reality of EU economic policy coordination. As it stands today, EU coordination is fundamentally not about enforcing rules, but rather about using various soft powers (publicity, peer pressure, threats and incentives) to compel countries to follow the desired economic policies. Implementation of the framework is highly sensitive to the political situation in each Member State. Decisions tend to be calibrated so as to protect pro-European sentiments in the Member State in question and, hopefully, nurture its political willingness and ability to cooperate in the future. And since equality of treatment is sacrosanct, leniency applied in one case immediately becomes established practice and a basis for further decisions.

The EU coordination framework is facing a fundamental dilemma. On the one hand, the framework has expanded and evolved far beyond what is possible to administer in an objective, technocratic fashion. If the EU made use of all the powers formally available to it, it could rival national governments as the prime economic policy maker in the Member States. On the other hand, the imperfect stage of development of the Union as a political community⁸⁵ sets limits on its capacity to exert coercive power on the Member States. Any government depends on its subjects for the attainment of its policies, and the absence of a broad recognition of its legitimacy makes it difficult to rule effectively.⁸⁶ Presently, the formal powers of economic policy coordination granted to the EU exceed what its feeble political structures are able to legitimize. To promote major economic reforms in a Member State, the EU generally cannot rely on coercion. Success depends on its ability to build broad support and ownership for the reforms by the Member State's governing bodies and electorate. Attempts to use of coercive powers beyond the limits set by legitimacy would only lead to conflict, problems of compliance and likely electoral backlash.

Experience with the macroeconomic programs during and after the euro crisis provides interesting insight to the difficulty of imposing economic policies on a Member State from the outside.⁸⁷

⁸⁵ This is reflected in the long-standing discussions about the lack of EU level accountability and democratic legitimacy, and the broader justification of the EU as a political organization. J.H.H. Weiler, 'The Transformation of Europe' (1991) 100 *The Yale Law Journal* 2403; J.H.H. Weiler, U. Haltern and F. Meyer "European Democracy and its Critique" (1995) 18 *West European Politics* 4; J.H.H. Weiler, *The Constitution of Europe* (Cambridge: Cambridge University Press, 1999); G. de Búrca, "The Quest for Legitimacy in the European Union" (1996) 59 *M.L. Rev.* 349; Curtin (2009), p.247. See also S. Dullien and J.I. Torreblanca, *What is Political Union? European Council of Foreign Relations Policy Brief* 70, 2012.

⁸⁶ Beetham and Lord (1998), p. 10, D. Beetham, *The Legitimation of Power* (London: Macmillan, 1991) pp. 28-29.

⁸⁷ While EU actors (the Eurogroup, the Commission and the ECB) played a key role in designing and managing the crisis programs, they were formally run through intergovernmental arrangements rather than the EU constitutional framework. Further, in formal terms the crisis programs and the conditionality therein were agreements – concessional loans in exchange for reforms – in which each party entered voluntarily. The negotiations may have been extremely asymmetric, but the crisis countries always had the full legal option to decline the agreement. What they lacked was the economic incentives to do so.

Success of the programs depended, by and large, on the extent that each government believed in and was able to sell the program to the electorate and thus create broad ownership for it. Where such ownership was absent, implementation faltered. Further, any perception of the national government being reduced to subservience to the creditors was typically badly received by the electorate and punished at the polls. And in each country, the experience has been traumatic and has tested the popular trust in the benevolence of the EU as an economic authority.

In principle, there are two ways to fix the mismatch between the extensive formal powers of the EU in the economic field and the weakness of the political structures to support their use. Either one strengthens the political and accountability structures underlying economic policy coordination, or one scales back the level of ambition of the coordination framework. Not surprisingly, the recent high-level reports on the future of the EMU prefer the first solution. The 2012 European Council Conclusions on completing EMU stress the need “to ensure democratic legitimacy and accountability at the level at which decisions are taken and implemented”, and suggest that “further integration of policy making and greater pooling of competences must be accompanied by a commensurate involvement of the European Parliament”.⁸⁸ The Five Presidents’ Report discusses democratic accountability, legitimacy and institutional strengthening, and argues for a greater sharing of competences between the EU and national levels. Both reports follow the traditional line of legitimacy argumentation and its remedy in the EU: the legitimacy gap is to be bridged by strengthening EU competence further, building on the accountability chain between the Commission and the European Parliament,⁸⁹ and to a more limited extent, by engaging national parliaments in EU-level debates but without granting them formal decision-making powers. The Reports have had little substantive to say apart from the obvious: that decision-making should be legitimate and politically accountable.

We see little hope that the proposals included in the EMU Reports would have a meaningful effect on the legitimacy gap. Specifically, we doubt that increasing the role of the European Parliament would provide a solution to the problems of enforcement. The Parliament already participates in the adoption of a significant part of EU legislation relating to economic governance. It is not obvious what the Parliament’s role could be in relation to its enforcement, apart from the accountability relationship it already enjoys with the Commission. In particular, its increased role would hardly be seen as an adequate compensation for a potential loss of power by the national governing bodies.⁹⁰ We do not think the legitimacy gap can be bridged or significantly narrowed through any institutional reform. The EU’s ability to legitimize its use of power can expand over time, along with a gradual development of a genuine European political community. But the pace of that development is constrained by impediments that are of fundamental nature, rooted in history and culture. They may evolve over time, but they cannot be legislated away.

⁸⁸ See Council, “European Council conclusions on completing EMU adopted on 14 December 2012”; Council, “European Council conclusions on completing EMU adopted on 18 October 2012” at [15].

⁸⁹ See Curtin (2009) p. 260.

⁹⁰ M.N. Franklin and S.B. Hobolt, “The legacy of lethargy: How elections to the European Parliament depress turnout” (2011) 30 Electoral Studies 67. Evidence pointing in this direction can also be found in studies relating to compliance: the scope of EP contribution through legislative amendments affects non-compliance: it forces Member States to concessions which later result in domestic opposition and increase non-compliance with EU legislation. T.A. Börzel and M. Knoll, “It’s the Policy, Stupid! Sector-Specific Non-compliance in the European Union”, Paper prepared for the APSA meeting, Washington D.C., August 27-31 2014, p. 27.

These impediments leave the EU poorly equipped to coerce Member States to implement policies which are politically salient, divisive or entail significant redistribution.⁹¹ As Majone argues, policies involving delicate value judgments between efficiency and equity can only be made legitimately within fairly homogenous communities,⁹² and involving the EU into such judgments would only serve to aggravate the Union's democratic deficit. When Moravcsik, in his controversial contribution in 2002, disputed the existence of such democratic deficit, the basis of his claim was that the EU had successfully steered clear of such contentious areas; that the powers of EU institutions were tightly constrained by, inter alia, narrow mandates and separation of powers, and the functions it performed were of low electoral salience and commonly delegated also in national systems.⁹³ Whether or not one agrees with Moravcsik's original analysis, it is clear that time has turned the basis of his claim on its head. The EU coordination framework has extended deep into policy areas that deal precisely with such value judgments, where legitimacy becomes critical and strict enforcement therefore much more difficult.

As there is not much to be done to strengthen the EU's legitimacy resources, we believe there is more promise in the alternative approach, namely shrinking EU powers back into line with the legitimacy resources it possesses. Legitimacy is linked to respecting the limits of one's powers. Legitimate power is first and foremost limited power.⁹⁴ This approach would not mean scrapping the entire economic policy coordination framework, but it would mean a thorough reconsideration of its contents. EU competences would need to be more narrowly construed and focused to areas which are politically less salient and where Member States share a sufficiently broad and stable range of common interests to justify common actions.⁹⁵ In such cases the EU can act as a useful constituency for solving common-action problems. None of the elements of the EU economic policy framework are easy to squeeze into that description, but the Excessive Deficit Procedure probably comes closest. The common interest is relatively clear (unsustainable fiscal policies by one Member State entail negative externalities on the others) and the degree of intrusiveness relatively modest (the SGP only deals with the bottom line of the budget, not its composition). Strict enforcement of the EDP will certainly not be easy – experience proves otherwise. However, it is the part of the framework that has the best chance to succeed at least to a moderate extent.

In contrast, the MIP operates squarely in the difficult area of value judgments and high political salience. Take, for example, the 2016 Country Specific Recommendations addressed to France as part of the MIP.⁹⁶ These focus on issues such as the minimum wage (which should be more flexible downwards), removal of barriers to entry into regulated professions (such as taxis), the corporate income tax rate (which should be reduced) and the VAT (where preferential rates should be abolished). All of these recommendations seem economically sound. At the same time, each of

⁹¹ It is also unclear how effective such measures would be implemented. In general, compliance costs experienced by the Member States are crucial in explaining violations of EU legislation by them, and that such costs are high i.e. in relation to policies with substantial redistributive consequences. T.A. Börzel and M. Knoll, *"It's the Policy, Stupid! Sector-Specific Non-compliance in the European Union"*, Paper prepared for the APSA meeting, Washington D.C., August 27-31 2014, p. 1.

⁹² G. Majone, *Regulating Europe* (London: Routledge, 1996), pp. 298-299.

⁹³ A. Moravcsik, "In Defence of the 'Democratic Deficit': Reassessing Legitimacy in the European Union" (2002) 40 *Journal of Common Market Studies* 603.

⁹⁴ Beetham (1991) p. 35.

⁹⁵ F.W. Scharpf, *Governing in Europe: Effective and Democratic?* (Oxford: Oxford University Press, 1999) p. 11.

⁹⁶ *European Commission Recommendation for a Council Recommendation on the 2016 national reform programme of France and delivering a Council opinion on the 2016 stability programme of France. 18.5.2016*

them touches on an issue that is politically highly visible, divisive, and has, at best, an indirect and remote link to EU common interest.

We do not see a problem in the EU raising such issues as examples where policies could be improved. Publicity and suasion may actually help the formation of the requisite political majorities in the Member State to pass useful reforms. It would, however, be a completely different matter for the EU to coerce a reluctant Member State to pass such reforms by resorting to the Excessive Imbalances Procedure and the sanctions it entails. In general, we do not believe the EU has the capacity to legitimize such intrusive exercise of power.⁹⁷ Trying to do so would likely result in conflict and political backlash, and knowing this, the Commission is unlikely to try.

In reality, rather than a centralized steering mechanism for ensuring healthy macroeconomic policies described in the legislation, the MIP seems to have evolved into a service largely similar to the IMF Article IV Reports or the OECD Country Reports: a carefully studied, independent expert view on Member States' economic policies. In our view, this is as far as it can go within the current realities, and trying to take it any further would be an overreach.

In terms of the prospects for strict implementation, the third major part of the framework, the preventive arm of the SGP, falls somewhere between the corrective arm and the MIP. Like the corrective arm, it is less intrusive than the MIP in the sense that it targets the bottom line of the government's budget, not the content of policies, and thus may put less of a burden on the EU's legitimacy resources. On the other hand, the preventive arm deals with countries whose fiscal situation does not yet pose an immediate risk and hence, like with the MIP, any immediate EU common interest is less obvious. Attempts by the EU to use coercion to enforce the corrective arm would likely be perceived as disproportionate and be received badly by the national polity. Here too the EU's true capacity to use the formal coercive powers granted to it by the six pack might prove to be very limited.

5. Conclusions

Our key findings are threefold. First, the EU's economic policy coordination framework has changed in fundamental ways. What was initially a fairly narrow exercise aimed at preventing Member States from getting into fiscal trouble has become a highly complex, holistic system for steering all areas of their economic policies, including the most political and divisive. As a consequence, the framework has also morphed from a mostly rules-based system into a largely discretionary one. While the framework was always difficult to administer in a purely technocratic manner, this evolution ensured that its implementation would become a deeply political exercise.

Second, enforcement of the framework is widely perceived to have been weak. This finding applies both to its mainly rules-based elements within the fiscal framework and to its more discretionary part within the MIP. When fiscal rules have been broken or excessive imbalances identified, the EU has declined to use the means of coercion available to it and has rather resorted to negotiation and interpretation. There is so far no evidence that the strengthening of the Commission's role in 2011 has resulted in more stringent enforcement.

⁹⁷ Hypothetically, there might be situations where a Member State would not oppose being put into EIP. If the government has already decided to move ahead with a controversial reform, a supportive intervention by the EU in the form of EIP might help to galvanize political support for it.

Third, this should not come as a surprise, as the weak enforcement reflects the natural and entirely predictable limits to the EU's ability to exercise of power over its sovereign members. The Union does not possess sufficient legitimacy to overrule national governments on matters of high political importance and visibility. Attempting to use of its coercive powers in such situations would likely lead to conflict and electoral backlash, thus further weakening the EU's ability to compel Member States towards sound economic policies. Instead of coercion, the EU has chosen a cautious and politically sensitive approach that relies on negotiation and persuasion to encourage Member States towards better policies. We consider this approach the only realistic option in the current stage of cultural and political integration of the EU. Moreover, real-world federations have shown that there are other ways to integrate that do not rely on unrealistic assumptions on the ability to control Member States.

If one accepts these findings, what should be the conclusion? One could argue that, as such, the framework serves a useful purpose, does little harm, and hence there is little reason to reform it. However, we believe there are compelling reasons to think that granting the EU formal powers it is structurally unable to use may actually be harmful. First, non-application of some parts of the framework tends to erode the credibility of the whole. As long as some parts of the framework are not consistently enforced, there will be uncertainty about whether any part will.

But second, and more importantly, the expanded coordination framework does not exist in a vacuum but is part of a larger EMU vision, the functioning of which relies on a strict enforcement of the framework. Specifically, greater pooling of sovereignty and stronger centralized control of Member States' economic policies have always been seen as the foundation on which greater sharing of economic risks among the euro area Member States can be built. The mere existence of formal EU powers over Member States' policies, enforceable or not, prompts calls for fulfilling the rest of the plan by creating mechanisms of risk sharing and even redistribution. Proceeding with such plans could easily overburden the fragile foundation, causing such mechanisms to collapse in moral hazard and freeriding.

Finally, formal powers, even when unused, have consequences for the attribution of responsibilities and accountability. The EU not making use of the coercive powers available to it can – and most likely will – be interpreted as implicit validation of the Member States' economic policies and thereby as a partial assumption of responsibility over their consequences.⁹⁸ When things go wrong, it will be difficult for the EU to avoid at least part of the blame.

For these reasons, we see it better to scale back the economic policy coordination framework to what can realistically be implemented. This would mean focusing on those parts of the framework that are, as far as possible, based on clear rules and observable data, which operate at the level of the budget bottom line instead of the content of individual policies, and where the EU common interest is direct. The Excessive Deficit Procedure seems to be the part of the framework that best meets these criteria. Even there, the challenges of effective enforcement are sizeable. To have a chance to succeed, the framework should be made as rules based and predictable, even if that meant sacrificing intelligence and flexibility. As to the rest of the framework, the problems of enforcement are fundamental. The MIP is by its very nature discretionary and deals with politically

⁹⁸ "[T]he very act of attempting to regulate the borrowing of member states signals a certain level of responsibility. Weak or half-hearted regulations may have been worse than no regulations at all." J. Rodden, "Can Market Discipline Survive in the U.S. Federation?" In P.E. Peterson and D. Nadler (eds), *The Global Debt Crisis: Haunting U.S. and European Federalism* (Washington, D.C.: Brookings Institution Press, 2013).

salient matters, and the preventive arm of the SGP is based on unobservable data. For both, the link to EU common interest is remote. For these two processes it might be preferable to eliminate coercion and the threat of sanctions and recast them as processes of peer pressure and independent advice.

Such a proposal would bring the EU coordination framework close to where it was before the financial and debt crisis. Could reverting back to the old framework, the shortcomings of which the crisis had so clearly demonstrated, really be the solution? Perhaps so. First, there have been important developments outside the economic policy coordination framework. The banking union has the potential substantially to improve the resilience of the EMU, and the ESM provides a formalized crisis management framework. Also, we propose to redesign the EDP with the sole aim of making it actually enforceable. Further steps may be needed, for example, to facilitate the participation of private creditors in sovereign debt workouts, which would also strengthen the functioning of market incentives towards responsible policies. Such developments would not immunize the EMU against instability, but they could provide a satisfactory compromise between stability and democratic control.

Ultimately, the EU should face the reality that adding unenforceable legislation simply will not make EMU any more stable. EMU can be planned as an economic design but it must be run as a supranational system of governance and democracy. Governance structures that are at odds with the cultural and political realities at the national level and the EU will not fix the flaws in EMU, but will instead undermine people's perception of self-governance and democracy. A stable and complete EMU is built not only on a solid economic foundation but also on respect for the fundamental limits of democratic legitimacy.