

Chapter 5

The EU's economic governance in 2016: beyond austerity?

Amandine Crespy and Vivien A. Schmidt

Introduction

After an initial phase of firefighting against the sovereign debt crisis that began in 2010, characterized by policies focused on strict austerity and structural reforms, the European Commission headed by Jean-Claude Juncker as of November 2014 sought to go beyond what some observers called 'austeritarianism' (Hyman 2015), the top-down enforcement of austerity. The Five President Report¹ was an attempt to provide a post-crisis management *political* response to the weaknesses of the Eurozone by calling for the completion of a 'genuine monetary union' which would allow for more 'convergence, prosperity and social cohesion'. At the same time, a number of procedural and policy aspects of the European Semester² were altered in order to address its lack of effectiveness (output legitimacy) in relaunching European economies, its weak democratic credentials (input legitimacy) and its poor transparency, accountability, and openness (throughput legitimacy) (Schmidt 2013, 2015 and 2016). In a previous edition of *Social Policy in the European Union*, Zeitlin and Vanhercke (2015) noted that, by 2015, the European Semester had undergone a process of 'socialization' but remained cautious with regard to the actual outcomes and how much more social cohesion-friendly policymaking had occurred or would be forthcoming.

Against this background, this chapter investigates to what extent the double shift in policy and governance initiated in late 2014, consolidated in 2015 bore fruit in 2016. In brief, we ask whether, eight years into the Eurozone crisis, EU and domestic policymakers have succeeded in agreeing on policies and governance procedures that take them beyond the collective bureaucratic management of austerity. To elucidate this question, we investigate three broad issues pertaining to socio-economic governance in the EU. In the first section, we assess to what extent the European Semester has moved from austerity to investment by looking at the discourses, policy recipes and implementation. The second section examines the opportunities and challenges raised in 2016 for promoting upward economic and social convergence in the Eurozone. The third section deals with the issue of power and democracy by looking at the politics of the European Semester. Section 4 concludes and looks ahead.

1. 'Completing Europe's Economic and Monetary Union', Report by Jean-Claude Juncker in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz, 22 June 2015.
2. The European Semester is a broad, hybrid governance framework set up since 2010 which aims at containing debt and deficit levels as well as steering structural reforms in the realm of macro-economic and social policy. It does so by a combination of stringent regulations and soft coordination as well as by a combination of bureaucratic surveillance by the European Commission and multilateral political control by the Council.

1. From austerity to investment? In search of progressive structural reforms

1.1 Fiscal flexibility and the turn to investment

A turn in discourse

When it took office in November 2014, the Commission led by Jean-Claude Juncker initiated a shift in discourse away from fiscal consolidation towards investment. While structural reforms were central from the outset, the new catchword is ‘upward convergence’, thus signalling that structural reforms are not the equivalent of social regression. Most recently, however, this language has been somewhat altered, in the 2017 AGS issued at the end of 2016. While ‘boosting investment’ remains the first objective, the emphasis is now put on improving the financial sector and tackling barriers to investment in the Member States together with boosting the European Funds for Strategic Investment and looking for investment opportunities from abroad. Meanwhile, the notion of social investment (European Commission 2013) has disappeared, although social policy concerns remain and are included under the rubric of structural reforms, focusing on how reforms (mainly education and training and the re-design of social protection) can generate incentives and increase the level of employment. The Commission and the Council stress the concept of having a ‘positive fiscal stance’ (European Commission 2016a) which refers to a specific strategy that is neither restrictive (read: austerity) nor fully ‘expansionary’ (read: Keynesian-type of spending). While it identifies the euro area fiscal policy as ‘broadly neutral’ over 2014-2017, the Commission calls for a stronger differentiation according to Member States and the possible use of more ‘active’ fiscal policies when appropriate. In other words, the Commission wants to achieve an overall balance and convergence in competitiveness and welfare by tackling what it considers as a ‘telling paradox: those who do not have fiscal space want to use it; those who have fiscal space do not want to use it’ (European Commission 2016a: 3).

More flexibility on fiscal discipline

From 2014 onwards, in the face of stagnating growth and rising social inequalities as a result of austerity, the European Commission gradually introduced more flexibility in its ‘governing by the rules and ruling by the numbers’ (Schmidt 2015a and 2016). The Six Pack regulations increased Commission discretion in evaluating a Member State’s fiscal position by enabling it to take into account the ‘range of relevant factors’ when judging non-compliance, including mitigating or aggravating ones, along with ‘exceptional circumstances’ (Mabbett and Schelkle 2014: 12-13). The fact that calculations became central to these procedures gave way to a ‘politics of numbers’ that has raised questions about the ‘accounting’ end of flexibility as well as the Commission’s accountability. One such example has been the change to calculating the deficit in terms of a ‘primary’ surplus (deficit minus interest payments). This enabled the Commission to allow countries that posted a primary surplus to delay rapid deficit reduction in order to propel growth, which is why France and Italy were given two-year delays to meet their targets, first in 2013 and again in 2015.

In response to criticism of the Commission's discretionary decisions and increased flexibility by Northern creditor countries and proponents of stability, the practice of flexible fiscal discipline was clarified in a Commission communication entitled *Making the best use of the flexibility within the existing rules of the Stability and Growth Pact* (European Commission 2015). Three clauses were codified: a) the 'investment clause'³: Member States' contributions to EU-linked investment projects shall not be counted in deficit and debt calculation (with more specific conditions for countries under the EDP), b) a 'structural reform clause' excludes the costs of such reforms from deficit calculation if said reforms are 'major', 'fully implemented' and foreseen to 'have long-term positive budgetary effects, including by raising potential sustainable growth', c) the 'cyclical conditions clause' stipulates that the fiscal effort should be 'modulated' with respect to economic cycles and possible economic downturns. Without further specifications, these rules leave a great deal to interpretation.

Controversy arose in 2016 when the Commission started to use the flexibility clauses to grant Southern European countries more leeway in their trajectory towards fiscal discipline. Unprecedented budgetary flexibility was granted to Italy, while decisions for Spain and Portugal were delayed until after the Spanish election in June. Under pressure from Germany and the Netherlands, which criticized the lack of credibility of the EU rules, the Commission and Council triggered procedures leading to sanctions. These, however, were only symbolic moves, as no proper fines were demanded by the EU. When France was also granted more time to meet the fiscal targets under the Stability and Growth Pact (SGP) – for at least the third time since 2012 – President Juncker's statement that it was justified 'because it's France' triggered controversy and bitter criticism from the Dutch Finance Minister Dijsselbloem in particular (European Parliament 2016a). In contrast, the European Parliament considered, in its 2016 resolution reviewing the European Semester, that investment was still lagging behind and that a greater use of the flexibility clauses of the SGP should be made (European Parliament 2016b). In brief, the European Commission has introduced flexibility clauses to loosen fiscal discipline, notably under the pressure of President Hollande and Prime Minister Renzi (beginning in 2014). But their actual use has proved to be a dangerous political game for the Commission, which has to manage disagreements between debtor and creditor countries.

Modest progress on the investment front

Stimulating investment has been the main pillar of the Juncker Commission's strategy. In June 2016, the European Commission launched the 'Juncker Plan 2.0'⁴ which extends the initial €300 bn objective over 3 years to a global objective of €500 bn over 5 years, i.e. by 2020. The resources taken from EU budget lines under the EU's Research and Innovation programme Horizon 2020, transport and infrastructure provide guarantees allowing the European Investment Bank to fund innovative and risky projects co-financed by public and private entities. By December 2016, the European Funds for Strategic Investment served to support 361 projects approved for a total of €27,5 bn, i.e.

3. Eligible investments are national expenditures on projects co-funded by the EU under the Structural and Cohesion policy, Trans-European Networks and the Connecting Europe Facility, as well as national co-financing of projects also co-financed by the European Fund for Strategic Investments.
4. European Fund for Strategic Investments and a new European External Investment Plan from September 2016.

around €154 billion of total investment (European Commission 2016). This involved 151 infrastructure projects and 234 small and medium enterprises financing agreements.

Although the amount of investment to date may appear to represent a promising start to the initiative, a number of assessments question the leverage capacity of the EFSI for boosting genuinely new and risky investment. First, one year after its set up, the plan had benefited projects mostly from Western and larger countries in particular France, Germany, Italy, Spain and the United Kingdom (Willermain and Genard 2016). Secondly, from the 57 projects approved in May 2016, 42 were found to be very similar to the types of projects that have been funded by the European Investment Bank (EIB) in the past (Claeys and Leandro 2016). Finally, the plan has been criticized for failing to leverage enough private investment. When Members of the European Parliament (MEP) debated the plan's achievements in June 2016, only the European People's Party (EPP) was entirely satisfied with it. The President of the Progressive Alliance of Socialists and Democrats (S&D) group Gianelli Pitella, like other observers, critiqued the Plan on the grounds that it should support additional projects rather than organizing a reshuffling of EU resources to support projects that would have been funded anyway, and maintained that the EIB should accept a higher degree of risk. Other groups were even more critical, with the general view being that the Juncker plan falls short of being a sufficient response to the deep stagnation faced by the EU. As a matter of fact, both public and private investment are still too weak in Europe. In 18 Member States, public investment ranges from sharp decline to stagnation compared to its average level in the 1995-2007 period (ECB 2016).

1.2 The continued neo-liberal bias of structural reforms

The granting of more flexibility on fiscal discipline involved a sort of bargain for promoting the further implementation of the structural reforms advocated in the framework of the European Semester. To be sure, the notion of structural reforms has had a floating and ambiguous meaning since the first 'adjustment programmes' were promoted by the International Monetary Fund and the World Bank in various parts of the world. It has covered eclectic – if not contradictory – policy ideas in the European Semester accompanied by a discursive turn that went from promoting strict austerity and structural reforms towards more fiscal flexibility and (social) investment. That said, structural reforms exhibit a persistent core consisting of typically neoliberal policy recipes that have been present since the heyday of neoliberalism: the liberalization of products and services markets, the deregulation of labour markets and 'rationalization' of welfare systems, and public administration reform.

Labour market reforms: flexibility without security?

The European Semester focuses very strongly on labour market reforms, which consistently account for the largest share of all CSRs ranging from 18 to 30% of all CSRs, followed by pension and healthcare reform (from 9 to 16%) (Crespy and Vanheuverzwijn forthcoming). The reforms advocated all emphasize the need to create incentives for raising levels of employment. The understanding of how to promote modernization of labour markets focuses on two (arguably) problematic assumptions. The first is that

it would be sufficient to 'activate', typically through better education and training or incentives stemming from the tax and the social system, for workers to go back into employment. This ignores the fact that the very slow rate of increase in economic activity, which links to low demand for new workers, may be the real culprit. The second (somewhat naïve) assumption is that national governments will implement politically as much as economically costly policies against the background of the fiscal discipline pillar of the Semester, including those with little room for fiscal manoeuvre (i.e., those with or at risk of excessive deficit, debt, or macroeconomic imbalance).

EU-related pressure for labour market reform has had an effect, in particular in Member States that had not been very successful in pushing through such reforms prior to the crisis. The Italian Jobs Act from 2015 and the French El Khomri Law on Work from 2016⁵ as well as the reform of labour law passed by decree in September 2017 by Emmanuel Macron's government are cases in point. While resulting in a breakthrough with regard to increasing the flexibility of labour markets, progress in terms of new rights or security is meagre. Moreover, in both countries, there is no evidence that education and training systems, or unemployment services, have been significantly improved⁶. As inequalities are on the rise in most EU countries, it appears that a) in-work poverty becomes more prevalent as a result of part-time and temporary jobs (European Parliament Research Service 2016: 11-12) and b) the reforms of the welfare states through the prism of so-called active labour market policies 'operate mainly through the reduction of security for insiders, not by increasing job security for outsiders' (Arpe *et al.* 2015: 50).

Social investment

To gain a fuller understanding of the strategy promoted through the European Semester and its effects, it is useful to consider more closely all CSRs adopted since 2011 to see whether a strategy of social retrenchment or social investment wins out (Crespy and Vanheuverzwijn forthcoming). First, it is hard to speak of a shift from a strategy of social retrenchment towards social investment, since a careful coding of the CSRs shows that, from the outset, structural reforms have served to simultaneously urge the Member State to proceed with social retrenchment *and* social investment policies. Secondly, we observe that the share of the former tends to decrease over time while CSRs related to the latter have increased from 2011 to 2016. Counter-intuitively, this may not point to a major shift towards social investment. This is because the more governments embrace reforms rooted in social retrenchment (e.g. pension reform), the less likely are they to receive CSR's in that area in the following years, leading almost mechanically to a greater salience of social investment solutions. Moreover, our suspicion is confirmed by the fact that, while the salience of social investment CSRs has increased over time, the level of CSR implementation has steadily decreased from about 40-45% in 2011 to approximately 25% in 2014 (Darvas and Leandro 2016).

5. *Loi n° 2016-1088 du 8 août 2016 relative au travail, à la modernisation du dialogue social et à la sécurisation des parcours professionnels.*

6. This is pointed out in the CSRs of both countries in 2017. The reform of education and training (especially vocational training) has been a major plea during his campaign of the newly elected French President Emmanuel Macron.

Thus, the ideological bias combined with the implementation bias of the Semester only reinforces a fundamental structural feature of EU socio-economic governance inherited from the past. Whereas Country-specific Recommendations pertaining to fiscal discipline remain potentially constraining (with sanctions always possible) under the revised SGP regime, the CSR's urging the Member States to engage with social investment remain optional, and in fact are largely wishful thinking in the absence of sufficient fiscal space and a – still absent – coherent discourse about the economic efficiency and political desirability of social investment.

As a result, worrisome imbalances are still to be observed in significant parts of Europe. Trying to assess to what extent the various EU countries deal with social protection – in terms of either a classical transfer-based or an innovative investment-based strategy – is primarily a matter of evaluating their recovery after a period of implementing austerity packages and cutting welfare states across the board from 2010 to 2013. EU rules and policies exert significant constraints on domestic reforms and ‘while the paradigm of fiscal austerity and pressure on social standards has dominated the reform process in all the countries under scrutiny, its actual implementation has varied from one country to the other’ (Agostini *et al.* 2016: 109-110, see also Bouget *et al.* 2015: 12). In 2013, actual support through activation policies reached the level of more than 30% of the active population in only 8 EU countries (Dhéret and Franssen 2017: 23). More generally, social investment has not materialised into an explicit ‘new’ political agenda promoted by the EU institutions. Researchers observe that social investment policies are mostly present in those Member States which have historically more robust continental welfare states in continental Europe and Scandinavia which have therefore been more resilient in the face of the great recession (Bouget *et al.* 2015). In the other countries, the resources provided by the EU structural funds do not suffice to compensate the effects of fiscal discipline.

Finally, with regard to more general EU policies, efforts have been being made to direct resources from various existing EU funds⁷ towards social investment. By doing so, though, the European Commission has been pursuing ‘social innovation’, that is an approach essentially aimed at the marketization strategy consisting in outsourcing welfare policies to a policy environment characterized by a de-politicized vision of resource allocation, technocratic project-based management and, possibly, profit-seeking.

2. Upward convergence. Debates and challenges

2.1 To tackle or not to tackle social dumping?

In October 2016, the European Commission put forward a legislative initiative for revising the Directive on Posted Workers from 1996. The initiative aims at tackling violations of labour law and the absence of a level playing field among the Member States as far as wages and social protection are concerned. By doing so, the Commission operationalized the plea to tackle ‘social dumping’ in the enlarged Union made by Jean-

7. Essentially the European Social Fund and the European Structural and Investment Fund.

Claude Juncker in his programme as he was running the Commission's presidency. This addressed the concerns raised notably by France and Germany against the background of rapidly increasing use of posting at a rapid pace, with a 44% increase compared with 2010 (European Commission 2016c). The revision of the Directive proposed by the Commission foresees establishing an equal remuneration between posted and local workers, to extend the rules of posting to temporary workers, and to limit the posting to a period of two years. The revision of the directive proved highly contentious and brought about a striking conflict line between Western European countries and the Central and Eastern European countries, which saw the initiative as an unfair attempt to restrain the posting of workers. In the summer, the national parliaments of these countries triggered the yellow card procedure for the violation of subsidiarity on the grounds that, through the notion of 'remuneration', the Commission was infringing on national competences, notably wage policy and regulation of temporary work.

The issue brought about clear dividing lines within the Council, as well as in the European Parliament. Due to the divisive nature of the piece, two co-rapporteurs from the S&D and the EPP groups were appointed and agreement on a draft report has proved difficult and eventually occurred in December. The shadow of the debate about social dumping vs economic freedom and competitiveness has continued to have an impact on all political debates, not least the campaign of the French presidential election. As a matter of fact, under the newly elected President Macron, France has put forward a new proposal for revising the directive (aimed especially at better fighting fraud through 'letter box' companies), which has delayed the decision-making process and made an agreement among the Member States more complicated. An agreement has nevertheless been found in the Council in October 2017.

2.2 The poor implementation of the Youth Guarantee

In December 2016, the European Commission presented a report on the implementation of the Youth Guarantee launched in 2013. The aim of the Youth Guarantee is to ensure that all youth under 25 receive a quality job, internship or education offer within four months of finishing school or becoming unemployed. Besides the funding project of the European Social Funds, the Youth Employment Initiative was set up to with EUR 6.4 billion, for a total of EUR 12.7 billion for the period 2014-2020. A substantial part of the money was used to advance funds and help the Member States to speed up the implementation of the scheme. Three years on, the Commission pointed to some encouraging results, notably a drop of 3 points in youth unemployment, and reported that the Guarantee benefited some 14 million young Europeans. However, 15 EU countries still have youth unemployment rates above 15% with peaks around 45% for Spain and Greece (OECD data). Moreover, 12% of young Europeans are still 'not in employment, education or training'. The Youth Guarantee has been criticized by MEPs and the ETUC for failing to tackle the full scale of the problem and often leading young people into precarious jobs. A main problem detected is that young people exiting a youth guarantee scheme take up a job offer, but often on a temporary basis, thus leaving them returning to a youth guarantee scheme afterwards. Both the European Parliament (EP) and the International Labour Organisation reckoned that approximately EUR 20

billion would be needed to address youth unemployment (Morgan 2016). Furthermore, the Commission and the EP assessed that the actual implementation was still at an early stage as of 2016 and that only one in five Member States had achieved full implementation of the various measures planned in the framework of the Youth Guarantee (European Parliament 2017).

2.3 A stabilisation mechanism in the Euro area?

The policy debates about the reform of EMU has prompted reflections on the need for automatic macro-economic stabilizers within the Euro area. More specifically, the idea of a European unemployment benefits scheme has been much discussed by researchers and policy makers and the debate climaxed at a high-level conference taking place in Brussels in July 2016 under the auspices of Centre for European Policy Studies. A number of personalities such as Marianne Thyssen, Pierre Moscovici, Pier Carlo Padoan, Sebastian Dullien and Paul De Grauwe promoted the idea of setting up a fund, discussing the various designs put forward in a number of studies (e.g. Vandenbrouche *et al.* 2016). The most realistic options do not involve direct transfers from the EU to unemployed individuals. Rather, the prevailing design promoted is a sort of insurance fund which would flow into national schemes. The funds could be activated by those countries which are affected the most by external shocks, thus tackling the problem of collective coordination and reduced national budgets in times of crisis. Although the idea has been much discussed and on the public debate agenda since 2013 at least, the time does not seem ripe for the European Commission to make a such a bold proposal as it does not seem that it would enjoy the support of a strong enough majority of Member States. Decision makers might wonder about the acceptance among voters of further involvement of the EU in social policy matters. Public opinion is divided, with a push for more EU action to tackle unemployment countered by great resistance to deeper integration. Especially among the richer, creditor countries there are concerns that such a European unemployment insurance funds would act as a *de facto* mechanism for organizing permanent financial transfers towards the more vulnerable EU members with high unemployment figures. There is a belief that unemployment issues should instead be solved through the increase in GDP and the deregulation of labour markets.

All in all, little progress has been made to keep up Jean-Claude Juncker's promise that a 'social triple A' was the objective for the EU. This being said, in the aftermath of the referendum on Brexit (see Clegg in this volume), the Commission has been keen to show that the EU can move forward, especially with its social agenda. A main initiative in this regard is the European Pillar of Social Rights (see Sabato and Vanhercke in this volume). Similar to the European Semester, it should foster convergence through a mix of regulation and open coordination in an extremely wide range of policies where the EU actually has few competences. There is so far wide scepticism among political and social actors as to which results – if any – can be achieved through this type of fuzzy process. Furthermore, it is not clear how the Pillar can foster convergence in the Euro area in particular while dealing with policies which apply *de facto* to the EU-27.

More generally, it is striking to notice that there are currently no concrete initiatives on the table to achieve the objectives set in the Five Presidents Report for deepening the Monetary Union. It remains to be seen whether a new French-German political dynamic can bring the Europeans forward.

3. Hybrid governance, power and democracy

3.1 The politics of the European Semester: elusive ownership and asymmetric power relations

Since its inception in 2011, the European Semester has undergone a number of significant changes in the way it is operated. The objective of these changes has been mainly to improve the throughput legitimacy of the Semester, that is the efficacy, accountability, transparency, inclusiveness and openness of the procedures so as to generate policy recommendations that are seen as more legitimate in the eyes of the Member States. The 2016 cycle has been the first one operated along the lines defined by the Commission to ‘revamp the European Semester’ in October 2015.

A main change in terms of governance aimed to allow for more input from the national administrations into the process. This occurred through a modification of the calendar and the timing of the various reporting sequences. In the revamped version of the Semester, there is a period of 2-3 months for the Commission and Member States governments to discuss the CSRs which are going to emerge from the Commission’s analysis. Exchanges are fed by a series of informal ‘fact-finding missions’ in the national capitals and more formal ‘bilateral meetings’ in Brussels bringing together national officials and services of the Commission (DGs ECFIN, EMPL and the General Secretariat) during December and February. Thus, the multiple consultations between the presentation of the country report and the adoption of the CSRs serves to allow for bottom-up input and to make sure that no government is taken by surprise by CSRs which could be politically sensitive.

A second series of changes seeks to enhance the ‘ownership’ of the reforms by bringing in a range of new actors, including national parliaments, social partners, NGOs, local governments, and think tanks. By stimulating ‘ownership’, the Commission pursues a twofold objective. First, enhancing a downstream communication about the Semester itself and the surveillance of national reforms by the Commission through the Semester; second, consulting stakeholders in order to be aware of their differing views and to benefit from their expertise on specific policy issues. A key means to reach out to stakeholders in the Member States has been the appointment of European Semester officers, Commission officials posted in the Commission’s representation office in the national capitals. They act as the interface between the Commission and the stakeholders by maintaining formal and informal contacts with the relevant actors on the ground, and organizing visits from the Commission officials ranging from fact-finding missions to Commissioners’ visits.

While the European Semester has become more efficient, it has arguably consolidated as a bureaucratic process geared towards expertise, with the paradoxical intention to be more involved and, at the same time, to stay away from national politics in order to avoid averse politicization. The involvement of political actors such as unions or national parliaments has been increasing over the past two years but remains limited to information and dialogue without much influence in most Member States (Sabato *et al.* 2017, Vanheuverzwijn and Crespy 2016). Attempts from the Commission to make it a *politically* relevant process run into several types of obstacles: a) when national actors (such as unions) disagree with the fundamental spirit of the structural reform agenda; b) when national actors (such as national parliaments) are uninterested in engaging with a non-binding process; c) when national governments do not embrace CSRs due to electoral constraints and d) when stakeholders, governments and the public contest the legitimacy of the EU Commission to monitor or interfere in national reforms in certain policy areas, especially those at the juncture between economic and social policy.

The problem for the Commission is that, even as it attempts to enhance throughput legitimacy through greater transparency, accountability, and inclusiveness under the assumption that this will ensure better output policy effectiveness and performance, input legitimacy remains in question. Apart from occasional politicization related to deficit rules, the European Semester is barely visible beyond state bureaucracies. In a very diffuse manner, economic governance in the EU continues to appear hierarchical and top-down, with the Commission and creditor countries promoting only a 'one size fits all' (read: German) model of competitiveness with no alternative strategy for those countries where it does not seem to work. While the growth prospects have been slowly improving, this has not translated into a significant decrease in unemployment or more welfare in a number of countries. Greece still finds itself in dire straits, which raises questions about the legitimacy of the EU in terms of both efficacy and democracy.

3.2 New intergovernmentalism vs new supranationalism, plus new parliamentarism?

The changing arrangements in the realm of EU economic governance have triggered a debate among EU scholars as to who, from the Member States or the supranational institutions of the EU, has gained power or autonomy. The debates, focusing on new forms of intergovernmentalism or supranationalism, show that power cannot be regarded as a zero-sum game. The complex interactions among the various institutional actors reveal a constant fluctuation between the bureaucratic management of everyday policy making and fundamentally political dynamics.

Scholars who explain EU governance as characterized by the 'new intergovernmentalism' see the EU's member-state leaders in the European Council as much more legislatively active than in the past. They find that the Member States have taken on an unprecedented leadership role that they exercise through consensus-seeking deliberation and the creation of *de novo* regulatory bodies and instruments outside the purview of the Commission, such as the European Central Bank (ECB) and the European Stability Mechanism (ESM), in efforts to maintain and/or regain control over EU integration

(Puetter 2014, Bickerton *et al.* 2015, Fabbrini 2015). Such an approach enables us to explain the changing positions in the Council, where despite German dominance, Chancellor Merkel compromised time and again, first to respond to the push for growth in 2012 by Italian Prime Minister Monti (supported by President Hollande), and then to the insistence on flexibility in 2014 by Italian Prime Minister Renzi (again supported by President Hollande). However, one may argue that even if there was a deliberative consensus among the Member States, it was largely in the shadow of Germany, as the 'reluctant hegemon' (Bulmer and Patterson 2013).

Furthermore, supranational actors also played key roles, as the 'new supranationalists' would argue (Dehousse 2015, Bauer and Bekker 2014). Importantly, the new supranationalists would not deny that supranational technical actors are no longer the drivers of integration, as in the pre-Maastricht era. Rather, they contend that, in an ironic twist, it is the technical actors themselves who developed and persuaded intergovernmental political leaders to pass the policy initiatives they then enforce. These new supranationalists thus focus on supranational agents' ideas and institutional entrepreneurship to make European integration work better, whether or not this serves their specific power and interests (Dehousse 2015, Bauer and Bekker 2014). The European Commission has gained significant surveillance powers in the European Semester by, for example, building its in-house expertise on the Member States' economies, and using its discretion in applying the rules (Schmidt 2016). The ECB's autonomy is apparent in the Eurozone crisis, as it progressively reinterpreted its mandate, going from a narrow view focused on inflation fighting inflation and insisting that it could not be a lender of last resort to doing almost everything that such a lender does. This started with 'non-standard' and then 'unorthodox' policies of buying member-state debt (despite the prohibition in the treaties) by doing it on the secondary markets, and going all the way through to quantitative easing in 2015 (Buiter and Rahbari 2012, Braun 2015). Furthermore, the ECB accompanied its actions by urging Member States to engage in austerity and structural reform. As a member of the Troika, the ECB was party to the harsh demands put on program countries under conditionality, including Ireland and Portugal as well as Greece in the first, second, and third bailouts. For non-program countries under pressure from the markets, moreover, the potential demands were similar. Hence, some may argue that the ECB has moved 'from a monetary to a political institution' (Theodoropoulou 2015: 46).

Although the EP continues to have little coercive power in comparison to intergovernmental or supranational actors, it has wielded increasing institutional power, if only informally, in particular by becoming the 'go-to' body for legitimacy. Even in the case of Eurozone governance, a policy area in which the EP has been singularly devoid of competence (Fasone 2014, Crum 2015), it nevertheless had a role to play. That role came about in part as a result of the Lisbon Treaty, which gave the EP some powers of oversight as well as strengthened its powers to hold the executive accountable. Such accountability established the EP's right to be informed or occasionally consulted by the Commission on matters of multilateral economic surveillance; and it ensured the EP's ability to invite the Commission, national ministers, and the Presidents of the Council, the Eurogroup, and the European Council to an Economic Dialogue or Exchange of Views (Fasone 2014: 183, Héritier *et al.* 2015: 80). Moreover, the EP was also called upon

to legislate as part of the Community Method first with the ‘Six Pack’ and the ‘Two Pack,’ and then in the cases of Banking Union and the Single Supervisory Mechanism (SSM). Thus, while its role remains limited, the EP is trying to profile itself as a democratic watchdog of the complicated and rapidly changing economic governance in the EU.

Conclusion and outlook

Since the first reforms from 2010, economic governance of the EU has been – and still is – very much in flux. Since the end of 2014 especially, the Juncker Commission has sought to address the criticism of the excessive focus on austerity by promoting investment and allowing for more flexibility in the enforcement of fiscal discipline. In turn, a greater emphasis has been put on structural reforms with a strong focus on labour market deregulation. At the same time, the promotion of social investment has remained weak and *de facto* constrained by the prevailing orthodox conception of competitiveness. As a result, and in spite of slow growth recovery in most EU Member States, the EU’s strategy has still been failing to address the persistent economic imbalances across the Member States, their painful social consequences and dangerous political implications.

Against this background, the feeling is widespread that the status quo is not sustainable and that a new model for managing interdependencies in the EU is necessary. There is a good chance that further integration for the EU-27 will mean more differentiation. Tomorrow’s EU is best conceived not as a hard-core Europe centered around the Eurozone, let alone a future ‘superstate’, but as a region-state made up of a soft core of overlapping clusters of Member States in the EU’s many policy communities (Schmidt 2015b). This will require distinguishing among different types of policies, though. Defence could be an area where only some Member States may want to invest more resources. In contrast, the management of the EU’s external borders and the migrants influx into the EU cannot possibly be left as the burden to be borne by Southern Member States only. For all Member States to feel part of this soft- core EU, whatever their level of involvement, they need to be full members of the EU institutions. This means that they should be able to exercise voice in all policy communities, but vote (in the Council and the EP) only in those areas in which they fully participate. Since all are members in the most significant policy community, the Single Market, this ensures that they will be voting a lot. But for the Eurozone or Schengen, for example, only active members should be able to vote.

The deeper integration of the Euro area should occur only by strengthening both its policy rationale and its democratic credentials. The current debates may well build on ill-conceived assumptions. The first misconception is that convergence of member-state economies is a *sine qua non* for a successful monetary union; the second is that such convergence requires deregulating national labour markets and rationalizing welfare states. As Waltraud Schelkle (2017) has argued, the Eurozone is best understood as a mutually beneficial risk-sharing insurance union in which the diversity of the Member States constitutes its strength. Thus, rather than seeking to reduce diversity, it should be accepted (even celebrated) as a reality.

Therefore, what the Eurozone needs, rather than centralized governance by restrictive rules and sanction-triggering numbers, is to coordinate macroeconomic governance while decentralizing microeconomic governance to the benefit of national capitals (Schmidt 2015b). For example, why not make macroeconomic governance by the ECB more flexible, say, by using the Maastricht criteria as general guidelines for variable yearly targets, depending upon the Eurozone's employment as well as inflation prospects? Rather than demanding that all Member States meet the same yearly targets (e.g., of deficit and debt), why not set differential country-specific targets (depending upon where the Member States are in their economic cycle, and whether they are overheating and therefore need to contract, or are contracting and need to expand)? This would put responsibility for the country's economics back in national governments' hands. And this in turn could help counter the populist drift in many countries, as political parties of the mainstream right and left could begin again to differentiate their policies from one another, with proposals for different pathways to economic health and the public good. Furthermore, there is an ongoing debate on how elected parliamentarians could be better involved through a 'Parliament of the Euro area' made of either national MPs – as suggested by Piketty and colleagues in their proposal for a 'T-Dem' (Hennette *et al.* 2017) – or of MEPs, as suggested by Emmanuel Macron and Wolfgang Schäuble (Reuters 2017).

No institutional reform will work, however, if Member States continue to have to contend with excessive debt loads that weigh on their economies (e.g., Greece and Italy), if they are left without significant investment funds provided by banks or the state (e.g., Portugal, Spain, Italy, and even France), as well as if some countries continue to have massive surpluses while failing to invest sufficiently (i.e., Germany and other smaller Northern European countries). Thus, some extra form of solidarity is necessary, beyond the European Stability Mechanism, such as Eurobonds, Europe-wide unemployment insurance, EU investment resources that dwarf the Juncker Plan, or other mechanisms. Inevitably, this raises the question of stepping up the own resources of the EU and its budget.

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