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THE LIMITATIONS OF POLICY COORDINATION IN THE EURO AREA UNDER THE EUROPEAN SE

THE LIMITATIONS OF POLICY COORDINATION IN THE EURO AREA UNDER THE EUROPEAN SEMESTER

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EXECUTIVE SUMMARY

This paper assesses economic policy coordination in the euro area under the European Semester. In sections 2 and 3, we make a positive (and not

- The reference to the euro-area aggregate fiscal stance is not much more than empty rhetoric. How the optimal aggregate fiscal stance should be determined is not defined. The Council recommends that the aggregate fiscal stance should be in line with sustainability risks and cyclical conditions, but it does not even state what this aggregate stance is. There is no top-down approach to determine national fiscal stances that correspond with the optimal aggregate, and it is therefore accidental if the sum of country-specific fiscal stances corresponds with the optimal aggregate fiscal stance.

- Fostering investment is a key goal mentioned in two euro-area recommendations, but CSRs to the five largest euro-area countries are not consistent with this goal.

- The euro-area recommendation to correct excessive internal and external debt is not well reflected in the CSRs to the five largest euro-area countries despite the fact that the Alert Mechanism Report of 2015, which was published before the CSRs, identifies this as an excessive imbalance in Italy, the Netherlands and Spain.

- The euro-area recommendation to reduce the high tax wedges on labour is not well reflected in the CSRs to the five largest euro-area countries despite the highlighted importance of this issue in the preamble of the Council recommendation for the euro area.

- Reform of services markets: this euro-area recommendation is well reflected in the CSRs of the five largest euro-area cou[illegible]
  [illegible]

complying with European Semester recommendations, risk limiting the domestic ownership of reforms, would be unfair to countries that have already implemented reforms and are unlikely to influence those countries that have sound fiscal positions.

- ***Ex-post*** monitoring of reform implementation by an independent EU-level 'structural council' would be worth consideration, not least because it could improve transparency and could highlight the steps the European Commission could take to improve the cross-country consistency of CSRs.

1. INTRODUCTION

The European Semester is a yearly cycle of economic policy coordination within the European Union. It is supposed to improve economic policy coordination within the union and ensure the implementation of the EU's economic rules (such as those in the Stability and Growth Pact – SGP – and the Macroeconomic Imbalance Procedure – MIP). In autumn each year, the European Commission sets out the EU priorities for the coming year in the Annual Growth Survey and publishes its opinions on each country's draft budgetary plan. After each country presents its Stability (euro-area countries) or Convergence (non-euro area countries) Programme and its National Reform Programme (later, in the spring), which set out their budgetary and economic policies, respectively, the European Commission proposes Country-Specific Recommendations (CSRs) for budgetary and economic policies. The Council discusses these recommendations, amends them if deemed appropriate and adopts them.

Recommendations made in the context of an Excessive Deficit Procedure (EDP) and an Excessive Imbalance Procedure (EIP) are binding. For other recommendations, member states "***shall take due account of the guidance addressed to them in the development of their economic, employment and budgetary policies before taking key decisions on their national budgets for the succeeding years***"[1]. Non-compliance with recommendations can lead

3. On average, 6 recommendations were made to each country in 2014. The following ten countries implemented one recommendation in full or achieved substantial progress: Austria, Belgium, Denmark, Croatia, Lithuania, Malta, Netherlands, Portugal, Slovenia and the United Kingdom.

European Semester. Moreover, the OECD's reform responsiveness rate was practically the same in 2013-14 (30 percent) as in 2007-08 (31 percent), while it was somewhat higher in 2011-12 (42 percent). The somewhat higher rate in 2011-12 could be explained by increased efforts during the crisis, but from 2007-08 to 2013-14 there was no increase in reform implementation, notwithstanding the new European economic governance frameworks.

The other panels of Figure 3 show the two indicators (when available) for all EU countries except Cyprus, and for the United States and Japan[4]. The similarity we highlighted holds for almost every EU country.

Figure 3 highlights that the countries under a financial assistance programme or undergoing severe macroeconomic adjustments, implement the most. The highest reform responsiveness rate, 92 percent, was obsers w[jYaYe[NsOTc]t-]ts

3. THE 2015 EURO-AREA RECOMMENDATIONS

On 14 July 20ye

6. Annex 2 gives the full text of the recommendations.

For the Netherlands, the first recommendation is: "***Shift public expenditure towards supporting investment in R&D and work on framework conditions for improving private R&D expenditure in order to counter the declining trend in public R&D expenditure and increase the potential for economic growth***."

For Italy and Spain, investment is not even mentioned in their CSRs.

We conclude that these CSRs are insufficient to foster a reasonable increase in public and private investment.

- Public investment: As we noted above, the Commission's proposal to use "t***he available fiscal space***" was deleted by the Council from the German recommendation on public investment. This implies that a public investment stimulus should not be expected, only a change in the composition of public expenditures in favour of investment, similarly to the Netherlands. In our view, one should not expect much from changing the composition of [illegible]

the high tax wedges on labour is not well reflected
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We see the establishment of national competitiveness councils as a kind of decentralisation, through which reform priorities would be defined nationally. It will likely increase the ownership of the reform process because a conclusion by such a national council could be seen by the national parliament and the government as a recommendation coming from inside the country, but not as a

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any coordination mechanisms or the use of the MIP would enable countries to be forced to have larger deficits than their national preferences would suggest. We are sceptical about whether the optimal aggregate fiscal stance could be achieved by anything other than pure chance. We expect that vague statements will continue to be made in the future about the aggregate fiscal stance and the benefits of coordination.

4.2.2 The implementation of structural reforms

A number of proposals have been made on the implementation of structural reforms. The IMF (2015b) and Banerji ***et al*** (2015) suggested some ways to enhance the implementation of structural reforms. These include the definition of "outcome-based" benchmarks, which are sufficiently concrete, measurable and directly under the control of policymakers, and the use of EU legislation where possible instead of coordination. Such proposals were included in the ***Five Presidents' Report*** for the medium term ("Stage 2", which should be completed by 2025). The proposal aims to formalise and make more binding the con[illegible]

the discussion of the reform process as a means of decentralisation, which can improve ownership of the process.

CONCLUDING REMARKS

The European Semester was enacted in 2011 with the consent of the Council and the European Parliament to foster economic policy coordination, to enforce the overhauled Stability and Growth Pact and the nPacro

ANNEX 1: COMPARISON OF 2014 EUROPEAN SEMESTER AND 2013 OECD RECOMMENDATIONS

Table 4 compares the 2014 European Semester CSRs and the 2013 OECD recommendations for the six largest EU countries, France, Germany, Italy, Poland, Spain and the United Kingdom. OECD recommendations are set every two years, so these two sets of recommendations are broadly comparable (especially given the persistence through time of both CSRs and OECD recommendations). The table shows that while there are a few similar recommendations by the OECD, there are still many differences with the Country-Specific Recommendations made in the context of the European Semester. Also, European Semester recommendations are usually much more detailed, and may contain many sub-recommendations. OECD recommendations typically do not. Thus, a single OECD recommendation might echo part of a European Semester recommendation, but not its entirety. Therefore, while there exist common recommendations given to each country in the context of the OECD Going for Growth and the European Semester, these do not explain the finding that implementation rates are very similar for both types of recommendations.

Table 4: 2014 European Semester vs 2013 OECD Going for Growth recommendations

European Semester Country-Specific Recommendations	OECD Going for Growth Recommendations
France	
Reinforce the budgetary strategy: • Comply with the rules of the SGP • Implement ambitious structural reforms to increase the adjustment capacity and boost growth and employment • Step up e orts to achieve e ciency gains across all sub-sectors of general government • Reinforce incentives to streamline local government expenditure • Take steps to tackle the increase in public expenditure on health • Take additional measures when and where needed to bring the pension system into balance by 2020	

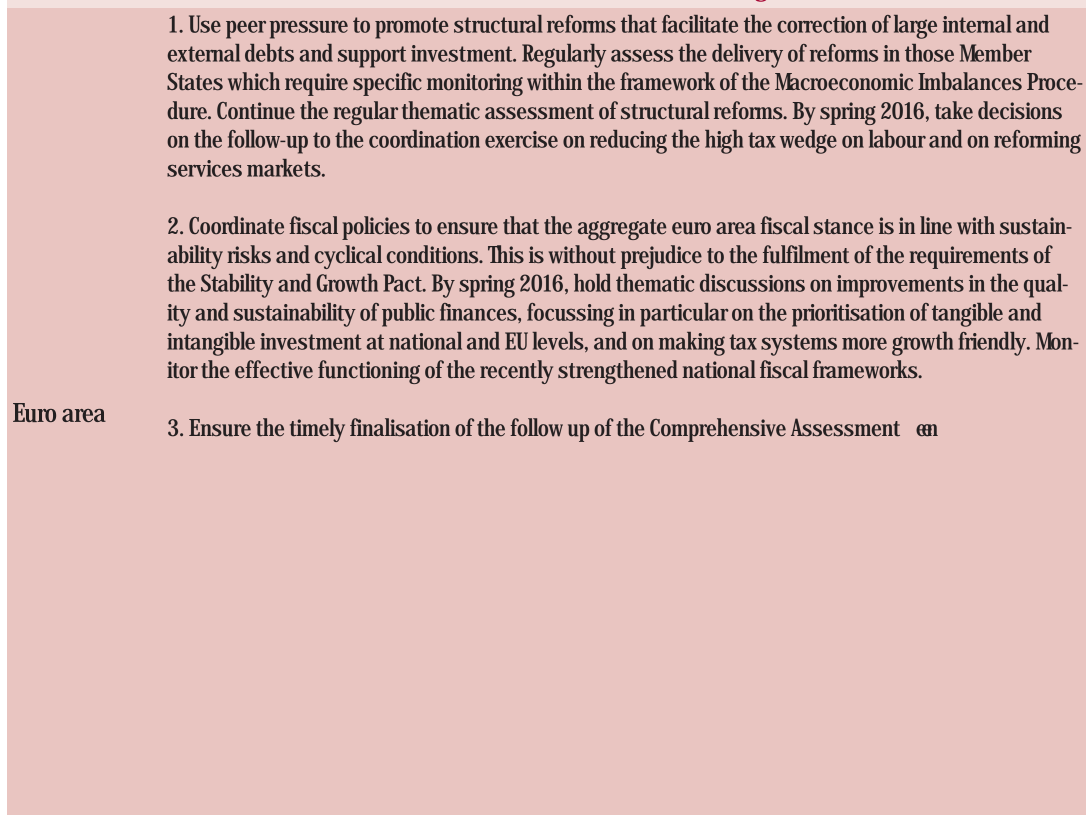
- Take further action to combat labour-market rigidity
- Take additional measures to reform the unemployment benefit system
- Ensurent b0j-zjnz"40

• Guarantee NeO]t-WU] _FWF“e[NeO]t-WU] _FWF“ccsWU FWF“e[FWF“e[NL“e[NaO]t-WU]] FWF“e[NrO]t-WUZa]FWFY]t-WU]] FWF“e[NtO]t-WUZ_adWF“e[Nta]t-WU]] FWF“e[N

• Approve the list of strategic infrastructure in the energy sector and enhance port management and connections with the hinterland.	
No similar recommendation	Pursue rebalancing of protection from jobs to workers' income
Poland	
European Semester Country-Specific Recommendations	**OECD Going for Growth Recommendations**
Reinforce the budgetary strategy: • Comply with the rules of the SGP • Implement ambitious structural reforms to increase the adjustment capacity and boost growth and employment • Minimise cuts in growth-enhancing investment, improve the targeting of social policies and the cost effectiveness of spending and the overall efficiency of the healthcare sector, broaden the tax base for example by addressing the issue of an extensive system of reduced VAT rates, and improve tax compliance, in particular by increasing the efficiency of the tax administration • Establish an independent fiscal council.	No similar recommendation
• Strengthen efforts to reduce youth unemployment in line with the objectives of a youth guarantee • Increase adult participation in lifelong learning • Combat labour market segmentation • Continue efforts to increase female labour market participation • Include farmers in the general pension system • Phase out the special pension system for miners • Underpin the general pension reform by stepping up efforts to promote the employability of older workers to raise e[illegible]	

• Ensure a full implementation of the preventive, corrective and enforcement measures in the Budgetary Stability Organic Law at all levels of government • Carry out by February 2015 a systematic review of expenditure at all levels of government • Continue to increase the cost-e ectiveness of the healthcare sector • Adopt by the end of 2014 a comprehensive tax reform • Step up the fight against tax evasion	No similar recommendation
• Complete reform of the saving banks sector **• Promote banks' efforts to sustain strong capital ratios** **• M[illegible]**	

Table 5: The 2015 recommendations for the euro-area and the five largest euro-area Member States



Euro area	1. Use peer pressure to promote structural reforms that facilitate the correction of large internal and external debts and support investment. Regularly assess the delivery of reforms in those Member States which require specific monitoring within the framework of the Macroeconomic Imbalances Procedure. Continue the regular thematic assessment of structural reforms. By spring 2016, take decisions on the follow-up to the coordination exercise on reducing the high tax wedge on labour and on reforming services markets. 2. Coordinate fiscal policies to ensure that the aggregate euro area fiscal stance is in line with sustainability risks and cyclical conditions. This is without prejudice to the fulfilment of the requirements of the Stability and Growth Pact. By spring 2016, hold thematic discussions on improvements in the quality and sustainability of public finances, focussing in particular on the prioritisation of tangible and intangible investment at national and EU levels, and on making tax systems more growth friendly. Monitor the effective functioning of the recently strengthened national fiscal frameworks. 3. Ensure the timely finalisation of the follow up of the Comprehensive Assessment een

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6. Reform the labour law to provide more incentives for employers to hire on open-ended contracts. Facilitate take up of derogations at company and branch level from general legal provisions, in particular as regards working time arrangements. Reform the law creating the *accords de maintien de l'emploi* by the end of 2015 in order to increase their take-up by companiesh