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The "European Semester": More Dialogue, Less Diktat

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The European Commission is beginning a fourth round of the so called European Semester procedure, designed to encourage Member States to pursue responsible economic policies and coordinate them across the bloc to help the EU exit the crisis and prevent large-scale economic downturns. However, the full power of this instrument is still uncharted. The key questions are whether Member States will accept guidance from the EU and whether the results will be beneficial if they do. For both to succeed, less of a top-down approach is required.

Designed Coordination. The European Semester is an attempt to encourage the inclusion of European Commission (EC) recommendations into the budgets of every Member State. The annual procedure is intended to put pressure on Member States to implement responsible economic policies, with a special focus on budgetary issues and other macroeconomic imbalances. At the end of each year, the EC checks whether the Member States have met its macroeconomic balance criteria (in the state's current accounts balance, inflation, private-sector debt, general government debt) and it generally assesses the economic fundamentals of the EU. Then each March, the Council draws on the European Parliament's opinion on the EU's economic performance and prepares policy guidelines for the bloc. In May, after the Member States have presented their own plans and priorities (through the Stability and Convergence Programmes or National Reform Programmes), the EC drafts country-specific recommendations for each, which in turn are approved by the European Council. The idea is to give governments these recommendations before their draft national budgets have been adopted, when there is still a degree of room for dialogue with the EU institutions to make the recommendations more acceptable to the Member States.

The End of the Honeymoon. On its first go in 2011, the European Semester was still a riddle to participants. Despite apparent support from the EU institutions, it was unclear whether the new framework would share the fate of the Stability and Growth Pact (SGP), an instrument designed in the 1990s to impose discipline on Member States. The SGP, when implemented, was intended to ensure responsible fiscal policy by setting a ceiling on national budget deficits of 3% of GDP and encouraging a budget surplus in times of prosperity. Yet, Member States ignored it without suffering penalties, not least, paradoxically, Germany and France—its biggest promoters. When these countries fell short of the fiscal criteria, they simply voted down their punishment at European Council summits.

On paper, the European Semester is a more robust system that is more automatic with regards to the penalty mechanism. Whereas a qualified majority of the Council was needed to impose the sanctions and fines called for by the Commission under SGP, the Semester requires reverse-qualified majority voting (hence, a qualified majority is needed to reject rather than impose the fine). Thanks to the "six-pack" and "two-pack" measures adopted by the EU, the Commission has greater powers to regulate macroeconomic balance in the bloc, though the European Council remains involved in the process of creating the recommendations and is, potentially, an Achilles heel in the process. Thus, the question remains whether the Commission has enough power to use this tool.

A first test (not counting France's bargaining in May) came in November this year when the EC pointed to Germany's current accounts surplus and suggested it was excessive, then proposed remedying it by boosting domestic demand. It is an open question whether Germany will actually comply with the recommendation, especially since it was not made as part of the country-specific recommendations and thus is not yet obligatory. The real test may well come next year when new recommendations are published. The credibility of this new package of recommendations will hang on whether this issue appears in them and whether Germany accommodates them.

The European Semester's Anti-crisis Bias. The broad scope and intrusive nature of the Semester have been identified as the principal challenges to its widespread acceptance by Member States. The European Semester intrudes upon key facets of national sovereignty. Indeed, the fact that governments would even conceive of adopting such an intrusive system is a reflection of the severity of the financial crisis. The recommendations cover fiscal policy, pension and health systems, the financial sector and housing, services, the digital agenda, the energy sector, R&D, the labour market, education, the quality of public administration, and others.

That said, the asymmetric nature of the eurozone crisis has also introduced a degree of flexibility into the Semester, replacing the "one-size-fits-all" thinking with country-specific differentiation; and because this mechanism is coordinated between the EU institutions, including the European Council, the recommendations are in fact accepted by all sides and negotiations on their specific formulation begins comparatively early. Without this, the dialogue would be limited. The other side of the coin, of course, is that the recommendations are sometimes not as sharp as they need to be.

That means that apart from the problem of garnering Member State acceptance for the Semester framework, another problem is present—mainly, the mechanism's usefulness. The criteria that should be met by Member States under the Semester serve the rule that stability in times of crisis is the real key to economic success and if any country breaks the criteria, it would pose a risk to itself and should thus be corrected. This conservative and crisis-driven approach arises from the importance currently given to evading any risk that could put a fragile recovery in jeopardy.

And yet a growing band of politicians and experts are questioning whether a "policy of indices" focused on macroeconomic discipline is helpful. After all, the objective to meet certain disciplinary criteria invites comparisons with the so called Washington Consensus criteria, designed to help the developing world sustainably converge with the north. Those criteria certainly seemed sound (fiscal discipline, an expanding fiscal base, lower interest rates, financial market liberalisation, trade liberalisation, privatisation) but the outcomes were found wanting, not least when it came to promoting growth. If the Semester holds the same flaws, the recovery would be weakened.

The Polish Context. In Poland, as in other countries in the EU, the country-specific recommendations since 2011 have remained relatively homogeneous. The most important concern fiscal policy. Poland is bound by the Excessive Deficit Procedure, according to which the country's budget deficit should be stabilised at 2.8% of GDP by 2015. Failing to meet this target would be negatively received by the EU, and indeed also in Poland since the Commission would be in charge of giving warnings and imposing sanctions (if the European Council did not vote to offer Poland relief). Yet, the issue of the European Semester and the problem of the Excessive Deficit Procedure hardly feature in public opinion. This would make the incentives to comply with the recommendations rather low, despite the generally impressive dedication of the Polish administration to run the Semester's process properly on the ground.

Recommendations. Much depends therefore on how seriously the Member States engage with this tool. As an instrument that is managed principally by the Commission, the Semester system is almost pre-destined to be weakened by Member States bent on safeguarding their own discretion in budget matters. Indeed, their desire to play down its implications may explain why the Semester recommendations currently go rather unnoticed by the media compared to such related proposals as completing the banking union, creating a genuine EMU or fighting youth unemployment. The obvious course for the Commission to increase the chances of compliance therefore is to enhance its dialogue with Member States.

But even if it were properly implemented, the Semester system would still be unlikely to boost growth and jobs. One problem is that the system focuses on certain flagship features, such as fiscal deficits and trade imbalances and these figures do not fully reflect the health of each economy, let alone use the potential of the single market. Another is that, in times of crisis, revolutionary upgrades might be more helpful than conservative ones. And then of course there is the short-term perspective of the key recommendations, whereas sustainable growth should be assessed long-term and be focused on causes not symptoms of the problem.

Marking a break with this crisis-driven conservatism and from a dialogue often focused on diluting the recommendations, the Commission should encourage greater political courage and initiative from the Member States. Under a modified system, governments should have a choice whether to stick to the objectives proposed by the Commission or present their own plan to boost competitiveness. In order to encourage countries to take bold steps, the Commission could seek out best practices, not least from outside the EU. A catalogue of such ideas could be presented to the States, and they should decide whether to stick to the Commission's economic recommendations or try to maximise their own growth potential by picking from among or mixing voluntary solutions.

For Warsaw, the Semester provides a good opportunity to revise the country's economic policy. The recommendations given by the Commission may also be a refreshing pivot-point in Poland's modernisation, especially if a more innovative and creative Semester system emerges. A good incentive for the government to implement the necessary reforms linked to the Semester could be increased media interest and coverage of the progress of the recommendations and how the Semester could help catch-up most developed EU Member States.