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Coordinating macroeconomic policies in the Eurozone

On the hierarchical nature of the Macroeconomic Imbalance Procedure in Italy and Belgium

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Abstract

This paper analyses the hierarchical character of the Macroeconomic Imbalance Procedure (MIP). It has been argued that the MIP can constrain national democratic decision-making and thus adds to a perceived technocratic dominance of the EU. On the other side of the debate some argue that the MIP is still insufficiently binding to induce Member States to enact the reforms that are deemed appropriate for a well-functioning Eurozone. Within the context of this debate this paper – the second of a series – provides empirical evidence of whether recommendations under the MIP contribute to real policy change and how this role is to be perceived, whether as hierarchical imposition or more in terms of constructive dialogue. It does so by tracing the role of two domestically contested MIP recommendations, namely: the liberalisation of professional services in Italy and the Belgian practice of automatic wage indexation. It argues that the influence of the MIP should be seen in terms of agenda setting and possible political pressure if the domestic environment allows for it rather than legal coercion. Secondly, it argues that over the years the instrument has become more political, interactive and non-hierarchical.

Economic governance, technocracy, peer pressure, policy coordination

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Introduction

One of the main novelties of the new post-crisis economic governance framework of the European Union (EU) is the Macroeconomic Imbalance Procedure (MIP). The procedure aims to detect, prevent and correct imbalances, such as debt overhang or competitiveness decline, in Europe's economies and is embedded in the European Semester cycle for socioeconomic and fiscal policy coordination. The MIP can be seen as the EU's response to having failed sufficiently to monitor and address economic problems in Ireland and Spain in the run-up to the crisis. Both states had pursued sound fiscal policies and were seen as 'good pupils' due to high economic growth, but still needed a bailout. Accordingly, policy-makers were convinced that the pre-crisis framework showed significant shortcomings, since crises and bailouts can be caused by other factors than levels of public debt or fiscal deficit. This perceived gap in the oversight framework was to be solved by establishing a macroeconomic counterpart to the Stability and Growth Pact (SGP), namely the MIP.

The Country-Specific Recommendations (CSRs) that the Commission makes to Member States as part of the MIP should not be interpreted as legally enforceable decrees. However, the inclusion of a sanctioning procedure for excessive imbalances does imply a more obligatory character of the recommendations than under pre-crisis economic coordination regimes. With recommendations and potential sanctions touching upon sensitive domains of national socioeconomic policy-making, such as wage setting or health care, the procedure has sparked considerable controversy in academic circles. Two debates stand out in particular and will lead us to the central questions of this paper.

Some of the early literature is focused on the legitimacy of the MIP. Legal scholars have criticized the broad and limitless definition of an 'excessive imbalance' (which is taken to mean '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, or of the Union as a whole' (Reg. 1176/2011, Art. (2)(1))). This broad definition could result in too much discretionary authority being placed in the hands of the European institutions and could imply overreach (Joerges and Weimer, 2012; Chalmers, 2012). Political scientists have criticized the MIP as excessively constraining national democratic decision-making and as such constituting a move towards 'executive dominance' (Crum, 2013; Curtin, 2014), based on 'governing by the rules and ruling by the numbers' (Schmidt, 2015), or constituting 'a legally and politically unconstrained expert regime' (Scharpf, 2013).

These authors seem to assume that the MIP represents a type of hierarchical imposition of policies on Member States. Yet, this interpretation of the new economic governance regime based on studying its legal design might misrepresent the MIP as it ignores the agency dimension and does not include the MIP's evolution over time. The Juncker Commission speaks in its documents of creating 'political ownership' and engaging in 'genuine dialogue with the Member States, which does not seem to suggest a strictly coercive approach (EC, 2015a). Member States have over the years pushed back against an overly prescriptive approach by the Commission (Lithuanian Presidency, 2013), but the more open and focussed approach of the 'political' Juncker Commission has been warmly welcomed by Member States (EFC, 2015).

Some of the more recent literature moves from analysing the MIP's design to compliance. Here we find some of Brussels' leading economic think tanks who argue that the MIP is mostly an empty shell, as implementation rates on recommendations are weak and declining, peer pressure is seen as an ineffective mechanism to ensure compliance (Gros and Alcidi, 2015; Sapir and Wolff, 2015; Darvas and Leandro, 2015; Zuleeg 2015). The conclusion that the MIP lacks effectiveness fuels the discussion on whether the Commission should be more rigorous in applying the MIP (ECB, 2016), whether monitoring should move to a 'more independent' institution (Schäuble, 2016) or whether new instruments and competences at European level are necessary to increase the implementation rate (European Parliament, 2016; Van Rompuy et al., 2017). The Five Presidents' Report argues in this context that the MIP should be strengthened and the sanction procedure should be used more forcefully (Juncker, 2015).

Often criticisms of effectiveness are based on a quantitative count of 'full' or 'substantial' progress on recommendations on a yearly basis. This tells us little about the causal mechanisms behind the MIP. And it can be seen as a questionable approach when measuring structural reforms in deeply embedded governance areas, which are by nature highly complex, multi-annual processes of compromise building. As argued by the Employment Committee Chair: 'If a CSR gets implemented after four years due to the complexities of the national process, I would still think this is a 100% implementation and not 25% as we are sometimes told – or tell ourselves' (Beyers, 2016). The Commission services conclude in their first assessment that the MIP has contributed to enhancing policy compliance and that Member States have responded ambitiously and more targeted towards addressing imbalances (EC, 2016a). Besides, the assumption that more pressure or additional instruments and competences would lead to better implementation on CSRs lacks a sufficient empirical basis.

This paper starts from the premise that we cannot simply assume that the MIP is so coercive as to breach all sorts of legitimacy standards – as claimed by some of its critics. Nor can we assume that the MIP is too soft and flexible to bring about required policy change and accordingly, that it should be made more binding to increase effectiveness. What is missing in these debates so far is a systematic account of how the MIP has been applied in practice, in order to determine its characteristics empirically. We should not only study the institutional design of the MIP and/or take annual implementation rates at face value. To understand and evaluate the MIP's real-world effects, we have to trace its practical operation over multiple years and multiple cases. This paper presents an account of the evolution of the MIP and a brief overview of two cases out of five covered in my PhD project. The central research questions that follow from the abovementioned debates are the following: how hierarchical is the MIP? And secondly, to the extent that the MIP is indeed hierarchical, how effective are its hierarchical features in inducing national policy change?

The next section will briefly elaborate on the concept of hierarchy, the methodology and the cases. The third section explains the legal design of the MIP and presents an account of the institutional evolution of the MIP. The fourth and fifth sections assess the cases of professional services market liberalisation in Italy and the practice of wage indexation in Belgium. The final section discusses some preliminary lessons we can draw from these two cases.

Concepts, methodology and cases

Economics is not an exact science, so policies cannot be designed in the abstract and simply be demanded to be implemented by Member States. This would make national politics a pretty empty phenomenon. Overly strong insistence or pressure on implementation to overturn reservations of domestic political elites would legitimise the criticisms of the MIP that recommendations are biased, discretionary or illegitimate. While this may be true, this paper adds to this assertion that one cannot fully dismiss the economic logic behind the recommendations either. At every level of politics there is interaction with experts or technocracy and in each field there is constant debate over the best approach. The question in judging the character of the MIP is what form does the interaction between the central and national levels take? In other words, does this constitute a hierarchical relation in which central norms are imposed on Member States?

The concept of hierarchy (rather than imposition or intrusiveness) to study and characterize the MIP follows from the literature on New Modes of Governance in the years preceding the crisis (see e.g. Kohler-Koch and Rittberger, 2006). New

Modes of Governance are typically characterized as non-hierarchical modes that favour less prescriptive regulatory approaches, that can be seen as more accommodative to diversity and local experimentation and which are characterized by deliberation among actors and adaptability of broader framework goals. The MIP is often seen as a move away from these characteristics of non-hierarchical governance. Dawson for example, sees the MIP as exemplary of the post-crisis reassertion of the EU legal order's harder edge (2015). On the other hand, empirical evidence from the social side of the European Semester claims that pre-crisis non-hierarchical governance features such as flexibility and learning still play a prominent role (Zeitlin and Vanhercke, 2015). We can therefore not simply assume that the pre-crisis non-hierarchical governance approach has been fully subordinated to a rigorous compliance framework, as some authors seem to suggest. Whether this reassertion of the debate also holds true for the MIP is still to be tested.

Hierarchy in governance frameworks is a multidimensional concept. This means that different aspects of a framework can contribute to a possible hierarchical character. As such, the concept of hierarchy is meant to transcend the discussion of hard law versus soft law that one can find in much of the legal literature on governance frameworks. To specify the concept further, one can identify at least three dimensions: prescriptiveness of the recommendations; the degree of flexibility with which European actors deal with national reservations; and the mechanisms for implementation enforcement, which can take the form of legal coercion, threatening with sanctions or stepping up the procedure, peer pressure or open dialogue and debunking of nationally held policy beliefs.

The MIP by nature can be expected to include a more hierarchical approach than normal Semester recommendations, as the procedure has been deliberately set-up to deal with particularly worrisome trends. But to what extent it is indeed hierarchical and how this plays out in practice remains unclear. For example, on paper a sanction procedure exists, but the function this sanction procedure performs in practice cannot be automatically read off from the legislative texts.

Effectiveness can be studied by assessing whether the recommendation and its follow-up processes contribute to inducing a Member State to adopt the policy approach that is prescribed. However, given the aforementioned calls to make the instrument more binding, this paper assesses effectiveness within cases where we might expect a more hierarchical approach due to recommendations not being implemented. It is thus not the overall effectiveness of the procedure that is being assessed, but its possible hierarchical elements. Effectiveness should also be studied in tandem with hierarchy. The parallel with the SGP here is striking, if the 3% rule is interpreted as a rigorous rule it is perhaps not very effective, as the threshold has been broken frequently. But interpreted more in

terms of a benchmark, it is surprisingly powerful and overall the SGP has managed to significantly impact fiscal policies in the Eurozone (Begg, 2016).

The hierarchical character of the MIP will be studied in this paper by assessing its design, broader evolution over time, and practical application through case studies. Empirical assessment of policy coordination processes such as the MIP is extremely challenging. Causality is not always directly observable and works in indirect ways. To put it simply, no politician will admit that he/she implemented a reform only because the EU institutions told him/her so. Researchers draw completely contrary conclusions, sometimes even based on similar material (see the discussion of the OMC in Zeitlin et al., 2014). In order to overcome such methodological difficulties, Zeitlin has proposed a combination of three research strategies to assess influences, mechanisms and effects of policy coordination: first contextualized process tracing as a means to identify and assess practical influence on domestic actors, debates, procedures and policies; second, careful triangulation in order to multiply points of observation and to offset potential sources of bias; and third, systematic comparison of findings across countries, policy domains and time periods in order to identify general tendencies and dimensions of variation (2009; 215-216).

In my research, this approach boils down to tracing the evolution and effects of the recommendations over all Semester cycles up to 2016, with a focus on both empirical change in the Member States with regard to the policy area and analysis of the context in which this has occurred. The process tracing has been carried out through careful document analysis of all relevant Commission reports and recommendations, complemented where necessary by national reports and interviews to provide the context. I have conducted a total of 54 in-depth interviews between autumn 2015 and spring 2017. For triangulation purposes, the interviewees include those actors most closely involved within the European Commission, Council Committees, ministries, economic advisory institutions, central banks, politicians, social partners, representatives of professional orders (in the Italian case) and where relevant independent experts. The statements in this paper have been crosschecked in the interviews as far as possible. This makes it possible to contextualise each step in the process to establish a causal narrative. Finally, process tracing can be regarded as a suitable method since it allows for asking open questions on how the recommendations have been perceived, where pressure was exerted and to what effect.

In addition to process tracing and triangulation, the final section of this paper will draw some lessons from the general assessment of the MIP and the cases. In total the PhD project covers five cases, including also MIP recommendations on the Dutch fiscal treatment of mortgage debt, labour market segmentation in France and the German current account surplus. The five cases have all been

identified as hard cases, whereby the Member State has for multiple years insufficiently implemented the CSR. As such these can be seen as paradigmatic of the phenomenon being studied. In other words, when a Member State refuses to implement a CSR we can expect a more hierarchical approach by the institutions, providing an opportunity to examine how hierarchy plays out in practice. The cases involve long-standing highly politicized debates, where the status quo is protected by powerful interests. This allows me to study the expected clash between the cold economic logic of the recommendations and long-held domestic policy beliefs. To be clear, the question is not how successful the MIP is in general, which would imply that indeed by selecting only hard cases this research would be selecting on the dependent variable and present a non-representative account of the procedure. The aim of the research part is exploring the nature of hierarchy and its effect, which requires hard cases.

The evolution and design of the MIP

The MIP's annual cycle starts with the Alert Mechanism Report (AMR), an annex to the Annual Growth Survey of economic policy priorities for the EU. The AMR is a filtering device to single out particularly worrisome trends, which deserve further scrutiny and thus become part of the MIP. The intention of the AMR is to preserve accountability in interpretation of economic developments by policymakers and commentators; hence, it is based on a set of indicators with thresholds to signal when a value is worrisome. The scoreboard of indicators is not meant to be used automatically to expose risks. In fact the recital of Regulation (EU) No. 1176/2011, cautions against an 'automatic reading' of the AMR and makes clear that the breach 'of one or more indicative thresholds need not necessarily imply that macroeconomic imbalances are emerging'. Here it has to be underlined that values in the scoreboard are backward looking rather than predictive, they reflect the economic reality of two years before issuance of the AMR. Whether a trend is in fact worrisome is a more elaborate question to be determined in the In-Depth review that follows from the AMR scoreboard. The scoreboard of 11 headline indicators is grouped into external imbalances and competitiveness on the one hand (such as the current account balance and nominal unit labour costs) and internal imbalances on the other (such as unemployment rate and real house prices).

On the basis of the indicators the AMR selects Member States for which an In-Depth Review is warranted to determine whether there are indeed imbalances. To limit the number of documents since 2015 the In-Depth Reviews and the Staff Working Documents which assess the policy efforts of a Member State are merged into a single document; the Country Reports. The Country Reports are perceived by many Commission officials as the core building block of the

process. This is where the Commission services argue to what extent imbalances present problems, take stock on what has been done to address the imbalances and discuss what policy directions could be helpful in solving them. For larger Member States, a sub-section of the Report aims to establish an account of potential spillover effects for the euro area. What follows is a decision on the level of imbalances, these levels have varied over the years, but since 2016 comprise four levels: no imbalances, imbalances, excessive imbalances which requires specific monitoring and excessive imbalances requiring the opening of the Excessive Imbalance Procedure (EIP). Excessive in this context means that imbalances jeopardise or risk jeopardising the proper functioning of the Economic and Monetary Union. One could think of external imbalances relating to competitiveness that could risk a sudden stop or reversal of capital flows that can disrupt the financial markets, imbalances that lead to the insolvency of large financial institutions, or inflation divergences that could reduce the effectiveness of monetary policy. Finally, the Semester Country Specific Recommendations (CSRs) – some of which are linked to the MIP - are published and discussed in the Council advisory committees of Member State officials before being adopted by the Council. In the adoption process, the CSRs that are linked to the MIP are discussed in a ‘jumbo meeting’ between the Employment Committee (EMCO) and the MIP’s main driver: the Economic Policy Committee (EPC).

The most controversial part of the MIP is the corrective arm: the Excessive Imbalance Procedure. The EIP is based on the following steps: after a thorough analysis by DG ECFIN, the College of Commissioners may propose to the ECOFIN to place a Member State under the EIP if indeed excessive imbalances are found. After discussion in the Economic and Financial Committee (EFC) – the advisory committee to the ECOFIN Council of high-level Member State officials - the ECOFIN adopts by QMV and following the comply-or-explain rule, a decision opening an EIP. It also adopts a recommendation on the socioeconomic policies to be adopted to correct the imbalances. In this case, the Member State submits a corrective action plan, which should be endorsed by the ECOFIN. DG ECFIN monitors the implementation of the plan and in case of violation, the College of Commissioners proposes financial sanctions – for Eurozone states only – of up to 0.1 per cent of GDP. After discussion in the EFC, the ECOFIN Council decides the sanction by Reversed Qualified Majority Voting (RQMV) (De Streel, 2015).

RQMV gives the Commission considerably more discretion in the application of sanctions, meaning that sanctions are less likely to be voted down in the Council, as happened before with Germany and France under the SGP. Moreover, a sanction can be issued for twice failing to submit a sufficient corrective action plan. What must be clearly noted here is the fact that the sanctioning procedure, as shown by the details above, is not based on non-compliance with a particular recommendation as formulated by the Commission, but on the basis of not

providing a sufficient corrective action plan as formulated by the Member State itself, even if these have to be consistent with the guidelines and time frame as set out by the Council (Art. 8.1 of Reg. 1176/2011). Similarly, the EIP can be abrogated as soon as there is evidence of the correction of the excessive imbalance, so there is an obligation concerning the result, not an obligation to fully comply with the corrective action plan (Art. 11 of Reg. 1176/2011). Both examples show subtle differences, meaning that the MIP still preserves a degree of discretion for the Member State, while still having to comply with the overall objectives of the procedure. This shows a clear difference with the SGP, which has more pronounced rules and criteria defined by the European institutions rather than the Member State and which accordingly can be seen as more prescriptive.

The sanction procedure has been a point of criticism among legal scholars. In EU law a recommendation has always been considered a non-binding instrument, so that a decision of the Council under the EIP for failure to sufficiently address imbalances in a way that is consistent with 'recommended' action could raise serious doubts in the European courts (see quotes by President of the EU Court of Justice Lennaerts in Zeitlin and Vanhercke, 2014: 57). Some question whether sanctions can be activated at all, since these would be based on legally ambiguous concepts such as 'sufficient' action to address imbalances (Moschella, 2014). Yet the legal interpretation of the procedure does not fully capture the context or interpretation of and intentions behind the MIP, as the second part of this section on the MIP's evolution throughout the years will show.

Interviewees do not seem to recall much controversy over the possible application of the sanction procedure when the MIP was still being designed. As technical experts from the Commission explain: *This was the time when we in general were looking for more toughness in our rules* (Interview 8^{*2}). *Everyone agreed that we also needed some bite in the procedure* (Interview 9^{*}). The legal services of the Council, Commission and Parliament (EP) approved the regulation on MIP without much criticism. In the EP – which widely supported the introduction of the MIP - discussions on sanctions focussed rather on whether the Commission would be granted enough leeway by the Council to impose sanctions. Member States were reluctant to see too much discretion in the hands of the Commission; the compromise that was found is the formula on RQMV.

One official close to the ECOFIN Council and Eurogroup, argues that Member States agreed to the sanction procedure because *nobody really believed there*

² Interview quotes marked with a * are my own translation from Dutch to English.

would ever be sanctions under the MIP (Interview 49). Commission officials describe the EIP more in terms of a last resort in extreme cases. *You would need a very solid argument* (Interview 9*). The Commission would have to prove the existence of very clear spillover effects, thus legitimising more forceful European action. An obvious housing bubble that is not addressed could be an example. But as an evaluation by the EFC already concluded, defining and identifying spill over effects proves to be very difficult (EFC, 2014). All in all the sanction procedure seems to function more as a deterrent, so that the procedure is taken more seriously, rather than anything that is likely to be used anytime soon. As ECFIN Commissioner Moscovici summarises what seems to be the predominant view in the Commission: *penalties are a failure, both for the country sanctioned and the body imposing the fine* (Financial Times, 2015).

Discussions at the start of MIP focussed more on other aspects, such as the scoreboard of indicators in the AMR. It brings the state of the Eurozone economy back to a relatively concise table of values and thresholds and thus attracts both political attention and controversy. Initially it was discussed to limit the number of indicators to three, just to give some warning signals and raise political awareness. But as the discussion evolved every country had its own preferred indicator, while downplaying the importance of indicators on which they scored poorly. Italy did not want public debt to be included in the MIP, but the Commission felt that high public debt makes an economy more vulnerable on the other indicators. Germany in general favoured an intergovernmental approach to structural reforms over the MIP, but also did not accept the idea that a current account surplus could be seen as an imbalance. They had to be reassured by the Commission that a surplus would not easily lead to sanctions and only agreed to the MIP when the thresholds were set unevenly (-4% of GDP and +6%).³ As one Council official explains the German view at the time:

I clearly remember Schäuble trying to downplay the role of the MIP. The focus was all on fiscal discipline. And no one really dared to discuss this with the Germans, everybody felt guilty, everyone had their own imbalances which also translated into fiscal imbalances (Interview 49).

While the AMR and EIP attracted much controversy, those that work with the MIP continue to downplay the importance of both tools in how the procedure works in practice. The analyses of imbalances go deeper than the scoreboard and there is more to compliance than a sanction procedure. The MIP includes

³ This asymmetry in thresholds is often criticized by economists, who argue that too much focus is put on internal devaluation in deficit countries, without appropriate revaluation in surplus countries (De Grauwe, 2013). At the same time Germany is criticised strongly by other politicians who interpret the 6% as a European rule (e.g. Italian Prime Minister Renzi in FT, 2015).

multilateral discussions and thematic sessions in the Council and Eurogroup on economic issues that received less attention or were considered taboo before the crisis and every step in the MIP is followed up with bilateral dialogue between the Commission and each state. Some would argue that this is where the real value of the MIP lies, characterizations on the MIP's purpose range from: '*an authority argument*' (Interview 17), to '*it creates a solid framework for a good discussion*' (Interview 5*), or '*we use these types of instruments mainly to open up a dialogue*' (Interview 6*).

This interactive dimension of the MIP (and the Semester as a whole) has evolved over the years. The first year was described by one interviewee as *a purely paper-based exercise* (Interview 16). ECFIN officials would simply read reports and interpret statistics. Given the state of economic crisis in the first years of the MIP the Commission interpreted its mandate as strictly as it could. The first Semester cycle saw many Member States placed under the MIP and for some countries all CSRs were linked to the MIP. At the same time Commission officials were instructed not to give in to amendments on their CSRs in Council Committees. This was not taken well by Member State representatives:

I remember that there were some serious questions on the recommendations and the Commission came into the committee and said "we are not allowed to discuss this". So I thought 'come on, what are we doing here if we are not allowed to discuss?' (Interview 47 – former EPC chair).

This polarisation, so the Commission who felt that the Member States were all bad pupils focussed on doing as little as possible, that was the feeling they gave us at least and consequently the counter response of the Member States was a sense of 'we need to find ways around these recommendations by any means necessary'. This created a very unproductive dynamic. (Interview 25 – Belgian official).*

The top-down approach met heavy resistance and was not effective per se. Member States started calling for 'more leeway' and 'sufficient space' for 'national ownership' (Cypriot Presidency, 2012; Lithuanian Presidency, 2013). Over the next Semester cycles, new elements were added to ensure that the Commission and Member States would be more on the same line. The number of bilateral meetings between the Commission experts and high-level civil servants of Member States was increased. Member States received the opportunity to comment on the Country Reports and discuss these comments in the Council advisory committees. Specific MIP fact-finding missions were introduced, which can also include experts from central banks, academics, social partners and economic institutes, and can be preceded by extensive questionnaires to be filled

out by the Member State. The Commission also set up offices with European Semester Officers in each Member State as a communication liaison. And finally, it is also worth noting that within the Commission and between the Council committees, a more interactive balance has been reached over the years, with better inclusion of the actors on the social and employment side (see also Zeitlin and Vanhercke, 2014; 2015).

A clear turning point in the usage of the MIP has also been the change of the Commission in 2014. Juncker from the start believed in a more political approach, based more on encouragement and dialogue than threats and sanctions: *'You cannot run a single currency on the basis of rules and statistics alone. It needs constant political assessment, as the basis of new economic, fiscal and social policy choices'* (Juncker, 2015a). As one Commission official explains the change:

The former Commission was much more about 'we have the right analysis and if you are open to common sense, you will come to the same conclusion'. This Commission is more about 'we have agreed together on the political direction, so let's now do it'. (Interview 16).

Political in the eyes of Commission officials means that the Juncker Commission uses a more pragmatic approach in the MIP, *with knowledge and feeling for the political context in a Member State* (Interview 8*). *Political means that they recognise that there is no consensus, based on scientific evidence, about there being only one policy option. (...) So when it comes to the politically sensitive stuff it is much more 'hands off'* (Interview 16).

The Juncker Commission has also responded to Council criticisms of an overly prescriptive approach by slimming down the Semester CSRs to key priority issues that are actionable and monitorable within a twelve to eighteen month timescale (EC, 2015b). However, Member States for which more severe imbalances have been identified continue to receive more detailed and time-bound CSRs, with more intensified monitoring on implementation (EC, 2016). Furthermore, in 2015 the Commission found itself needing to explain its flexible interpretation of the fiscal rules of the SGP. In its explanation, the Commission established an explicit link between efforts with regards to structural reforms and decisions within the Excessive Deficit Procedure (EC, 2015). As argued in the introduction, Member States' representatives have welcomed Juncker's more open approach. But where the Barroso Commission was seen as too deterministic, so the Juncker Commission has been criticized as making the Semester more ambiguous, with compliance rates deemed insufficient.

In sum, this section has argued that interpreting the hierarchical character of the MIP from a legal reading of the procedure alone does not fully capture the underlying dynamics and purpose of the MIP. It has also shown that the MIP has evolved over time based on learning-by-doing practices and discretionary engineering within the procedure to adapt to new realities. From a study on the design of the MIP or the surrounding debates in general, however, one cannot reach a conclusive assessment of either the hierarchical character or effectiveness of the more political approach that has emerged over the past years. This requires in-depth case analysis, as the next sections intend to provide.

The liberalisation of professional services in Italy

Italy is undoubtedly a prominent case when assessing the MIP. It is widely seen as experiencing severe imbalances in the economy, most notably the highest public debt stock in the Eurozone in combination with persistent low economic growth. The Italian economy has structurally underperformed compared to other large Eurozone countries since it introduced the euro and has seen a steep decline in GDP during the crisis years. The IMF warned that without significant changes Italy is not expected to return to pre-crisis levels of economic performance until the mid 2020s. Other Eurozone states will have grown 20-25% larger than 2008 by then (IMF, 2016). The prospect of not one, but two 'lost decades' will not only create economical difficulty in terms of servicing the debt or for the already vulnerable banking sector, but also challenge confidence in the political class to deliver results. Some economic commentators fear Italians will ultimately turn against the euro and try to step out of the Eurozone (e.g. Fuest, 2016; Münchau, 2016; Stiglitz, 2016).

Weak productivity growth is widely acknowledged as the root cause of Italy's poor economic performance. Especially Total Factor Productivity (TFP) - the portion of economic output that is not explained by increases in labour or capital, but rather by adopting new technologies or more efficient business practices - has declined by 0.3% on average each year since euro adoption. Productivity in manufacturing in the 1980s and early 90s was well above the levels of Germany and France. But the sectors in which Italy had specialized faced diminishing demand and strong competition from low-wage countries in recent years. The slowdown in productivity predates the euro introduction, so causality is not a given.

Productivity is one of the most difficult economic variables to affect through policy, the functioning of the labour market, educational system, efficiency of the public administration, tax incentives and the banking system are all part of the

story. For Italy this means that all CSRs are linked to the MIP. One segment where productivity has been especially low is the services sector. Accordingly, Italy has been repeatedly recommended to increase competition in services to drive investment towards more productive providers. Tackling barriers to competition in the services sector should be seen as part of a broader package to incentivise a transition towards a more dynamic industrial structure that better allows resources to flow to more productive sectors. This section will zoom in on one aspect of the CSR on competition in the services market, namely the liberalisation of professional services, a recurring policy issue in the Semester's CSRs. For Italy there is a specific focus on three heavily regulated professions in the CSRs: lawyers, notaries and pharmacists.

As with many structural reforms, the benefits of increasing competition are not always directly visible or obvious whereas the costs are often immediately felt. In the case of professions this has resulted in heavy resistance towards the measures from the professional orders, making implementation of measures particularly difficult and thus classifying as a hard case. The position of the European institutions is clear, as exemplified in the conclusion of a special report for the Eurogroup published days after the resignation of the Berlusconi government in November 2011:

To secure broad and lasting support [for structural reforms], the government needs to clearly and convincingly explain the unbearably high costs of failure, pit the benefits to the society as a whole against the unavoidable resistance from vocal interest groups' loath to lose their special privileges, and ensure that everybody contributes to the adjustment efforts with fairness principles (European Commission, 2011; 8).

Like many other European states Italy makes a distinction between regulated and non-regulated professions. But in Italy the orders that control the regulated professions have been particularly powerful and autonomous. Until the first big reform of professional services in 2006 started to erode their autonomy, the orders had a tight grip on the market. They could set qualification standards to control entry, set or recommend tariffs and restrict competitive pricing, the sale of certain products, advertising or business structures such as multidisciplinary firms. For notaries and pharmacists there are also quantitative restrictions, driving up costs for licenses. Many Italians perceive of the professionals as an elite class that enjoys special privileges, a world which is difficult to penetrate for outsiders who do not have the right connections (Carboni, 2015). Liberalisation is meant to open up the sectors, increase productivity and lower prices. At the same time professional orders regard themselves as offering a public service that is not to be treated in a similar fashion as normal firms. "Law is an art, not a trade" is an often-heard argument in these debates. Finding a good

communicative narrative on how seemingly detailed measures related to issues such as the ownership of law firms fit a broader productivity strategy has been a big challenge for Italian politicians.

Repeated efforts by politicians to open this restrictive environment faced heavy resistance, often proposals were delayed in parliament and discarded when the government changed (Micelotta and Washington, 2013). But following the EU Services Directive (2006/123/EC) the pro-liberalisation Prodi government managed to break through the protests and introduce a series of services liberalisation, including on professions. These liberalisations made Italy jump significantly in the OECD Product Market Regulation index and stand out as one of the biggest de jure reformers of that period. But the PMR score measures legislation only. De facto the reforms faced difficulties in implementation and there was still significant room for further liberalisation, although there was clearly some success from the reform (OECD, 2009; Pagliero, 2015).

In the summer of 2011 the ECB's President Trichet and President-elect Draghi took an unprecedented step of sending a confidential letter to both Italy and Spain with a list of reform suggestions.⁴ For Italy the letter mentions increasing competition in services as a key challenge and calls for the full liberalisation of professional services. The central bankers were worried about the steep rise in interest rates in the bond markets and expected both countries to come up with a legislative response. The letter makes no mention of the ECB's Securities Market Programme by which the bank can directly intervene in secondary markets to calm the rise in interest rates. However, to all relevant players it was obvious that the reform list represented the conditionality attached to this programme as the ECB held off on its decision to invoke the programme while waiting for a response from both countries (Sacchi, 2015). The Eurozone leaders ended up accepting the response of the Berlusconi government after months of negotiation in a crisis summit on October 26. But by then markets had lost all confidence. Italy found little demand for its paper in the market and investors also started turning against the some of the larger banks. As is commonly known, this led to the downfall of Berlusconi and the instalment of the technocratic Monti government.

The new 'national effort Government' – consisting of non-party affiliated technocrats - enjoyed an exceptional majority in parliament with all major parties apart from Lega Nord supporting it. This created a unique reform momentum where initially *no one would even dare to say no to Monti's proposals*

⁴ The letter was later leaked and published in the newspaper Corriere della Serra of 29 September 2011. (See also Financial Times, 2011)

(Interview 32). Shortly after its instalment the Monti government introduced a significant set of reforms that calmed the markets, based on three package-deal decrees: 'Salva Italia', containing measures to ensure financial stability and 'Cresci Italia' and 'Simplifica Italia', both focussed on measures to enhance growth. The three packages represented more elaborate and bold plans for reform than seen during the Berlusconi days, including on the liberalisation of professional services. But the effectiveness of measures is dependent on the details in the few hundred legislative acts that are needed to implement these decrees.

In 2012 when the MIP was first introduced, Italy was simply asked to implement and adopt the liberalisation measures. It is clear from the documents that Monti received strong support from EU institutions and his approach is praised as determined and wide-ranging. The focus on implementation by the Commission was not wholly unfounded. Monti was governing a very large coalition with very different policy positions and when the risk of default started to wane political division started to play a role again. Especially the centre right – which was in the majority in the parliament - adopted an increasingly oppositional stance towards liberalisation measures. After a year of Monti government less than a quarter of measures from Cresci Italia – the decree with most liberalisation measures – had been implemented (Il Sole 24 Ore, 2012). It took parliament a year and five months to pass all the legislative acts with regards to professional services. In the meantime the parliament managed to significantly adapt the proposals.

Monti at first had been reluctant to water down his measures and had also refused prior consultation with the orders. But this strategy turned out to be based on overconfidence. When Monti ignored a letter sent to him by Federfarma (representing almost all pharmacy owners) and signed by 73 MPs, which described the liberalisation measure as a very serious sign of unreasonableness he was taken by surprise when Berlusconi's PdL managed to push forward an amendment that forced the government to accept a watered down version of the proposals. After this incident the Monti government had to take a more conciliatory approach towards the professions and accept more watering down of the proposals. The most serious setback from a pro-liberalization point of view came a few days after the fall of the Monti government in 2013. A bill (Law 247/2012) was passed by parliament giving self-regulatory power back to the order of lawyers. The bill re-centralized power back to the National Bar Association and away from local orders. It backtracked on the freedom of comparative advertising on price established under the 2006 reforms and contained new restrictions to enter the Ordini. As long-time Senator and lawyer Ichino explains the debates at the time:

They [the lawyers] do not recognise this problem of productivity I think, they don't accept this field of discussion. (...) The Bar Association has a particularly strong position in parliament, there are a lot of lawyers in parliament. I was fiercely against this bill and was seen as a traitor, because I was against something that all the lawyers were supporting. All the lawyers were in favour, in a bipartisan way, left wing and right wing.
(Interview 36)

Monti's government managed to adopt a number of liberalisation measures on professional services, but not sufficiently in the eyes of the Commission. Over 2013 the Commission acknowledges that 'some progress' is made, but continues to uphold the CSR in a call for more ambition. Interviewees explain that deliberate decisions were made at the time to spend all political capital on issues with immediate effects to calm the markets, such as the pension reform. And while officially the MIP does not prioritise certain reforms over others it was clear to insiders that Monti had strong support in his approach from Brussels. *Monti was considered by the European institutions as their guy* (Interview 29) and the working relationship between the Italian and European institutions at the time was described as *excellent* (Interview 47).

This was not the case for the government that followed. The elections of February 2013 created a hung parliament with only a slight majority for the centre-left coalition over the centre-right and the strong rise of the new Five Star Movement. The Letta government that followed clashed repeatedly and publicly with the Commission over budgetary room for manoeuvre. Letta himself described the pressure of the Commission on budgetary issues as *too rigid, without any flexibility*. But the SGP framework was also very important for his government. It acted as a useful external constraint to *avoid the assault, the attack of lobbies, parties, to get money, because 2013 was the year when we started to say: 'now the worst is behind us, now after three years of tightening the belt we have to re-give money to people'*. But we avoided doing this too much, because we needed to keep the budget under control (Interview, 46 - Letta).

The Commission had also become sceptical of the decrease in reform momentum. The In Depth Review of early 2014 clearly strikes a different tone than previous documents. Italy is criticized for a slow pace of reforms and sluggish implementation and called upon to 'decisively step up the pace of reforms' (EC, 2014a: 10). It concludes for the first time that Italy was *experiencing excessive macroeconomic imbalances, which require specific monitoring and strong policy action*. This step, whereby excessive imbalances are identified but no sanction procedure is opened, did not exist before. It was introduced as an alternative to opening up the sanction procedure for Italy. The ECB and a number of Member States had argued for opening a sanction

procedure, but there was never sufficient support for such steps as this was seen as too politically sensitive and not yet justified. The Italian government never felt any credible threat, arguing that if Italy were sanctioned, France should be sanctioned too.

The idea behind specific monitoring was, as a Commission official explains *to make the government feel that we are really insisting. We come and check in once every few months* (Interview 28). In the 2014 period there was a mission almost every month and in the meantime the Commission wanted to be informed on all sorts of other steps. This put strong pressure on the administration, which struggled to find enough resources to cope with the required information. The amount of missions was perceived by the Italian officials as overburdening, as assessment over assessment. The step is too bureaucratic to really have an impact on politicians, who in general are not very much aware of the existence of the MIP. There seems to be merit to close monitoring and stocktaking in a political situation where implementation of reforms seems to be particularly challenging. But as a real pressure tool the added value of additional monitoring missions is highly questionable. As explained by one interviewee:

... we were already under close monitoring of European institutions and other partners, it is as if you feel that you are the kid being disciplined by the parents, you already know that they are checking on you. Then they say 'now we are going to really really check on you', you were already checking on me, what's this? (Interview 32, political advisor to Renzi)

The additional pressure on Italy was also never really tested. Soon after the Commission's critical assessment, the government changed colour and Renzi became the new Prime Minister. The National Reform Programme that followed contained a wide set of new reform proposals and for the first time included a clear schedule and deadlines. In response the Stability Programme asked for a two-year extension of achieving the budgetary medium-term objective. The subsequent Commission assessment remains highly critical of the lack of progress on the 2013 CSRs, but concludes that the new NRP presents a comprehensive, ambitious and time-bound plan for action and thus gives Renzi the benefit of the doubt and considers the budgetary flexibility justified (EC, 2014b).

On professional services the Renzi government introduced a competition law to re-start the process of liberalisation, but the law faced a similar fate as previous attempts. Significant changes were made in parliament leaving the initial drafters and supporters of the bill disillusioned: *If I were the Commission I would be disappointed* (Interview 31 – public official). *The bill was a pretty good bill in the beginning, but it was emptied by amendments, now it should be rewritten, the*

way it is now it does not make sense (Interview 36 – Senator). Conscious about the opposition to his initiative Renzi was convinced it would be better to focus on changing the Constitution first. Under Article 117 of the Italian Constitution the regulation of professional services is attributed to the regions, which significantly increases the number of veto points to get liberalisation laws adopted. The new Constitution would attribute competence on professional services to the central state. The Commission was sympathetic to this position, as Renzi was able to deliver reforms on a number of other policy areas, most notably with the Jobs Act. But with Italians voting against the new Constitution in December 2016 and the growth of Total Factor Productivity projected to be almost fully unchanged, even slightly negative until 2019 (MEF, 2016) interviewees expect a renewed focus on liberalisation measures by the Commission in the future.

Despite Italy remaining in the excessive imbalances category of the MIP exerting real pressure remains problematic. For a long time Europe played an important role in Italy's path of structural reforms as so called 'vincolo esterno', a useful external constraint that helped isolate Italian politicians from domestic opposition (Jones, 2017). But with Monti things slowly started to turn towards the exact opposite. The reforms and austerity had a heavy toll on Italians without clear results in terms of economic growth. Over the course of the crisis the role of the EU has slowly become suspect in the eyes of Italians. When Berlusconi pulled the plug on the Monti government he argued for example:

The technocratic government is finishing today and we hope there will no longer be a suspension of democracy. (...) Monti has bowed down in front of EU requests, particularly those of the 'German European Union' of Northern Europe, which only lead to recession (see e.g. Inquirer, 2012).

In the days of Monti or even Letta, some Europhiles would argue for reforms in the general public policy debate with slogans like 'Europe asked for it' 'we have their backing'. But this rhetoric had to change to 'Giovanni asked for it' (the Italian version of Joe the Plumber), since opposition parties started making a distinction between what Europe wanted and what was in the interest of Italians. Step by step rhetoric kicked in that glorified the years before euro introduction when the Italian economy grew fast. People start looking for a symbol to blame and the European institutions or the euro are an easy target. For example, by leading Five Star Movement politician Di Battista:

What I know are the consequences of the introduction of the euro: the loss of purchasing power, the decline in wages, the reduction in competitiveness, the social degradation and unemployment. (translated from German, Die Welt, 2016)

The change in political rhetoric in part explains Renzi's more confrontational stance towards the EU. In the words of one of his advisors: *it does not buy you credit vis-à-vis the political community to show that you are compliant with Europe, maybe with the 5% that voted for Monti, but certainly not with the public at large* (Interview 38). It further underlines that the Commission in the MIP is only as strong as the legitimacy that is given to it in the domestic environment. The Semester was taken very seriously when it was introduced, but the leverage role of the Commission has worn off and is now seen as alien in the eyes of part of the public. As Letta explains how pressure worked in his time and now:

At that time the pressure was there, with sanctions, not formal sanctions, but political sanctions, this means it was a period in which an interview with a Commissioner saying that Italy was not doing its homework was terrible in terms of reputation for the country. Today this is different. Europe is not so popular, so there is no political sanction by a letter like that or an interview like that. But at that time it was important, so the agenda of the government was conditioned by this attitude. And yes this has changed completely now. (Interview 46)

With the CSRs only very indirectly affecting reforms in Italy and even having counterproductive effects in the political arena, the question becomes whether there is any added value to the MIP in Italy? The answer is that this added value seems to be mostly technocratic and related to the Semester at large, rather than the specificities of the MIP. For example in terms of administrative capacity, all interviewees who worked within the administration felt that – despite flaws and risks – it was important to continue monitoring Italian reforms. The number of missions was criticized, but the missions themselves and the sequencing of the Semester and its documents such as the National Reform Programme were seen as a clear improvement with added value for the administration. Codogno, who was responsible for the technical drafting Semester documents, describes policy coordination in Italy before the Semester (Lisbon process/ OMC) as not very compelling and with difficulty to get the attention of directorates in the administration or Ministers themselves, let alone wider public attention. But this changed completely in 2011.

It changed completely when it became part of the Semester. The Semester to me is extremely important, it may seem stupid but having the same time schedule, a budgetary schedule in Europe and on reforms and having an organised discussion on this, this was a good change. Let's face it, this was extremely important. (...) This process to some extent forced the different

parts of the administration to be aligned, so basically it was a way to get everybody involved. (Interview 47)

When it comes to the liberalisation of professions, the added value seems to lie in keeping the issue on the agenda. This is a reform without a lot of obvious political incentives, as it will not lead to electoral support in the short term, nor is it likely to attract much positive media attention, while it will make direct enemies in parliament and civil society. Because of these reasons, having an external institution like the Commission include this type of reform in the broader strategy of productivity-enhancing reforms, with facts and figures on growth potential is therefore seen as an important contribution. As one ministerial official involved with competition summed it up from his point of view:

Without the EU there would not even have been discussion in the past ten years on liberalisation in this field, now at least we talk about it. (Interview 31)

The Belgian practice of automatic wage indexation

Many economists believe that the EMU needs some sort of monitoring and coordination of wage developments to counter diverging trends and since members of a currency union lack other adjustment mechanisms (exchange rates) in times of economic distress (e.g. De Grauwe, 2016; Höpner and Lutter 2014; Sapir, 2016). Eurozone leaders have identified imbalances caused by diverging wage trends as having played a key role in causing and aggravating the euro crisis, albeit not the only factor (Juncker et al., 2015). But discussing wage developments at European level has always been controversial as this is seen as the sovereign domain of social partners. ECB President Trichet was known to carry charts on Eurozone countries where wage rises did not match productivity and continuously warned European leaders about the dangers of these developments, but before the crisis this had little effect. Article 153.5 of the TFEU explicitly states that the issue of wages is outside the scope of EU competences, a clause deliberately introduced at the start of EMU.

Despite its controversy wage developments were widely discussed in the early days of the crisis. In 2011 European leaders concluded the 'Euro Plus Pact', an intergovernmental Pact, which stipulates that wages should evolve in line with productivity and calls for reviewing centralisation and indexation in wage-setting mechanisms. The status of the Euro Plus Pact is unclear; it was once described by a Commission official as like the parrot in Monty Python: 'we don't know if it's dead or just sleeping'. As a result, the MIP can be seen as the primary mechanism for smoothing diverging wage trends. At the same time the

Regulation on the MIP is cautious about too much interference. Recital 25 states that the Commission 'shall fully respect the role of social partners and differences in systems of wage setting' and Article 1.3 states that the MIP 'shall not affect the right to negotiate, conclude or enforce collective agreements' (Reg. 1176/2011). Despite these legal safeguards, wage developments and wage-setting practices have featured prominently in the European Semester and the MIP (see e.g. Schulten and Müller, 2014).

Belgium has received a recommendation on wage developments and its system of wage setting in every Semester cycle. The Belgian case is especially interesting since the CSR has over the years focussed both on bringing wages into line with productivity and on decentralisation of collective bargaining. Belgium is asked to reform the competitiveness law to make sure that corrective measures can be taken and that companies can derogate from the central wage agreements. Accordingly, this CSR can be seen as one of the most prescriptive recommendations on wages. The criticism is primarily focussed on the practice of automatic wage indexation, whereby wages automatically follow cost-of-living trends for almost all sectors, thus preserving purchasing power against inflation.

Most Member States abolished the practice of automatic indexation in the 1980s and have decentralised bargaining arrangements to varying degrees. Indexation would leave an economy vulnerable to wage-inflation spirals, which since the rapid rise of oil prices in the 1970s led to increased opposition to the practice of automatic wage indexation. At the start of EMU the system again received heavy criticism, countries with indexation practices were seen as having structurally higher inflation rates, thus impairing the common inflation target of the ECB. In response to these discussions the Belgian government in the 1990s introduced safeguards to ensure that wages and inflation would not fall excessively out of line. Indexation was to be based on the Health Index, which excludes price changes in alcohol, tobacco, petrol and diesel. And a framework to preserve competitiveness was introduced: the wage norm.

The wage norm – based on the Law of 1996 - is a biannual national standard for the maximum real wage increases negotiated at sectoral level. The wage norm is based on a forecast of weighted rises in nominal hourly labour costs in Belgium's three main trading partners (France, Germany and the Netherlands). As such, it aims to preserve competitiveness by ensuring that wages do not evolve out of line with neighbouring countries. So wage bargaining at sectoral level should fall between the index and the norm. The indexation is however guaranteed, even if this means the wage norm will be exceeded (Art. 6.2 in the 1996 Law). Despite the 1996 Law, the Commission figures show that the wage gap with neighbouring countries grew much wider during the period 2005-2010. During this period, Belgian wages rose faster than the EU average, while at the same

time the average wage growth of the three neighbours was well below the EU average. Part of the wage gap can thus be explained by wage moderation⁵ in these countries (especially Germany), but the effects on cost competitiveness with the main trading partners is visible nonetheless. Higher wage growth in itself is not necessarily problematic. It helped preserve demand in the early days of the crisis in Belgium, as the indexation mechanism acted as an economic stabilizer. But if continued high wage growth is combined with low productivity growth (even if Belgium has a high overall productivity level), competitiveness will slowly deteriorate, external imbalances will increase and employment will suffer. The trend of slow deterioration of competitiveness warranted the opening of the MIP and a CSR that calls for more flexibility for firms to deviate from the index on the basis of productivity differentials.

This recommendation did not go down well in Belgian political circles and was interpreted as a call to fully abolish automatic wage indexation like other countries had done in the 1980s.

Politically the first CSRs were seen as a full frontal attack on the Belgian social system by the ECB and the European Commission (Interview 19, public official).*

The first reports were absolutely not well-received, it was very one-sided and based on the fetish of DG ECFIN [considering automatic wage indexation as flawed] (Interview 23, trade unionist).*

The response was like 'they are meddling top-down in our social model'. And you saw immediately that these recommendations were used politically by the right-wing parties who framed the recommendation as a binding norm that should be implemented blindly. (Interview 25, advisor to Di Rupo)*

At the time, some actors believed that the Commission and ECB were on a crusade to diminish the power of trade unions. A 2012 DG ECFIN study had for example created a lot of bad blood by suggesting that reforms leading to better employment outcomes would include ensuring that wage bargaining would be organised in a 'less centralized way', with reforms possibly resulting in 'an overall reduction in the wage-setting power of trade unions' (EC, 2012a; 104).

Automatic wage indexation has been a widespread practice since the 1920s and is widely seen as an essential pillar of the Belgian social model. The indexation

⁵ In the 2017 Annual Growth Survey the Commission criticizes not only Member States whose wages have outgrown productivity developments, but also states where too modest wage developments lead to weaker aggregate demand (EC, 2016).

practice has over the years been heavily defended by the trade unions. The Belgian trade unions have a strong position in the state structure; they cooperate and enjoy wide support. They are divided along ideological lines (Christian, Liberal and Socialist), rather than along regional lines (Flemish and Wallonia), which gives them additional legitimacy to counter divisive trends in the Belgian state structure. The system of indexation gives the trade unions a nation-wide negotiation baseline; from there, they can negotiate additional top-ups in collective agreements, giving them an advantage over the trade unions in e.g. Germany or the Netherlands. Besides, it is seen as an important element of solidarity, since it also applies to sectors that have less bargaining power. Most political parties dare not touch the index and even employers want to focus on how to make the system work rather than abolishing the practice of wage indexation as such, *for strategic reasons* (Interview 20). In the domestic debate (so excluding Commission, OECD and IMF) until the crisis no studies can be found that argue for radical changes to the index (NBB, 2012/Annex 6). As one interviewee sums up the position of the Belgians:

The internal debate for many, many years has been 'no one shall touch indexation', you can change the name, so what does indexation mean, but indexation as such should stay, this has not really changed because of anything. This is the holy cow, you shall not touch indexation (Interview 22, public official).

Belgium tried to change the CSR so that the part on wage indexation would be taken out and the recommendation would focus on competitiveness more generally, but failed to find support. Prime Minister Di Rupo even brought the issue up to European Council level, which is very rare, but it did not help his case. Many Member States follow the line of the ECB in claiming that indexation does not contribute to a well-functioning EMU, because of its inflationary effects. Belgium has continuously tried to argue that due to its size, spillover effects would be small, but the support for changing the recommendation was very low. One interviewee described discussions in the Council Committees where the ECB would be the first to be allowed to speak and would heavily argue against automatic indexation and other representatives speaking afterwards simply adopted the language of the ECB. Other representatives indeed admitted that they value the role of the ECB in Council Committees. They are seen by some to have the best-informed position due to their extensive research services, but they rarely find a lot of support for their proposed amendments to CSRs.

The recommendation was however not without its effects. The Di Rupo cabinet organised several thematic sessions around cost-competitiveness in Belgium and asked advisory institutions to come with a thorough analysis on the competitiveness of Belgium (NBB, FPB and CRB, 2011). The analysis of a loss of

competitiveness was widely shared among Belgian policy-makers, but the explicit link with wage indexation has been controversial. The idea was to come to a more fact-based debate, as the Belgian officials found the Commission's academic underpinnings thin and biased. The Di Rupo government told the Commission that they had a strategy to limit wage growth without touching indexation, but they needed time to achieve the desired effects. The Commission granted this flexibility, but remained of the position that it would be better to address the source of too high wage growth. Therefore it continued to issue CSRs on indexation in a sharp tone, claiming Belgium made 'limited progress' on the issue. The tone led to annoyance in Belgium as the Di Rupo government felt it was already taking significant steps, leading to social unrest and street protests.

At the same time the Commission realised its heavy criticism on the indexation practice was falling on deaf ears and it was time to change tactics. From 2014 onwards the tone in documents is more nuanced and in 2015 the word 'indexation' is taken out of the CSR, like Di Rupo had wanted all along. This step can be explained by the fact ineffectiveness of the previous strategy, but also the installation of the 'political' Commission Juncker, which decided to take a more distant approach towards politically sensitive topics. With Juncker himself coming from Luxembourg – which is one among the few countries that has automatic wage indexation – and the Social Affairs Commissioner coming from Belgium, it is not unlikely that this 'politicisation' has played a strong role.

However, what also has become quite clear in the interviews is that the interaction between the European institutions and Belgian actors has played a role. Several interviewees have described a more open attitude and wider policy focus in discussions from both sides in later years. In technical meetings the experts would discuss the effects of indexation in two to two-and-half hour sessions and political discussions were held with the Cabinet of the Prime Minister. Some note that there was even some convergence of positions towards the end of the Di Rupo government, with the Belgians becoming more willing to discuss the negative sides of indexation and the Commission becoming more open towards the positives.

The perception of the problem has changed from two sides, also from our side, especially in the recommendation, it has become more diplomatic, more neutral. There was too much focus on indexation.' Or, 'I think initially five or six years ago, it was 'wage indexation, it is a no-brainer, it does not make sense' (...) So also from our side it has evolved, we have more emphasized that it effects employment, the adjustment of your economy (Interview 17 – Commission official).

Opening up the recommendation in 2015 has made it much more effective, it has opened up the negotiation and find a common solution, politically (Interview 24 – Belgian official).

What certainly altered the impact that the recommendation had on the Belgian debate was the change of government in the fall of 2014. In the new Michel government, the socialist parties were replaced by the Flemish right-wing N-VA party. The N-VA made a strong case for a change of course on socioeconomic issues, with reforms to enhance competitiveness as a primary aim. It is important to understand that the N-VA came into existence to establish a reform of the state to ensure more independence for the Flanders region. In the Michel government, they did not manage to secure any major concessions on state reform, which makes a clear change of course on socioeconomic issues all the more important to preserve their electoral base. For the substance of these economic reforms the N-VA leader Bart de Wever in his policy-outline document during the formation of the government cites all the 2014 CSRs for Belgium literally and calls upon the new government to implement these (De Wever, 2014).⁶ Such a move would likely lead to strong opposition in less Europhile states.

To close the wage gap with neighbouring countries the Michel government enacted a so-called 'index jump'. The index jump is a one-off corrective measure comprising a temporary suspension of all wage indexation agreements until inflation has eroded real wages by 2%. In terms of cost competitiveness and lowering unit labour cost (ULC) growth, it did its job. The 2016 Country Report notes a flat ULC growth in 2014-2016, which in combination with more dynamic growth in other countries has resulted in a narrowing of the wage gap (EC, 2016b). The Commission never recommended an index jump specifically; for them the preferred solution has always been a reform in the broader context, this meant reforming the Law of 1996. But, since overall trends were correcting, even if done by other means, Belgium was taken out of the MIP.

This decision to take Belgium out of the MIP was celebrated by the government as a sign that Belgium is on the right path. The government had trouble explaining what they were doing, as their measures are arousing heavy protests. Being taken out of the MIP is seen as that their work is bearing fruit. Especially for the N-VA this is an important political signal to show the difference with the previous government, which is precisely the message they want to get across (Interview 27, N-VA official). It has to be born in mind that the Michel

⁶ In reality he would focus primarily on the parts of the CSRs that were in relative accord with the view of his party, such as pension reform, wage setting or in part the tax shift away from labour.

government (and especially N-VA) is in a difficult position on other right-wing issues: Belgium in 2016 experienced a relatively large influx of asylum seekers which created a lot of tension and the budget deficit increased in 2016, whereas it decreased steadily under Di Rupo.

However, the real concern has always been long-term sustainability and thus a reform of the Law of 1996. With the Di Rupo government also promising a reform of this law, but never sufficiently delivering, the Commission's decision to take Belgium out of the MIP before a definitive deal is struck was taken badly by a number of Member States. They feared that this would relieve Belgium of the necessary pressure to reform indexation. Interviewees however stress that despite the decision to take Belgium out of the MIP pressure is still very much felt.

So they took Belgium out of the MIP now, because it is clear that we will be back in if nothing happens. The Commission and the EFC gave off this warning.' .. it creates strong pressure on this government and it is really the first time that I see that, that the pressure is so strong (Interview 24).

This decision by the EFC puts the Commission in a position of leverage in which peer pressure is more effective than in other cases. It is clear that it would be a very bad political sign for the government if they would be put back into the MIP. And this puts pressure on the negotiations to come to an agreement. In the fall of 2016 Belgium had to come with its Draft Budgetary Plan for 2017 in order to meet the deadline for the budgetary scrutiny of the Two-Pack regulation. In May 2016 Belgium had just managed to escape the opening of an Excessive Deficit Procedure. The so-called Article 126(3) TFEU assessment, the first step in the EDP, had given Belgium leeway due to structural reforms being implemented that would benefit public finances in the long-term, primarily the pension reform. But for the following year it was clear that Belgium needed to put in an extra fiscal effort (EC, 2016a).

Ahead of these budgetary negotiations it was clear to the government that they needed to come up with a broader story than just fiscal cutbacks. A reform of the 1996 Law would be the most prominent on the agenda. One interviewee who was closely involved in the negotiations over the 1996 Law argues that there is a clear link between the budgetary assessment of the Commission and the planned reform:

So they say to the government on the law of '96, if you book that, we will be less problematic with the budget. (...) I am sure that the Commission in another situation with another government would never do that, because it would change nothing. But it means that we are now in a situation where the Commission also analyses the political situation in a country. (Interview 24 – public official)

This link is all the more curious given the fact that the assessment of the Commission in autumn is a purely fiscal one, de jure efforts on structural reforms have no place in the autumn assessment. If a Member State's budget shows significant deviation from the planned adjustment path, it is deemed at risk of non-compliance with the provisions of the SGP and a new assessment follows in spring on whether or not to open up an EDP, the Article 126(3) TFEU assessment. Only in this later assessment are growth-enhancing structural reforms, i.e. those that improve the public finances in the medium term, included in the assessment of whether to escalate or de-escalate within the procedure. Formally the MIP and EDP are separate procedures (apart from the indirect link in the Article 126(3) TFEU assessment). A Commission official denies the existence of a de facto political link in the autumn assessment, arguing instead that this is political rhetoric on the Belgian side (Interview 48). But while the autumn assessment is a purely fiscal one made and published by the Commission services, the Commission (this includes the College of Commissioners) also adopts a resolution on the basis of this assessment by the services, which in turn is discussed by the Eurogroup. With the adoption of the Eurogroup as requirement one can easily imagine that political considerations play a role in decisions on the EDP. As evidenced by this explanation on the context of the previous quote:

It was said in a bilateral meeting; it was also the first time in a meeting between the government and the Commission that the desk experts were not present. It was only the political level and the Commission, from the EU it was people of the EFC and the SecGen. They will perhaps not recognise it, but for the government it was very clear. (Interview 24 – public official)

Other interviewees in Belgium seemed to have a similar impression on linkages between the EDP and the MIP, for example:

I think they will give their approval to the budget, but then we have to show that we are serious with our structural reforms, and that of course includes the reform of the 1996 Law. (Interview 27, N-VA official)*

In October 2016 the Michel government agreed on a new budget including a reform of the Law of 1996. As argued in this section, the budgetary pressure and Commission CSR on the law had been influential in the negotiations. The reform did not abolish indexation, but the new law allows for better correction to ensure that a new wage gap does not emerge in the future by making the wage norm stricter. These new safeguards sufficiently satisfied the Commission, which concluded that Belgium had achieved 'substantial progress' on the CSR (EC, 2017). This in practice means that the CSR will be taken away in future Semester cycles. Interestingly enough, the Commission assessment on the budget shows

no traces of a political link between budgetary flexibility and the reform of the 1996 Law. The autumn package included 3 billion euro in additional savings, but the Commission concluded that Belgium is at risk of non-compliance with the provisions of the SGP so a 126(3) TFEU report is warranted (EC, 2016c), a clear setback for the government. But, hopeful about the more holistic spring assessment (which includes efforts on structural reforms), the Minister for Budgetary Affairs Wilmes promised: 'For 2017 Europe will look with a more favourable view at our country' (De Standaard, 2016a*).

Concluding remarks

The Macroeconomic Imbalance Procedure represents the most far-ranging integrationist initiative in the realm of socioeconomic policy-making so far. The MIP recommendations touch upon some of the core competences of Member States, where EU involvement by nature is sensitive. For this reason the procedure deserves the attention from European integration scholars as it offers valuable lessons on both the necessity to address the consequences of national policies within a currency union, as well as the limits and difficulties of EU integration in this domain.

This paper has shown that we should not perceive of the MIP as a top-down compliance framework. The analysis also shows that a more intrusive approach in the MIP is problematic, as the EU itself becomes part of debates along domestic political alignments. Structural reforms are highly contextual and involve long-standing debates. In Italy politicians have to downplay the significance of EU involvement in the public debate since the perception of their involvement has become an argument for politicians and interest groups to argue against certain reforms. In Belgium an overly prescriptive approach led to fierce resistance from politicians and trade unions and the Commission's argument that wage indexation as such is problematic failed to convince even those who stand favourable to other reform in this area. It is questionable whether the EU should want to play an overly prominent role in domestic debates as the European institutions do not seem to have the capacity to assume the policy consequences of their recommended action. This should be a basis for caution when arguing for forms of automaticity in compliance, such as a stricter use of the sanction procedure. This argument also holds for currently debated innovations; such as making access to the EU budget partly conditional on implementation of recommendations or to access to any form of solidarity mechanism/fiscal capacity.

Given these political dynamics it is also important to remove the perception that indeed the MIP has acted as a very hierarchical procedure in recent years. The

Commission interpreted its mandate with a degree of rigour at the start of the Semester, but this has changed over time as the Commission became increasingly aware that it has to balance in a fragile economic, social and political equilibrium. The role of the Commission has changed over time based on learning-by-doing and the instalment of the Juncker Commission, which has introduced a more political approach that takes better account of local context. This evolution over time has gone hand in hand with the development of the interactive dimension of the procedure. Actors see the increase of discussions with the Commission as useful. The bilateral meetings also force officials, both within ministries and in the Commission, to come to a consensus view on policy issues and brief higher-level officials on the state of reform. Discussions in these bilateral meetings, technical meetings as well as thematic sessions in Council advisory committees can help in the uploading and downloading of policy ideas and best practices and also lead to a better understanding of each other's positions. It seems that indeed non-hierarchical features such as deliberation remain important. The development of the interactive dimension should also be seen as recognition that the strength of the MIP lies perhaps more in its contribution to keeping issues on the agenda. It can help in creating a sense of urgency on imbalances and ensure that various actors are aligned around policy priorities, rather than exerting direct power over the design and implementation of reforms. Additional monitoring missions for countries that experience excessive imbalances are also seen as more effective around these purposes than as tools of political pressure.

All in all the role of the sanction procedure seems to be limited and pressure should be understood more in terms of political pressure and reputational damage, rather than legal coercion. Characterizations of the MIP as technocratic dominance or as displacing democracy seem either dated or misplaced. Reputational damage is not soft per se: interviewees in Italy describe that political pressure from the EU institutions was felt strongly when the EU considered reform momentum to be slowing down. Belgium is a more clear cut case in this regard, in the budgetary negotiations of the government it was clear to political players that they could be placed back into the MIP if the compromise did not also include a reform of the law on indexation practices. As a political signal this would have been considered damaging to a government that prides itself on a good record in terms of competitiveness-enhancing reforms. This discussion proves that hierarchical elements (albeit not legal coercion) can thus be both effective and counter-effective depending on domestic factors. Determining these factors with more precision will be one of the key challenges in my PhD.

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