

Is the European Semester effective and useful?

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Executive summary

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WE STUDY WHETHER and to what extent EU countries implement recommendations on macroeconomic imbalances given by the EU in the so-called European Semester. We assess how recommendations have evolved since 2013, based on a new database. We also study how EU recommendations on addressing macroeconomic imbalances compare to recommendations given by the International Monetary Fund.

OVERALL IMPLEMENTATION OF recommendations by EU countries has worsened in the last few years, in particular when it comes to recommendations addressed to countries with excessive macroeconomic imbalances. The policy content of the recommendations is broadly aligned with economic priorities emphasised by their corresponding legal bases, but to our surprise a sizable share of recommendations, such as on childcare, are also labelled as relevant for resolving macroeconomic imbalances. Moreover, for countries with macroeconomic imbalances, the IMF tends to emphasise financial imbalances more frequently than the EU. We also note that the EU makes significant political choices about which imbalances are judged to be excessive and which are judged not excessive.

LOW IMPLEMENTATION IS likely a result of the fundamental dilemma facing the EU. National policies have major cross-border implications making coordination important, but countries take sovereign decisions mostly based on national considerations. We therefore argue that recommendations given in the context of macroeconomic imbalances should be focused on key issues of macroeconomic and cross-border relevance. Moreover, we note a significant gap between analyses as described in the recitals of recommendations and the actual recommendations, and would urge greater consistency. Finally, the European Semester exercise is very difficult to digest and communication of key analyses and recommendations could be significantly improved to make them more accessible to national policymakers.

Introduction

Since 2010, the European Semester has been the framework for the coordination of economic policies across the European Union. Through the semester, EU countries discuss their economic reform and budget plans and the European Commission monitors progress at specific times throughout the year. The European Semester aims to ensure sound public finances, prevent and correct excessive macroeconomic imbalances, foster structural reforms and boost jobs, growth and investment. To meet these objectives, every year the European Commission prepares recommendations for each member state on the basis of detailed country-specific analyses. The Council of the EU subsequently modifies – if necessary – and adopts the Commission proposals for these country-specific recommendations (CSRs). National governments are then supposed to implement them. The process has become the key EU mechanism for steering and guiding member states' fiscal, macroeconomic and structural policymaking.

The European Semester incorporates three separate processes that work in parallel:

- Fiscal surveillance based on the Stability and Growth Pact (SGP), which the EU tried to strengthen significantly with a number of new regulations that came into force in 2011 and 2013.
- The so-called Macroeconomic Imbalances Procedure (MIP): The starting point for MIP was the realisation that large macroeconomic imbalances built-up in the euro area in the pre-crisis years and the EU lacked instruments to even monitor such imbalances¹. The unwinding of such imbalances was placing a huge strain on the euro area, and the EU therefore put in place the MIP regulation in 2011 ((EU) 1176/2011) to correct imbalances².
- Coordination of EU countries' economic and employment policies, as foreseen in the Treaty on the Functioning of the EU (TFEU) based on the integrated guidelines, a loose form of policy coordination³.

This Policy Contribution evaluates member-state implementation of the country-specific recommendations (CSRs) focussing on macroeconomic imbalances. We find that overall, implementation has been modest but has worsened in recent years. In particular, implementation among countries with excessive imbalances has fallen significantly. Implementation rates vary substantially for different countries and policy areas. Finally, the multi-annual assessment shows that the implementation records of some countries improve when looking at a longer period, but implementation is overall still weak.

We also assess the policy content of CSRs. Recommendations made under the MIP regulation are often irrelevant for macro-financial imbalances and rather relate to the loose policy coordination framework. Moreover, a comparison between the CSRs addressed to countries with macroeconomic imbalances and relevant recommendations given by the International Monetary Fund shows that, while in general the content, number, length, scope and level of detail of recommendations in the two surveillance frameworks are quite similar, CSRs flag problems in the financial sector much less often than the IMF. The EU recommendations therefore appear less pertinent to addressing macroeconomic imbalances than those of the IMF.

1 In particular: high current-account balances, large external debts, large corporate or household debt, excessive credit growth and wage/price developments that significantly diverged from the euro-area average.

2 In cases of non-compliance, the procedure allows – as a last resort – the imposition of sanctions on the non-compliant member state, similarly to the SGP procedure.

3 Coordination is founded on the broad economic policy guidelines and employment guidelines – which together form the so-called Integrated Guidelines – adopted every year by the Council. However, since 2010, the Integrated Guidelines have been revised only once, in 2015. The Integrated Guidelines reflect the Europe 2020 strategy for smart, sustainable and inclusive growth and do not have any sanctions attached for non-compliance. They are thus the loosest form of coordination of national policies.

Box 1: A new dataset to analyse implementation of CSRs

To analyse trends in implementation of CSRs, we constructed a dataset of implementation scores from the European Commission's assessments of the implementation of recommendations. There is good reason to believe these assessments are accurate. In a European Court of Auditors survey of the members of the Economic Policy Committee – a group of national officials that supports the work of ECOFIN⁴ – 89.5 percent of respondents described the Commission's assessment of implementation as completely or generally accurate (European Court of Auditors, 2018).

We used the only publicly available sources of the Commission's assessments – the Country Reports⁵, which are published eight months after initial recommendations are given⁶. In these reports, the Commission evaluates implementation at the aggregate CSR-level but also, starting with the 2013 recommendations, at the disaggregated or subpart-level. Breaking CSRs up into more specific components offers some clear advantages: evaluating implementation of recommendations at this more granular level becomes easier, more accurate and more informative. To illustrate, CSR 3 given to Spain in 2017 reads: *"Ensure adequate and sustained investment in research and innovation and strengthen its governance across government levels. Ensure a thorough and timely implementation of the law on market unity for existing and forthcoming legislation."*. Arguably, though bundled together in the text, this CSR consists of two distinct subparts as it recommends two totally different policy measures.

To the best of our knowledge, we are the first to systematically analyse implementation of CSRs at the subpart level outside the European Commission (EC 2016, Bricongne and Turrini 2017)⁷. Our dataset, therefore, covers the period from 2013 to 2017 and contains the Commission's implementation score for each subpart, which can be one of the following: 'no progress', 'limited progress', 'some progress', 'substantial progress' and 'fully addressed' (see the online Annex 1). We transformed these scores into numerical variables of 0 for 'no progress', 25 for 'limited progress', 50 for 'some progress', 75 for 'substantial progress' and 100 for 'fully addressed', in order to compare average implementation between aggregates.

As a result, the average implementation scores we compute should be interpreted carefully: a mean implementation score of 100 (the maximum) indicates that all subparts addressed have been fully implemented, whereas a score of 0 (minimum) means that there has been no progress on any subpart. However, a score of 50 does not necessarily mean that half of recommendations have been fully implemented and half have not. Rather, it indicates that there has been 'some progress' with the recommendations on average.

Furthermore, we assign to each CSR subpart the policy areas that describe its content. As in the internal database of the Commission, we chose up to three policy areas for each subpart from a set of 32 areas in total (see the online Annex 2), so relative frequencies of policy areas sum up to more than 100 percent⁸. The dataset also contains for each subpart the corresponding legal basis on which the recommendation is made. This is derived from the recitals of the CSR text, which specify whether the CSR is relevant for the MIP.

4 See https://europa.eu/epc/home_en.

5 For the 2013 CSRs, the information is taken from the Commission Staff Working Documents titled 'Assessment of the national reform programme and convergence /stability programme'.

6 Since 2015, these reports – published every February – have contained assessments of compliance with the previous year's CSRs. These assessments thus capture progress achieved within roughly eight months following the Council of the EU's approval of the recommendations. Commission services continue to update their assessments regularly. The European Commission also carries out an assessment each spring (May) and a multi-annual assessment of the CSRs, ie not just in the year after the recommendations are made, but in all subsequent years. However, neither these subsequent assessments nor the database maintained for that purpose are made public.

7 As a rule, CSRs are broken down into subparts in our dataset as in the Country Reports, but in some cases the breakdown into subparts in the Country Reports does not clearly map to the CSR text.

8 A correspondence between subparts and policy areas is part of the Commission database but is not made public through the Country Reports. We are confident after a number of discussions that we closely approximate the Commission's matching.

Finally, SGP-related subparts are not publicly evaluated in the Country Reports, ie starting with the 2014 European Semester, since the fiscal data is only finalised after the publication of the reports. We therefore exclude them from the sample whenever we calculate average implementation scores over time.

Do countries comply with recommendations?

From 2013-17, the implementation by EU countries of CSRs worsened (Figure 1). Overall average implementation ranged between ‘limited progress’ and ‘some progress’, meaning that on average member states fell short on adopting measures to at least partly address the recommendations or follow up on the adoption of these measures with implementation. Darvas and Leandro (2015, 2016) found similar results for implementation at the CSR level from 2011-15. Interestingly, the deterioration in implementation coincides with the streamlining of the CSRs introduced by the Juncker Commission, which reduced their number and length. The implementation record is worse even after all important caveats are taken into account. In a series of robustness checks, we controlled for country composition, excluded policy recommendations in certain areas such as energy and carried out sample checks excluding the SGP-related recommendations⁹. The main material result did not change: implementation rates have fallen substantially since 2014.

But do countries with excessive macroeconomic imbalances comply better with recommendations? One would expect countries with excessive imbalances to implement the recommendations more rigorously because their imbalances are a particularly relevant concern. And indeed, in 2013-15, implementation scores were better. However, the decline in implementation since then has been more substantial among member states facing excessive imbalances (Figure 1).

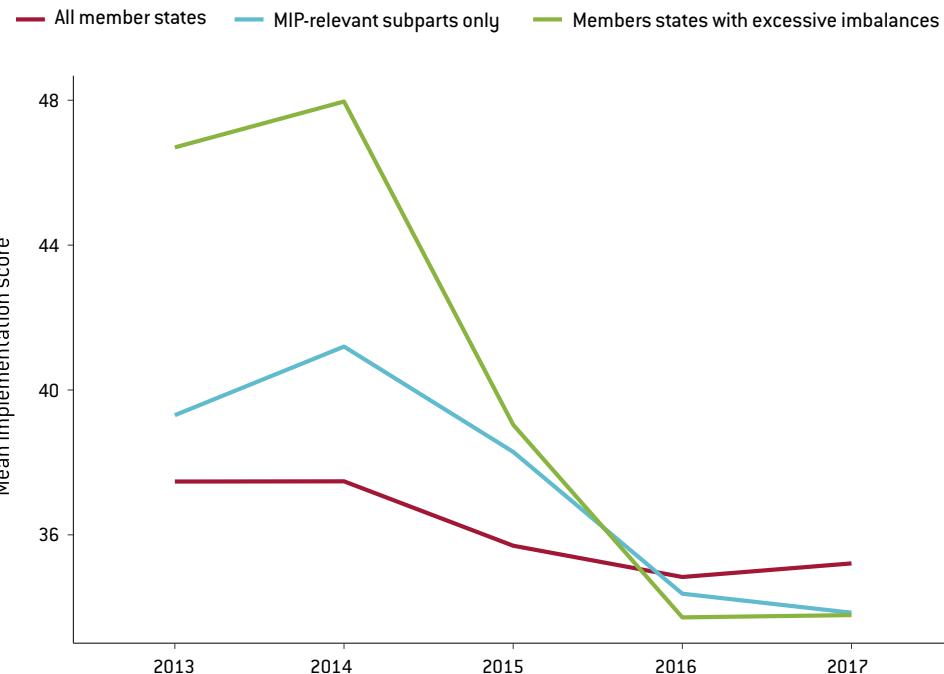
Over time, the MIP has been followed less by member states. Reasons for this decline in implementation could include the reduction of market pressure and the changing nature of the policy challenges¹⁰.

Implementation has differed substantially across countries, as shown by average implementation scores with all recommendations from 2013-17 (Figure 2). The countries with highest implementation scores were Finland (53), the United Kingdom (51), Slovenia (48), Malta (46) and Spain (44). Implementation was lowest in Luxembourg (23), Slovakia (29), Hungary (29), Germany (29) and Bulgaria (30).

⁹ One issue is the inconsistency of the timing of the assessments (of the 2013 CSRs done in May 2014 vs. following years done in February). However, the drop in compliance occurs between the 2014 and 2015 rounds. A second issue is that the composition of the sample is not fixed over time. Firstly, there are changes in the composition of the subparts that are assessed. To ensure a fair comparison we exclude SGP related subparts for the reasons clarified in Box 1 from the entire sample. In addition, there was a significant reduction in energy, resources and climate change recommendations, which nevertheless has only a negligible effect on the implementation score. Secondly, the country composition of the sample changes, mainly because member states undergoing financial assistance programmes do not receive CSRs to avoid duplication. However, the participation of these member states in later rounds of the European Semester does not explain the deterioration in compliance between 2013 and 2016.

¹⁰ Specifically, the countries with excessive imbalances in 2013 and 2014 narrowly avoided loss of market access and the possibility of having to accept a financial assistance programme (eg Spain in 2013, Italy in 2014 and Slovenia in both years). This fresh memory might have added to domestic political pressure to implement much-needed reforms. In contrast, member states with excessive imbalances in later years, while still grappling with legacy problems that leave them vulnerable to economic shocks, have faced less market pressure and some have even managed successfully to exit financial assistance programmes (eg Cyprus, Portugal).

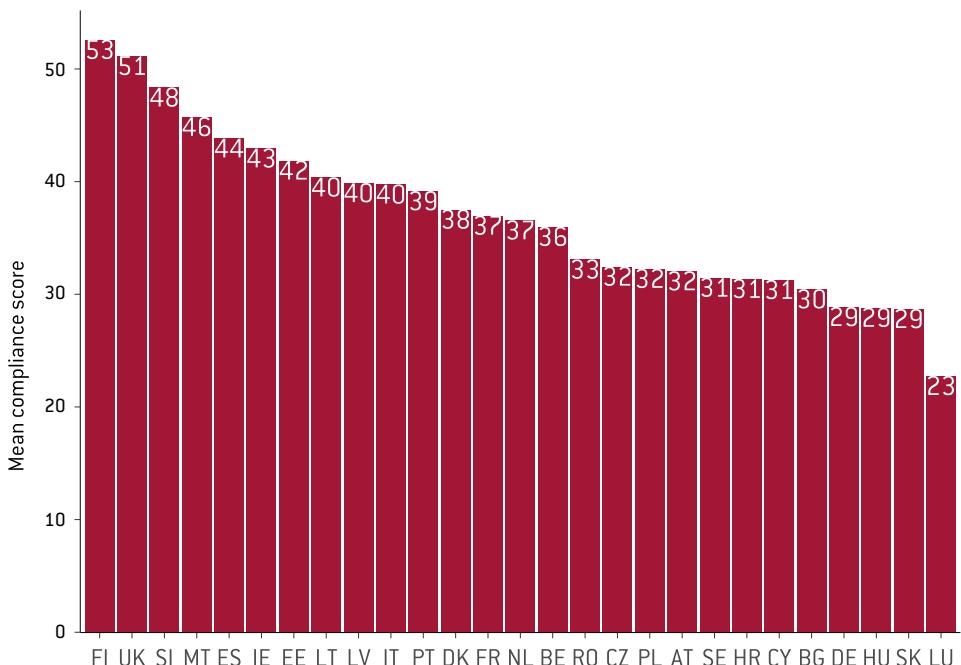
Figure 1: Average implementation score, by year



Source: Bruegel based on Country Reports. Note: subparts related to fiscal policy in terms of SGP targets are excluded.

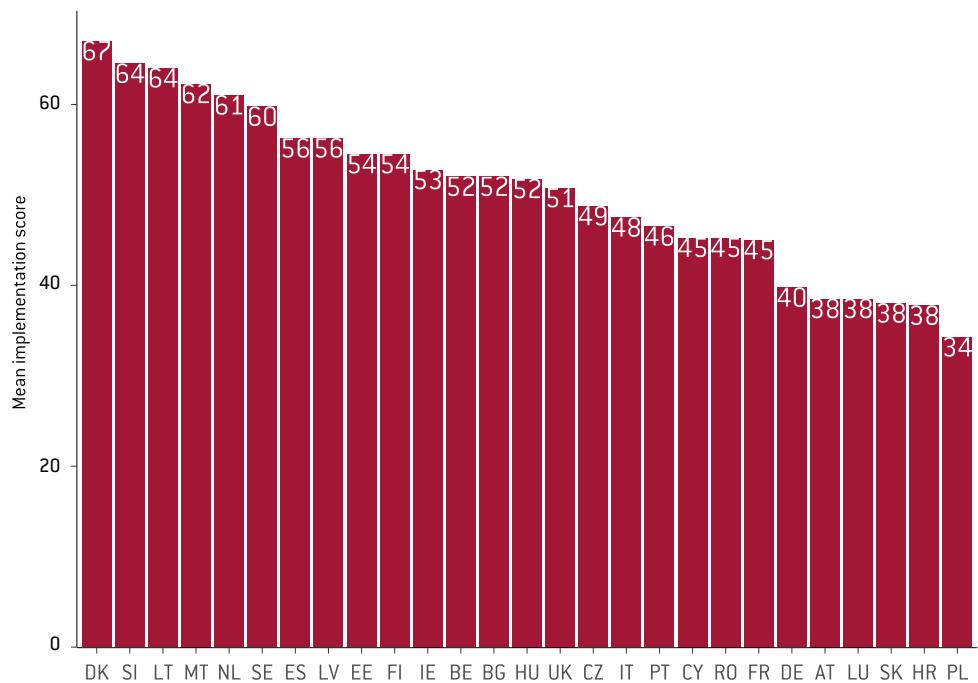
Countries' average implementation records for 2013-17 hide significant variation (online Annex 3). The trend is towards greater implementation in, for example, Bulgaria and the Czech Republic, and towards less implementation in, for example, Croatia and Poland. Implementation in countries including Luxembourg and the Netherlands has fluctuated significantly. It is beyond the scope of this paper to examine the political economic factors driving this country action, but factors likely include issues such as the capacity of a country to put in place reforms, electoral cycles and the business cycle.

Figure 2: Average implementation score, by country [2013-17]



Source: Bruegel based on Country Reports. Note: subparts related to fiscal policy in terms of SGP targets are excluded.

Figure 3: Average implementation score from multi-annual assessment, by country [2011-17]



Source: Bruegel based on 2018 Country Reports. Note: This assessment takes place at the CSR and not the subpart level and includes all CSRs since 2011.

The Commission expects recommendations to be fully implemented in the 12 to 18 months following adoption by the Council but only publishes precise evaluations of implementation after eight months. The Commission's so-called multi-annual assessment (published irregularly and with limited information) shows that member states also fall short in implementation after 18 months. The average implementation score from the multi-annual assessment as of mid-2017 is 49, which corresponds to 'some progress'¹¹. This is higher than the scores after eight months, but still falls short of full implementation after 12 to 18 months¹². The European Court of Auditors (2018; see Box 1) found that only 53 percent of respondents considered the CSRs realistic, while 26 percent said they were 'somewhat realistic' and 11 percent 'not at all realistic.' The main reason for those sceptical views was the challenging timeframe for implementation (European Court of Auditors, 2018).

The country-specific multiannual assessment figures released for the first time in the 2018 Country Reports¹³ (Figure 3) show that there is no evidence of backtracking: member states' cumulative progress with all CSRs since 2011 is at least as good as implementation of each year's CSRs within the first eight months. However, the extent of the improvement (measured

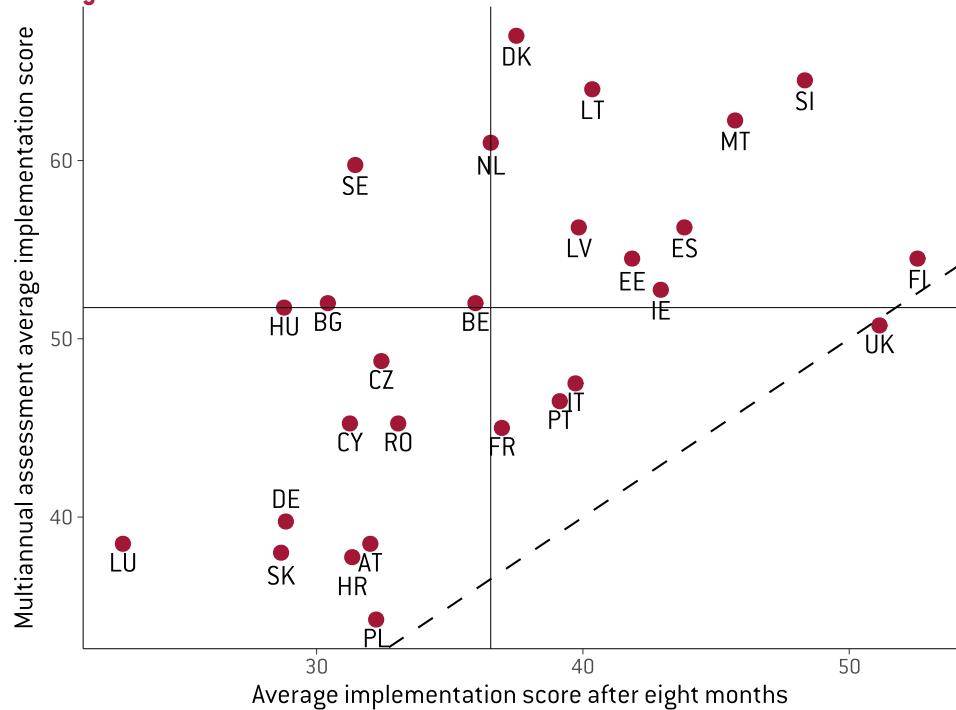
11 The multi-annual assessment of progress pools all CSRs since 2011 and takes stock of overall progress achieved on each up to a specific point in time.

12 Full implementation would imply that all CSRs given up to and including 2015 have been fully implemented, which is clearly not the case. The Commission staff working document outlining these figures from the multi-annual assessment acknowledged that more progress was made with earlier recommendations (European Commission, 2017) but does not make public the breakdown by year.

13 The multi-annual assessment and the assessments after eight months are not directly comparable because: i) the multiannual assessment includes the 2011-17 CSRs whereas the eight-month assessment includes only the 2013-17 CSRs; ii) the multiannual assessment measures implementation over variable periods depending on the year of the CSR (six years for the 2011 recommendations, five years for the 2012 recommendations, etc), while the eight-month assessments measure implementation over a fixed period; iii) the multiannual assessment is done at the CSR level whereas for the eight-month assessments we use the subpart level; iv) progress with SGP-related CSRs is included in the multiannual assessment but excluded from the eight-month assessments.

by the distance from the dashed line in Figure 4) varies significantly in different countries. For example, there appears to have been no progress beyond the eight-month implementation scores for the UK, Finland and Poland. However, the multiannual assessment shows much-improved implementation in countries including Denmark, Sweden, the Netherlands, Lithuania, Hungary and Bulgaria. As a result, the ranking of countries also changes significantly. This implies that some of the differences between countries in the eight-month assessments arise from differences in speed of implementation, rather than in willingness or ability to implement CSRs.

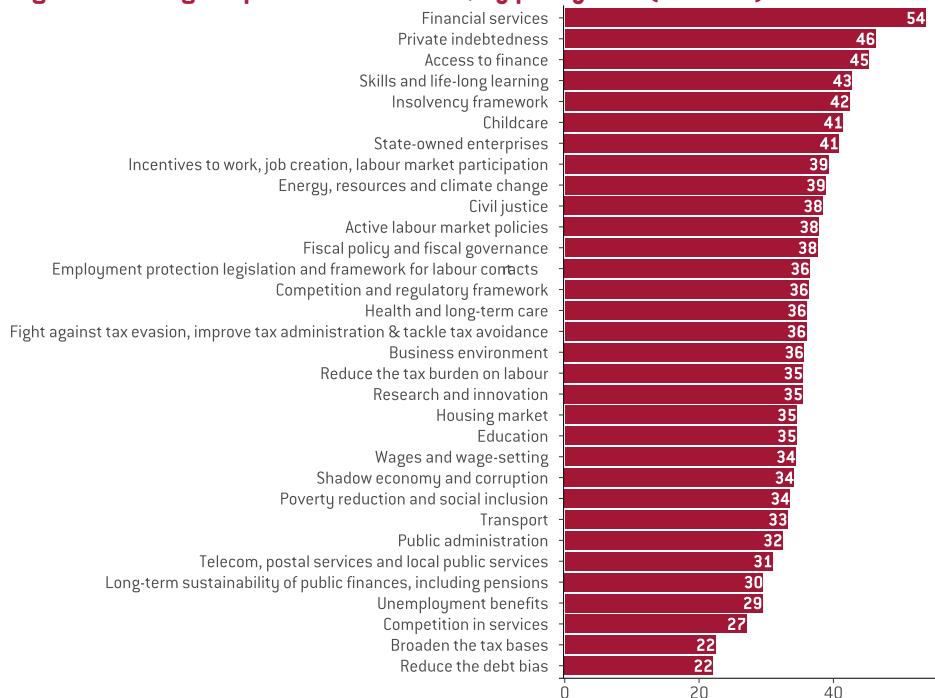
Figure 4: Average implementation scores, multi-annual vs. after eight months, by country



Source: Bruegel based on Country Reports. Note: subparts related to fiscal policy in terms of SGP targets are excluded from the eight-month average implementation scores. The dashed line has a slope of 45° and the two axes indicate the score of the median country in the respective assessment.

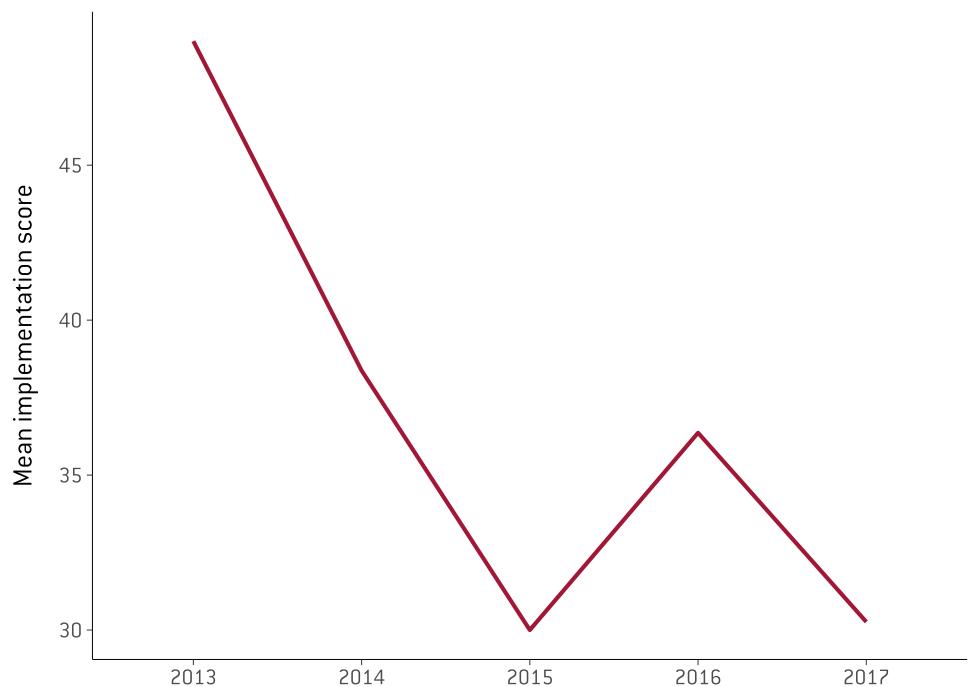
Implementation scores after eight months vary for different policy areas (Figure 5). In particular, implementation scores are on average high for the financial sector (financial services: 54; private indebtedness: 46; access to finance: 45; and the insolvency framework: 42), skills and life-long learning (43) and fiscal policy and fiscal governance (42). However, recommendations related to taxation, such as on reducing the debt bias (22) or broadening the tax base (22), competition in services (27) and reforms focused on unemployment benefits (29) and the long-term sustainability of public finances including pensions (29), are overall poorly implemented. The average implementation scores by policy area are relatively stable over time, with the notable exception of fiscal recommendations. Implementation of fiscal governance recommendations or fiscal recommendations on the structure of government expenditure has deteriorated significantly (Figure 6).

Figure 5: Average implementation score, by policy area (2013-17)



Source: Bruegel based on Country Reports. Note: subparts related to fiscal policy in terms of SGP targets are excluded, so subparts of the fiscal policy and fiscal governance policy area mostly relate to questions of fiscal governance at the national or sub-national level, or the structure of government expenditure.

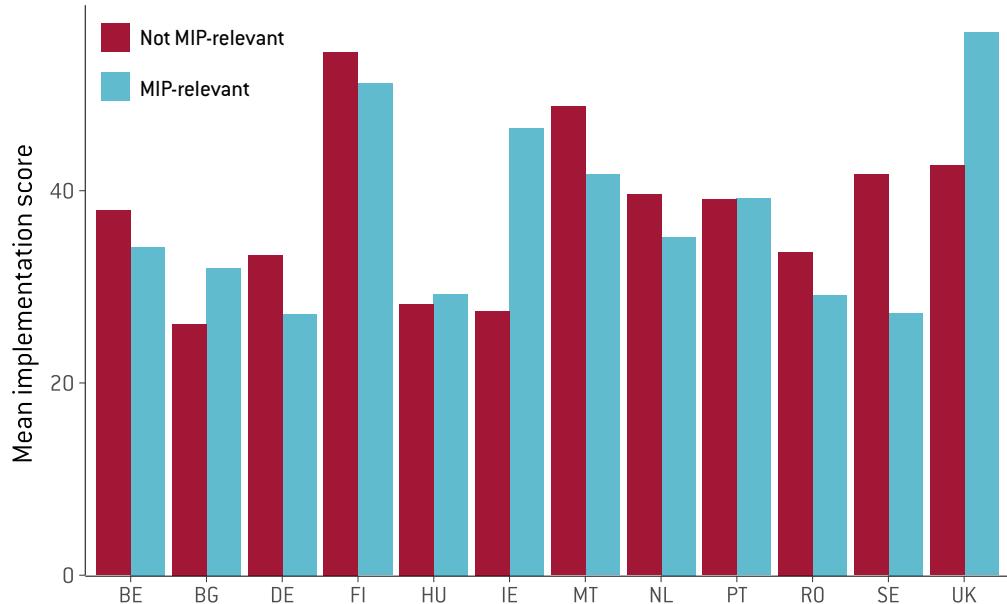
Figure 6: Average implementation score, subparts with a fiscal policy and fiscal governance component



Source: Bruegel based on Country Reports. Note: subparts related to fiscal policy in terms of SGP targets are excluded, so this mostly relates to questions of fiscal governance at the national or sub-national level, or the structure of government expenditure.

Finally, we study whether MIP-related recommendations are implemented better than recommendations based on looser economic policy coordination that do not have the possibility for sanctions. Figure 7 shows there is no systematic difference and it is therefore difficult to assert that the macroeconomic imbalances procedure has made an actual difference in terms of national policy action.

Figure 7: Average implementation score by country and legal basis (2013-17)



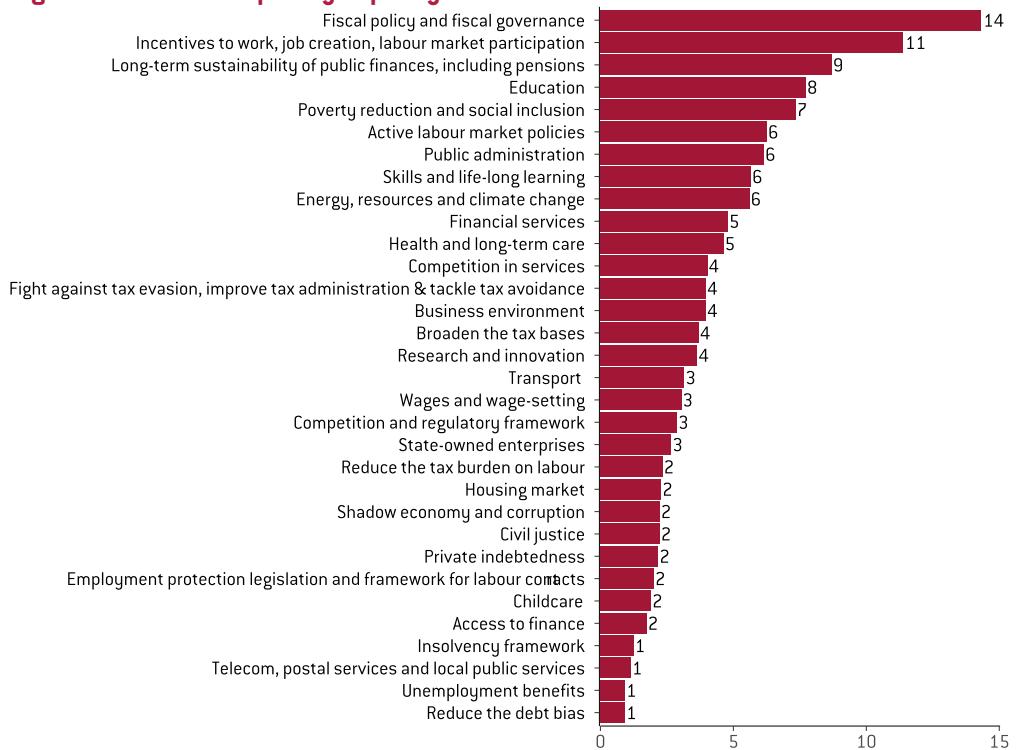
Source: Bruegel based on Country Reports. Note: subparts related to fiscal policy in terms of SGP targets are excluded. The countries shown have at least 10 subparts under each legal basis.

What is the content of the recommendations?

During 2013-17, CSRs mainly encompassed recommendations relating to fiscal policy and fiscal governance (14 percent), incentives to work, job creation and labour market participation (11 percent), the long-term sustainability of public finances including pensions (9 percent) and education (8 percent). Recommendations on poverty reduction and social inclusion, active labour market policies and energy, resources and climate change are also very frequently addressed to member states (Figure 8).

One question is if the policy content varies depending on whether the recommendations are relevant for macroeconomic imbalances or not (See the online Annex 5). Specifically, non-MIP-relevant CSRs are most frequently related to fiscal policy and fiscal governance (14 percent), incentives to work, job creation, labour market participation (13 percent), long-term sustainability of public finances including pensions (11 percent), education (11 percent) and poverty reduction and social inclusion (10 percent). In general, recommendations that are not linked to the MIP are concentrated in a few policy areas, especially those associated with the Europe 2020 agenda for smart, sustainable and inclusive growth and included in the – common for all EU members – integrated guidelines (the broad economic policy guidelines (BEPG) and employment guidelines). Only for issues related to the financial sector and certain aspects of labour policies is there a stronger emphasis on the MIP.

Figure 8: Relative frequency of policy areas

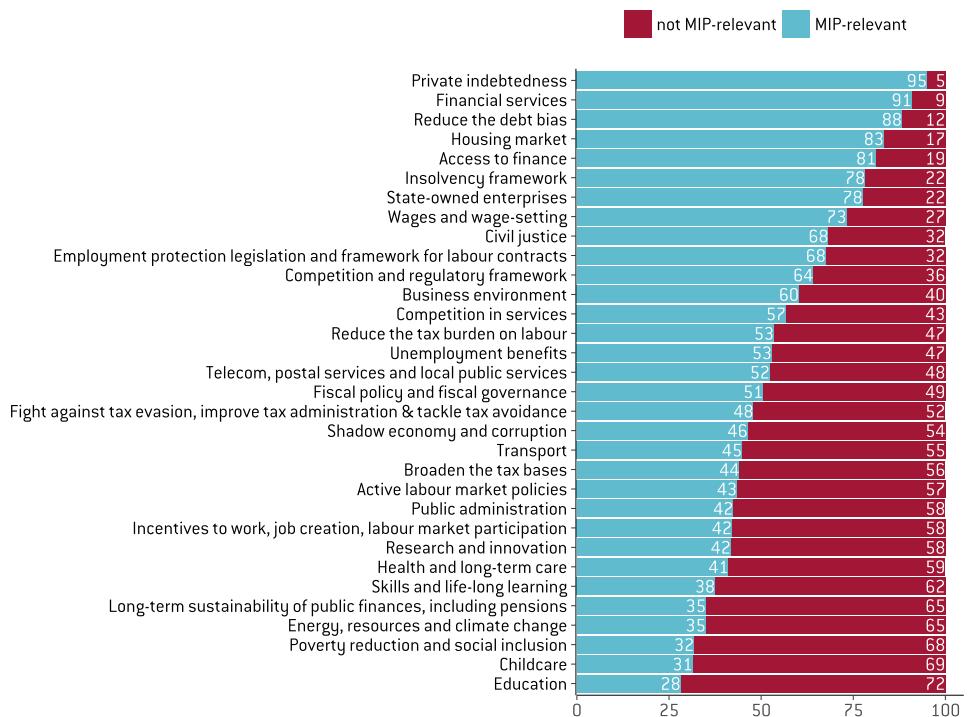


Source: Bruegel based on Country Reports.

Almost all CSRs addressed to countries facing excessive imbalances and the vast majority of CSRs addressed to countries facing imbalances are labelled MIP-relevant, a trend that strengthened from 2015. This is not legally necessary and has been criticised by the European Court of Auditors for creating confusion by including recommendations that are only remotely – if at all – linked to addressing imbalances, potentially weakening the effectiveness and credibility of the MIP (European Court of Auditors, 2018).

To gain a further insight into the extent of ‘over-labelling’ we looked at how subparts belonging to each policy area are distributed by legal basis. Figure 9 shows that reforms seem to fall into line with the legal basis one would expect based on common sense. Most actions related to private indebtedness (95 percent), financial services (91 percent), reducing the debt bias in taxation (88 percent), the housing market (83 percent), access to finance (81 percent), insolvency framework (78 percent), state-owned enterprises (78 percent), wages and wage-setting (73 percent), civil justice (68 percent), and employment protection legislation/framework for labour contracts (68 percent) are labelled MIP-relevant, as they are pertinent for imbalances in the MIP sense, eg private indebtedness and cost competitiveness. However, most recommendations focusing on education (72 percent), childcare (69 percent), poverty and social inclusion (68 percent) and energy, resources and climate change (65 percent) are not relevant for the MIP. Still, it is surprising to see that childcare seems to play a role in macroeconomic imbalances. We therefore side with the European Court of Auditors that there is a concern about over-labelling.

Figure 9: Relative frequency of legal basis, by policy area



Source: Bruegel based on Country Reports.

Are EU policy recommendations sensible?

We compare the EU's CSRs to the recommendations given by the International Monetary Fund¹⁴. Obviously, IMF recommendations can also be faulty and we do not claim that they are more pertinent than CSRs. The exercise can still help us to benchmark and compare the EU to a major external institution that very much focuses on macro-financial imbalances – the key topic of concern in countries under the macroeconomic imbalances procedure.

We therefore focus on the European Semester recommendations for the countries identified as having imbalances – excessive or not – in 2016¹⁵.

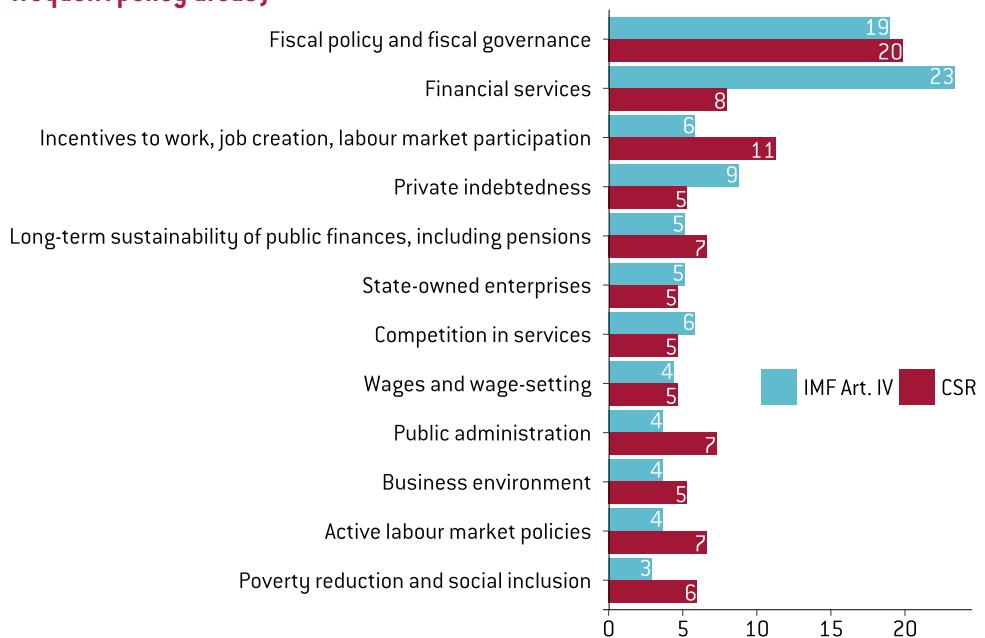
In addition, in Box 2, we make a qualitative assessment of the CSRs given to the three largest euro-area economies (France, Germany and Italy) in 2017: in particular, we study the link between the economic rationale developed in the recitals and the recommendations themselves.

Compared to CSRs, Article IV recommendations emphasised considerably more often issues related to financial services and private indebtedness. CSRs were more likely to include recommendations associated with incentives for work, job creation and labour market participation, public administration, active labour market policies and poverty reduction and social inclusion.

¹⁴ In the context of the IMF's country surveillance consultations under Article IV of the IMF Articles of Agreement. The IMF's recommendations are not directly comparable to the CSRs. However, IMF Staff Reports contain in their appendices lists of the Article IV recommendations from the previous year and authorities' actions related to the recommendations. We made the comparison on the basis of those lists, which explains our choice of 2016 as the year we use for comparison.

¹⁵ For France, the Netherlands and Portugal, we could only find a list for the 2015 Article IV consultations. We could not find one for Sweden for 2015 or 2016.

Figure 10: Relative frequency of policy areas, by surveillance framework (12 most frequent policy areas)



Source: Bruegel based on European Commission's Country Reports and IMF's Staff Reports.

In terms of recommendations by country (see the online Annex 6), we found there was a fair level of consensus in the recommendations of the two surveillance frameworks, though this did not amount to replication. In particular, the proportion of IMF recommendations with an exact or partial match in the respective CSRs ranges from about 38 percent for Finland to 100 percent for Croatia. On average, about half of the IMF recommendations matched fully or partially with a CSR subpart¹⁶.

Furthermore, the IMF recommendations that do not have a CSR counterpart are for the most part recommendations related to the financial sector (Figure 10). Differently from the CSRs, the IMF recommended that all 12 countries surveyed in the sample should take measures on the supervision of financial intermediaries, macro-prudential policies and reducing the stock of non-performing loans (NPLs). For instance, the IMF suggested that German authorities “expand the macro-prudential toolkit to better address potential future excesses in the housing sector” and “ensure that life insurance companies maintain sufficient capital buffers to withstand a prolonged period of low interest rates”, two recommendations that are not included in the CSR package. Similarly, Spain received a number of recommendations on reducing NPLs, strengthening banks’ capital and funding positions and macro-prudential policy. Italy received recommendations on resolving failing banks from the IMF but not under the European Semester in 2016. Examples of non-financial recommendations are those related to labour market reform in Italy, in particular promoting firm-level bargaining, monitoring the take-up of the newly legislated open contract and the use of enhanced flexibility in allocating labour within firms.

These are all examples of recommendations that if put forward in the CSRs would be unambiguously related to the MIP and linked to the core issues associated with macro-

¹⁶ We acknowledge that there is no clear way to match the recommendations. In general we matched recommendations when they explicitly mentioned the same reform or policy action, in whole or in part. Some of the unmatched recommendations might be at least related, eg boosting participation of women in the labour force (IMF) and improving access to childcare (CSRs).

economic and financial risks. Their absence raises the question of whether the CSRs go far enough in flagging these risks, particularly in the financial sector, for countries that face macroeconomic imbalances. In general however, the content, number, length, scope and level of detail of recommendations in the two surveillance frameworks are quite similar.

Box 2: Qualitative assessment of 2017 CSRs in France, Germany and Italy

In 2017, France and Italy were considered to be experiencing 'excessive' macroeconomic imbalances while Germany was considered to be experiencing an imbalance only.

This weighting between excessive and non-excessive balances is clearly a political choice and cannot be justified by the economics of spillovers. The French economic situation certainly does not create more negative spillovers onto the EU as a whole than the German economic situation.

All three countries are in the bottom half of countries in terms of CSR implementation rates: they do not seem to care much about the macroeconomic imbalances procedure recommendations from Brussels.

One reason for such low implementation rates might be that recommendations are based on flawed analysis. However, a close reading of the recitals of the Council recommendations suggests the opposite. The analysis of the economic challenges in all three countries is quite detailed and corresponds to what many international economists and international organisations, such as the IMF, would say.

For example, in Italy besides the obvious fiscal challenges, the recitals of the Council decision discuss in quite some detail issues relating to the effectiveness of the administration, the justice system, corruption and the labour market.

In France, the excessive imbalances relate to competitiveness and public debt and the core of the recitals rightly focuses on the need for deficit reductions, the state's very large expenditure ratio, the inefficiencies in spending calling for a spending review, the structure of the tax system and the sharp divide in labour market performance between foreign-born and EU-born workers.

In Germany, the recitals focus on the high current account surplus and its drivers such as low private and public investment, overly strong fiscal consolidation, the complex corporation tax system, relatively weak research and education investment, barriers to digitisation and the low rate of investment in electricity transmission and distribution networks.

Yet, despite good analysis, recommendations are kept fairly general when it comes to macroeconomic imbalances (even though they are quite strong and clear on fiscal policies for these three countries). It is also not always fully clear how the recommendations link to the recitals. For example, in Germany one recommendation is to "*reduce the disincentive to work for second earners*". This recommendation is certainly politically debatable and it is questionable why the EU would meddle in this national choice. More worryingly, the link between this recommendation and Germany's actual imbalances, in particular the current account surplus, is difficult to see. The main recommendation also clearly makes a choice in that it considers fulfilment of the fiscal rule more important than addressing the macroeconomic imbalance.

Conclusion

We analysed three questions: do EU countries comply with CSRs? What is the content of those recommendations? Do recommendations make sense?

On the first count, we found that member states do not fully implement CSRs, regardless of the implementation horizon. More worryingly, implementation has deteriorated in recent years, especially among countries facing excessive imbalances. Performance varies substantially across countries and policy areas. We found no evidence that CSRs given in the context of the MIP are implemented faster than CSRs based on the legally less-binding Integrated Guidelines¹⁷.

On the content of CSRs, we found that although MIP recommendations emphasise policy areas linked to imbalances (such as financial reforms, the competitiveness of labour and the housing market), the original intent of the MIP is diluted when CSRs relate to, for example, education or childcare. Such recommendations are hardly relevant for macroeconomic and financial imbalances and could further erode the importance national policymakers attach to recommendations from Brussels.

Finally, the economic analysis underpinning CSRs appears sound according to our analysis of a few countries. However, recommendations are often weaker and less clear than the underlying analysis. We also note that the EU makes significant political choices that are not easy to justify based on economic logic. For example, Germany's imbalances were not considered excessive while France's imbalances were in 2017. We also find a significant overlap with recommendations given by the IMF. Nevertheless, for countries with imbalances, the emphasis in CSRs on the financial sector is considerably weaker than in equivalent recommendations from the IMF.

In terms of the implications for EU economic governance, our results cast serious doubt on the effectiveness of the European Semester and suggest that policymakers should reconsider it. We consider the low effectiveness to be a result of the fundamental dilemma facing the euro area in particular. National policies matter hugely for all euro-area countries, justifying mechanisms for policy coordination. But national policies are put in place by national authorities and parliaments that do not want their sovereignty to be diminished.

This dilemma cannot be resolved in the European Union as it is currently set up. The best that can be achieved is improving second and third-best solutions. Our main recommendation is to focus MIP CSRs on those items that are really relevant for macroeconomic imbalances and spillovers to other countries. Recommendations that are only nice to have should be ditched to reduce the amount of paperwork sent to national policymakers. The focus of EU surveillance should be on the real risks for the euro area and the EU as a whole – while the principle of subsidiarity suggests that childcare – while extremely important – should be decided at national or even regional level. Finally, the European Commission needs to improve its communication so that the CSRs are clearly visible and understandable in national debates. The current form of CSRs makes for barely-digestible documents. More streamlined and understandable communication would be useful.

¹⁷ We intend to undertake econometric analysis to identify the political economy and other factors explaining this variation. An analysis by the European Commission (2016, Annex 3) for 2014-15 found a statistically significant positive association between compliance and the category of imbalance.

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Annexes

The annexes to this Policy Contribution are available online:

Annex 1: Compliance scores - <http://bruegel.org/wp-content/uploads/2018/06/PC-2018-09-online-annexes-1.pdf>

Annex 2: Policy areas - <http://bruegel.org/wp-content/uploads/2018/06/PC-2018-09-online-annexes-2.pdf>

Annex 3: Average compliance scores by country - <http://bruegel.org/wp-content/uploads/2018/06/PC-2018-09-online-annexes-3-new.pdf>

Annex 4: Average compliance scores by policy area - <http://bruegel.org/wp-content/uploads/2018/06/PC-2018-09-online-annexes-4-new.pdf>

Annex 5: Relative frequency of policy areas, by legal basis <http://bruegel.org/wp-content/uploads/2018/06/PC-2018-09-online-annexes-5-new.pdf>

Annex 6: Article IV recommendations and matching CSRs - <http://bruegel.org/wp-content/uploads/2018/06/PC-2018-09-online-annexes-6.pdf>