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Economic Governance from Rules to Management
How to strengthen member states

The toolbox of economic governance has been considerably expanded this past decade. Further development of instruments should not be expected; steps towards a fiscal union will remain modest in the foreseeable future. Although the many merits of the existing toolbox, it ensured neither respect for the SGP rules nor convergence. The crisis situation following the corona pandemic called for emergency measures. As we have to prepare for post-corona economic governance, this is the time to reflect on new and complementary economic instruments and procedures. Many ideas are going around for modifying the existing toolbox. Important as the discussions about, among others, the re-ignition of the SGP and semester may be, the current situation should be used to initiate a new governance trajectory aimed at reinforcing independent national institutions and maximising national ownership of objectives related to convergence. The required complementary governance agenda draws on experience in success EU policies areas and is aimed at converging national institutions in the framework of EU networks. When it comes to the SGP, rules are important but they are meaningless without ownership for the intentions behind the rules. This will demand a switch in roles from the European Commission and in particular from DG ECFIN and the European Fiscal Board (EFB). In essence, the proposed new approach is based on the subsidiarity-based distinction between first and second-order control. The member states have to supervise themselves and the Commission has to monitor whether they have the required independent institutions.

Evaluation European Local Energy Assistance Technical Assistance Facility

Ideas are more powerful than is commonly understood

J.M. Keynes
1 Introduction: Moving beyond the economic debate on EMU

Where to look for ideas for moving EMU forward? Discussions about deepening EMU have plateaued in more ways than one. Firstly, corona resulted in an increase in already high debt levels and underlined the national weaknesses that have undermined the resilience and credibility of the euro. Growth is required to ensure the sustainability of debts and to pre-empt new threats to the banking sector. Convergence (i.e. overcoming poor growth conditions in member states) is still the Achilles heel of EMU. Even with steps towards a fiscal union, convergence will remain essential. Hence, the important question since the start of the euro-project is still relevant: how to strengthen the member states? True to form, regulation (hierarchical steering and supervision) has remained the primary governance tool in EMU. A range of supporting governance tools have been put in place but the effect on convergence has remained modest. Something else is needed. Secondly, the EMU toolbox is more or less complete with the main components of the SGP, ESM, forms of conditionality, financial support for capacity building and some (more or less temporary) support funds (see Annex 1). There may be some modifications of the toolbox but an ambitious fiscal union is not in the cards.

Thirdly, independent national institutions related to ensuring sound national economic environments are hardly on the political agenda. National authorities and the EU Commission are reluctant to address each other’s weaknesses and there is already quite a body of research doubting the effectiveness of external capacity building funds and programmes. Ideas to confront national weaknesses are lacking.

Having written a paper on the need for strong member states in the EU, we now have to discuss the additional role the EU can play in supervising and strengthening the quality of national governments. More than strong member states is needed. The EU level will have to incorporate strong and independent national authorities in policy development and enforcement. The link between strong states and the specific contributions that are required from the EU accentuates the relevance of subsidiarity. As legal principle, subsidiarity concerns the separation of tasks. As organisational principle, subsidiarity involves managing interdependence. Strong supranational economic supervision and enforcement are ineffective, but intergovernmental cooperation is not enough either. Effective EU cooperation demands maximum involvement of national authorities in European tasks and networks. The trend towards centralisation of EU tasks at EU level (as in the case of e.g. DG ECFIN) erodes crucial national capacities rather than helping to create an interconnected multilevel European administrative system.

This Policy Brief moves beyond the economic debates on strengthening EMU by drawing lessons from the management of complex organisations in the private sector (i.e. private sector governance). A core component of private sector management theory concerns reorganisations to rebalance centralised and decentralised tasks. Even though national and EU administrations devote considerable attention to upgrading the quality of their organisations, there is little attention in the EU for professionalising and reorganising the quality of the EU’s inter-organisational relations. As a result, the EU suffers from an inter-organisational management deficit that in part helps to explain convergence problems. Subsidiarity, therefore, raises the question: how to divide economic roles between the member states and the EU?

2 Towards an organisational diagnosis of EMU

Economic governance: Christmas trees and centralisation

The current economic situation in the eurozone is worrying but, at least with low interest rates, there is not an immediate existential threat to the euro. The main economic challenges that threaten the euro
include: high levels of state debt, the need to normalise monetary and fiscal policies (the unwinding of the ECB programmes), and a looming banking crisis. Together with pressures arising from high (youth) unemployment in some countries and the increase in non-performing loans, the eurozone is running out of safety mechanisms.

The question of how to deal with the current situation depends on the diagnosis. To stimulate growth, European investment plans and flexibility in the SGP will offer some short-term relief at best but do not tackle the underlying question of why the EU’s economic system has not produced the required national reforms.

A certain level of agreement exists in terms of economic solutions. Firstly, an emergency fiscal capacity is deemed unavoidable. Even though some form of NextGen-type budget is expected to remain, any EU or eurozone budget will remain relatively modest. Secondly, member states at some point have to be able to stand on their own feet once the ECB starts to unwind its support programmes. Thirdly, some form of respectful debt relief will have to be factored in. Finally, in the long run the formal ‘no-bail-out’ rules will still be supported by many economists and think-tankers but the immediate question remains how to deal with current (and increasing) debts. A substantial fiscal union is not an option given political and legal considerations and, in any case, will not address the root causes of the weaknesses of the eurozone.

These points bring the focus back to the need for rebalancing centralised and decentralised tasks in order to trigger bottom-up national reforms and to increase the resilience of member states. Also, when looking at the past developments of EMU (stopping short of debt sharing), a fundamental deepening of economic governance should not be expected.

Before addressing what the EU’s contribution to strengthening member states can be, it is important to determine in what direction economic governance is now heading. When looking at the trend in economic governance (Annex 1), we see that it has become more centralised and hierarchical: rule-based (including centralised performance control) and top-down recommendations and assistance programmes, and a recurrent tendency to work towards governmentalisation in the form of a fiscal union. Looking at past results, this is apparently not the toolkit to ensure upward convergence. One of the main weaknesses of many (economic) public policy discussions is that they are about strategic policies and not about organisational structures needed for formulating, implementing and controlling these policies. In the private sector it is standard procedure to adapt ways of working in case of apparent weakness. However, it is hard in the context of the EU to address flaws in the inter-organisational relations between the EU and the national levels.


Literally, on the Commission website the graphical presentation of the steps in economic supervision, with the pre-emptive and corrective arms, proudly shows a detailed Christmas tree. Yet, the policies have not delivered convergence. If the solutions do not work, then that diagnosis was probably wrong.

More recently, to stimulate convergence, attempts to emulate successful economic governance from Northern countries have been launched, with, among others, the initiation of Independent Fiscal Institutions (IFIs), National Productivity Boards (NPBs), and the somewhat related European Fiscal Board (Box 2). However, these have made little impact on the ground, and the number of countries with effective supervisory...
bodies has hardly increased. Moreover, there is an uneasy relationship between the national and the EU economic institutions resulting in a mutual-trust trap because the Commission is double-hatted as enforcer of sound economic policies as well as friend cooperating with national economic institutions. Finally, it is doubtful whether the Commission is keen on considering a different set of roles in economic governance. This problem has already existed for some time but has so far not been addressed in a meaningful way.

A public management perspective on EMU
An organisational diagnosis of EMU points to queries about the trends towards centralisation. Any organisation consists of tasks distributed between the central and decentralised levels. Important questions for any organisation are: how are tasks distributed and how is the coordination between the layers in the organisation organised? Complex organisations in dynamic situations (such as EMU) have to be decentralised. Decentralisation enriches information handling, allows for closeness to target audiences, increases commitment to objectives (empowerment), forces capabilities to be matched to complexity and thus strengthens ownership of the strategy and objectives of the organisation as a whole. Yet, decentralisation of responsibilities never stands on its own as it requires re-centralisation (to ensure different forms of interactive target setting and to build new mutual control mechanisms). In short: the centre has a responsibility for defining functions of the system as a whole while respecting the importance of decentralisation. Although the centre is responsible for the system, this does not mean that the tasks need to be performed exclusively by the centre. The more lower levels are involved, the bigger the effects on the sense of ownership. Preferences for and tendencies towards centralisation have to be checked as they will erode responsibilities and ownership at lower levels.

The balance between decentralised responsibilities and centralised control has not been extensively thought through in economic governance. The principle of subsidiarity (the political and legal equivalent of decentralisation) offers some leads.

Subsidiarity, as used here, starts from the assumption that member states are capable partners in the EU (able to grow out of their debts). The capability develops through ‘being involved’ so that expertise is developed, contacts are established throughout the system, a sense of ownership can emerge, new (EU) loyalties are able to grow, etc. Hence, capabilities are related to empowerment. In addition, in organisational terms, subsidiarity underlines that a strong EU is required as manager (not as controller or fiscal authority). Insisting that ‘rules are rules’ does not necessarily demand a stronger legal/authoritative centre but might call for a better manager able to bring in lower-level actors. In essence, the EU level is generally needed as strategic manager of interconnected networks of national authorities.

A clear distinction between national and EU roles is vital. As in private organisations, the centre has to respect the tasks at lower levels. A primary task of the centre is to ensure that first and second-order controls function effectively. In the EU, first-order control is generally the competence of national institutions. Member states implement and enforce EU policies (‘direct control’). Second-order control lies with the EU Commission and entails controlling the controller (‘indirect control’). Although second-order control lies in the hands of the EU Commission, it can be organised on the basis of teams of national experts to ensure maximum involvement of member states, to support mutual exchange and to arrive at a shared professional culture (upward convergence).

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This distinction between first and second-order responsibilities in implementation and enforcement can be compared to ‘empowerment’ in management theory. Empowerment is an essential component of building ownership as well as of stimulating common world views and professional values (e.g. of independent fact-finding and analysis).

Some qualifications are, of course, in order. Involving (‘co-opting’) the relevant parts of national governments in EU processes does not immediately result in upward convergence. Independence, visibility and prestige have to gained over longer periods of time. Moreover, influence will also depend on many other variables (e.g. conflicting interests and political salience) Yet, it does strengthen national authorities, and their embedding in professional EU communities offers a wider defence against national political interference. The EU statistical system – among others – is an area where this switch from national political interference to European professionalisation has been clearly visible (Box 1). By being embedded in European networks composed of other independent actors, national policy makers and enforcers have to serve two masters – the national and the EU network. National political interference therefore becomes more difficult as well as EU-wide less accepted.¹

**Box 1: First and second-order control in the European Statistical System**

Benchmark examples of first and second-order control can be found in several areas, such as food safety, European Competition Network and some parts of EU border control (Schengen Evaluation Mechanism).

The distinction can also be seen in the European Statistical System:
- Member States have their own responsibilities for first-line quality control on data. Extensive collectively designed and agreed guidelines are available for national quality control.
- Eurostat coordinates team-based, peer review inspections. Reports and recommendations are written by mutual inspection teams under the supervision of the Commission (i.e. Eurostat).

This way of working has been a major component of the successful convergence in data gathering in the EU. The European Statistical System has come a long way since 2007 when Greece had to admit that its budget figures were far from accurate.

Quality control has been developed over the past decades. Recent revisions of the elaborate system can be found in:
- European Statistical System Peer Reviews Third Round: 2021-2023
- Overall methodology for the third round of peer reviews endorsed by the ESS Committee in May 2020 (Eurostat).
- See also: Quality Declaration of the European Statistical System (2016, Eurostat)

Eurostat falls under Gentiloni, Commissioner for Economy. Other economic control functions related to DG ECFIN are problematic in terms of subsidiarity-based economic governance. Some examples (see Box 2) underline the tendency to ignore the need for decentralisation in complex and dynamic environments.

3 Subsidiarity-based economic governance: interconnecting the dots

In the EU’s multilevel administrative system, economic policies are largely a national prerogative. Decentralised responsibilities are the starting point from a legal as well as a political/legitimacy point of view. Decentralised economic governance is unavoidable in view of the continuous hard choices national governments have to make and defend in their national Parliaments.

The organisational EMU diagnosis above shows that a revised distribution of roles between the EU and national authorities is required. When it comes to enforcement, member states have to ensure first-order control. It is therefore imperative that member states have the required independent institutions. Independent first-order control and related institutions are a precondition for national ownership based on own national assessments of strengths and weaknesses, media debates, independent national monitoring of political processes, and national political accountability.

In addition, these independent national institutions need to be embedded in EU networks in view of mutual quality control (with the necessary bite of recommendations and continued mutual supervision), exchange of best practices, and – of special importance – the creation of an independent professional quality control esprit de corps. The European network is also a shield against political interference from national governments.

The EU level is responsible for second-order control. Information, political accountability and ownerships are located at national level. To complement national roles, it is the EU’s task to safeguard the overall strategic objectives and – in that particular context – to organise the mutual supervision of national capacities. This requires mutually agreed code books of information gathering and processing, declarations of independence, and checks on the suitability of national capacities (number of PhDs, sufficiency of budgets, independent economic models and information – not coming from the ministry of finance –, etc.).

The second-order team-based control therefore has several functions: controlling the controllers and defending professional values of quality and independence. It has to be organised in such a way that decentralised empowerment is safeguarded – in other words, that centralisation of tasks is prevented.

In case of deficiencies, legal enforcement (based on reporting by the teams) lies in the hands of the Commission but there are good reasons for relying on the inputs from team-based mutual visitations and reporting.

The current EFB, IFIs, and DG ECFIN are not subsidiarity-based. They are centralised and even operate with dubious levels of independence. Due to their current ways of operating, their impact on national ownership and national institution building can be expected to be limited. For example, the National Productivity Boards in weak countries lack the independent team spirit of countries with already more advanced systems, they are not challenged to be equal partners in EU teams, they have no shared responsibility for the work of the EFB, etc. The Commission is active in capacity and network building but is not working towards subsidiarity-based systems in which it also adapts its own roles towards the requirements of the networks (see Box 3).

If we apply the current approach to network building in relation to the NPBs we see that the Commission first of all performs a legal check on whether official NPBs have been appointed. Moreover, efforts to realise strong EU networks of NPBs and IFIs are limited and mostly disconnected from the EFB.
Box 2: Subsidiarity-based economic governance

The central level:
To manage is not to control. Ensuring that the network of national IFIs and NPBs is up and running. Create small independent secretariats that perform the second line of control. Encroachment on first-order control (as DG ECFIN does) reduces ownership. Teams of peers (first annually and later once every three years) assess the quality of national institutions in terms of quality of staff, independent financing, quality of national reports, and national media coverage. The centre ensures independence and transparency of the secretariats of the networks. Any legal actions based on network reports remain with the Commission. (Currently the Commission only looks at whether an IFI exists irrespective of its quality and it even accepts data from Italian authorities of dubious origin. The role of the Commission can be limited to its legal role.) Evidently, use can be made not only of national reports of the IFIs and NPBs, but also of those of central banks/ECB and IMF, etc.

The network:
- Secretarial/operational tasks: The network organises team meetings and ensures that reports written by the network are distributed and that it defines operational rules and quality criteria. The network is important for establishing a common independent enforcement culture, developing common perspectives on weaknesses in the eurozone, organising peer evaluations and reporting, and monitoring follow-up of recommendations. The network should establish common standards for national requirements and procedures (legal finalisation proceeds through the Community method).
- Strategic tasks: Ensuring that diagnoses are made, strategic plans are produced and evaluations of progress are made. These strategic tasks can be performed on the basis of secretarial (operational) tasks of the centre and active input in diagnosing, strategy making and assessments by the national teams.

The Commission remains legally responsible for taking actions against countries that do not have their house in order - yet the tasks of reporting on the quality of national bodies, identifying weaknesses, and providing the related transparency remain with the network.

The national level:
This level establishes the IFIs and NPBs according to the requirements defined by the network, and participates in the European networks and assessments. The national bodies are responsible for the first line of control (regular assessments of national economic policies) and media outreach. Prestige, size and visibility are essential.

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More importantly, the majority of member states lack strong national economic institutions. Most member states have taken initiatives but these new institutions are of varying quality. Moreover, the roles of the relevant networks have remained light in terms of coordination. The importance of cross-national teamwork and of instituting a culture of independence has apparently not been recognised by all.

Furthermore, there is little attention for the management role in the relevant supervisory network. As in other areas, the Commission is reluctant to share supervisory authority outside its own hierarchy (compare for example: Better Regulation). Similarly, the national authorities seem reluctant to share authority with DG ECFIN. So far, shared understanding of what a system of national economic governance should look like is lacking. The subsidiarity-based agenda will offer an institutional addition to the current debates on economic governance. Box 2 presents a subsidiarity-based model.

To prevent confusion: the subsidiarity agenda is not the only economic governance agenda needed. So far, it is the agenda that has attracted least attention. At the same time, care has to be taken that the SGP is restarted wisely, and possibly some form of Recovery and Resilience Facility (RRF) will be required over a longer period of time, the banking union needs further steps, and debt restructuring might be needed. These challenges are already high on the political agendas and the effectiveness should not be overstated if countries lack the capacities to live up to the intentions of the SGP. The EU’s management deficit in economic governance has not been recognised.

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6 The Commission–run biannual platform EUNIFI established by DG ECFIN in November 2013, regularly attended by 31 bodies from 26 Member States, and the self-organised and independent Network of EUIFIs (described by practitioners as ‘the Network’) established in September 2015 as a platform to promote IFIs’ interests.
**Box 3: Questionable trends in (economic) governance and the problem of re-inventing wheels**

- **DG ECFIN**: Carries out first-order control on economic policy in member states while instead it should perform second-order control supervisory tasks, preferably in subsidiarity-based teams. From a subsidiarity perspective, the important question in the work of DG ECFIN ought to be: do the member states have the appropriate economic institutions? This relates to the size of, for example, national productivity boards (NPBs), the available scholarly expertise, the statutory independence, etc. If DG ECFIN were to empower national economic institutions it would push back first-order control to the member states and manage the control of the national controllers on the basis of national teams.

- **European Fiscal Board (EFB)**:
  1) Like DG ECFIN, the EFB has a first-order control task instead of ensuring that national authorities are maximally involved in producing reports.
  2) The EFB hardly sets the example of independent authority on account of its limited role (12 days per year) and as a semi-independent structure closely tied to the Commission. The EFB stands apart from national, economic analytical tasks, and as a capacity in itself is too small to have any impact.

- **The ECB's economic analysis capacity**: This capacity operates independent from the analysis capacities of national central banks, and not every national central bank has its own independent, substantial research department.

- Similar deficiencies can be found in, for example, the supervision of the rule of law and (partially) in border control.

**4 Next step: leadership**

Debates on economic governance are crucial to moving EMU forward. It is high time to complement the reflections on improving EMU with strategies addressing its design as multilevel administrative system. In the private sector, it is well established that complex and dynamic environments demand well-designed organisational structures to implement the agreed objectives and strategies. In European public administration, the structures that bind the member states together are often poorly or wrongly designed (e.g. where the EU takes over first-order control as in the case of DG ECFIN or the EFB).

Convergence of the quality of national economic institutions in terms of independence and national prestige requires the creation of a subsidiarity-based economic governance system. It is clear that after three decades and with little attention for the design of transnational networks, EMU’s organisation has not resulted in stronger member states.

‘Governance’ and ‘subsidiarity’ are less sexy than highly political fights over policies and budgets. Assessments of organisational roles in the context of simultaneous centralisation and decentralisation processes are common in the private sector but hardly an issue in European public administration. Yet, precisely because it is not sexy, this type of reform in the background of the technocratic tranquillity could be successful. Subsidiarity is generally (and warmly) accepted as a core EU principle but has not been systematically applied to crisis areas such as EMU.

EMU is not an exceptional field when it comes to the need to strengthen national institutions and building the required European systems. Effective multilevel governance systems have been created (also following crises) in areas such as food safety (e.g. BSE and dioxin chicken), EU competition policy (overload) and statistics (unreliable economic data e.g. from Greece).

Leadership is now required to gather support from like-minded member states for improving subsidiarity-based economic
governance. This leadership can hardly be expected from the Commission, partly because its own functions and tasks (DG ECFIN, EFB) should be thoroughly reconsidered, but also because the Commission has several functions that will complicate leading the required strategic discussions.

Steps to be taken include:

- Elaboration of comparable benchmarks for national institutions and for the managerial added value of EU institutions (in -organisational- detail and along the lines of first and second-order control), also with a view to better understanding why convergence succeeded in some areas while failing in others.
- The creation of support among like-minded countries.
- Ensuring a common ‘world view’ between member states and the Commission: does a shared diagnosis exist concerning EMU’s weaknesses at national and EU levels? Is subsidiarity accepted as a basis for the organisational development of the EU’s system of economic governance?
- Identification of national institutions that are vital to economic governance (e.g. supervision of pension systems, better regulation authorities, etc.). For each, the question will have to be asked: are the relevant EU networks up and running? Are the secretariats (EU agencies) of these networks functioning as can be expected in the EU’s multilevel subsidiarity-based system?
- Working towards a shared understanding of what subsidiarity-based governance demands in terms of general requirements (e.g. independent analysis, transparency, first and second-order control, maximising subsidiarity while ensuring team-based enforcement by the Commission where possible, teamwork to maximise empowerment of national institutions, keeping EU institutions/agencies lean and mean).
- Using the lessons from the benchmarks and the requirements for subsidiarity-based governance, stress tests are needed of the European networks of vital economic institutions (testing national capacities and the management roles of EU institutions in terms of network-based second-order control).
Annex 1  Milestones towards hierarchical steering and a fiscal Union

As regards EU control, different stages can be identified. This periodisation allows identification of milestones in economic governance.

- 1992: The Maastricht Treaty started lightly with the establishment of the convergence criteria.
- 1997: Start of the legal approach: Germany pressed for the Stability Pact that developed, at French insistence, into the Stability and Growth Pact. Further additions (including a brief attempt to make the rules flexible in 2005) to the legal approach have included: Six-Pack, Fiscal Compact, Two-Pack, and TSCG (Treaty on Stability, Coordination and Governance).
- 2000: Open coordination: Because of the limited EU competences regarding fiscal and economic policies, the Lisbon Council Meeting initiated the Lisbon Process as a large-scale learning and peer group process. At one point, approximately 300 variables were part of the deliberations.
- Direct forms of fiscal steering: beyond the elaboration of rules themselves, the ESM was created which can be regarded as rule-based with the almost legalistic and much-feared tool of the Memorandum of Understanding.
- Currently, the RRF is the main tool, especially the ‘grants’ component.

The Lisbon Process and the increasingly detailed legal approach were attempts at ensuring stability. The European Presidency under Swedish Prime Minister Reinfeldt concluded towards the end that ‘the Lisbon Agenda has been a failure’. The recent report from former President of the Economic and Financial Committee (EFC) and the Eurogroup working Group (EWG) Wieser (2020), likened the legalistic semester to a Christmas tree with DGs of the Commission adding their specific concerns, and he noted the deficiencies of the process. Literally, on the Commission website the graphical presentation of the steps in economic supervision, with the pre-emptive and corrective arms, shows a finely detailed Christmas tree. Apart from questionable effectiveness, the rule-based approach is not popular among the enforces in the EU Commission. Prodi spoke of “stupid” rules, Juncker of the dangers of applying rules (“Countries are like wild horses, punishing them is not the way to tame them”), while Moscovici’s moto was “dialogue, dialogue, dialogue.” Legal governance is hard to combine with a Commission preferring political governance. The dislike of rules (including fines, preconditions and controls) and the difficulties of enforcing them is also visible in the current discussions on the rule of law and the related conditionality in the EU budget.

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