Macroeconomic Conditionalities:
Using the Controversial Link between EU Cohesion Policy and Economic Governance

Martin Sacher, October 2019

This blog summarises the following published article: Sacher, M. (2019). Macroeconomic Conditionalities: Using the Controversial Link between EU Cohesion Policy and Economic Governance, *Journal of Contemporary European Research* 15(2): 179-193. https://doi.org/10.30950/jcer.v15i2.1005

Research for this article was funded by the Luxembourg National Research Fund (FNR).

Cohesion policy, as one of the EU's few redistributive policy fields, provides important financial resources to EU member states for investment in line with the EU's economic priorities. The institutional setting of EU economic governance has been subject to significant change since the outbreak of the euro area crisis that has not only reinforced the rules of fiscal and macroeconomic surveillance, coordination and enforcement, but has also linked the European Structural and Investment Funds (ESIF) to the rules and objectives of fiscal and economic policy coordination. With the 2014-2020 funding period, several mechanisms were put in place that link these two policy fields (see European Union 2013). The economic rationale behind the introduction of macroeconomic conditionalities was the supposed necessity of a sound fiscal framework for investment to be effective (European Commission 2011). The European Commission has been given considerable enforcement power in imposing this link between cohesion policy and economic governance. It can now request revisions to member states' Partnership Agreements when it is deemed necessary for supporting the implementation of a relevant Country-Specific Recommendation issued under the European Semester. More strikingly, the Commission has to propose to the Council the suspension of ESIF commitments or payments if a member state does not take effective action to correct its excessive deficit under the corrective arm of the Stability and Growth Pact (SGP) (European Union 2013). While macroeconomic conditionalities already existed for the Cohesion Fund, conditionality is now extended to all ESIF (Viță 2017). The extension of macroeconomic conditionalities was debated in the context of the negotiations of the 2014-2020 Multiannual Financial Framework, at the height of the euro area crisis. It has been subject to significant opposition, especially from the European Parliament (European Parliament 2013). The economic rationale of sanctioning non-compliance with fiscal rules through the suspension of investment resources has been criticised on the grounds of its potentially counterproductive impact on the goal of cohesion, its de facto punishment of regions for the action of central governments (see Begg, Macchiarelli, Bachtler, Mendez, et al. 2014) and its potential pro-cyclical impact (see Huguenot-Noël, Hunter and Zuleeg 2017).

The application of the extended macroeconomic conditionalities was triggered for the first time in 2016. The Spanish and Portuguese governments, which were both under the corrective arm of the SGP (the Excessive Deficit Procedure (EDP)) since 2009, had failed to take effective action to address their excessive deficits. The Council Decisions of 12 July 2016 that established this failure triggered the sanctioning procedure under the macroeconomic conditionalities, as well as a sanctioning procedure based on SGP legislation according to which the Commission is supposed to propose to the Council the imposition of a fine. This latter proposal can be circumvented if justified by exceptional economic circumstances (European Union 2011). The suspension of ESIF commitments or payments can, however, only be lifted if the EDP is held in abeyance or if the Council abrogates the decision on the existence of an excessive deficit. Exceptional economic circumstances cannot serve as a justification for avoiding a suspension proposal.[1]

[1] The provisions described in the published article are those in force between 2014 and 2020. For the funding period 2021-2027, the rules have been reformed. The new provisions allow for the circumvention of the suspension of ESIF for not having taken effective action in case of a *severe economic downturn* (European Union 2021).

The Commission did not propose a fine for the two countries' non-compliance under SGP rules, taking into account their reasoned requests and exceptional economic circumstances (European Commission 2016a). Meanwhile, the proposal for a suspension of ESIF commitments was postponed until after a structured dialogue with the European Parliament had been held and the two countries had submitted their Draft Budgetary Plans (DBP) under the European Semester. Despite its mandatory character, the proposal for a suspension was not finally issued. The Commission took the decision to hold the EDP in abeyance after its assessment of the member states' reform plans, and the proposal for a suspension therefore became obsolete (European Commission 2016b). Given the Commission's legal obligation to propose a suspension, the application of the procedure seems to have been softened compared to the letter of its legal basis.

While a sanctioning procedure under Economic and Monetary Union (EMU) that did not lead to the imposition of sanctions is not exceptional in its outcome, the sanctioning procedure under the macroeconomic conditionalities is exceptional in its mandatory and quasi-automatic character. Therefore, it relates to the debate on the power of supranational actors under the institutional setting of post-crisis EMU. The academic debate on the impact of EU economic governance reforms upon the power relations between national and supranational actors points to increased surveillance and enforcement powers in the hands of the European Commission (Dehousse 2016; Chang 2013; Bauer and Becker 2014), with the Commission having greater margin of manoeuvre on rule interpretation and application (Schmidt 2016), but depending on the case applying the rules either in a flexible or in a rigid manner (Vanheuverzwijn 2017). The debate on the changing institutional setting and the potential enforcement of rules in economic governance has also been approached from a legal angle, pointing to an increased hardening of soft law governance procedures (Terpan 2015; Saurugger and Terpan 2016; Hodson 2018). While this legal approach allows for a precise characterisation of the institutional setting, the legal character of governance procedures does not allow for any predictions as to how the actors apply the provisions in practice (Hodson 2018).

The published article aims to answer the following question: Why was the application of the sanctioning procedure under the macroeconomic conditionalities with regard to Spain and Portugal softened compared to the hardness of its legal provisions? The analysis draws on aspects of the 'usage of Europe' approach (see Jacquot and Woll 2003; Woll and Jacquot 2010) in combination with the concepts of hard and soft law in order to show the consequences of strategic action for the application of the procedure and the enforcement of the rules.

The analysis of the published article shows that the Commission's role during the application can be characterised by a tension between the obligation to propose the suspension of ESIF commitments and the prevailing internal opinion that a suspension would not be appropriate in light of the economic situation in the countries concerned. This tension is reflected in the Commission's use of the threat of sanctions as an instrument to push Spain and Portugal to comply with their obligations under the EDP, while nevertheless opting for a soft and flexible approach concerning the amount of commitments to be suspended. MEPs engaged in strategic action that aimed to prevent the hard *shadow of hierarchy* (see Héritier and Lehmkuhl 2011) in the form of the suspension from taking effect and thereby moved the procedure in the direction of soft enforcement. They did so by using the idea that the suspension of the funds would have a negative economic impact and by strategically using the resource of time. By prolonging the structured dialogue, the European Parliament gave more time for Portugal and Spain to present new figures. Ultimately, both countries were found to be in compliance with their fiscal obligations before the Commission could propose a suspension.

The mandatory and thus hard law character of the procedure was softened by the European Commission's flexible application of the provisions and by the European Parliament's *strategic usage* (see Woll and Jacquot 2010) of the procedure. The application of macroeconomic conditionalities with regard to Portugal and Spain is therefore a good example of how strategic usage can shape the application of procedures in terms of their hardness or softness.

While it may seem contradictory that the Commission strategically uses the procedure while at the same time holding the opinion that sanctions are not the best course of action, this observation actually supports the idea that sanctions are generally supposed to be used in severe situations, and are mainly an instrument to induce policy change. Therefore, the usefulness of the SGP and the role of the Commission in policy enforcement should not be assessed based on the imposition of sanctions, but by considering the strategic use of the provisions of the procedure and the variety of goals that can be pursued using the threat of sanctions. The results of this analysis are of further relevance in light of the increasing reliance on conditionalities in wider EU governance, which might even link ESIF funding to respecting the rule of law. However, even strong conditionality provisions are no guarantee for strict enforcement, as the effective character of the provisions will depend on their use by European and national actors.

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