

# The new political economy of healthcare in the European Union: The impact of fiscal governance

Scott L Greer, University of Michigan School of Public Health, [slgreer@umich.edu](mailto:slgreer@umich.edu)  
Holly Jarman, University of Michigan School of Public Health, [hjarman@umich.edu](mailto:hjarman@umich.edu)  
Rita Baeten, European Social Observatory, [baeten@ose.be](mailto:baeten@ose.be)

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## *Abstract:*

We argue that the political economy of health care in the European Union is being changed by the creation of a substantial new apparatus of European fiscal governance. A series of treaties and legal changes since 2008 have given the EU new powers and duties to enforce budgetary austerity in the member states, and this apparatus of fiscal governance has already extended to include detailed and sometimes coercive policy recommendations to member states about the governance of their health care systems. We map the structures of this new fiscal governance and the way it purports to affect health care decisionmaking.

## 1. Introduction

EU fiscal governance is a largely new system, built since 2010, in which the institutions and member states of the European Union monitor and constrain each others' finances and policies in order to keep deficits below 3% and debt below 60% of GDP. Focused on public expenditure, it promises to shape the health systems of EU member states. without being driven or justified by concerns with health systems. Rather, it is directed at ensuring conformity with a set of fiscal and economic policy objectives in member states. Because health systems are large, expensive, and public, they are targets of any fiscal governance system that tries to constrain state expenditure <sup>1</sup>. That is a pattern we have seen in EU health policies before <sup>2</sup>. Because the EU's powers under Article 168 of the Lisbon Treaty for healthcare policy are weak, and member states are reluctant to support EU health policies, policies affecting health and healthcare have traditionally been driven by other concerns such as market integration, environmental protection, or competition law, and based on those treaty articles <sup>3</sup>.

This paper, as part of a special issue on austerity and health in Europe, focuses on the substantial institutional changes made to the EU since 2010 as a result of the financial crisis that began in 2008 and that manifested as a sovereign debt crisis in the Eurozone in 2010. We argue that the political economy of health care in the EU, by which we mean the relationship between political and economic power, has been modified by these extensive changes. The result is that the EU has made substantial claims of authority over health care

systems in the name of overall fiscal governance rather than health care; that the system of fiscal governance that now includes health care is primarily designed to constrain expenditure rather than promote health or other goals; and that the sustainability and effects of the system remain to be seen but could be important issues.

The next section discusses the crisis as it happened, starting with the loss of market confidence in Greek debt and the cascading bond market problems of different Eurozone members. Member states reacted with a short term expedient, providing large loans subject to the supervision of an intrusive “Troika” of the European Commission, IMF, and, with essentially no legal or theoretical backing, the European Central Bank. The Troika’s task was to make specific policy recommendations and release financial support in return for compliance with the policies.

Member states also reacted with a longer-term effort to police EU member state finances that is intended to be more effective than the old fiscal governance systems that had self-evidently failed to prevent a crisis. The third section of the paper discusses the architecture of the long-term fiscal governance system that they built through legislation and a new treaty. The fourth section focuses in on the part of that architecture most directly concerned with health systems, namely the “European Semester”, a process that gives increasingly specific and detailed instructions about health policies to member states. The fifth section discusses what we know so far about the effects of EU fiscal governance, on its own terms (as a force for policy change) and in terms of its effects on health.

Our focus is on the architecture and effects of the EU policies. That should not obscure two facts. First, the bulk of austerity policies have been enacted by governments, not at the specific behest of the EU. This translates to a problem of overdetermination: if a

government that seeks austere policies is also subject to EU austerity rules, against a backdrop of austerity in most rich countries, and amidst rising deficits or debt, then it is hard to determine just what caused the austerity policies. In at least one case- Latvia <sup>4</sup>- the EU restrained a right-wing and ethnically exclusivist government <sup>5</sup> from its preferred policies, obliging it to make smaller cutbacks than the Latvian government sought. Nor should it obscure the effects of the crisis itself on health, through mechanisms such as unemployment <sup>6</sup>.

Second, the EU is largely governed by center-right politicians and has been so throughout the crisis. A majority of the member states in the Council, a plurality of the members of the European Parliament, and the bulk of the Commissioners (who are selected by member states and ratified by the Parliament) are all of the right. We should normatively and empirically expect policies of the right rather than the left. The legislation and treaty that constitute the new system of fiscal governance, discussed below, were political choices by European leaders that could have been made differently (and who also proved themselves quite capable of ignoring Commission proposals)<sup>7</sup>.

Europe's elected leaders have, however, voted to constrain their successors in both broad economic and social policy, and in health policies. They have constructed a regime that is deliberately "hard", with automatic mechanisms to identify deviations from their preferred economic and social policies, elaborate surveillance and policy prescription that extends to healthcare, and legal consequences on the European and domestic levels for future member states that choose a different path. The EU might show its democracy in the fact that it bound its member states for the future, but it is also constraining the future

options of its leaders. In the future, the EU will have a major role in health policy in pursuit of low deficits and debt, best described as austerity economics <sup>8</sup>.

## **2. Fiscal governance in the EU**

The European Union has long been a primarily economic project, developing political unity through economic unity. This bias towards economic integration, repeatedly agreed or accepted by member states and politicians over decades, produced a characteristic “constitutional asymmetry” in which market-making, and the regulation and deregulation of European markets, was legally and politically easier than creation of compensatory mechanisms for redistribution <sup>9</sup>. With the drive to monetary union, member state governments began to see greater needs to coordinate their fiscal and public policies so that one state could not destabilize broader European markets. The EU adopted a regulatory approach, using a set of harder and softer legal mechanisms to (in theory) prevent and punish imprudent governments. As the financial crisis showed, these mechanisms were flawed in themselves, as disciplinary instruments, and in their functionality, as mechanisms to prevent economic crisis.

### **Prehistory: EU fiscal governance before the crisis**

EU fiscal governance draws on an approach and body of knowledge that have been established over decades <sup>10, 11</sup>. There is a long history of economic and monetary integration in the European Union, dating back to the 1970s when the end of the Bretton Woods monetary system led to currencies floating against each other and countervailing

efforts by European policymakers to increase the predictability of exchange rates. Given that exchange rates reflect real differences in economies, reducing the variability in exchange rates reduces the ability of the monetary system to cope with variability in states' economies- including their business cycles, inflation rates, and fiscal policies.

Within most modern states, the loss of floating exchange rates is compensated by a welfare state that redistributes resources towards people and regions whose economic prospects are weak. But the EU has no serious redistributive mechanism between states. Its budget, most of which comes from value added taxes, is capped by the member states at about 1% of EU GDP, while EU countries spend an average of 8.3% on healthcare alone. Much of the EU budget is then spent in ways that are only weakly redistributive, such as agricultural policy, or constitute infrastructure investments in poorer regions that are helpful but resemble a redistributive welfare state in neither quantity nor kind. At no point have member states seriously agreed on greater redistribution. This means that the cost of adjustment to any currency union must be born through some kind of internal mechanism such as lower wages and public expenditure.

In theory, one way to avoid financial or economic crisis in a currency union is to forestall it by having similar economies with similar fiscal policies that avoid debt and thereby, in theory, reduce their vulnerability to shocks. Countries with limited debt are in principle less likely to fall into financing crisis, and in the 2008- crisis have reacted with more impressive measures to preserve employment and welfare. The logic of monetary and economic union without redistribution might suggest a very prudent fiscal policy by the member states. In the context of the Eurozone, that means a set of institutional

arrangements to monitor and constrain member state deficits and the policies that might create them

The 1992 Maastricht Treaty, in which most EU member states made the commitment to monetary union, built in mechanisms to police member state debts and deficits. Accession to the single currency required that member states have, among other indicators, deficits below 3% of GDP and debt below 60% of GDP. In theory, noncompliant states would not be admitted to the Euro. At the same time as they agreed the Maastricht Treaty, the member states committed themselves to a Stability and Growth Pact (SGP) that would enforce the same fiscal policies after the establishment of the Eurozone<sup>12</sup>. Member states were obliged by the SGP to have standardized statistics, which would allow the European Commission to gauge their compliance; and then adhere to the 3% deficit and 60% debt targets.

Flanking the SGP mechanism, which in theory was hard law with fines for noncompliant states, the EU started to build a machinery for developing social policy ideas and recommendations. This “soft law” machinery was justified by the SGP targets and the need to coordinate fiscal policy so that SGP breaches or economic distortion could be headed off. A mechanism called the “Broad Economic Policy Guidelines” (BEPG) brought member states and the Commission together to evaluate policies, ensuring in theory that there would be ex-ante policing of expansionary policies as well as the ex-post sanctions of the SGP. It certainly seemed weak. Notably, Ireland was formally reprimanded for procyclical policies but ignored the reprimand<sup>13</sup> while member states found various ways to water down its recommendations<sup>14</sup>.

After the Maastricht Treaty, but before the establishment of the Euro in 2000, member states of a more social democratic persuasion had a majority in the late 1990s and early 2000s, and wanted to put “social” concerns such as health and pensions onto the EU agenda with more equal footing to fiscal policy targets<sup>15</sup>. Their tool was the much-studied and generally disappointing Open Method of Coordination (OMC), a process in which the Commission and member states agree various social policy targets and monitor progress towards them<sup>16</sup>. While the OMC has had very limited and contingent effects on policy, it has contributed to the EU’s expertise and confidence in making detailed recommendations on social policy. Between the BEPG, the OMC, and the surveillance activities of other agencies such as the OECD and IMF, there is quite a library of potential, typically liberalizing, reform ideas for each member state. Many of them have been agreed with a greater or lesser degree of seriousness by the member state through processes such as the OMC and advisory committees such as the Economic Policy Committee and Social Protection Committee. This agreement authorizes the Commission and other bodies to start trying to expand and enforce commitments member states politicians might have regarded as inconsequential<sup>17</sup>.

As it happened, many Eurozone member states were admitted to the Euro without adhering to Maastricht targets (progress toward them was declared sufficient)<sup>18</sup>. After the single currency started operation in 2000, member states continued to violate the SGP. In 2005, when the Commission threatened to start noncompliance proceedings against powerful France and Germany, the member states agreed to soften the SGP, expanding the “soft law” policy mechanism still more. Sanctions for SGP violations were made easier to evade, but soft law mechanisms for fiscal and policy surveillance were expanded<sup>19</sup>.



The Eurozone saw a boom in many of its peripheral economies in the first decade of the twenty-first century, largely because interest rates in peripheral economies (in central and eastern Europe as well as the Eurozone) dropped greatly. This allows banks in the somewhat stagnant core countries such as Germany to make loans to speculative developments in the more peripheral states. In turn, this “hot money” often distorted economies (the boom in Spanish construction sped up that country’s effective deindustrialization, for example)<sup>8</sup>. The influx of money also allowed Greece to continue its inegalitarian, expensive welfare path, with a segmented welfare state that lavished resources on some groups while producing broadly inegalitarian outcomes <sup>20</sup>. The budgets of peripheral states such as Ireland and Spain were, on paper, healthier and more austere in these years than Germany or France because they benefitted from booms fuelled by speculative inflows that the Eurozone enabled.

In summary, the prehistory of fiscal governance in the Eurozone is not a story of success. Maastricht Treaty required limited public debts and deficits for Eurozone accession, and the SGP required that member states, once in the Eurozone, continue to adhere to those limits. The BEPG were supposed to coordinate policies to prevent SGP violations, but were not effective. In the late 1990s, more Social Democratic governments added the Open Method of Coordination as a way to promote social policy goals and soften the SGP focus on deficits and debts. After the launch of the Eurozone, the SGP as well as the softer BEPG and OMC were broadly ineffective, and the SGP was notably rewritten to be softer when it was being violated by Germany and France. As of 2008, then, there was not much reason to be impressed with the effectiveness of an SGP and flanking soft law mechanisms that had been violated with impunity and had been rewritten to be less

powerful. As the crisis would reveal, furthermore, speculative capital made it possible for Ireland and Spain to be compliant with the SGP, despite structural weaknesses, and the efforts to coordinate statistics had not prevented misrepresentation in Greece or other countries. Eurozone fiscal governance had not been obviously successful at preventing deficits or debts.

### **History: Financial crisis, fiscal crisis, political crisis**

Dependence on hot money and speculative projects is dangerous in a financial crisis such as began in 2008; loss of bond-buyers' faith in the solvency of banks, in particular, led to an abrupt economic stop that ripped through the economies of Europe <sup>21-23</sup>. When European policymakers, notably the ECB and Germany, refused to say that they would support Eurozone member states in trouble, market players saw an opportunity to bet against the debt of such countries and financial institutions exposed to them. Early in the crisis, a firm statement of support from key policymakers could probably have prevented all subsequent developments, but they were not willing to risk creation of an ineffective ("soft") budget constraint, and let the weakest peripheral economy, Greece, face increasingly difficult government debt markets <sup>24</sup>. The result was an investment strike against government debt in much of the EU periphery, with governments finding it increasingly difficult to sell their debt.

Greece, then Ireland, Portugal, and Cyprus entered a form of receivership in relatively short order, with their European Union partners forcing them into receivership even when markets had not obviously done so (as in the cases of Ireland and Cyprus).

Behind them was the risk of a run on Spanish or Italian government debt, which threatened the whole Eurozone. Receivership meant conditional loans supervised by an improvised “Troika” created for the purpose and composed of the European Commission, European Central Bank (ECB), and International Monetary Fund (IMF) with no obvious base in the European treaties. The participation of the ECB, in particular, was striking; there was nothing in the EU treaties, or in the theory of central banking, that suggests it is appropriate for the central bank to be engaged in detailed fiscal and public policymaking. Member states in crisis that were not part of the Eurozone, such as Latvia and Hungary, were subject to joint intervention by the IMF and European Commission (“Balance of Payments programmes”).

The Troika’s main tool for containing the crisis (before it hit Italy and Spain), was well known from the experience of international financial institutions: conditional lending. Conditional lending can be seen as a tool for managing the risk of soft budget constraints while maximizing lender influence over countries’ policies and fiscal choices. In conditional lending, the loan is divided into “tranches” which are contingent on the recipient state carrying out a set of policy reforms (called “Economic Adjustment Programmes,” EAPs) that are expected to make the recipient state’s economy more sustainable. The loans from the Troika to Cyprus, Greece, Ireland, and Portugal were far larger than debtor states normally receive from international financial institutions, reflecting the risk to other Eurozone countries’ banks and economies.

The EAPs contain broad fiscal objectives as well as somewhat softer advice. The broad fiscal objectives are mostly about reducing government deficits- in other words, through budget cuts and tax increases. The policy contents of the EAPs are substantial and

directive and often reflect on health policy <sup>25</sup>, which seems reasonable given that the health sector is one with substantial fraud in areas such as pharmaceuticals, purchasing, and informal payments <sup>26</sup> as well as the kinds of waste studied by health economists and health services researchers. The second (2012) Greek EAP, in particular, focuses on reforming the healthcare sector, in part because of the scale of the problems discovered in the healthcare sector during the efforts to implement the first, 2010, EAP <sup>27</sup>. They include, to take the Greek case as an example, concentration of responsibilities for health in the health ministry, installation of an e-prescription system (in part to reduce fraud), introduce double-entry bookkeeping in hospitals (!), increased transparency about performance and finances including audits, and efforts to reduce pharmaceutical expenditure such as introduction of generic substitution. Measures such as the labor market liberalization that all EAPs recommend also would influence the conditions of health sector workers. For example, the public sector headcount reduction's effects were important in the case of doctors who quit the public sector rather than accept full-time public sector employment <sup>28</sup>. In Cyprus, the policy recommendations actually contain provisions that are somewhat progressive, since they in principle urge Cyprus to retrench its existing fragmented system while expanding financial access <sup>29,30</sup>.

The record of conditional loans in promoting this kind of structural adjustment has been extensively studied in the several decades when they have been widely used, and is not good <sup>31</sup>. One literature review found that effects on growth are small on average, they are damaging for weaker groups in society, they tend not to damage corrupt elites, and they face unexpected consequences and major implementation problems <sup>32</sup>. The IMF's own review of the Greek lending program seems to show these results <sup>33</sup>, though the Troika has

forced changes in the organization of healthcare in Greece and the other peripheral states<sup>34</sup>.

Meanwhile, the states under the Troika have mostly fulfilled the core economic targets of reduced deficits, though shrinking or stagnant economies mean that their debt:GDP ratios are still generally getting higher. Fulfilling these targets does not occur through the relatively nuanced policies in the EAPs such as generic substitution or ministerial reorganization so much as through major changes in the public finances such as budget cuts, reductions in the list of covered services, pension cuts, staff cuts, claw-backs, or revenue measures such as higher taxes or user fees. This seems to be the case, and the reason, for the upheaval in the health services of the peripheral Eurozone. Any benefits of efficiency measures have been overwhelmed, in the short term, by the organizational and health access consequences of budget cuts (the IMF, in fact, is promoting restoration of some budgets in order to reduce communicable diseases and improve health access for the long-term impoverished)<sup>28</sup>.

### **Shaping the future?: strengthening fiscal governance**

There might have been a variety of ways to understand and frame the financial crisis, but the one that Europe's key elites settled on focused on the risk of a soft budget constraint- in other words, the argument that states would pursue imprudent fiscal policies if they expected a future bailout. "Creditor" countries, led by Germany but also including states such as Finland and the Netherlands, adopted the position that the Troika bailouts, and any future hope of a bailout, would have to be accompanied by very strict and punitive measures that would prevent states spending irresponsibly. The political bargain, as seen

especially from leading creditor country Germany, is that the bailouts and other irregular behavior during the crisis must not become a precedent, and the route to achieve this is a redoubled commitment to balanced budgets.

The result was the new architecture of fiscal governance in the EU, which involves legislation as well as a whole new treaty that obliges signatory states to adhere to the SGP and even make it part of their domestic constitutional law. The next section, 3, discusses the architecture of this fiscal governance system, and section 4 discusses its most specific form of policy advice, the European Semester.

The Commission Staff Working Paper on the Semester as a whole for 2014 (SWD(2014) 401), summarizing the agenda for policy reform, gives a particularly striking presentation of the logic of policymaking in EU fiscal policy. After noting deterioration in a range of social statistics, including unemployment and risk of poverty, and spelling out some of the links between poverty, health, education, and generally blighted life chances, it continues:

“In mitigating these challenges for the well-functioning of the euro area, ambitious implementation of structural reforms leading to a more flexible economy are key. Structural reforms cannot only contribute to a durable rebalancing process, but also attenuate the negative impact of households' deleveraging: stronger real wage adjustment leads to a smoother reaction of employment and, consequently, of real output, while a faster adjustment in prices allows for an also faster adjustment in the real interest rate towards the equilibrium level.” (p.9)

The prose is not very clear, but in short the solution to a deteriorating social situation marked by low incomes and unemployment is adoption of “structural reforms” (basically labor market liberalization) whose objective is to enable lower wages (“stronger real wage adjustment”) and raise unemployment (“smoother reaction of employment”), risking deflation (“faster adjustment in prices” and “real output”) in order to attain an “equilibrium real interest rate”.

This is austerity economics with a vengeance <sup>8</sup>. The goal, an equilibrium real exchange rate, is a fiction confined to limited economic models, but the policy objectives justified by the goal are concrete: unemployment and lower wages for many. Apparently the theory is that once wages are lower and employment higher, the economy will be durably rebalanced and therefore able to grow again, and that will in turn improve the dire social statistics the Commission discussed in the previous paragraph. But in the mean time, we are left with the argument that the solution to unemployment and poverty is policy that enables more unemployment and poverty. This argument, with its obvious distributional implications has a long and contested history in politics and economics. It has now been entrenched in the fiscal governance of the EU, discussed in the next two sections and elsewhere <sup>34, 35</sup>.

### **3. On paper: the architecture of fiscal governance**

Given that the origins of fiscal governance lie in the Eurozone financial crisis, it is not surprising that the focus and justification of EU fiscal governance is the policy objective of 3% deficits and a 60% debt: GDP ratio. Health systems and broader policy determinants of

health are important in this framework because of their budgetary implications.

Furthermore, if objectives are fiscal, the argument that a given policy is a necessary investment is relatively hard to make; the costs are clear and on-budget, while the benefits are more speculative<sup>36</sup>.

The EU's reformed fiscal governance architecture does four things: i) promotes greater harmonization among states regarding the goals, methods, and schedules used in planning their national budgets, ii) builds on deficit and debt rules to allow broader 'macroeconomic imbalances' to be addressed, iii) broadens and deepens the ability of the central EU institutions and third party organizations (such as the IMF) to conduct surveillance, and iv) strengthens penalties for non-compliance.

In 2011, the EU passed five regulations and one directive, collectively known as the 'six-pack', aimed at addressing the SGP's perceived weaknesses (see Table 1). The six-pack ties states to Medium Term Objectives (MTOs), defined in terms of a state's structural budget balance (European Commission 2013). The six-pack defines what constitutes a significant deviation from an MTO, and sets out what should happen if a state strays from that path. The regulations contain strong sanctions for states that are non-compliant with recommendations under the Excessive Deficit Procedure (European Commission 2014: 4), which, despite its name, is now used to enforce compliance with both debt and deficit rules. Non-compliance can result in annual fines or suspension of Cohesion Fund financing for projects such as infrastructure.

The final two regulations in the six-pack broaden the SGP considerably, extending the norms underlying the debt and deficit rules to many other potential areas of policy. The Macroeconomic Imbalance Procedure (MIP) covers "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 EU as a whole". The MIP allows the Commission to conduct more extensive surveillance of states and publish recommendations about how to address imbalances. States with excessive imbalances must respond by formulating Corrective Action Plans in which they describe the policy actions they will take to address the imbalances identified. Failing to submit an acceptable CAP or non-compliance in implementation can result in penalties. Aspects of both the EDP and MIP are decided by Reverse QMV, meaning that unless a qualified majority of the Council votes against a penalty within a certain time period, it is imposed automatically.

Table 1: Reforming the EU's Fiscal Governance Architecture

Year	Policy	Effect
2011	<p>The Six-Pack</p> <ul style="list-style-type: none"> <li>• Regulation (EU) 1173/2011</li> <li>• Regulation (EU) 1174/2011</li> <li>• Regulation (EU) 1175/2011</li> <li>• Regulation (EU) 1176/2011</li> <li>• Council Regulation (EU)</li> </ul>	<p>Strengthen the SGP</p> <ul style="list-style-type: none"> <li>• Compliance with and enforcement of SGP rules.</li> <li>• Correct excessive macroeconomic imbalances.</li> <li>• Multilateral surveillance via European Semester.</li> </ul>

	<p>1177/2011</p> <ul style="list-style-type: none"> <li>• Council Directive 2011/85/EU</li> </ul>	<ul style="list-style-type: none"> <li>• Define scope of Macroeconomic Imbalance Procedure.</li> <li>• Boost corrective arm of SGP via Excessive Deficit Procedure.</li> <li>• Harmonize ways in which states (except UK) plan and publish budgets.</li> </ul>
201 2	<p>Treaty on Stability, Coordination, and Governance</p> <ul style="list-style-type: none"> <li>• Non-EU international treaty signed by 25 EU member states.</li> </ul>	<p>Ensure tougher fiscal discipline</p> <ul style="list-style-type: none"> <li>• Require states to converge on MTOs.</li> <li>• Require states to maintain lower deficit ceiling than under SGP.</li> <li>• Require states to transpose commitments into national law of a “binding force and permanent character, preferably constitutional”.</li> <li>• CJEU can issue financial sanctions for non-compliance.</li> </ul>
201 3	<p>The Two-Pack</p> <ul style="list-style-type: none"> <li>• Regulation 472/2013</li> <li>• Regulation (EU) 473/2013</li> </ul>	<p>Formalize ad hoc fiscal governance arrangements</p> <ul style="list-style-type: none"> <li>• Increase surveillance for financially unstable states, broaden information base</li> </ul>

		<p>for surveillance.</p> <ul style="list-style-type: none"> <li>• Add common timeline to European Semester, acknowledge the TSCG.</li> </ul>
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But the six-pack did not go far enough for some states. The Treaty on Stability, Coordination, and Governance contains elements originally intended to be part of EU law, but opposition from the UK and Czech Republic forced policymakers to conclude the treaty outside of EU frameworks. The treaty requires member states to adhere to tougher deficit standards than under the SGP, and requires them to transpose their commitments to fiscal discipline into national law of a 'binding force and permanent character, preferably constitutional'.

To deal with this unexpected failure to integrate the Treaty into EU law, the EU passed two more regulations in 2013 known as the 'two-pack', designed to formalize and consolidate some of the ad hoc procedures developed during the crisis and acknowledge the TSCG within EU law. These regulations strengthen the 'European Semester' a common annual cycle of review, recommendation, and adjustment, that promotes greater harmonization among member states in terms of budgetary planning and agenda setting (see below), and formalize a number of procedures for dealing with states in crisis.

Taken together, the reforms constitute a significant challenge to welfare states in the EU as they currently exist. In future years, the EU's rising healthcare costs, significant pension obligations, and ageing population- and any government interested in expenditure- are likely to collide with the blunt instrument of its fiscal governance

architecture. These governance structures do not address income inequality, redistribution or policy goals such as healthy populations. Although the EU is reshaping itself fiscally, we have yet to see how this increased fiscal discipline will impact safety nets across Europe.

#### **4. The European Semester and the expansion of EU competencies**

Since at least the late 1990s the EU effect on healthcare systems was framed almost uniquely as an application of its general economic legislation to health care<sup>34, 37</sup>. While the OMC, BEPG, and lesser forms of international exchange all aspired to influence member state health policies, they were very soft forms of law that worked only when they had allies within the member states who were able to use them in domestic politics<sup>38</sup>.

The European Semester of economic policy coordination refers to an ongoing cycle of reviews and recommendations that brings together all the elements of the fiscal and macro-economic governance architecture discussed in the previous section. First implemented in 2011, the European Semester is a mechanism designed to ensure both vertical and horizontal coordination – not just among member states or between member states and the central EU institutions, but also across policy areas.

The Semester extends the logic of fiscal governance. In theory it pre-empts economic crisis by shaping member states policies to pre-empt imbalances and expenditure beyond SGP limits. It should both prevent policies that threaten progress

towards SGP compliance, and develop policies that address wasteful areas of expenditure that, left unchanged, would threaten SGP compliance.

The Semester starts in November with the publication by the Commission of an Annual Growth Survey, which sets out priorities for increasing growth and employment over the next year. The European Parliament has one of its rare opportunities to intervene when it and the Council discuss the Survey over the next months. The Spring meeting of the European Council (heads of state) then specifies challenges and policy directions. Member states then send their National Reform Programmes containing national economic plans and Stability/Convergence Plans, which outline their medium-term budget plans, to the European Commission. It evaluates them and then issues draft Country Specific Recommendations, finally adopted by the Council in June or July. These CSRs are the core of the process, giving specific advice on policies. Member states in a financial assistance mechanism (BoP programme or EAP) are under much more intense surveillance and are not subjected to the normal Semester process.

The process is, in law and in practice, mainly focused on austere fiscal objectives. In law, the Annual Growth Survey is focused on jobs and economic growth, and frames the national plans and the CSRs in terms of contribution to the SGP, prevention of Macroeconomic imbalances (through the Macroeconomic Imbalance Procedure), and the “Europe 2020” strategic objectives of jobs and economic growth. The formal process also includes minimal opportunities for civil society and legislatures, including the European Parliament, to have input; this might not be a big change for some member states with traditionally weak legislatures, but is a big change for states with traditions of strong parliaments or minority governments (in which there is no stable parliamentary coalition

to support the government). It is also a big change from earlier soft law processes such as the OMC which were supposed to incorporate civil society; the Semester is legitimated by fiscal policy, not better policy or legitimation through participation. Given that the Council of the EU is in principle a unique body, one sectoral Council configuration (e.g. of health ministers) is in principle unable to intervene on a decision of another Council configuration (e.g. of finance ministers). As a result, health ministers can only make broad comments about their preferred approach to health policy and not directly intervene in the Semester<sup>39</sup>.

The process has been firmly controlled by the European Commission, and within the Commission, DG Economic and Financial Affairs (ECFIN). Since the 2014 appointment of the new and more right-wing Juncker Commission, ECFIN has been led by a French Socialist, and so the Secretariat General, under President Juncker's control, has been taking more of a role at ECFIN's expense. The Commission is acting here as the effective secretariat to a broad creditor coalition of member states. There are few indications of a member state having successfully "uploaded" its preferences for a health CSR to the Commission, though there is a clear similarity between Austrian CSRs and its government's reform agendas. This is important. The EU is not merely validating the preferences of domestic actors, as frequently happened with earlier soft law processes. Healthcare expertise and interests are at two removes from the process: The broad social DG Employment and Social Affairs is involved in the decision-making on social policy recommendations, including on health. The small DG responsible for health is only involved in the preparatory process, providing expert input. Neither DG has any obligation to listen to the preferences of the health DG.

The austerity focus is more important by member states that receive a CSR with a legal basis in the Macroeconomic Imbalance Procedure, which can trigger coercive responses (see the section above). An increasing number of health CSRs have this legal basis. It is not clear how this basis is determined or what it will mean in practice, but it clearly links health policy CSRs to the important fiscal policy mechanisms.

As with much of the fiscal governance system, the policies are designed to limit political discretion. Nonetheless, the Commission does have discretion and has used it; for example, in the first CSRs it tended not to issue CSRs for both health and long term care if one demanded major policy change, and it was less likely to request health system reforms of states that opted out of the Eurozone with low political support for the EU (e.g. the UK). Member states that used the Semester to announce themselves major healthcare reforms did not receive recommendations in that year. Over time, however, the CSRs are extending to most states for both healthcare and long-term care.

The healthcare recommendations are mostly quite generic. They urge to enhance the cost-effectiveness of public spending and focus on the reduction of pharmaceutical expenditure, and lower hospital expenditure through better out-patient, primary, preventative care and better coordinating and integrating care delivery. They tend to suggest structural reforms, which means that the budgetary effects are likely to be longer-term. So long as they are generic and sound like many international suggestions for health reform (e.g. the OECD), member states have a relatively easy time claiming compliance. Many health ministries and experts, formally excluded from most of the Semester process, are also “lying low,” preferring not to educate DG ECFIN in order that it might produce more specific recommendations. This is not the case in other areas of social policy, such as

pensions, where recommendations are more detailed and regularly amended, and embedded in a pan-European network of officials and experts <sup>40</sup>.

## 5. Discussion

How do we understand the effects of the EU's fiscal governance system? There are a variety of ways in which we can evaluate it. This section first examines it on its own narrow terms: will member states comply? It then discusses the specific effect on healthcare systems. ##### in this issue discusses the impact of austerity on health outcomes.

### **Fiscal governance on its own terms: compliance**

The first question is whether the new fiscal governance regime will gain compliance. That can be answered in several ways.

First, comparative analysis can benefit from an abundance of cases of such balanced budget rules in the United States. Forty-nine of the fifty states have balanced-budget provisions in their constitutions, mostly dating back to the nineteenth century, which makes them the largest pool of jurisdictions with a history of the kind of obligations Europeans have now adopted. Their record is not encouraging. Essentially all of the states have debt in some sense (such as special authorities for capital expenditure or underfunded pension plans) and courts turn out to be very deferential to governments <sup>41</sup>. If the US courts have largely been deferential to state governments, because of the complexity and political salience of budgeting, what are the odds that the member state courts (or the



CJEU, should a member state refuse to respond to an adverse Council decision) would be more assertive?

Second, historical analysis of the EU's record is not positive for fiscal governance measures. As the "prehistory" section above showed, the EU's regulatory approach to fiscal governance has been faced serious compliance problems, notably the 2005 revisions to the SGP when Germany and France agreed to change the pact that they had both violated. The broad fiscal governance architecture shows signs of heading in the same direction. Spain has already been granted some latitude despite breaching its targets in 2014, and so has France. Defining concepts such as a deficit, let alone a structural deficit, also remains difficult and contentious <sup>42</sup>. The political stakes of declaring a major EU state noncompliant, and potentially triggering corrective action, are high enough to create reasons for the Commission and Council to use what latitude remains to them to avoid taking such an action. The credibility of the EU's commitment remains to be seen: Spain has already been allowed to escape penalties because its reform plans impressed the Council. Italy and France might be the crucial cases.

Third, an end to crisis economic situation might be a justification for the EU fiscal governance system. Unfortunately for analysis, there is a major confounding factor in analyzing the success or failure of fiscal governance in the Eurozone so far (we make this argument at greater length in (author 2015)). While the logic of Troika loans and the new fiscal governance is that it will credibly prevent policies that expand government debt and thereby reassure markets, the actual calm on European markets has been due to actions of the European Central Bank <sup>43</sup>. ECB President Mario Draghi turned the crisis with a speech in which he said the ECB would do "whatever it takes" to prevent the breakup of the

Eurozone. Interest rates on government debt in the peripheral countries immediately dropped. Later the ECB announced a program, called Outright Monetary Transactions (OMT), that would have involved purchasing and thereby supporting a wide range of debt. The OMT program was never implemented, and was of doubtful legality, but it calmed markets by making it clear that debt holders betting on a breakup of the Eurozone would be outmatched by a central bank with money-creation powers. Interest rates on peripheral debt dropped further, almost to pre-2008 levels. This history suggests that it was ECB action, rather than a credible promise of future austere fiscal policy, that actually preserved the Eurozone.

As for compliance with CSRs in health, the problem for evaluation is that they are so generic. The first serious evaluation of the Semester, produced by the European Parliament's research staff, was harsh. Across all member states and policy fields it found that EU member states fully implemented an average of 17% of CSRs and completely failed to implement 44%. The rate of non-implementation ranged from 64% in recalcitrant Slovenia to 17% in dutiful Italy<sup>44</sup>. Health compliance data is complicated by the generic nature of the recommendations. A later evaluation, by the European Commission, produced different results, with the ranking of countries rather different, and much more positive view with some progress on a large majority of CSRs<sup>45</sup>. According to a Commission assessment, the implementation record of the health and long-term care CSRs is estimated at 35 %, based on a synthetic indicator of EU-wide implementation (the best compliance was with the fiscal and financial policy CSRs). Provisionally, it seems that the smaller and weaker states in the Semester, and not just the ones in worse trouble, are more influenced than larger and economically healthier states.

The comparative data, historical EU data, and short history of the new fiscal governance all call its implementation into question: the tough “law on the books” of EU fiscal governance might not be matched by the “law on the streets” of policymaking and budgeting. The United States experience, though, shows that imperfect compliance by the standards of the law can be good compliance from a policy perspective; U.S. states generally do have budgets in rough balance, and are accordingly procyclical and given to cut back social policy expenditure just when needs are greatest. The policing seems to be because markets use balanced budgets as a sign of investment quality <sup>41</sup>.

What are the effects of fiscal governance on healthcare systems? Separating fiscal governance from general austerity policies is difficult; as in the case of Latvia, European influence can actually be more supportive of social expenditure than member state governments. There are some striking specific examples, mostly to do with communicable disease control; cutting AIDS treatment budgets has led to higher rates of infection in Greece, and cutting mosquito abatement budgets in Greece led to a re-emergence of malaria <sup>46, 47</sup>. Countries in the Excessive Deficit, Balance of Payments, or Troika procedures, and in fact most others, have increased co-payments, limited services and access to services for segments of the population, as well as cutting workforce, pensions, or public sector pay and benefits <sup>34, 48-50</sup>. The result, unsurprisingly, has been an increasing percentage of people in countries subject to EU austerity programs who report lack of access to healthcare due to inability to pay <sup>34</sup>.

What is the overall effect? On one hand, it seems that the Semester in health is not having big specific effects yet: generic calls for reorganization are having less effect than cruder, more direct policies to reduce expenditure such as reduction in access, reduction in

pay, or less expenditure. On the other hand, the prospect of violating fiscal targets seems to be driving a great deal of policy reform in the member states. The effect of the formal EU fiscal architecture is hard to clearly identify here, in part because it is new and in part because austerity is overdetermined in most member states (by bond markets, the ECB, and right-wing electoral coalitions as well as the formal EU architecture; the UK, for example, did not sign the fiscal compact but is pursuing austerity policies). Putting the two together, it seems that the EU fiscal governance framework, reinforced by the threat of central bank and market responses, constrains member states and thereby forces them to make reforms. The specific content of the CSRs is less effective, not because it is manipulated by member states but because it is generic and because the most specific recommendations are justified by the weakest legal base, namely the Europe 2020 strategy. If this is the case, as the process develops the recommendations will get more specific and member states will face more implementation pressure.

## **6. Conclusion**

Healthcare systems and policies are embedded in the larger political economies of nations: from access to regulation to public health policies, political forces and systems shape healthcare systems. Those larger political economies are shaped by larger forces than the healthcare systems; politicians are elected for a wide range of reasons unconnected to health policy, and make tradeoffs across a wide range of policies and objectives.

Fiscal governance in the European Union is an example of how health systems are embedded in larger political projects. A financial crisis turned into a sovereign debt crisis.

In the hands of Europe's largely right-wing governments, the crisis gave way to a short-term austere response in the Troika, and a longer-term form in the reinforcement and expansion of the fiscal governance system. Healthcare is an expensive part of the budget, and so it was an obvious target for reformers concerned with immediate savings and longer-term reforms that would enable compliance with the SGP through prudent budgeting. The result is an ambitious effort with clear political objectives to coordinate member state health policies and empower governments to make structural reforms in the interests of fiscal policy objectives.

The ambition of the new EU fiscal governance is impressive: tightly coordinated policy and budget making focused on public deficits and debt and enforced by all the EU institutions. It is an ambitious, and ideological project by the current liberal/ right coalition in Europe to lock in their small-government preferences for the future.

It might not work. It is possible to argue that EU leaders have created a large and invasive mechanism for monitoring and shaping member state policy in the name of the SGP that will fail on its own terms, neither being implemented nor producing the economic growth that is supposed to remedy the EU's social problems<sup>51</sup>. But it is more likely that the EU's framework has helped to anchor expectations: only member state that are compliant or reforming to be complaint will receive help from the ECB and the rest of the EU<sup>41</sup>. Meanwhile, the Semester is producing a learning process that will lead to more specific reform ideas that can be evaluated- and yet will still be grounded in fiscal austerity rather than health goals. Either outcome would be a problem for the health of Europeans as well as the health of European politics.

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