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Europe Afterwards. Recommendations for a global strategy to settle the crisis

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Abstract

Faced with the sovereign debt crisis, the eurozone Member States have been obliged to take decisions moving towards greater European integration. This has rekindled the debate over European federalism. But the move towards greater European integration has been made under the pressure of circumstances, without any overall plan. Therefore, it seems time to reflect on a global solution, on coordination between the various responses that have already been put forward and on a synthesis between the various positions of the different actors. A global response to the crisis might comprise the creation of a European Treasury, the definition of a European growth strategy and institutional reforms that aim to underpin the democratic legitimacy of the eurozone. Moreover, it is also necessary to look into the issue of differentiated European integration.

INTRODUCTION

Answering the question of the eurozone's future is becoming increasingly urgent [1]. The proposal to have a referendum in Greece, which was finally withdrawn, regarding the decisions taken during the eurozone summit on 27th October 2011 was a source of perplexity on the part the country's European partners, the US and emerging powers; this fear resurfaced after the Greek general elections on 6th May which did not lead to the emergence of a clear majority but to the impossibility of forming a government. Is the European Union able to take binding decisions at the very highest level? We know that European decisions are difficult ones to take given the differences between the Member States, but if, in addition to this, the decisions unanimously taken are, afterwards, challenged by one State, then their credibility becomes extremely low.

The choice then seems clear – *a priori*: on the one hand, we have an evolution towards a more integrated political-economic system in the eurozone, and, on the other, national entrenchment, potentially till the implosion of the eurozone. However, since the start of the crisis,

a compromise situation has held sway. Member States have chosen to privilege an intergovernmental decision-making method which seemingly guarantees national interests and weakens the institutions that guarantee the common interest such as the Commission and the European Parliament. At the same time, under pressure from financial markets, they have taken decisions that are moving towards ever greater fiscal solidarity and enhanced supervisory rules. This compromise undoubtedly results from the paradoxical nature of Europe's situation: the combination of (i) major differences leading Member States to refuse to abandon their right to veto over European decisions and (ii) great economic interdependency.

But this compromise seems to be increasingly fragile. By simply browsing blogs and opinion polls, one can see that many citizens say that the debate has been hijacked and criticise the decision-making method, which privileges decisions negotiated by national diplomacies under the pressure of the markets. As for investors, they are worried about the uncertainty that results from the intergovernmental method. The consequence of this has been widespread irrita-

1. A first version of this text has been published in the "Schuman report, State of the Union 2012" <http://www.robert-schuman.eu/ouvrage.php?num=141>

tion in the face of a never ending political and economic crisis.

Whilst the European Union and the eurozone hesitate between collapse, status quo and continued integration, fundamental debates over the future of European integration are underway: political union, fiscal federalism, the status of countries outside of the eurozone and in particular the UK. Debate has been started at the highest level in Germany. Angela Merkel was quite clear in an interview she gave to several European dailies on 19th January 2012: *"After a long process, we shall transfer more competence over to the Commission which will function like a European government for European competences. This implies a strong Parliament. The Council, which brings together the heads of government, will then form the second chamber. Finally we shall have a European Court of Justice as the Supreme Court. This might be the shape of the future European Political Union (...)"* [2]. She revived debate again in an interview on 7th June 2012 over political Union and a two-speed Europe. This debate has to find echo within the entire Union and notably in France. However, whilst many taboos are now being lifted concerning the future of European integration, a non-debate over Europe has become clear in many EU Member States. The crisis is pushing us, however, to make choices whose economic and political consequences have to be debated immediately.

1. THE CRISIS : A CHANCE TO COMPLETE EUROPEAN INTEGRATION?

From crisis federalism ...

With the debt crisis in the eurozone, the issue of European federalism has become topical once more.

The present crisis has highlighted the incomplete nature of European integration and, more particularly, that of the eurozone: its Member States are caught midstream, since they have quit national monetary policies and markets without going the whole way – ie achieving budgetary integration and speaking as one, embodied by a clear, political leadership that enjoys strong democratic legitimacy.

As forecast by Tommaso Padoa-Schioppa, in normal circumstances an intermediary stage like this can

last for a long time; however in this time of crisis and exceptional circumstances, Europe now faces both a danger and an opportunity: the danger may lead to the collapse of the eurozone and the dismantling of the Union, the opportunity may allow further progress towards integration on the budgetary and political point levels.

The failure of the treaty establishing a constitution for Europe at first led to the clear wish on the part of national political elites to give up all references to any "federal" future for the European project. However what are we now seeing? Paradoxically, the present crisis is forcing the EU's founding countries towards greater integration. The European Financial Stability Facility (EFSF) created in May 2010, the power of which has been increased in 2011, is nothing more than a mechanism by which some States borrow on the markets for other distressed States, thereby spreading the risk within the eurozone. The rigorous conditions that are associated with it de facto limit the sovereignty of States benefiting from the aid. Moreover the crisis has strengthened the role played by an institution that is federal in nature – the ECB – whose role as lender of last resort – as far as it is willing to assume it – seems the only element capable of calming the markets.

Moreover, the Member States and the Community's Institutions are trying to strengthen economic governance mechanisms. The Council and the European Parliament have approved six legislative acts to strengthen economic supervision in the eurozone ("the six pack"). The Heads of State and Government also agreed on the intergovernmental treaty establishing a new "fiscal pact" which plans for the implementation of stricter rules in terms of countering deficit and public debt as well as introducing possible sanctions against States which are lax in this area. Hence real fiscal federalism is emerging even though the word is taboo in some Member States and barely audible in France.

However, as vital as they may be, these various elements do not seem to be enough to restore confidence. And this is not only because these "small steps" – which essentially strengthen preventive policies – cannot provide a global response to a systemic crisis which is already there; in addition, this method does not rise to the challenge made to the Union and the eurozone's democratic legitimacy. This deficit also fuels mistrust,

2. http://www.lemonde.fr/europe/article/2012/01/25/angela-merkel-ma-vision-c-est-l-union-politique_1634107_3214.html#ens_id=1634127

both of the austerity policies “imposed by external forces” on the States that have been weakened by the crisis, and of the solidarity policies, which the citizens of the States, solicited for their aid, fear will create a deadweight effect and encourage lax attitudes on the part of the “other” States.

It is because they cannot agree on a common idea about political and economic governance of the Union that the Member States cannot keep pace with the crisis.

... towards a joint economic project

Although the crisis is leading to greater federalism in terms of economic policy, Europe cannot afford to continue its integration under obligation and only according to necessity. A project such as this has to be undertaken according to a prior plan that enjoys an adequate level of political legitimacy [3]. If European policy is to make sense again then we must immediately remedy this lack of organization and be brave enough to debate quite openly the content that is to be given to the future European project [4].

With this in view the shape of an economic government of the eurozone has to be defined. Indeed this has still not been clarified. It is true that, at each stage in the crisis, Europe has taken another step forwards, working hard towards solidarity, and seems to be increasingly aware of the need to stand as one. But, at the same time, Europe does not know how to go further beyond the adoption of binding rules so that it has a true strategy to settle the crisis. Economic and political differences, the admission of the need for efforts without agreeing on how they should be shared, means that every State is waiting for the others to take the first step, which prevents us from focusing on our common interest.

The ECB is expecting from the States to make the fiscal union a reality, to implement the necessary structural reforms and to create a banking Union. Germany – and States such as the Netherlands or Finland – are waiting for Southern States to show they can do without an economy subsidized with public and private debt and to undertake structural reforms that will enable them to combat tax evasion, corruption and corporatism. Germany would like to submit national budgets to independent supervision, so that politics does not mean

clientelism. It also wants political union to provide a legitimate base to the sharing of financial risks. France wants a growth strategy and is waiting for the ECB to take its responsibilities as lender of last resort, to reassure financial markets and thereby avoid hikes in interest rates while protecting its banks. It would like a European government that can respond to the crises and undertake a contra-cyclical policy. The countries in the south of Europe weakened by the debt crisis are hoping for financial solidarity on the part of their partners. They want eurobonds which would relieve the burden of their interest rates.

And what if everyone was right to a certain extent? And what if, instead of waiting for the others to make the first move, we acted together? Everyone might find greater advantage than inconvenience in this and Europe would emerge from the crisis in a dignified manner. A major share of Germany’s expectations have now been satisfied: the common economic supervisory mechanisms have mostly been strengthened. The Fiscal Pact has confirmed the Member States’ commitment in this direction. But although supervision is useful in preventing the repetition of past errors (excessive debt and divergence in competitiveness), it cannot solve the present crisis alone. We have to go further.

2. WHAT SHOULD BE DONE? PROVIDING A GLOBAL POLITICAL RESPONSE TO A SYSTEMIC CRISIS

Apart from the vital emergency measures taken during 2011 in a bid to extinguish the fire and restore the eurozone’s financial stability, a fundamental reform of the European institutions is now necessary so that the outline of a true economic government of the eurozone can be defined [5]. Below are some ideas that might be included in a global solution.

The first pillar would aim to guarantee the political legitimacy and democratic legitimacy of the eurozone. Institutional reforms aiming to prepare for the future governance of Europe are indeed necessary. On a world scale, the eurozone States should have a joint representation within the IMF and the international financial bodies. The European Union should also look into how it might protect its legitimate interests in the globali-

3. In a speech on « Europe and the Markets » delivered on 3rd November 2011 at the Embassy of Germany in Paris, Josef Ackerman, Chairman of the Board and of the Executive Committee of the Deutsche Bank AG Group declared: “We must, I am sure, undertake debate rapidly on the constitutional legitimisation of the unification of Europe”.

4. Cf. Jean Pisani-Ferry, *Le réveil des démons. La crise de l’euro et comment nous en sortir*, Paris, Fayard, 2011.

5. On this point see Jean-François Jamet, *L’Europe peut-elle se passer d’un gouvernement économique ?*, La documentation française, coll. Réflexe Europe – Débats, 2011.

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sation process. This might include reforms to the rules of public procurement, market access or stepping up the protection of the intellectual property of European businesses.

The strengthening of economic Europe has to go hand in hand with thought about political Union, which has started in Germany at the highest level. There are many ideas which are now well known:

- greater involvement by national parliaments in the decision making process, thereby implementing article 13 of the Stability Treaty;
- the merger between the Presidency of the Commission – the composition of which has to be revised – and that of the European Council as of the European Elections in 2014, with the election of a candidate to this position by universal suffrage, which would enable a response both to the need for European leaders and the imperative of democratic responsibility; etc.

Then, as a second pillar, a growth strategy, based on real proposals that would go beyond main guidelines, which in reality do not involve those who draw them up, has to be defined. The proposals might focus on varying axes, the combination of which would satisfy different sensitivities that emerge in the Union, thereby facilitating the conclusion of a political agreement on a European growth pact: improvements in the efficiency of existing public spending, which might satisfy countries like Germany, the Netherlands, and even Finland; a true European investment plan, as requested by France; finally structural reforms, notably in the social and fiscal spheres. Given the tensions on the markets, financial stability would also have to be strengthened in order to re-create a predictable macro-economic environment in the eurozone, notably with the creation of a supranational banking supervisory authority. This authority would be able to restructure those banks that were in danger of bankruptcy and guarantee savers' deposits.

Thirdly, and in response to the imperative of economic efficacy, a European Treasury has to be created to manage joint eurozone debt issuances, with a taxed-based own resource to guarantee its credibility (for example a European business tax that would substitute the national equivalents that have now been discredited due to fiscal competition). The pooled debt would be limited to eurobills, ie short term debt to a total of

10% of their GDP as suggested by Thomas Philippon and Christian Hellwig [6]. With the agreement of the European political institutions the European Treasury would be able to issue long term loans to fund – alongside structural funds, partially transformed into funds used to support a countercyclical economic policy – a European investment programme. Finally, the European Stability Mechanism, whose entry into force has been brought forward to the beginning of July 2012, would be seen as a real European monetary fund able to organise the orderly default of a State or a European bank: its first mission would be to organise a further re-scheduling of the Greek debt. This would be completed by a long term privatisation plan: a number of Greek public assets would be pooled in a joint structure, which would be purchased by a European institution funded by the Member States and managed by the European Investment Bank, which would enable Greece to make an immediate reduction to its debt.

Lastly, the ECB, reassured by the establishment of this more effective, more credible, more legitimate fiscal union, would assume its role as lender of last resort. However, to prevent a deadweight effect, the ECB would simultaneously announce that in the future it would refuse (apart from in times of recession) to accept as collateral any new bonds issued by States if they do not respect the common fiscal rules.

Each of the players in the present European psychodrama holds a piece to the puzzle and it is time to put them all together: let us put a systemic response forward in response to the systemic crisis. Changes to the treaty will be necessary as far as some of the reforms are concerned. It will take time but the path will be clearly traced. It is quite right that they should be validated democratically by the Parliaments or directly by the citizens. But the choice will then be clear: stay in the European Union or leave it. Of course, the question remains of whether some countries would not be tempted to block the process or veto it. In any case progress towards integration will only be effective if alternatives are anticipated in the event of non-ratification by one or several States. Independent of solutions like ratification by a (super) qualified majority, it would appear clear that the Union's integration will be achieved according to differentiated routes.

6. Christian Hellwig and Thomas Philippon, "Eurobills, not Eurobonds", *voxeu.org*, 2nd December 2011.

3. TWO SPEED EUROPE: A PATH TO INTEGRATION?

The repeated summits bringing together the eurozone Heads of State and government over the last few months, which aimed to provide a response to the debt crisis, have revealed, in the opinion of many observers, the apparently growing gap between the eurozone and the rest of the Union. The crisis has therefore brought to light the spectre of a "multi-speed Europe" again - and in this instance the issue of "a flexible Europe" has to be reconsidered.

Flexible Europe already exists

Differentiation, more commonly called "variable geometry", has been spoken of on several occasions over the last few years as a means to escape the status quo and to organise the possibility of joint action and yet take on board Member States' national interests. Hence this means enabling countries who so desire it to continue integration when unanimity paralyses the Community and conversely it enables the countries most reticent about integration to opt out [7].

Differentiation has however been the focus of criticism, which highlights the danger of creating a "multi-speed Europe" and of increasing institutional compromises to the detriment of the legibility of the Community's policies. History shows us however that the European Union has already experienced several kinds of differentiated integration both in and out of treaties. Multi-speed Europe is now a reality and differentiation, in its varying forms (out-of-treaty, in the Treaties, constructive abstention, enhanced cooperation), has played an important role in the community integration process; the Prüm Treaty in terms of police cooperation, industrial projects in the aviation and space sectors (Airbus-EADS, the European Space Agency and Arianespace) and the launch of enhanced cooperation regarding cross-border divorce regulations and the European patent. More recently the budgetary pact, the "euro+" pact and the European Financial Stability Facility were initiated without all of the Member States being involved.

Is this method, which has proven its worth, still topical? Today it is clear that all of the Union's future policies, in certain eminently political areas (taxation,

social, diplomacy, defence, energy etc ...), cannot apply to all of the Union's countries in the same way, which necessarily leads to negotiations over the introduction of cooperation between such and such States to move forwards in these areas. The simple reference to these areas shows that European integration is now committed to a new political outlook which affect States' sovereignty and national socio-political consensus, for which it is even more difficult for European governments to give up their "right to veto". Hence the heterogeneity of interests within the Union has to be recognised, whilst allowing room for future joint action for those who want it.

A way to overcome the differences brought to light by the crisis

The present crisis has highlighted economic differences and political divergence within the European Union: different economic traditions; divergence over competitiveness and growth models; different visions of the strategies to implement in the face of the debt crisis, etc. More generally there are different socio-economic models within the European Union - Latin, Scandinavian, Anglo-Saxon or German - however, because of the diversity in model, history and strategy, the European Union is still far from achieving harmonisation from a fiscal or social point of view for example.

In terms of taxation, differentiation might prove to be very useful. Decisions concerning this area are indeed taken unanimously and some States are extremely reticent about greater tax convergence (Ireland and the UK notably but also the Baltic States, Cyprus, etc.). But this situation is harmful: the complexity and the diversity of Member States' tax systems is a major impediment to the circulation of capital, workers and services. Therefore there is an objective cost for the development of the internal market, prices and growth in the Union. Conversely harmonisation - even if it were just partial - would enable a simpler system for mobile workers, the Union would be more attractive to investors and it would lead to significant administrative savings for businesses operating in several Member States. Hence defining an action plan to harmonise Member States' tax systems might at first be achieved by enhanced cooperation between eurozone Member States, which want to harmonise, first, their

7. Cf. T. Chopin and J.-F. Jamet, « La différenciation peut-elle contribuer à l'approfondissement de l'intégration communautaire ? », *Questions d'Europe, Policy Paper* by the Robert Schuman Foundation, n°106 and 107 July 2008

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business tax base, and then, the rates applied. The decision taken by France and Germany last summer on this issue has opened the way. Another idea would be to introduce a European environment tax – among willing Member States – by harmonising the present environment tax base and the rates that are applied.

In the field of social policies, because of the differences in States' points of view regarding social matters, differentiation might also enable progress on certain specific points and initiate convergence. A European minimum salary might be introduced for example. This would be set in terms of a percentage of the median salary in each Member State (the percentage would be the same for all of the participating States and the absolute level of the minimum salary would vary according to the median salary of the State in question). Member States would still be able to set a minimum salary above this threshold. This solution would enable the respect of diversity in living standards and productivity in Europe, whilst guaranteeing a certain amount of social protection for all European workers. There are other examples of this "differentiated" approach as the means to having a more integrated Europe.

European integration is the fruit of compromise between national interests and distinct political visions of Europe. From this point of view it is normal to have differing opinions, and this is all the more so when it comes to expressing views on eminently political, structuring issues for the future of European integration, as is the case in the fiscal and social domains. Hence it is not so much a question of deploring differences, which by definition are inherent to a project that aims to build a Union of States, than of acknowledging and accepting them as inevitable realities and finding the way to manage the heterogeneity of collective and national preferences of Europeans in one area or another.

Undoubtedly a "multi-speed" Europe is one of the most privileged means in this regard. In fine, an approach like this is doubly advantageous: firstly it opens up areas for joint action in spite of the diversity of views and national interests, whilst responding to the requirements of efficacy and legitimacy; moreover it helps us break with the fantasy of unity and homogeneity, acknowledging that the Union is the pertinent level for public action in order to rise to a certain number of challenges, particularly that of convergence, as revealed by the crisis.

Several Europes?

In this light could the juxtaposition of several Europes (notably a large "Union" with loose links and a close-knit, more integrated "Community" based on the eurozone) gradually become an option to be taken seriously? Several levels of integration might be envisaged:

- a more integrated eurozone, both politically and financially
- a European Union integrating the countries that want to join the eurozone and take part in enhanced integration in areas beyond economic policy;
- an enhanced European economic area that matches the internal market, providing those countries which are not EU members (e.g. Iceland, Norway, Liechtenstein) the opportunity of taking part in decisions involving the internal market.

Obviously several Member States will hesitate between several options, particularly the UK which might prefer the last one. The last option might also offer a solution in terms of extending European integration to new States without bringing into question the political and economic coherence of either the EU or the eurozone.

Of course the danger is that the Member States will divide over the issue by frustrating for those who would remain outside of the core. This route should thus not be seen as the constitution of a club whose members would be able to choose or reject new participants, since this choice could depend more on the specific interest of each of the members than on the common interest. It is therefore vital to ensure that differentiated integration is an open process and that if it is subject to conditionality (as with participation in the eurozone), that this is legitimate, transparent and respected.

Having set out these reserves and in spite of the obstacles that may arise, the question of Germany's and France's role in the establishment of an integrated Community such as this has first to be debated and settled between the two countries, because the strength of the Franco-German couple lies in its heterogeneous nature. If they want to maintain their driving force France and Germany

must work closely with their partners in Benelux, the countries of southern Europe, such as Spain and Italy, but also the countries of central Europe, like Poland for example.

CONCLUSION

Hence we are entering a period of reformation which supposes a renewed project for European integration. Because of its extent it has to be part of a mid and long term plan. European leaders can no longer afford to manage the emergencies, delaying their more ambitious ideas for later. The nobility of politics lies in uncertainty, that of drawing up a project, whilst creating the means to implement it. Thought about the most effective, most democratic European decision making mechanisms is at an advanced stage at the very highest level in Germany. German proposals over the future of the EU have indeed multiplied over the last few months. Deep thought is also being given in Poland. This has to find an echo across the entire Union and notably in France. Are Europeans ready to take on this debate? It is up to European and national politicians and beyond that, all those who want to be involved, to rise to the challenge.

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