

DIRECTORATE-GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT **C**
CITIZENS' RIGHTS AND CONSTITUTIONAL AFFAIRS



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**Challenges of multi-tier
governance
in the European Union
Effectiveness, efficiency and
legitimacy**

COMPENDIUM OF NOTES



DIRECTORATE GENERAL FOR INTERNAL POLICIES

**POLICY DEPARTMENT C: CITIZENS' RIGHTS AND
CONSTITUTIONAL AFFAIRS**

CONSTITUTIONAL AFFAIRS

Challenges of multi-tier governance in the European Union

Effectiveness, efficiency and legitimacy

COMPENDIUM OF NOTES

Abstract

This compendium includes articles of a number of eminent experts invited by the Policy Department C to exchange with the Members of the Constitutional Affairs Committee of the European Parliament on the issues related to the challenges of the multi-tier governance in the EU. They aim at providing unique insights into the major questions of efficiency, effectiveness and legitimacy that the EU governance is currently facing. While dealing with the lessons from the past experiences of the differentiated integration, they put naturally a specific focus on current challenges with the respect to the Economic and Monetary union. They further analyse the impact of those developments on the European institutions and their decision-making processes and mechanisms of its legitimation. The compendium concludes with options for managing this increasing tension towards differentiation within the EU in the future.

This document was requested by the European Parliament's Committee on Constitutional Affairs.

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DIRECTORATE GENERAL FOR INTERNAL POLICIES

**POLICY DEPARTMENT C: CITIZENS' RIGHTS AND
CONSTITUTIONAL AFFAIRS**

CONSTITUTIONAL AFFAIRS

What future(s) of democratic governance in Europe: learning from the crisis

**Conclusions of a Workshop on the challenges of
multi-tier governance in the EU**

Ingolf Pernice

Abstract

An interdisciplinary workshop of October 4, 2012, at the premises of the European Parliament developed a wide range of analysis of the present crisis and of ideas for meeting challenges of the financial crisis in the European Union. This contribution concludes on the experience of the workshop and summarizes the positions achieved and the future challenges with respect to the multi-tier governance

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LIST OF ABBREVIATIONS

- CAP** Common Agricultural Policy
- ECJ** European Court of Justice
- ESM** European Stability Mechanism
- FT** Treaty on Stability, Coordination and Governance in
the Economic and Monetary Union
- GFCC** German Federal Constitutional Court
- MEP** Member of the European Parliament
- MP** Member of Parliament
- TEU** Treaty on European Union
- TFEU** Treaty on the Functioning of the European Union
- TSCG** Treaty on Stability, Coordination and Governance

EXECUTIVE SUMMARY

Background: Challenges of crisis and democracy

The “sovereign” debt crisis in Europe is not over yet. It is shaking the European Union deeply, and questions extend from remedies to the immediate threat of breaking down of some of the Member States’ economies up to the much more general issue of how to ensure financial stability and economic growth through a democratic system of multi-tier governance in the EU. This does include a discussion on what lessons have to be learned from the crisis regarding key issues of economic integration in Europe as well as the democratic legitimacy of the policies led both at the national and European levels.

It is clear that none of the Member States can be compelled, under the Treaties, either to implement structural reforms and strict austerity policies, or to participate in rescue programs or financial stability mechanisms and to engage in other kinds of coordination including obligations like to establish a debt brake and a correction mechanism in their national constitutions. But it is similarly clear that none of the governments – and parliaments – having decided to act as they did took their decisions voluntarily. They all felt forced by the need to avoid bankruptcy and the risk of a breakdown of the financial system all together with catastrophic consequences. It became clear, finally, that in the EU, but even more so in the EMU, each of the national decisions on economic and fiscal policies – let alone administrative and taxation systems – can substantially impact other Member States. This is a problem of democracy and a problem of efficiency too.

The system established by the Treaty of Maastricht keeping the mode of intergovernmental cooperation for the economic and fiscal policies of the Member States as a basis for the euro as a common currency with the ECB as a centralized governing body has failed to provide a workable solution. The attempt to co-ordinate national economic policies and to ensure budgetary discipline throughout the Member States through the method of intergovernmentalism has failed. This form of executive federalism can neither ensure a sustainable basis for the euro, nor is it acceptable in terms of democratic legitimacy. The more the relevant decisions are taken by the ministers of finance and the more they are made binding in nature and give concrete guidance to not only governments but also to the budgetary authorities of the Member States, the less it appears to be acceptable that parliaments have no direct say on them. And without strict coordination, the spill-overs of autonomous national economic and fiscal policies are contrary to the idea of democracy too.

The financial crisis, thus, is a crisis of democracy. People seem to lose confidence in the European project, the legitimacy of which was based more upon the common dream of peace, stability and welfare and on the success in the implementation of its objectives, including the enlargement, than on elections, representation and accountability. With the achievement of peace and a high degree of welfare, with the present crisis and loss of confidence among the citizens of the Union, however, both, “political messianism” (*Weiler*) and output legitimacy (*Scharpf*) are no longer sufficient to legitimise the Union, so that not only institutional reforms are needed to ensure better political representation and more accountability but also a re-foundation and more clarity on the political missions of the Union, being an instrument for its citizens to ensure peace and liberty, to promote social solidarity and prosperity, and to meet the challenges of globalisation.

Responses: New EU policies and new arrangements for democracy

To meet the challenges to the euro and to the EU as a whole, the discussion at the workshop and the papers finalized and submitted subsequently developed an extraordinary richness of approaches and proposals the main thrust of which can be summarised in the following points:

- **“Repatriation”**: While the ESM and the Fiscal Treaty may contribute to provide for the necessary financial instruments to avoid bankruptcy of Member States in need, and they may help tightening the co-ordination of economic policies and the system of supervision and enforcement of fiscal discipline at the national level, a reform of the Treaties is needed for applying the community method including both, enhanced parliamentary control and full judicial review to economic and financial policies so to remedy to the structural asymmetry of the EMU: The EU must be turned into a real Economic and Fiscal Union with corresponding responsibilities of its institutions.
- **“Differentiated integration”** may continue to be a necessary tool for permitting progress in this field, and both modes – internal enhanced cooperation as well as the conclusion of international treaties among a coalition of willing – are acceptable for provisional regimes deepening integration, but the risks for the unity and the increasing complexity of the Union and the must be taken into account at each step. The same applies to proposals like for creating “enhanced cooperation zones”, allowing “negative differentiation” or accepting partial membership. This complexity would make it increasingly difficult for the citizen, to take ownership of the Union as a democratic and transparent political organisation.
- **“Institutional differentiation”** may be considered as an inevitable consequence of the differentiated integration. This would mean that not the European Parliament, but only its members coming from the Member States participating in the fore-runners policy, e.g. the eurozone, would be allowed to vote in such matters. Though some advantages regarding the legitimacy of decision taken in this mode are visible, it would introduce national grouping in the institution, which is contrary to its political grouping, and it would deepen the divisions and might create barriers to entry for the outsiders. Informal arrangements of self-regulation within the European Parliament were considered, therefore, more appropriate to ensure the necessary degree of legitimacy even where the “outs” participate in the decision-making.
- **“Budgetary solidarity”** is the motto for proposals aiming at enhancing the financial capacities of the Union so to provide for resources allowing some compensation of different speeds of growth and, in particular, an insurance for Member States against shocks rather than distributive transfers or to establish a new budget stabilisation fund. This would involve a substantial increase of the EU budget to be financed by European taxes such as a corporate income tax. Also “automatic macroeconomic stabilizers”, such as an unemployment insurance fund that works across borders, are among the proposals. The EU powers for implementing these ideas are yet to be created.
- **“Interparliamentary dialogue”**: Where relevant powers are conferred to the EU for binding decisions on a common framework and guidelines for national budgetary policies, to ensure the coherence required for the euro, when taxation becomes one of the powers of the EU and when insurance funds or even redistributive policies are among the instruments of the Union to enhance economic and social cohesion among the regions, a “parliamentarism of dialogue” must be organised among the national parliaments and the European Parliament. This could include

interparliamentary committees with decision-making powers in limited fields. A first step could be, wherever appropriate, to invite representatives of other parliaments to the discussions of each parliament with a view to make known and discuss each other's situation, policies and the interests.

- **“Politicisation of the Commission”**: Competences in the field of economic and fiscal policies, taxation etc. touch among the most relevant individual concerns of the citizen. Latest at that stage of European integration the recognition of the political role of the Commission and the need for more direct impact of the European elections on the policies led by the Commission are necessary. Political party families should present to the electorate their common candidate for the office of the President of the Commission, and the candidate of the group with the highest support EU-wide should be elected and nominated as the President of the Commission. If this person would simultaneously hold the office of the President of the European Council, the EU would have a personal face, and this double-hatted President would, with both offices, be accountable to the European Parliament. A similar procedure could be applied also for the other members of the Commission, with each party family presenting their top candidate for this office in each Member State.

INTRODUCTION

The European Union is in a deep crisis, and the risk of a breakdown of the system is high. In response to the challenges of unbearable sovereign debt and economic recession in some of the Member States people tend to see a solution in a sort of political retreat, e.g. the withdrawal or even expulsion of some Member States from the monetary union, some consider the virtues of the right to withdraw from the Union altogether under Article 50 TEU as ultima ratio for preserving national sovereignty and the right to fully benefit from their proper policies and economic achievements. This reflex of retreating oneself to home in case of danger, however, is the wrong way in a political community where no one can survive on his or her own. Each individual is condemned to live in a community and depends from others; to withdraw from the community would amount to suicide. Similarly, states are interdependent, nowadays, to such an extent that the claim of national sovereignty has lost meaning. After centuries of wars in Europe the European Community was established to ensure survival of the peoples of Europe, politically and economically, and the challenges of globalization do not allow our governments further to continue playing "sovereign", particularly not in times of crisis.

As Miguel Maduro brilliantly sets out in his paper,¹ the financial crisis in the Union is basically a crisis of democracy: "The crisis makes clear our interdependence but also our failure to internalize its consequences", he explains, and therefore "this failure is a democratic failure". It is particularly, but not only, as he says, "the interdependence generated by the euro" which resulted in the financial problems of the countries having lead "irresponsible fiscal policies", becoming a "problem for all". He presents this "as a democratic problem since the interest of the latter Member States are not taken into account in the former Member States' democratic processes". The same is true, particularly in a monetary union, for enhanced austerity policies on one Member State with the aim to become more competitive and no regard given to the consequences of this policy for those who have not taken similar measures. But also where not national policies but markets are taken as being the source of the crisis, he shows, the conditions under which they could benefit from the euro amounted to a "form of transnational democratic externalities imposed on states. Or, in other words, capital movements can be presented as having a profound impact inside a state without being subject to its democratic control". His conclusion, insofar, is that the Union's failure to solve the crisis is "imputable to the diffuse character of its political authority and its excessive reliance on national politics... The real EU democratic deficit is the absence of European politics". The crisis, thus, shows that the problem of the EU indeed is a problem of democratic governance. As a result, there seems to be a need for further political integration and new powers at the European level, instead of what Jürgen Habermas rightly criticises as undemocratic forms of "executive federalism" and an non-transparent domination by the European Council.² He argues that the crisis is "primarily due to an inadequate institutional underpinning of the common currency", the "systemic problem" of the euro, he says, requires "a systemic answer".³

With a view of finding ways for reforming the EU system of governance to become more democratic and more efficient in times of an on-going fiscal and economic crisis the

¹ Miguel Poiares Maduro, A New Governance for the European Union and the euro: Democracy and Justice, in this compendium, p.28-35

² Jürgen Habermas, Zur Verfassung Europas. Ein Essay, 2011, p. 81. On this line see also Vivian Schmidt, EU Differentiated Integration and the Role of the EU Political Economy, in this volume, p;168 stating „that leaving the bulk of decision-making to the intergovernmental bargaining of the European Council and EU Summits—however crucial this may be in the heat of the crisis—is actually the least democratic of processes“.

³ Jürgen Habermas, Only deeper European Integration can save the eurozone, The Guardian, 9 August 2012, at: <http://blog.daum.net/thesun-isnew-eachday/707> (last visit 26 Nov. 2012).

Committee for Constitutional Affairs of the European Parliament has invited a number of scholars of European law, politics and economics to present their ideas and discuss with the Members of the European Parliament and their staff. On the basis of their written outlines and oral presentation an extremely stimulating workshop addressed a great series of fundamental questions on options available for responding to the financial crises and ideas for a possible reform of the European Union system of multi-tier governance. "Multi-tier" was understood here as including both, the relationship of national and European institutions and the diverse forms of differentiated integration.

This introduction to the present volume is simultaneously developing some conclusions from the workshop. The take-away from the rich debate at the workshop cannot be a simple summary nor is it possible to give an objective and complete account doing justice both to the important ideas discussed during the workshop and further developed, following this discussion, in the written contributions collected in this volume. The following lines concentrate on five selected key questions of primary concern for the future of Europe: An evaluation of the present policies for finding a sustainable way out of the crisis (1.), the particular issue of creating special euro-groups within the institutions of the Union (2.), the need for new powers to be conferred upon the EU institutions (3.) the question of how to enhance democratic legitimacy in the Union (4.) and the proposal to open up a new public discourse upon new visions and missions for the European Union (5.).

1. PRESENT POLICIES - A WAY OUT OF THE CRISIS?

The first key issue was an analysis of the present policies developed for facing the financial crisis. While the discussion of the entire workshop was devoted in some way to the options for finding solutions for the imminent problems, the discussion started specifically with an evaluation of the ESM and the Fiscal Treaty concluded earlier this year (2.1.). It then took a particular focus on the compliance of the ESM with the bail-out-clause of Article 125 TFEU (2.2.) before the participants examined the underlying concept of intergovernmental cooperation with sanction mechanisms (2.3.).

1.1. The ESM and the Fiscal Treaty: Differentiation in the EU?

Most participants expressed their view that the ESM and the Fiscal Treaty (FT) are necessary tools for keeping the euro-System functioning notwithstanding strong challenges and threats coming from unforeseeable financial markets. Though the negotiations of these international treaties were led under great time pressure and with little public discussion or parliamentary consultation, they were not considered, as such, a threat particularly to the role and responsibilities of the European Parliament. Much will depend on the actual practices when the system is to start working. Article 13 FT allows a dialogue with the European Parliament as well as a substantial involvement of the national parliaments of the participating Member States. It will depend upon the effective operation of what could become a real "interparliamentary dialogue", and of the effective cooperation of the governments with the parliaments before it will be possible to assess to what extent this parliamentary involvement makes a difference. The new system, at least was considered more as an opportunity for parliaments than as threat. It will, thus, be important for the parliaments in the coming months, to effectively use these "windows of democracy".

The ESM and the FT have been challenged before the ECJ for violating the bail-out clause, duplicating and altering primary law as well as the Sixpack and illegally empowering institutions of the EU for monitoring and enforcement of the agreements.¹ Bruno de Witte discusses the arguments in a clear and convincing manner concluding that, finally, there is

¹ ECJ Case C-370/12 - *Pringle*.

no breach of European law.¹ Yet, these international agreements were regarded as both insufficient and only acceptable as transitional instruments. Andrew Duff made clear: "We need a powerful treasury of the EU". The "sunset-clause" in Article 16 FT therefore plays an important role, and its "repatriation" was considered to remain a fundamental task and objective for the future. Accordingly, the Community method was found necessary to be applied also in this area, a method Renaud Dehousse has positively evaluated too. In his view also "the responses to the eurozone crisis have shown once more that delegation of powers to supranational institutions is near unavoidable when governments intend to reinforce their cooperation in a lasting manner".²

Jean-Victor Louis stresses that the existing structures are unable to achieve the objectives of economic governance in the EU. He talks about an "anarchic differentiation" and a "kind of fragmented government equivalent to a lack of a true government" to be remedied.³ It is important, for him, to make the economic part of the EMU commensurate to the monetary union. New institutional devices would therefore be necessary. A centralised banking supervision could be based upon 127 (6) TFEU, but: establishing a "Banking Union, at its final stage, includes elements of Fiscal Union, and Fiscal Union goes hand in hand with more Economic Union and it includes and needs, more Political Union."⁴ With a view to the existing reluctance of the UK, he considers flexible solutions within and outside the Treaties but also addresses the limits both under European and national constitutional law, in particular the German Federal Constitutional Court (GFCC). He finally emphasises that the euro needs a representation at the global scene, particularly in standard setting boards prefiguring EU legislation, like the Basel Commission. Article 138 TFEU should be applied and the defence of the general interest should be combined with the experience of national institutions, including for initiating a reform of IMF to become an oversight organ with more powers.

The international treaties concluded to ensure the further functioning of the euro-system can be understood as a form of differentiated integration, and Janis Emmanouilidis argues that this does not necessarily mean fragmentation of the Union. For him "the experience of the last decades has repeatedly proven that closer cooperation between Member States has, at the end of the day, been a (strong) catalyst for a deepening of EU integration".⁵ With the necessary degree of openness and flexibility the risks of disintegration can be kept under control, and differentiated integration may even allow for appropriate progress. Preference is given to differentiation within the Treaties as opposed to outside of them, though the latter have proven some utility too, and the new ESM and FT in his view "largely adhered to the above-mentioned notion of an intergovernmental avant-garde".⁶ With the new concept of "negative differentiation" he discusses ways of partial exit from the EU taking the form either of "association (plus)" or of "partial membership".⁷ In the absence of new provisions for differentiation by provisions for a partial exit, proposed by Gian Luigi Tosato,⁸ an agreement negotiated under Article 50 (2) TEU could have similar effects: Differentiated integration could so be considered as an opportunity for developing new

¹ Bruno de Witte, European Stability Mechanism and Treaty on Stability, Coordination and Governance: Role of the EU Institutions and Consistency with the EU Legal Order, in this volume, p.81-83

² Renaud Dehousse, It the 'Community Method' Still Relevant?, in this volume, p.89

³ Jean-Victor Louis, Institutional Dilemmas of the Economic and Monetary Union, in this volume, p.55

⁴ Ibid., 58

⁵ Janis Emmanouilidis, Which lessons to draw from the past and current use of differentiated integration?, in this volume, p.66-67

⁶ Ibid., p. 67-68

⁷ Ibid., 69

⁸ Gian Luigi Tosato, New institutional solutions for multi-tier governance?, in this volume, p.160 .

„forms of belonging“ beneath the level, as he says, „of full membership or even of ‚negative integration‘ due to the voluntary withdrawal of Member States from the EU“.¹

It is clear, however, that every form of differentiated integration, be it positive or negative, by means of international treaties or within the Treaties as an enhanced cooperation, adds to the complexity of the Union. It was noted that this may threaten the legitimacy and even the functioning of the Union and its institutions. This is true, in particular, if new institutions are created along with differentiation: As Renaud Dehousse states: “At a time of widespread mistrust in political institutions, it is important for the public to understand who is in charge and accountable for what the Union does, or fails to do. The proliferation of institutional fora, each with their own rules, tends to undermine the transparency of decision-making”.² Wolfgang Wessels emphasises that “for the EP like for national parliaments the complexity of multi-tier governance has considerably increased the difficulties to play an adequate role vis-à-vis the strong multi-level players of the executive branch of government”.³ Also the ideas of introducing „a form of ‚enhanced cooperation‘ at primary law (Treaty) level“, or even “an exit-clause for flexible initiatives” put forward by Tosato,⁴ as challenging as they may look for facilitating further steps of flexible integration, would not necessarily lead to more transparency of the Union and understanding of its functioning by the citizens.

Given the great diversity of the Member States in their economic constitution, their different growth models, labour markets etc. up to their systems of taxation, Vivian Schmidt submits that „applying one-size-fits-all solutions cannot possibly work. Her idea to create new „enhanced cooperation zones“, assembling diverse groups of Member States with similar conditions with regard to specific features work more closely together could certainly help to promote differentiated integration.⁵ The complexity of the Union, though, would not be reduced.

1.2. Article 125 and the Amendment of Article 136 TFEU

A very specific, but by no means a minor issue was the question whether or not the new instruments can be made operational before the amendment of Article 136 TFEU is in force. All the Member States of the EU have to ratify this amendment, although it was adopted following the simplified amendment procedure under Article 48 (3) TEU. Doubts existed with regard to Britain, but Prime Minister Cameron seems to have expressed his willingness to take care of rapid ratification. And Britain should not have reasons to block the entry into force of the amendment, as it does not have directly effects upon non-euro Member States. The question is rather whether or not the amendment was necessary at all, with a view to ensure compliance of the ESM or its application with the bail-out-clause of Article 125 TFEU. A reference of the Irish Supreme Court to the ECJ in the Pringle-case on this and other questions of compliance of the ESM and the FT with EU law was pending before the ECJ.⁶ Bruno de Witte finds that the concerns are unfounded, at least after Article 136 (3) TFEU will be in force,⁷ but the question regarding Article 125 TFEU is of a broader reach. The view of a majority of commentators is that Article 125 TFEU actually prohibits all kinds

¹ Emmanoulidis (note 5), p.73

² Dehousse (note 2), P. 93

³ Wolfgang Wessels, National Parliaments and the EP in Multi-tier Governance: In Search for an Optimal Multi-level Parliamentary Architecture. Analysis, Assessment Advice, in this volume, p.102

⁴ Tosato (note 8), p.161

⁵ Schmidt (note 2), mentioning examples like „enhanced labor mobility zones“, „public service zones“, „immigration zones“ and also „fiscal policy zones“, p. 173

⁶ ECJ Case C-370/12, judgment of 27 Nov. 2012 - *Pringle*.

⁷ Bruno De Witte, European Stability Mechanism and Treaty on Stability, Coordination and Governance: Role of the EU Institutions and Consistency with the EU Legal Order, in this volume p.82

of financial support to a euro-State having difficulties to pay her debts. They argue that the complete system of the EMU is based upon not only national competence for fiscal policies, but also for its slip side: full responsibility of the Member States for their policies.

Yet, another possible interpretation of the provision should not be lost of minds, even if the new Article 136 (3) TFEU will settle the question at least for the future: Article 125 TFEU is not applicable to specific measures such as mentioned in the new Article 136 (3) TFEU: Indeed, the case that financial difficulties in one Member State could amount to a substantial threat for the euro as a whole was not taken into account when the system was established. Talking about the telos of Article 125 TFEU, it was, therefore, not to bind the hands of the other Member States or the Union to take the necessary action in order to ensure the functioning of the euro in a case of a general crisis. The basic idea of Article 125 TFEU to ensure fiscal discipline by making each euro-country responsible alone for her national budgetary policy and its consequences is also met if the provision is interpreted more narrowly: as excluding the expectation of creditors that the EU or any other Member State are held liable by them for debts of one Member State or that they might assume its commitments. This is, actually, the wording of the provision, and it should primarily be understood as a warning: If creditors lend money to a euro-country, this country alone can be held liable to pay the money back, even though it is a euro-country. Nothing in the text of Article 125 TFEU excludes that other Member States – or a new institution created by the euro-countries like the ESM – provides voluntarily credits, guarantees or even direct financial assistance to a fellow euro-country in trouble. There is no reason to believe that Member States creating the EMU excluded measures aiming at rescuing the euro in case of need, or any help among euro-states, if this help proved to be the only way to rescue the common currency - while help to non-euro-countries as well as for third states is allowed?

The question is not an academic one, it is relevant for earlier actions undertaken to rescue Greece and Ireland, and it might remain relevant if the entry into force of Article 136 (3) TFEU takes longer as it may be possible to wait until further action might be necessary to be taken under the ESM. Even if the ECJ has, meanwhile, ruled that the ESM is not in conflict with Article 125 TFEU and that the entry into force of Article 136 (3) TFEU is not a precondition for legally ratifying the ESM,¹ the question might, finally, come up again in the proceedings at the German Federal Constitutional Court on the constitutional complaints against the ratification of the ESM and the FT.

1.3. Cooperation, Sanctions and the Community Method

Similarly the legality of certain provisions and the proper functioning of the ESM and the FT was addressed (2.3.1.). The need for “repatiation”, thus subjecting the FT to the Community method as soon as possible was felt to be an inevitable conclusion (2.3.2.).

1.3.1. Legal questions on the ESM and the FT

Is it possible to include the European Court of Justice, the European Commission and the European Parliament in the system of the ESM and the FT and, thus, confer them new tasks and powers? Article 13 (2) TEU seems to be clear, as it states that „each institution shall act within the limits of the powers conferred to it in the Treaties...“. Bruno de Witte argues that this provision does not exclude giving the institutions new tasks, as long as no new powers are conferred to them. Yet, it seems to be an open question whether this distinction works and whether the functions of monitoring and control, negotiating of the conditionality for grants and the supervision of their implementation within the framework of the ESM and the FT do not involve powers the Commission did not have so far. No real decision-making

¹ ECJ Case C-370/12, judgment of 27 Nov. 2012 – *Pringle*, paras. 129-143, 183-185.

power is involved in most of the tasks conferred to the Commission. This is one of the reasons, the ECJ has judged in the recent the Pringle-case the new tasks entrusted to the Commission to be in conformity with the Treaties and the jurisprudence of the Court.¹ But the case does deal with the Financial Treaty. Article 3 (2) FT imposes the Contracting Parties to establish a correction mechanism „on the basis of common principles to be proposed by the European Commission, concerning in particular the nature, size and time-frame of the corrective action to be undertaken...“. It is difficult to say that this does not involve not some power for setting standards with quite binding effects, given that, in particular, the respect of these standards is subject under Article 8 FT to the control of the Commission and, finally, by the ECJ.

With regard to Article 273 TFEU the new tasks for ECJ to decide upon disputes on the application of the ESM and the FT seems to involve less striking problems. With regard to the function of the ECJ in the framework of the ESM the Court has taken the view that Article 273 TFEU perfectly covers the reference to the Court.² In contrast, the analogy established in Article 8 FT to the powers of ECJ under Article 260 TFEU – if really used in practice, what some consider unrealistic – could well be beyond what can be considered under Article 273 TFEU as “jurisdiction in any dispute between Member States which relates to the subject matter of the Treaties...“. The question, whether or not concerns of the Commission or another Member State regarding the proper implementation of the duty to provide, at a constitutional level, for a debt brake and a correction mechanism by one Member State really relates closely enough to the subject matter of the EU-Treaties – and not to the Financial Treaty only – was not discussed. It will, finally, be for the ECJ to establish whether or not, and to what degree, it finds itself to have jurisdiction on these issues.

This addresses the concerns of Roberto Galtieri, MEP, raising the question if the ESM and the FT are really an effective solution, really binding. Are the sanctions binding? If the sanction to be imposed in analogy to Article 160 TFEU would be illegal, the FT would be meaningless.

1.3.2. Repatriation or the application of the Community method

There was a strong belief that the solution found by the conclusion of the Financial Treaty among 25 Member States is insufficient and not acceptable to be a permanent solution. As Jan-Claude Piris stated, there is consensus that the eurozone needs to be turned into a real Economic and Fiscal Union. The revision-clause of Article 16 (1) FT, therefore, is taken very seriously. Due to the upcoming elections in many important Member States, it seems, however, not realistic to hope for meaningful progress on this issue before spring 2015, as Andrew Duff said, „there is no way to grapple these issues before“ this date. How to manage the transitional problems? Yet, the process of reflection on how the Treaties would have to be adapted has already started – as the present workshop clearly shows. It might be wise considering, in addition to any top down initiative taken by the Presidents of the institutions and their sherpas, to encourage a bottom-up process through a structured discourse in the civil society on local, regional and national levels.

2. EURO-GROUPS WITHIN THE EU INSTITUTIONS

Differentiated integration has proved to be a pragmatic and useful devise for achieving progress of integration in times where unanimity among the Member states cannot be

¹ ECJ Case C-370/12, judgment of 27 Nov. 2012 – *Pringle*, paras. 158-161.

² ECJ Case C-370/12, judgment of 27 Nov. 2012 – *Pringle*, paras. 170-176.

achieved. As Janis A. Emmanouilidis argues, differentiated integration has provided strategic opportunities as catalyst for deepening integration: For him, multispeed Europe is a reality. Nevertheless, there was consensus that a two-tier Europe or a two-speed Europe is not an option. Differentiated integration should not create barriers to entry, not entail special institutions nor split institutions according to “ins” and “outs”.

The issue of differentiated integration and coordinated action of some Member States under international agreements was also discussed as an issue of democratic legitimacy. Jean-Victor Louis only raises the question of a “euro-Committee” in the EP, while Renaud Dehousse strongly recommends it to be considered.¹ Louis questions the capacity of national parliaments to adequately exercise control over common European financial issues.² Wolfgang Wessels observes “considerable variations of parliamentary involvement in areas of multi-tier integration”. He concludes “that the role of parliaments has generally decreased in procedures of the differentiated integration”.³

This question was discussed in particular regarding the eurozone. Is it desirable and wise to introduce provisions under which issues regarding the eurozone are decided only among those Member States whose currency is the euro? Is it legitimate for the Court of Justice, the Commission and the European Parliament to take position on matters related to the eurozone without such a distinction? Could members of these institutions with an origin from countries with another currency not put at risk the functioning of the euro when they are allowed to participate in the decision-making regarding euro-policies? What if this other currency is competing with the euro? Many views on this question have been developed. Most participants agreed that specialized euro-groups in institutions other than the Council are difficult to imagine without a formal amendment of the Treaties. Inter-institutional agreements or some self-regulation within the European Parliament, however, were held acceptable to a limited extent by some discussants.

Judging legitimacy is a difficult issue in this respect. All seems to depend upon, first, to what extent questions related to the euro can be separated from the general interest of the EU and, second, whom the members of the ECJ, the Commission or the European Parliament are representing. As a matter of principle, only the Council is an institution whose members are representing national interests. The loyalty-rule for the others is different: The law, in particular European law, is what the ECJ is bound to defend (Article 19 (1) TEU). For the members of the Commission which „shall promote the general interest of the Union“ (Article 17 (1) TEU) and shall be „completely independent“, Article 17 (3) TEU makes clear that their „general competence and European commitment“ is key, and that they must be persons „whose independence is beyond doubt“. They are working for the interest of the Union, and not of particular Member States.

Even the members of the European Parliament are not supposed to represent national interests, though people tend to see, as Renaud Dehousse stated, their deputies in the EP as representing certain territories.⁴ They have strong domestic connections indeed. The argument was well founded in the past by the provisions of the Treaty on the European Parliament, stating that its deputies represented the peoples of the Member States. But it has been changed: As Articles 10 (2) and 14 (2) TEU now emphasise, Members of the European Parliament shall represent the citizens of the Unions. This provision is not about

¹ Dehousse, p.89 : „MEPs are largely perceived as national representatives, and it is unlikely that governments from “in” and “out” countries will accept that people elected in other countries may have a meaningful role in decisions affecting their interests. If the consolidated eurozone is to be endowed with a strong parliamentary branch, the European Parliament would therefore be well advised to reconsider its position“.

² Louis, p.59

³ Wessels , p.103

⁴ Dehousse

particular individuals, regions or Member States, but means the citizens of the Union as a collective, similar to what is „the people“ in Member States. Accordingly, Article 10 (4) TEU refers to the parties at the European level contributing to expressing „the will of citizens of the Union“. Finally, Article 3 (4) TEU together with Articles 119 to 144 TFEU make clear that the establishment and the functioning of the EMU and, in particular, the common currency, is one of the objectives of the Treaties and therefore defined as of common interest of the EU, and not a matter for the euro-countries only.

Though there are limited perspectives for all Member States to become part of the eurozone in a foreseeable future, a clear preference was expressed in the workshop for keeping the option open and not to deepen the split between euro- and non-euro Member States by the formation of specialized euro-groups within the institutions. Elmar Brok pointed out that the European monetary policy is not a policy of the euro-countries only, but a policy of the EU as a whole. If the aim is to avoid a fragmentation of the Union, any possible solution requires not only a high degree of loyalty of non-euro members in the institutions regarding the common objectives of the EMU, its proper functioning and the participation of all Member States, but also due respect of the „outs“ regarding the vested interests of the euro-countries for a prosperous euro, to the benefit of all.

Another solution, mentioned by Jean-Claude Piris, would be a new body of representatives of national parliaments with new powers of co-decision in the areas covered by the cooperation of euro-countries in the fields of economic and fiscal policies. Like for an analogy to the COSAC specialized in this field, or a joint parliamentary committee with 34 members, there was little support, however, for such new specialised institutions in the EU, as Jo Leinen said. Mixed parliamentary committees with only some members of each parliament do not provide legitimacy. In addition, Wolfgang Wessels pointed out that members of parliaments are reluctant to participate in such committees if they have no power to take relevant decisions: „In spite of many declarations parliamentarians draw no real benefits from these forms of dialogue as they produce no binding results. Thus even flexible fine-tuned procedures will not overcome major reasons for the irrelevance of a multi-level parliamentary cooperation.¹

Absent formal treaty amendments there seems to be a general feeling, instead, to consider informal arrangements of „self-regulation“ (Elmar Brok) particularly within the European Parliament for avoiding risks for the functioning and the legitimacy of decisions regarding the eurozone, on the one side, and for ensuring the openness of the eurozone for all „outs“ to join as provided for in the Treaties, on the other.

3. NEW POWERS FOR THE EU IN ECONOMIC AND FISCAL POLICIES

The diverse measures taken at the EU level for addressing the financial crisis have generally been welcomed, particularly such legislative acts like the Six-pack and the proposed two-pack, but also the ESM and the FT as a first, provisional step. It was clear, however, that new responsibilities and powers for economic and fiscal policies have to be conferred to the Union in order to achieve a workable and stable framework for the already centralized monetary policy (1.) Concerns, however, have been expressed with regard to the necessary limits of such new European competences and the respect of the budgetary autonomy of the Member States, which many believe is key for national sovereignty (2.). A solution could be Union powers for setting binding parameters for national budgetary policies in the form of benchmarks and corridors as required for the stability of the euro

¹ Wessels, p. 108

and enhanced growth Union-wide, margins within which each Member State would continue to take its decisions autonomously (3.). For the exercise of such Union powers certain mechanisms were considered in order to include the national Parliaments in the processes of decision-making at the EU level (4.).

3.1. EU economic and fiscal policies and an increased budget

The success of the European Union and the Community method, as compared to traditional modes of international cooperation, can be explained as a result of the decision to establish supra-national legislative powers, exercised by supra-national institutions with inclusive and democratically controlled procedures, subject to the rule of law and to effective judicial review. It was surprising, yet, that for ensuring an efficient economic fiscal political framework for the common currency governments believed that intergovernmental coordination and cooperation in economic and fiscal policies following the traditional mode of international cooperation would be an appropriate solution. And it was not less erroneous to believe that control and sanction mechanisms based upon expected reactions of the financial markets, in the case of failures of Member States and violations of the common discipline, or upon intergovernmental decision-making would be effective. Practice and the financial crisis have demonstrated that markets follow their own rationale, and that Member States of a Union diplomatically resist shaming and sanctioning one-another. The intergovernmental approach does not work, and to agree upon closer cooperation is not a solution to the structural problem of the EMU. More European solutions, therefore, need to be found, and have been discussed at the workshop.

One set of proposals was introduced by Vivian Schmidt to restart the European economy: Project bonds should be considered for stimulating infrastructure investments; re-allocation of existing resources to stimulate growth could be achieved by a reform of the structural funds and a reform of the CAP “beginning with a cap on big outlays to rich farmers—through the equivalent of a ‘millionaires’ tax” would allow using parts of that budget “for a poverty alleviation scheme for all citizens”;¹ and “automatic macroeconomic stabilizers”, she says, “need to be added to ensure that where eurozone member-states no longer had the capacity to protect the welfare of their own citizens, the EU would kick in”, including “an unemployment insurance fund that worked across borders plus a EU employment agency to facilitate cross-border movement”.² Part of this is not possible without amending the Treaties, however.

Consequently, the necessary conclusion reflected also in Article 16 FT is that new powers must be conferred to the European Union for the design and implementation of an economic and fiscal policy at the European level. Given the fact that budget is one of the key areas of national sovereignty (Jean Claude Piriš) there are clear political limits to such a step. New EU powers, therefore, can be accepted only in so far as required for establishing legally binding rules as necessary to avoid Member States’ economies drifting apart to an extent that the common currency cannot be sustained. Complementary to such new powers, there seems to be a need for a substantive increase of the financial resources of the EU to be used for an enhanced and reformed cohesion policy and – where need be – specific interventions to allow investment and stimulate growth in certain Member States or regions. Iain Begg explains that in the EU “the absence of sufficient fiscal capacity is an obstacle to a more substantial role for the EU (or euro area) level in either macroeconomic

¹ See also the critique of Iain Begg, Budgetary Solidarity in a multi-tiered Union, in this volume, p.182 on CAP: „the spending is not that well-targeted, insofar as rich farmers or landowners effectively receive substantial transfers ».

² Schmidt, p. 174

stabilisation or solidarity policies”.¹ Having discussed three options for “a fresh approach to solidarity” - some pooling of stabilisation capacity, a separate fiscal capacity for the euro area, and a new euro area fiscal capacity to raise revenue, i.e. by a corporate income tax² - he concludes “that a wide-ranging debate about budgetary solidarity is needed, both in the EU as a whole and in the euro area”.³

The problem is how to ensure solidarity on a mutual basis, with responsibility including for help and reforms on both sides, and – as discussed by Begg – to avoid moral hazard and increasing cleavages among the Member States.⁴ There would be little support, at least in Germany, for what is called a “transfer-Union”, where the taxpayer of some Member States would pay for unforeseeable debts of other, in particular if the latter fails to implement deep structural reforms as needed to cope with its problems. If it is true that the European Union already is a „transfer-Union“ to some extent today, it seems to be similarly true, nevertheless, that a substantial increase of such transfers is imperative for keeping the Union economically, socially and politically together. For Mattias Kumm it is important to see the real dimensions: Member States have invested six times the volume of the ESM when they intervened for salvaging their banks. This enormous transfer from public to private sector (financed by loans from the private sector), for him, was among the reasons for the financial crisis.⁵ In his view it should be a responsibility for the EU to ensure that not private banks but the ECB is the lender of last resort for Member States.⁶ And, he argues, with the common currency and the guarantee of free flow of capital the EU has taken a responsibility for some of the reasons of the crisis so that it is “plausible to allocate financial public sector risks resulting from financial sector failings with the European level. The costs of bank-bailouts are to a significant extent the result of genuinely European risks, for which it would be appropriate to hold the European Union as a whole accountable”.⁷

From the German experience of the „horizontal financial compensation“ in the federal state Kumm draws the conclusion that a transfer system would work only if payments are not directly made from one state to the other; instead, to be accepted, they need to be financed through European own resources. The funds collected by European taxes should than be reallocated by common democratically legitimate decision.⁸ Accordingly, also Vivian Schmidt discusses several kinds of „market generated taxes“ to be levied at the European level in order to feed a EU budget so to ensure that the EU is not any longer perceived as a „transfer union“ in which „one or more member states paid for the rest”.⁹

Schmidt proposes that the necessary funds should be raised by “new revenue streams” such as a financial transaction tax, a “transborder transaction tax”, or a “solidarity tax”.¹⁰ For Begg a promising solution “to fund new fiscal capacity” would be a corporate income tax.¹ Miguel Maduro suggests that an increased European budget alimented by such taxation for transactions who particularly benefit from the freedoms the EU, for economic

¹ Begg, p. 180

² Begg, p.186 „Extrapolating from current national yields, the potential revenue from such a tax – wholly assigned to the euro area level – is at least 2% of GDP. This would comfortably exceed the estimates of what is needed for a limited stabilisation capacity and could also be a source of tax backing for more elaborate crisis resolution funds.

³ Begg, p.187, with „constraints and challenges“ discussed

⁴ Begg, p. 180

⁵ Mattias Kumm, *Democratic Challenges Arising from the Eurocrisis: What kind of a constitutional crisis is Europe in an what should be done about it?*, in this volume, p. 132

⁶ Kumm, p.133

⁷ *Ibid.*, p. 135

⁸ *Ibid.*, p.136-138

⁹ Schmidt, p. 174

¹⁰ *Ibid.*, p. 174-et seq

activities with substantial external effects across borders or activities which Member States could not individually regulate or tax, should allow even replacing the current regime of loans including the ESM for resolving the financial crisis by an "EU budget stabilization fund" established to provide collateral for debt to be issued by states with difficulties in accessing financial markets, provided they agree an adjustment program with the Union.² Taxes he considers as appropriate would include, beside a financial transaction tax as the "paramount example", a European corporate tax or a tax on corporate shareholders or a carbon emission tax.³

European taxation would mean that the system is of general application throughout the EU. But how could this be made politically acceptable. Elmar Brok made clear that if such a tax is applicable only for a limited number of Member States, it could not easily be conceptualized to feed the general budget of the EU. However, if it were collected for a special fund, it would be difficult to find adequate democratic solutions for administrating it; would it be possible to allow non-participating countries to benefit from it, without again facing the political difficulties of a transfer-union? If differentiated budgeting in the EU is the solution with the effect of differentiating also solidarity mechanisms, this may accentuate, as Iain Begg submits, „cleavages between groups of Member States, undermining the unity of the EU“.⁴ For the present decade, in his view, the most promising answer is to concentrate on developing mechanisms that can offer budgetary solidarity as insurance against shocks, rather than distributive transfers.⁵

3.2. National budgetary autonomy: A question of sovereignty?

The key of national sovereignty, as many say, is the budgetary autonomy of the national parliaments. This was stated very clearly in the jurisprudence of the German Federal Constitutional Court, namely in the judgments on the Treaty of Lisbon, on the Greek umbrella and recently on the ESM/FT. The national parliaments must remain „the masters of their own budgets“.

„A necessary condition for the safeguarding of political latitude in the sense of the core of identity of the constitution (Article 20 (1) and (2), Article 79 (3) of the Basic Law) is that the budget legislature makes its decisions on revenue and expenditure free of other-directedness on the part of the bodies and of other Member States of the European Union and remains permanently "the master of its decisions" (see BVerfGE 129, 124 <179-180>)“.⁶

This was also referred to during the discussion at the workshop, and it seems to be clear that questioning the budgetary autonomy of the Member States or replacing their authority on economic and fiscal policies by Union powers would not be acceptable neither by this Court nor by the Member States at large.

On the other hand, questions may be raised regarding to the real extent of national budgetary autonomy in the present system. Legal constraints result from the provisions of

¹ Begg, p. 180

² Maduro, and similarly Kumm (note 5), p.136 . „Genuinely European resources, best raised from taxes or levies that burdens actors and transactions that are profiting financially from the internal market (e.g. shareholders, corporations, transactions with strong cross-border dimensions like certain financial transactions), appropriately connect regulatory responsibility with financial accountability“. It is questionable, however, if such a system would not run counter the idea of market freedoms and internal market, as particularly the use of these freedoms would be « punished » by such kind of taxes.

³ Maduro, p.40

⁴ Begg, p. 186

⁵ Begg, p. 187

⁶ GFCC case 2 BvR 1390/12 of 12.9.2012 - ESM, para. 197, see: http://www.bverfg.de/entscheidungen/rs20120912_2bvr139012en.html.

Articles 121 to 126 TFEU as well as from the Union legislation adopted for strengthening the Growth and Stability Pact. The Two-Pack, when adopted, will introduce further limits for the discretion of the Member States in the relevant policies. What is more important, however, is the spill-over of each policy-decision taken at the national level in economic, fiscal and even social and employment policies in each of the Member States on the others. Strict austerity policies over years in one Member State may put the economies of others under stress. Extensive public spending financed by credits in one Member State, on the other hand, may have the result of exercising enormous pressure on parliaments of other Member States to – involuntarily – agree on grants in an unknown dimension for salvaging the euro. This is not budgetary „autonomy“. The budgetary autonomy of national parliaments, many people are dreaming of and continue to defend, is already lost.

What is at stake is to design an institutional framework for ensuring effective but shared autonomy by establishing common rules under which it is possible to get control of the external effects of national economic and fiscal policies. Parliaments, in accepting such mechanisms, would not lose powers, but in fact regain some of the autonomy lost. And this would, finally, remedy the real democratic deficit.¹ If the citizens of one Member State are affected by the spill-over of decisions in another without having any influence on their framing, we face a problem of democracy. As can be seen very drastically in Greece, Ireland and Spain, also the consequences of a national policy, expressed in terms of conditionality of any assistance within the eurozone, can be felt to be not democratic at all. There are good reasons, thus, for considering remedies to this unsustainable situation. Competitive federalism is not a solution at least within the eurozone. Only a common policy seems to be a democratic way ahead.

3.3. European parameters as a framework for budgetary autonomy

The question how the constitutional framework of a common European economic and fiscal policy should look like is yet to be resolved. It is clear that the Commission should play a major role in the preparation of legislative acts and in the supervision of the implementation, while the European Parliament and the Council (euro-group) would take the decisions, with the Court of Justice ensuring judicial review and deciding, where appropriate, on sanctions. The Economic and Social Committee (Article 300 TFEU) could play a major advisory role regarding general questions, while it would be for the Economic and Financial Committee (Article 134 TFEU) to ensure coherence of the operational part of the Union policies also with the monetary policy of the ECB.

In substance, the new provisions could build upon Articles 9 to 11 FT. Action at the Union level must be limited to lay down common objectives to be met, in line with more general principles and guidelines. It may include setting up corridors within which public spending might be allocated to the diverse sectors, and seek for a coherent allocation of Union resources in order to stimulate or complement national policies.

Banking supervision, as presently envisaged to be established as a new task for the ECB, may be a first step towards a banking union, as part of an economic union. Together with the establishment of a centralised deposit guarantee and a privately financed banking resolution fund it will have to be embedded in the common economic and fiscal policy. As Louis states: “Banking Union, at its final stage, includes elements of Fiscal Union, and Fiscal Union goes hand in hand with more Economic Union and it includes and needs, more Political Union.”²

¹ Maduro, p. 47

² Louis, p. 58

3.4. National parliaments and the EU decision-making processes

Where questions of national budgets are decided upon, it seems to be difficult to do this without an enhanced involvement of the national parliaments. Wolfgang Wessels discusses the various options of such arrangements. His conclusion, however, is that none of the options is satisfying. Instead he finds a solution in a dialogue-model: "In a coordinated division of labour, parliaments of both levels should jointly exercise a comprehensive participation in the ex-ante preparation and an ex-post scrutiny and control. This model is based on a strategy of a multi-level alliance or coalition of parliaments vis-à-vis power seeking executives in the European Council".¹ Article 13 FT already provides for the establishment of a conference of representatives of the relevant committees for the European Parliament and the national parliaments „in order to discuss budgetary policies and other issues covered by the Treaty“. Very strong reservations were made, however, regarding any such new bodies without real powers. Members of parliaments would not find it to be of value to spend their time for discussing without relevant decision-making. COSAC was not considered to be model for resolving the problem of legitimacy.

It is necessary, therefore, to integrate close parliamentary interaction into the existing institutional setting with a view to include the European dimension of the national policies in the national discourse, and vice versa, to open up the minds of the decision-makers at the European level for specific national problems. This aim could be achieved by the participation of national members of parliament in the work of the budgetary committees of the European Parliament, and by the participation of members of this committee in the actual work and discussions of the budgetary committees of the national parliaments. Such openness and inclusion would support mutual understanding, but also allow for a more qualified control the national parliaments are exercising on their ministers in the Council. It seems to be a step further, when Andrea Manzella proposed to make the European Parliament a centre of parliamentary networks, or of interparliamentary committees with real decision-making powers as part of a new constitutional architecture of the Union: "Without this parliamentarism of dialogue, of monitoring and of cooperation between the European Parliament and national parliaments, the current European governance really would resemble to an intergovernmental alliance that like a steel cage falls on European society, forcing it to find an alternative road, without the breeze and the hopes of constitutionalism."²

4. DEMOCRATIC LEGITIMACY IN THE EUROPEAN UNION

Far beyond the issue of economic and financial competences at the Union level the question of democratic legitimacy in the European Union is still pending. In some respect, as Joseph H.H. Weiler pointed out, the Union is a "democracy without the people", and there is no "demos" at the European level indeed.³ He made clear that there is no real representation nor accountability; people have no real political choice when called to elections, and even if a specific policy – like the Lisbon Process 2012 or the climate change policy, Copenhagen summit – was a complete failure, there is no person to be thrown out and replaced, through elections, by a better political leader. Given the lack of a "demos", people in one country would not understand why they should agree to bail out another country or accept substantial financial transfers to other countries. Thus, the question of democratic

¹ Wessels

² Andrea Manzella, Is the EP legitimate as a parliamentary body in EU multi-tier governance?, in this volume, p.151 and seq.

³ Joseph H. H. Weiler, Democracy without the People: The Crisis of European Legitimacy "own resources", in this volume, p. 114

legitimacy reveals to be fundamental for any future solution also to the financial crisis in the EU.¹ Input legitimacy, thus, appears to be marginal and the democratic deficit is built into the very structure of the EU governance model. Output legitimacy, for Weiler is not an appropriate criterion, and what is remaining, to him, is political messianism: "In political messianism, the justification for action and its mobilising force, derive not from process, as in classical democracy, or from result and success, but from the ideal pursued, the destiny to be achieved, the 'Promised Land' waiting at the end of the road. Indeed, in messianic visions the end always trumps the means". And he sees European integrations "a political messianic venture par excellence".² Given the present failures and crisis, however, even this is not a sufficient source of legitimacy any more. Weiler, thus, concludes, that "the politicization of the Union which will be the key to capturing convincing political legitimacy.

A number of ideas on these issues, have been tabled at the workshop, and they are worthwhile to be considered further in the discussion.

4.1. Party-groups' candidate for a double-hatted President

It is an old idea that each party group represented in the European Parliament should present one top-candidate in the European elections for the office of the president of the Commission as well as a specific political program, so to allow the electorate a real political choice. But the idea seems to get new momentum, and Miguel Poires Maduro and Matthias Kumm³ are explaining why they deserve further consideration. Maduro is going so far as to propose "'transforming' elections to the European Parliament into an electoral competition for the government of Europe".⁴ If it is true, that the Commissions' president has not much power to implement his or her program, in particular, when the political colour of the majority of the ministers in the Council is the opposite, the real political power of the Commission is not sufficiently evaluated. The Commissions' president is already strong when he/she has the support of European Parliament. It is the Commission, still, who has the quasi-monopoly for making proposals for European legislation. And the Commission's President can channel his or her political ideas and initiatives through the preparation of, and his participation in the discussions of the European Council. With the expertise and competence of the Commission's services, composed of highly qualified and committed European civil servants with origin, culture and knowledge from all Member States, the President disposes of an exceptional manpower for elaborating his strategies and policies. Yet, the presidents' office could be strengthened further by merging it with the office of the president of the European Council. The EU, with a "double-hatted" President, elected and scrutinised by the European Parliament, would be given a face, and a success or failure of certain European policies could more easily be attributed to a person who is politically accountable and may be re-elected or replaced after the next elections.

4.2. Commissioners' candidates on top of national electoral lists

In each of the Member States, each party campaigning for European elections should, as suggested by Vivian Schmidt, present her candidate for the office of a Commissioner at the head of its national electoral list.⁵ The top-candidate of the party winning the election should be proposed under Article 17 (7) subpara. 2 TEU by his government for being appointed as a member of the Commission. Again, this would lead to more visibility and

¹ Ibid., passim.

² Weiler, p.120

³ Maduro, et seq.; Kumm (note 5). p.137 , arguing for a « genuine competition for a European government »

⁴ Maduro, p.47

⁵ Schmidt

allow choices on persons and programs and enhance legitimacy and – at the next elections – accountability of the Members of the Commission. Schmidt explains that not only the president's election by the European Parliament would “ensure that the elections themselves would help bring real (left/right) political debate back into the EU policymaking process, thereby helping gradually to politicize the EU” and that they would “serve as a first step to ensuring that the Commission gained a kind of democratic legitimacy of its own as initiator and implementer of EU legislation...”, and “by tying the Commission more directly to the EP through its election, it would become more accountable to the EP politically, and thereby expected to reorient EU policies in conformity with the EP electoral majority”.¹

4.3. The European Parliaments' powers in future politics

Apart from the Commission, the real powers and political influence of the European Parliament needs to be made more explicit. The economic dialogue established by the Six-Pack as well as, in particular, a strong involvement in the European semester present great opportunities for promoting democratic control in areas of high political sensitivity. With new powers of the EU in the area of taxation, banking supervision and a rescue fund for bank failures, but more importantly with European competences in the field of economic and fiscal policies, the European Parliament should become the place where policies with considerable impact on the daily life of citizens will be (co-)decided.

With such new fields of responsibility the European Parliament will attract more attention of the citizens, as its policies are becoming more relevant for the citizen, and more “salient”, as Andrew Moravcsik would say.² Political choices among parties participating in the elections will become possible and relevant, having an impact upon the policies led at the European level. As Matthias Kumm stresses, though neither the European Parliament nor the Commission played a substantial role in the decision-making regarding the financial crisis, and there were “no cross-national debates about alternative futures for Europe”, with the Six-pack, the ESM and the FT the Commission gains considerable powers to intervene in budgetary processes of Member States”.³ The need for enhanced legitimacy of the Commission therefore seems to be an important issue on the European political agenda.

4.4. The European dimension of the national parliaments' work

As suggested above, particularly in the field of economic and fiscal policies, the European role and responsibility also of the national parliaments should be made more explicit. It is important already now, though underestimated. If the national parliaments, as Article 10 TEU seems to imply, are one of the two sources of legitimacy, if not the primary source, as the GFCC suggests,⁴ they are acting as European Parliaments, and people should be more conscious of this responsibility. They have to guide and control their respective ministers in the Council, but they are also implementing the directives decided at the European level. Regarding budgetary policies within a European framework it should be for them not only to participate directly in the “economic dialogue” or indirectly through their ministers in the drafting of the rules and guidelines to be taken account of when national budgets are adopted, but also engage in an interparliamentary dialogue so to understand and take account of European as well as each-others particular needs and interests when

¹ Ibid.

² Andrew Moravcsik, In Defence of the ‘Democratic Deficit’. Reassessing Legitimacy in the European Union, in: JCMS (2002), p. 603, at 615 et seq., see: <http://www.princeton.edu/~amoravcs/library/deficit.pdf>

³ Kumm . p. 16 et seq.

⁴ GFCC, judgment of 12 October 1993, 2 BvR 2134 – Maastricht, BVerfGE 89, 155 at 185 et seq.; similarly: GFCC, judgment of 30 June 2009, 2 BvE 2/08 et al. – Lissabon, BVerfGE 123, 267 at 368: “additional independent source of democratic legitimation”, see: http://www.bverfg.de/entscheidungen/es20090630_2bve000208en.html.

determining the priorities of national economic and fiscal policies.¹ The idea of Maduro to organize a “state of the Union” speech and discussion regularly in each of the national parliaments² would add to enhancing mutual understanding among political elites at the two levels of governance in the Union.

5. NEW VISIONS AND MISSIONS FOR THE EU

If the legitimacy of European politics and action in the first periods was founded much more upon the successful progress of integration (output legitimacy) and guided by the visions of a united and peaceful Union of the peoples of Europe, Joseph H.H. Weiler talked about “political messianism”,³ it is difficult to find acceptance for it in times of crisis, an imminent failure of the EMU and where the original narratives for the benefits of integration have lost their particular value. As it seems to result from the discussions, there is a need to open a broad public discourse upon what the European Union is standing for, why people should commit themselves to keep it running and develop it further. There is a need for a new political messianism.

Clear preferences were expressed for unity, as opposed to any forms of a multi-speed, cherry-picking or differentiated Europe, the complexity of which would exclude understanding and support of the Union by the people. Instead, there is a need for unity to be completed and developed so to allow the citizens of the Union to participate, through their institutions at the European level, in the proactive shaping of globalization, a process which otherwise would just expose them and their states to pressures making democratic self-determination difficult. There is a need for having strong common institutions for a Europe the relative influence of which at the global level is continuously diminishing. This should allow the Union, in particular, to regain political control on the financial markets instead of believing that the financial markets would fix problems in the EMU by sanctioning Member States who are found violating the commonly agreed standards of budgetary discipline.

Rather than striving for an ideological unity of a demos, it is perhaps this insight in the utility of common institutions and policies to pursue objectives which are beyond reach for the individual Member States, and awareness for the need also to constrain national autonomy with a view to gain new opportunities for democratically legitimate action at the Union level in so far as individual policies of one country would adversely affect the legitimate interests of the citizens of others, what might progressively lead to the establishment of the necessary link of solidarity among the citizens of the Union and of a common European identity, the fundament of effective democracy.

¹ See Manzella, p.147

² Maduro, p. 49

³ Weiler, p.121 et sq.

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DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT C: CITIZENS' RIGHTS AND
CONSTITUTIONAL AFFAIRS

CONSTITUTIONAL AFFAIRS

A New governance for the European Union and the Euro: democracy and justice

Miguel Poiares Maduro

Abstract

The report provides a democratic explanation for the crisis and the EU's failure in successfully addressing it so far. It argues that the solution to the crisis and the future of EU governance must depart from a renewed justification of the project of European integration which must be founded on its democratic and justice enhancing potential. It criticizes two mainstream models of governance for the Euro area and explains the advantages and political viability of an alternative model based on a new EU budget, new EU policies, more EU politics and a more effective political authority. The financial solidarity necessary for any successful model of governance of the EU must be detached from transfers between states and related, instead, to the wealth generated by the process of Economic integration.

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EXECUTIVE SUMMARY

The focus is on the democratic challenges raised by the current crisis in the Euro system and the governance proposals to address it and strengthen the EU in general. But the report goes further in the connection it establishes between the crisis and democracy: rather than simply addressing the democratic consequences of the crisis and the alternative solutions being put forward, the report places democracy at the heart of the crisis itself. Main thesis is that the origins of the financial and economic crisis of the Euro system are state and market based democratic failures that the original regime of Euro governance did not adequately address. It is only by fully understanding the democratic character of the crisis that we can appropriately understand the extent of the democratic challenges faced by Europe and the role of the European Union in this context.

The author argues that the future governance of the EU must depart from a revised justification of the project of European integration: a justification that focuses on the democratic and social challenges faced by the Member States and the EU value in addressing them. The EU should not be constructed as a challenge to national democracy but, instead, as offering renewed possibilities for democracy and social justice where Member States can no longer offer them. In this context, it is fundamental for democracy to be linked to a theory of justice in the EU. Citizens should be able to understand the benefits flowing from the process of European integration but also why those benefits come with certain duties towards others. Rights must be complemented by political empowerment and civic solidarity for the Union to be able to develop a genuinely legitimate form of economic and political governance.

The report starts by providing a democratic explanation for the crisis and the Union's failure in successfully addressing it so far. The origin of the crisis can be found in the democratic failures of some Member States and the externalities they imposed on others but also in the incapacity of national democracies to control excessive cross-border capital flows. The Union's failure to solve the crisis is, instead, imputable to the diffuse character of its political authority and its excessive reliance on national politics. The latter are incapable of internalizing the consequences of the interdependence generated by the Euro and integrated markets. As a consequence the Union cannot, de facto, govern and its policies are prisoner to national politics. The real EU democratic deficit is the absence of European politics.

The second part of the report discusses two models of governance for the Euro area as the author reviews some of the proposals put forward so far. One model has at its core the Stability Compact. The other complements the discipline enshrined in the compact with instruments of financial solidarity and debt mutualisation. For example, either through the ESM or jointly issued bonds Member States insure each other's debt. For reasons detailed below I have serious reservations whether such models can work. Their dependence on a permanent negotiation with national democracies (and the multitude of actors therein) will prevent them from providing the certainty that markets require. As to democracy, they are bound to put national democracies on a collision course. Some states will perceive themselves as shouldering others (and their moral hazard) while the others will feel that they are being governed by the former. A key finding of this report is that financial solidarity in the EU must be detached from transfers between states and related, instead, to the wealth generated by the process of European economic integration.

My alternative proposal departs from the previous idea. It requires an EU budget capable of providing the Union with the necessary financial muscle to address and prevent future crises. This budget would dispense with the need for national democracies and their citizens to insure each other. Their liability would be limited to contributions to the EU budget

resulting from EU own resources. These resources, in turn, are linked to EU generated wealth: economic activities that the EU enables and have mostly benefited from the internal market. The legitimacy of these resources is further enhanced by linking them to forms of revenue that have made use of increased economic mobility to lower their tax burden at national level. The proposal suggests using the enhanced EU budget for two fundamental purposes: a stability fund providing collateral to state issued debt when necessary and subject to an adjustment program; and new EU policies aimed at addressing asymmetries in the economic and monetary union. In addition, I argue that the Union needs more than simply new policies. It needs to change the nature of its policies so as to improve how they “communicate” with citizens and increase their capacity to induce real systemic reforms in Member States. These changes would also allow the Union to complement the increased discipline it can impose on Member States through positive incentives. The final pillar of the model proposed addresses political integration. Rather than on institutions, my focus is on politics. By transforming the character of politics at EU level we will be able to infuse its institutional system with real democratic potential. I try to explain how to do it.

Throughout, the report highlights elements of a possible political strategy to promote these proposals. In my view this is the right path forward and the one more likely to gather the support of EU citizens in the different Member States. I have no doubt that some of what has already been suggested in the previous paragraph might be enough to label my proposal as impossible. But, as explained in more detail below, the question soon to be faced by European politicians is which, among several impossible proposals, may be the easiest to present to their citizens. I believe that this is the proposal put forward here. Not least because it links the developments argued for with a clear and convincing justification for the process of European integration. Furthermore, it does not require amending the Treaties (though it could benefit and be enhanced by Treaty amendments). Most of the suggestions put forward do require unanimity however. But I am also convinced that in all those cases recourse to enhanced cooperation is possible. I am naturally available to provide further clarification.

When the Euro was created it was presented as a big achievement of European integration but the rationale behind it was never fully articulated to European citizens. It was perhaps thought that any attempt to do so would engulf the project of the Economic and Monetary Union in endless political debates about the nature of European integration and the impact of the single currency on national sovereignty. Instead, the Euro seemed an ideal way to deepen European integration in the usual way: as a technocratic regime disciplining (but not replacing) national democracies. The governance regime emphasized this technocratic dimension of the project with a focus on the role of the European Central Bank and its insulation from political pressures. Economic and fiscal politics was left to the Member States, which were deprived of their role in monetary policy but, for the rest, were supposed to comply with certain limited rules that proved to be too weak to prevent the current crisis. The hope was that the model could protect both national and EU different legitimacies by a strict separation between the technocratic and political dimensions. The price to be paid was leaving outside Euro governance fundamental dimensions of economic and fiscal policy impacting on a monetary Union. This was necessary so as to preserve space for national politics.

This separation has failed. We have found out that a European Monetary Union cannot be fundamentally dependent on national politics. Yet, though many now recognize the political dimension of the Euro project and call the present crisis a political crisis, we are far from articulating exactly what that means and its consequences. In order to think right about the future democratic governance of the EU we have to clearly understand the political and democratic dimension of the current crisis.

1. UNDERSTANDING THE CRISIS ⁶³

Two Narratives and Democracy

Two narratives of the current crisis exist. The first is the dominant narrative. It puts most of the blame for the crisis on some Member States and their irresponsible fiscal policies and lack of economic competitiveness. Capital flight from those Member States is a simple consequence of those irresponsible fiscal policies and underlying economic problems. But, in the meanwhile, the interdependence generated by the Euro resulted in the financial problems of those states becoming a problem for all. This can be presented as a democratic problem since the interests of the latter Member States are not taken into account in the former Member States' democratic process (the EU can, in many respects, be presented precisely as expanding the scope of interests to be taken into account in national democracies). What happened is that no effective mechanisms were available to ensure that the fiscal policies of a Euro-Member State would take into account the interests of the other Member States.

This can be presented as a form of democratic externality that is favored by deeper integration and the interdependence it creates. The crisis makes clear our interdependence but also our failure to internalize its consequences. This failure is a democratic failure. But is a democratic failure of the Member States and one that extends beyond Euro related issues. It is sufficient to remember the circumstances in which a wrong assessment by the health authorities of a Member State on the risk of a particular vegetable led to heavy losses for farmers all over Europe. Many such externalities are also not a product of economic integration but independent from it. Consider, as an example of this type, the fact that 75% of nuclear power plants in Europe were built on a border with other states. This amounts to exporting the risk involved in the production of nuclear energy to states that do not benefit from it. In all these instances national democracies are likely to impose externalities on other democracies whose interests they do not attend to. This correction of inter-state democratic externalities ought to be one of the main functions of EU democratic governance, and, in some areas, it is indeed already the case. The Euro crisis is a product of this type of democratic failure that the Euro governance regime was not well set up to correct.

The second narrative does not see markets punishing the mismanagement of Member States but, instead, as the main causes of the crisis. The crisis is a product of unfettered capital flows. After creation of the Euro an excessive influx of capital occurred from northern banks to several EU Member States, particularly in the south. Those banks benefited from the Euro to inject liquidity into other Member States in search of increased profits. This artificially lowered interest rates in those Member States, creating a credit bubble. This narrative is, in fact, very similar to the dominant narrative of the American financial crisis, presented as a creditor generated problem rather than a debtor responsibility.

When the financial crisis took place in the US and expanded to European financial institutions it was only a matter of time until markets lost confidence and suddenly cut off access to credit in those countries. This increased interest rates on sovereign debt, further undermining confidence in those Member States. A self-fulfilling prophecy followed. Not only did capital no longer accrue to those states but, making use of the free movement of capital, started to leave those states on a massive scale. They became victims of what Dani Rodrik has described as a phenomenon similar to a run on the banks but at the level of

⁶³ I would like to thank Jose Tavares for the help he has provided in testing the economic consequences and rationale of some of the proposals put forward in this report. I would like to thank Joao Gama, Michael Graetz and Ana Paula Dourado for useful discussions on some aspects of the proposals on own resources included in this document. (author)

states.⁶⁴ Moreover, deprived of the possibility to devalue their currencies or reinstate currency controls, those Member States can no longer address those capital flows and their consequences.

This narrative can (and ought) also to be presented in democratic terms. This is a form of transnational democratic externalities imposed on states. Or, in other words, capital movements can be presented as having a profound impact inside a state without being subject to its democratic control.

This explains why the Bretton Woods consensus on capital controls⁶⁵ seemed so closely associated with democratic reasoning. The core idea was in fact to protect the effectiveness of domestic policies that could be undermined by the unfettered movement of capital to and from states. In other words, preserve the results of domestic democratic deliberation from interference, by exit or entry, of capital movements and their associated interests. However, reintroduction of capital controls at national level is not a solution. Not only is it unfeasible for a state to isolate itself from the world economy but capital controls also have negative effects. They prevent capital from moving to where it may be more efficiently used for the societal good. As the Euro demonstrated, flows of capital can also drastically increase the quality of life of poorer states by giving them easier and faster access to credit since their potential for growth is also bigger.

Whatever our view on capital controls it is impossible to conceive of a European internal market subject to national capital controls. The elimination of national controls on the free movement of capital is both a necessary dimension of the internal market and its benefits and a de facto impossibility for states in the context of the internal market.⁶⁶

An alternative might be free movement of capital with currencies fluctuating. Something that some argue ought to be reinstated, in the context of a solution for the crisis that would involve the breakup of the Euro. But it is a mistake to conceive of this as being free from democratic problems. The devaluation of a currency in a state results in externalities for other states. It imposes a kind of tax on the exports of those other states. It is simply the form that the externality takes that varies. Moreover, devaluation is not a free pass and imposes harsh social costs within countries undertaking it. Finally, one ought to remember that the existence of different national currencies in the internal market has not necessarily involved currency fluctuation (the internal market requires at least some stability in the monetary system). In a context of fixed exchange rates the costs of adjustment will still be very high and involve multiple externalities. In this way, it becomes clear that the democratic challenges mentioned today as resulting from the Euro would simply assume a different form in the absence of the Euro.

In fact, a stronger normative justification for the Euro might be the opportunity it offers to Europe to address the democratic challenges posed by capital flows. The latter, while, as mentioned, also bringing many advantages, challenge two dimensions of democracy: policy autonomy and distributive justice. They do so because they offer exit and entry possibilities to particular economic actors from deliberative settlements reached in the democratic process. The Euro offers an opportunity to address those risks both by providing a new deliberative space for those issues at the European level and empowering Europe to protect them at the global level. For this, however, the right governance model needs to be adopted.

Understanding this second democratic challenge is also crucial to understanding why it is wrong to present the current crisis as involving a trade-off between democracy and economic catastrophe. Many are assessing this crisis and the different alternatives to

⁶⁴ Dani Rodrik, *The Globalization Paradox - Democracy and The Future of the World Economy*, Norton, New York, 2011, p. 93.

⁶⁵ For a description see Rodrik, *op. cit.* p. 95 and ff.

⁶⁶ As the failed few past attempts to reintroduce them by some states have quickly demonstrated.

address it under this paradigm. But, for the reasons given above, this is simply wrong. Giving up the Euro will not, in itself, protect national democracies. The challenges to national democracy arise from economic integration and, in this particular context, unhindered capital mobility at European and global levels. If the Euro has failed so far it is because it has not been effective in protecting democracy from these challenges, not because it is itself the source of those challenges. The Euro may well be the only effective way to ensure, at European level, the conditions necessary for policy autonomy and distributive justice that any democracy requires.

This point must be forcefully made if one wants to secure the social legitimacy necessary for the deeper integration that many consider necessary to preserve European integration and the Euro. Any move towards deeper political and economic integration should be grounded on a choice by citizens and not presented to them simply as the unavoidable consequence of the Euro. It is fundamental for citizens to understand that the need for further political integration is the democratic answer to interdependence and not a mechanical necessity imposed by the logic of integration. More integration should be a matter of choice, not an inescapable consequence of a process outside their control. Certainly, in making this choice citizens must be informed of the economic and democratic consequences of the alternatives. For the reasons presented above, strong arguments exist to actually say that the EU may enhance democracy instead of challenging it. In place of the debate about more or less Europe we should be having a debate about what kind of Europe is necessary to answer the democratic challenges faced by the Member States.

EU Failings in Addressing the Crisis and Democracy

To fully understand the nature of the democratic challenges facing Europe and what to do to address them it is also important to make sense of EU (in)action in the aftermath of the crisis. The perceived incapacity of the EU political process to solve the crisis is a simple continuation of national democratic failure to internalize the consequences of interdependence. National democracies can neither correct their mutually imposed externalities nor effectively regulate the transnational forms of power that evade their control. But because European regulation of these phenomena is too deeply dependent on national politics it too has proved incapable of effectively addressing them.

In fact, the failure of the EU political process to successfully address the current crisis has, at its core, a political gap: the scope and level of politics has not followed the scope and level of political problems in Europe. This is our most important democratic deficit.

European integration generates a deep interdependence between national policies that has, however, never translated itself into European politics. But if national politics is not able to incorporate existing European interdependence on certain issues then it will not provide the correct political incentives for necessary and democratically legitimate solutions to those issues. This has consequences on what decisions the EU takes but also on how those decisions are interpreted since they are both the product of political incentives originating in national political processes and then, again, appropriated by the latter. In other words, political actors at EU level are predominantly responsive to national constituencies that are not able to internalize the consequences of interdependence. As a consequence, European decisions suffer from the democratic failure which those national political spaces are subject to. But they are furthermore affected by the fact that, when adopted, they are then subject to different (and often opposite) interpretations by those national political spaces.

This failure to internalize interdependence is aggravated by what many perceive as the erosion of solidarity within the EU. In fact, the reverse is rather the case. Rather than being the product of the absence of a European cultural or social identity, lack of European solidarity is the result of that very lack of internalization of the consequences of interdependence: this time, of the benefits it generates. The bedrock of European solidarity

will not be a pre-existing cultural or social identity. It will be an awareness of the benefits of European integration and that those benefits must come with duties too.⁶⁷ In other words, the easier (and more legitimate) path to European solidarity comes by establishing a link between the wealth generated by European integration and the requirement to distribute it fairly.

The EU is both a source of wealth creation, through market integration, and of redistributive effects, by mobility and competition in that market and the increased majoritarian character of its decisions. This requires democracy to be extended as far as the problems and the interests they affect extend. But it also requires some democratic notion of distributive fairness to legitimate the impact of what is done and decided in common.

Finally, the excessive dependence of the EU political process on national politics involves another negative consequence: political authority is too diffuse in Europe. We have often in the past been concerned with the democratic risks involved in concentration of political power. But the opposite may also amount to a democratic problem. When political power is too diffuse then democracy becomes ineffective or dominated by minorities. This is, in fact, what we have been witnessing in the EU. The diffuse character of its political authority in some domains is such that it can easily be rendered ineffective not only by a Member State but also by groups within or beyond a Member State. This is a form of political capture. Europe's difficulty in rising to the challenges posed by the crisis and its claimed ineffectiveness in regulating financial markets and opposing speculation are a consequence of the diffuse and weak character of its political authority.

Europe's answer to this problem has often been to try to side-step democracy itself. The EU's recurring preference for technocratic solutions is, in many instances, a simple consequence of the ineffectiveness of its political process. Since European democracy cannot effectively address some of the current issues, the solution has been to take those issues out of politics. It is true that democracy also needs editing and discipline and that this may require insulating certain questions from the politics of the day.⁶⁸ But this cannot be taken too far, otherwise it becomes a challenge to democracy itself. This highlights a conundrum faced by European integration in its relationship with politics; it seems to be faced with a choice between either too much politics or no politics at all. The answer involves a reorganization of European political spaces, including, as will be argued below, the emergence of a European political space.

2. CONDITIONS FOR A DEMOCRATIC AND JUST EU GOVERNANCE

Any answer to the current crisis and the form of EU governance adopted to that effect will have to fulfill certain conditions to be both effective and legitimate. What follows is a list of those conditions. The proposals that are later put forward must be understood in light of these conditions. These conditions are also closely related to the proposals.

1) *We need political authority.* Any successful model of governance will have to make clear that political authority stands behind the Euro and the EU. It is the absence of this political authority that undermines the effectiveness and credibility of Union governance of the Euro and its capacity to govern financial markets instead of being governed by them.

⁶⁷ This brings to mind the aphorism "[I]f duties without rights make slaves, rights without duties make strangers." Selbourne, D. *The Principle of Duty*. Abacus, 1997, p. 19.

⁶⁸ That is one of the functions of constitutions.

2) *We need accountability.* The current crisis is a prime example of the need for accountability. Citizens do not know to whom to assign blame for the current crisis and the failures in addressing it. Who exactly was responsible for the crisis? Markets or Member States? Or again, how should responsibility be allocated between them? And who in the EU was responsible for the failure of the Maastricht instruments of surveillance and coordination of national fiscal policies? Citizens also do not know who to hold accountable for the policies adopted, both at the EU and national level, following the crisis. Who should citizens hold accountable for the results of the adjustment programs “imposed” on some Member States: their national governments or the EU? And if the EU, does that mean the Commission, the ECB, the Council, or some Member States within the Council? The diffuse character of EU political authority makes accountability virtually impossible and favors its manipulation by political actors: national political actors can use the nature of intergovernmental bargaining to transfer political costs to the EU. But, increasingly, the EU institutions might use the fact that its policy choices will have to be enforced by national governments to evade accountability too. Clearer political authority will be a necessary (but not sufficient) condition for accountability in Europe. But we should take steps for such accountability even in its absence.

3) *We need to re-establish mutual trust between states and between citizens.* This has been severely affected by the crisis. Some Member States and their citizens believe they are paying for the mistakes and even cheating of others. These others believe that that it is the former that have not shown sufficient solidarity and are, instead, imposing a form of collective punishment on the latter. Moreover, these discourses are increasingly shaped around national and ethnic lines. The risk is real. In order to prevent it we do not simply need a contract linking solidarity with conditionality. We need both the rules and solidarity to be traced back by all citizens to collective goods shared by all. In other words, they must be linked to the broader purposes of European integration and the fair distribution of its costs and benefits.

4) *We need to render both the benefits and the democratic consequences of interdependence visible to citizens.* This will never be achieved by information campaigns, no matter how well designed. The real source of communication by a political authority with its citizens is through the policies that it enacts and how they impact and are perceived by citizens. The benefits and costs of the European Union are only properly internalized by citizens if they are inherent in the character of EU policies, including its revenues. It is in this way that the Union substantively communicates with citizens. In other words, EU policies must be simultaneously capable of informing citizens about the benefits of European integration and the reasons for their contribution to it.

5) *We need to legitimate financial solidarity by relating it to the wealth generated by European integration and not the wealth of some states.* The idea that the EU is an instrument to transfer the wealth of some states to other states is a poisonous tree that undermines any form of solidarity within the Union. We must detach financial solidarity and financial transfers between states. Financial solidarity must be a product of the wealth that the process of European integration itself generates and be guided by the goal of a fair distribution of the benefits of integration among all European citizens.

6) *We need political integration to support increased transfer of powers to the Union and its financial solidarity.* The starting point for this political integration must be a European political space. Any form of political integration based only on national political spaces will, for the reasons described above, both lack sufficiently clear political authority and be incapable of internalising the democratic consequences of interdependence. Ideally, this

form of political integration would also include a reform of the institutions so as to guarantee that their decision-making processes fit closer ideals of representation and participation in the context of multi-level polities.⁶⁹ The proposals to be put forward are aimed at promoting that political integration even in the absence of the treaty reform involved. I believe a change in the political culture of Europe can have profound democratizing consequences even in the absence of further institutional reforms. It is also important to note that I establish a close link between governance and policies, and democracy and justice. If it is well known that there ought to be no taxation without representation, it is equally true that there can be no representation without taxation. These are two sides of the same coin since there is no successful political community without distributive justice.

Some of these conditions are, implicitly, assumed in the emerging consensus around the need for a fiscal union (even if it would be more correct to talk about a genuine economic and monetary union). But what is meant by a fiscal union? Three dimensions can be identified in many of the proposals that have been advanced. More importantly, these dimensions appear to form the cornerstone of the report presented by President Herman Van Rompuy (and prepared in cooperation with the Presidents of the European Commission, the ECB and Eurogroup) at the last European Council:

- greater EU powers over national budgetary and fiscal policies;
- financial solidarity;
- stronger EU democratic legitimacy (presented as a necessary consequence of the two previous pillars).⁷⁰

On the basis of the vision highlighted in that report a roadmap with concrete proposals should, again, be presented to the European Council.

The logic appears straightforward. Enhanced EU control over national fiscal policies will guarantee that all states comply with the rules of the monetary union and, in turn, enable forms of mutualisation of debt. Stronger political integration would serve to legitimate these developments. However, behind this apparent simplicity things are rather more complicated. Is it really possible to effectively control national budgets at EU level? And can this be achieved without fundamentally colliding with the core of national democracy? How and when is the trade-off between discipline and solidarity to take place? What form should this solidarity take (e.g. Euro bonds, ESM, ECB intervention)? And how should political integration be organized so as to effectively enhance democracy instead of risking being perceived simply as one more challenge to national democracy? These and other questions explain part of the difficulty in concretizing the promise of a genuine economic and monetary union. In addition, these tough decisions are still ultimately dependent on national political processes which, as we have seen, are ill equipped to understand the consequences of interdependence and provide the right political incentives. The Union is, in certain respects, in a Catch 22 situation: European politics are required to address some of its current problems but the steps necessary for the emergence of European politics are for now dependent on national politics. What to do is therefore inextricably linked to how to do

⁶⁹ That are briefly described below.

⁷⁰ To these we should add the banking union which I will not address in the present short report focused on democratic questions. This is not meant to imply that the latter is of more limited importance. In fact, banking union is a fundamental part of any exit strategy for the crisis in both its financial and economic dimensions. However, it should not be limited to an EU centralized banking supervision and deposit guarantee scheme. It must include a genuine financial services internal market. Important competition distortions in the internal market arise from the fact that companies, no matter how economically and financially solid, have their access to credit dependent on their state of residence and cannot, de facto, obtain credit from banks in other Member States at lower interest rates. In some cases, the compatibility of these situations with internal market rules could even be discussed. This is not, however, the object of this report.

it. The proposals I will put forward take this into account even if they might, at first sight, appear counter-intuitive from the point of view of their feasibility.

Before presenting my proposals, however, I want to discuss the two alternatives that, in my view, have dominated the terms of the debate so far.

3. A UNION OF RULES

The first alternative would limit itself to building upon the Stability Compact and the revised legislative framework on excessive deficits and macro-economic imbalances, as resulting from adoption of the 'six-pack' in 2011. The thesis is that what failed with the Euro was appropriate supervision of Member State fiscal policies. If the EU were in a position to effectively guarantee Member State compliance with its fiscal discipline, trust in markets would be restored, the crisis would ultimately be overcome and the credibility of the Euro strengthened. The overwhelming majority of the steps taken so far regarding governance of the Euro have followed this approach. The Stability Compact embodies this approach. It could be incorporated into the Treaties in the context of a broader reform that would further enhance the powers of the Union with respect to Member State fiscal policies. The proposal to create an EU Treasury Minister fits in this model. The same could be said of the suggestion to grant more powers to the Court of Justice, beyond what is already in the Stability Compact.

This approach is also presented as reconcilable with democracy. The Union is not conceived as intruding in national democracies but simply guaranteeing the rule of law in the Euro area. It would be a European constitutionalization of fiscal discipline similar to that already in place in some Member States. Member States have democratically bound themselves to these rules and the Union is simply enforcing them, preventing some from free riding at the expense of others. This thesis endorses only the first of the two narratives on the crisis identified above. In doing so, it underestimates the extent of the democratic challenges faced by Europe. It also underestimates the democratic consequences of powers being transferred to the Union.

This is not the document to discuss the merits and demerits of "constitutionalizing" budget discipline. Very briefly one can say that the most important arguments in favor can, indeed, be presented not only as compatible with democracy but even protecting it. First, as mentioned, the lack of fiscal discipline of some Member States, resulting in externalities being imposed on other Member States, can be presented as a democratic failure since the former states do not take into account the interests of the latter. Second, constitutional limits on budget deficit may also help in correcting an inter-generational democratic problem (the generation that decides on the deficit is not necessarily the same that pays it) and, more broadly, disciplining the risks of political malfunction arising from the pressures of political cycles. It is not uncommon for political communities to insulate certain issues from the pressure of day to day politics in order to attend to long term interests. But, on the other side, the arguments against legally disciplining fiscal policy are also democratic. It is said that such legal instruments restrict the scope of political action and empower a particular economic conception of fiscal policy. Deficits may also produce positive effects either to correct urgent economic problems or if they are linked to productive investments. Whatever our view on the benefits and costs of constitutionalizing fiscal discipline, two things are clear in the current EU context: this discipline is a necessity, if not to reestablish market trust, surely to reestablish trust between Member States; but this discipline is also insufficient to address the current crisis.

It is insufficient for both economic and democratic reasons. It starts by ignoring that the fiscal situation of a state is closely dependent on its underlying economic situation. Several states that are now in a profound fiscal crisis were until recently fully compliant with the Maastricht criteria. The reasons for their fiscal crisis have to be found in deeper economic

problems that rapidly turned into a fiscal crisis. This has two consequences. First, it is a dream to assume that Economic and Monetary Union will magically function so as to ensure all its states enjoy permanent trade surpluses. Financial transfers will always be necessary; the question is how and under what conditions? Second, we need to take seriously the economic part of Economic and Monetary Union. A Fiscal Union requires more than fiscal discipline and coordination of economic policies between states. It requires an EU economic policy, albeit limited to correction of the asymmetries emerging in a monetary union.

But a Union only of rules and discipline would also be democratically unacceptable. Budgetary and fiscal issues have been at the core of democratic political debates for centuries. It is true that, as mentioned, in some states they have been in part insulated from politics and constitutionalized. But even where that is so, this was possible as part of a broader political and social contract and supported by institutions with an established democratic pedigree. The EU, as of now, does not yet offer either.

A regime relying exclusively on fiscal discipline to be enforced by the EU would undermine the already limited political and social legitimacy of the Union: either national political processes would preserve autonomy and the effectiveness of the rules would be put into question or the disciplining of national political processes by a non-political space would put democracy itself into question.

4. A UNION OF NATIONAL DEMOCRACIES

It is always attractive to talk about a Union or Federation of national democracies. It seems to reconcile the irreconcilable and as a label it works. It also seems to be the path preferentially explored in the report presented by President Rompuy to the Council. It reflects many of the proposals being put forward regarding forms of debt mutualisation and further political integration.

The idea is to complement the fiscal discipline regime embodied in the Fiscal Compact with forms of fiscal solidarity between states and enhanced democratic legitimacy (preferentially through national democracies). Fiscal solidarity would take the form of either a limited mutualisation of debt (in the form of jointly issued EU bonds or some form of ECB intervention) or loans to be provided by the ESM. We could describe this system as one where states provide insurance for other states' debt but such insurance is limited and dependent on a case by case political assessment. Democratic legitimacy would be provided by the participation of a broader set of national political actors in these decisions. National Parliaments and courts would be involved by, for example, reviewing assumption of any new financial liabilities by their state.

I have serious reservations regarding the feasibility and legitimacy of this model. Financially, it is doubtful whether this approach would be sufficient to restore confidence in the common currency and in the political will supporting it. To make governance of the Euro dependent on a permanent "negotiation" with national democracies would leave uncertainty as to the extent of financial and political support underlying the common currency permanently intact. It is this uncertainty that feeds market fears and speculation.

Even if the extent of financial solidarity and debt mutualisation cannot be unlimited, how to exercise it cannot depend on a form of political authority that is too diffuse to be effective. But that should not make us give up on democracy in this area. On the contrary, it should make us look into effective forms of democracy at EU level.

In fact, it can be argued that a model that would make EU democracy wholly or fundamentally dependent on national democracies is destined to fail. It would suffer from the fundamental problem of relying too much on national political processes incapable of internalising the consequences of interdependence and providing the right political incentives in that context. Furthermore, a model requiring constant bargaining on how

much some states ought to pay to others and, in turn, how these ought to be subject to the policies imposed by the former, would corrode European integration instead of supporting it. States paying would think they are carrying other states on their shoulders and rewarding moral hazard. Those being “disciplined” would take it as being governed by those loaning the money.

A European democracy will only be feasible if Euro problems are perceived as genuinely collective issues and if the answers to them are part of a broader political contract guaranteeing that all comply with the rules of the game but also that all share a fair distribution of the costs and benefits of European integration. For this to be possible it must be structured around proxy politics and not inter-state politics. We certainly ought to work on improving how national political spaces interact with EU policies and better balance EU imposed discipline on national fiscal policies with the preservation of some deliberative space for national politics. But a real European democracy requires a European political space.

5. A GENUINE ECONOMIC AND MONETARY UNION

In light of the dominant discourse on the crisis it may seem to many that our choice is between a Union anchored almost exclusively on discipline and that, sooner or later, will enter into a destructive conflict with national democracies, and a Union prisoner of permanent negotiation between those national democracies. But that is not so. There is an alternative. I have advanced above the necessary conditions for a successful model of governance of the EU and the Euro. It is now time to concretize the forms through which those conditions may be fulfilled and how and why they may be politically feasible.

My proposal is based on three pillars: an increased EU budget supported by real EU revenue sources; new EU policies and a different kind of policies; and more effective political authority supported by a European political space.

I am well aware that the simple mention of these three ideas is bound to generate immediate accusations of delusion. I would urge you, however, to continue reading this report and give me the opportunity to make the case as to why this is not only the right thing to do, but, even if counter-intuitively, the easiest thing to do. All proposals arising from the alternative models mentioned above have already been frequently discussed and labeled impossible. I am certain my proposal will equally be labeled impossible. At some point, however, if we indeed want to save the Euro and the project of European integration, an impossible solution will have to become possible. My argument is that the proposals that follow are the most possible of all the impossible proposals. And they have the added value of being the only ones which seriously engage with the depth of the democratic challenges faced by the Union and its Member States. It is important also to mention that some of these proposals require further development which is incompatible with the nature of this report. Some of its details also require expertise that I do not possess. In this respect, I want to thank to José Tavares who has accepted the task of testing the economic impact of some of the hypotheses put forward here and developing others.

a) A Budget and Resources for Stability and Democracy

Currently the Union budget is 1% of EU GDP. We estimate that an increase of the EU budget to at least 3% of GDP (an amount foreseen at earlier stages of European integration and also when the Euro was created) should provide the Union with the firepower necessary to play two fundamental roles in the context of a Monetary Union. First, introducing policies capable of addressing the asymmetries affecting the well-functioning of the monetary union. Second, using the EU budget to address financial emergencies like the one that the Union is currently living through. The accumulation of a yearly budget surplus could be used for stabilization in case of temporary sovereign debt payment crises. The amount of this yearly surplus should reach about 1 percent of Euro area GDP, which could

progressively be used as collateral for borrowing up to 2 trillion Euros. As the reserves in the fund accumulate to provide the necessary collateral for up to 2 trillion Euros, the less of a budget surplus would be necessary to be transferred to this fund and the more of the budget could be developed for other EU policies (which could always be reversed if additional strengthening of the fund by the EU budget were necessary).

This debt would not be issued by the EU (which would be legally complicated, if not impossible, under the current Treaties and, I suspect, difficult to include in any amendment to the Treaties). I am suggesting that the Union fund provide collateral for debt to be issued by states with difficulties in accessing the markets. The collateral provided by the EU fund ought to be sufficient to substantially lower the interest rates at which those states would be able to finance themselves. But for states to have access to this EU fund they would have to agree an adjustment program with the Union.

This proposal would, in fact, replace the current regime of loans provided to states under financial assistance and subject to adjustment programs. It would also replace the European Stability Mechanism. It would do so with three fundamental advantages:

- First, funding of the ESM is limited, for some already insufficient, and increases depend on additional agreements by the participating states in light of their respective national procedures (see Article 10 ESM). This is never easy and it may be further limited by national judicial decisions. Even how existing ESM financial muscle is to be exercised has already raised doubts, including as to what the appropriate decision-making rules will be. In this light, the ESM does not seem sufficient to generate trust in the markets. The mechanism we suggest would have much stronger firepower.
- Second, bringing adjustment programs into the scope of EU policies and institutions would provide them with enhanced legitimacy and transparency (in particular if the political reforms suggested below were also implemented). The current *troika* (involving the IMF, the ECB and the Commission) negotiated programs raise many questions of accountability and transparency. This is a criticism that is equally applicable to how the ESM will operate.
- Third, as mentioned, the ESM depends on funds guaranteed by the participating states. This limits its firepower but also undermines the social and democratic legitimacy of the Union. The citizens of Member States which at a particular moment in time would be net contributors under the ESM (loaning to it but not getting funds from it) would tend to construe it as an unjustified transfer of their funds to cover risks assumed by other Member States. Use of the EU budget would prevent that direct link from being established. It would also signal to citizens in all Member States that their financial solidarity will be limited to their obligations towards the EU budget and is the price to be paid for the general benefits and costs of being part of the EU.

This third advantage also clarifies why this proposal will actually be more feasible than alternatives such as Eurobonds. Not only do the latter share with the ESM the socially corrosive link that is established between financial solidarity and transfers between states, they also create in the mind of citizens the fear of an undetermined assumption of other states' risks. There will always be uncertainty as to how much debt might have to be jointly issued in the future. In other words, one of the problems that renders difficult, if not impossible, any real form of debt mutualisation is uncertainty as to the extent of the risk to be shared. The current proposal eliminates the information and transaction costs associated with that risk. Citizens will know that their obligations are fulfilled by their annual contributions to the EU budget. Their states, as such, will not incur any liability with respect to the actions of other states. Certainly, an indirect form of debt mutualisation exists

through the financial solidarity involved in the proposed EU budget stabilization fund. But the way it is legitimated in the eyes of citizens would be different. And, more importantly for its political feasibility, the risks incurred by citizens would decrease substantially.

The legitimacy of this form of financial solidarity would also be made stronger by changing the character and origin of EU revenues. The argument I want to put forward next is that what would make an increased EU budget possible, new own resources, could actually also serve to legitimate the Union. Again, I must articulate clearly and carefully what is another counterintuitive argument.

A polity, including the political authority exercised therein and the necessary solidarity between its members must be made meaningful and intelligible to its citizens not only by how it represents itself but also by what it does. One fundamental aspect is certainly how revenues are collected and taxes organized. These are not simply a source of revenue. They are also a way for the reasons for solidarity to be made clear to the members of the polity. How revenues are collected in a polity, and taxation allocated, also informs citizens of the reasons for that polity and what that it means to be a member of it. EU revenues should not simply be determined on a pragmatic basis of how much is required to fund the Union budget and what is the easiest way to obtain it. Instead, the sources of EU revenues should be determined by what makes the Union more legitimate to its citizens by making visible the reasons for the Union's existence and linking its revenues to the benefits and costs that different social groups obtain from European integration.

If conceived in this way, the new EU own resources would not only provide the EU with the funds necessary to support the proposed budget increase but would also contribute to a clearer justification of the project of European integration. Furthermore, only in this way will we be able to legitimate solidarity within the Union on any meaningful and lasting basis. It is essential that the Union is seen as redistributing Union wealth and not merely the wealth of some Member States. It is equally important for this solidarity to be related to the different degree to which different social groups benefit from European integration and, particularly, the internal market.

In this light, the choice of EU resources should focus on the following areas: economic activity enabled by the internal market; economic activity that, while taking place in a Member State, has important externalities in other Member States; or economic activity that Member States can no longer individually regulate and tax on their own. In all these domains, the Union would be justified in obtaining revenues from the activity in question either because that activity would not exist without the Union or because the intervention of the Union is the only way to limit the negative effects of that activity in some or all states. In addition, the way those EU resources (in particular taxes) should be designed must take into account who benefits most from European integration.

These principles shape my proposals for new own resources. Most of these proposals have already been discussed (some even proposed by the Commission and the EP), albeit in a different form, in different studies. But it is the link with democracy and a theory of justice that sheds a new light over the choice of some and not other resources and makes them both politically more viable and better capable of reinforcing EU legitimacy.

A financial transactions tax is a paramount example. The justification for a financial transaction tax or even a broader tax on financial or banking activities⁷¹ is threefold. First, in light of the catastrophic costs that a financial crisis can impose on society the financial system is, de facto, systemically insured by the state. What the Euro crisis tells us is that it will now, in fact, be collectively insured by all Member States of the Euro. The projected banking Union is evidence of this. This collective insurance justifies calling on the financial sector to provide a particular contribution to the EU budget which will help insure the

⁷¹ Which arguably not only generates substantially more resources but is also more difficult to evade and less capable of generating competitive distortions.

financial system. Second, mobility of capital is protected by the internal market and, albeit it brings many advantages, it also, as described above, may itself be the cause of severe crises in Member States. States can no longer effectively control capital movements and Union taxation could help to limit some of the risks arising from excessive capital flows and financial volatility. The tax ought, in effect, to be designed as much as possible so as to reward or penalize the different forms and degrees of risk involved in different financial activities. Third, capital is not the only economic factor protected by internal market rules, but it is certainly the most mobile. As such, it benefits more from free movement than labor, for example. This includes choosing more favorable tax regimes and, therefore, decreasing the overall tax burden by comparison with other forms of income. It is only fair for the Union to help, at least in part, to correct a distortion that has been furthered by the internal market. The income generated by such a European tax could vary immensely depending on its scope and, in particular, if it were a simple financial transactions tax between institutions or a broader banking or financial activities tax. The Commission proposal, which is relatively narrow and limited, estimates close to 60 billion Euros in revenue.

Another possible own resource would be a European Corporate Tax. This would not replace the national corporate tax.⁷² It would be of a marginal character and preferably linked to harmonization of the corporate tax base.⁷³ I cannot articulate the details of this proposal here but will highlight its possible structure and, more importantly, why it makes sense as an EU own resource.⁷⁴

Average corporate tax rates have decreased in the European Union in the last few decades. Almost all European Union Member States have lowered their corporate tax rates in recent years. As presented in more detail in the annex, the corporate tax base has also decreased dramatically in some states (particularly southern Europe). This is the product of tax competition. European states now fix their corporate rates so as to attract companies from other states. But the consequence is that a collective action problem is emerging whereby the final outcome may be disadvantageous for all states. There have been frequent calls for a harmonization of corporate taxation in Europe so as to address this collective action problem and reverse the current race to the bottom. However, this has been met with strong opposition from some Member States. Many states believe that they are entitled to compete by using their tax regime. Others think they have no alternative. While some states insist it is necessary to prevent a total race to the bottom, others are afraid that harmonization will preclude any form of tax competition. As a consequence, attempts to harmonize corporation taxation have been unsuccessful so far.

The proposal I am making will have the advantage of allowing tax competition but moderating it and preventing the current rate of tax avoidance by companies. A marginal rate somewhere between 2 to 5% on company profits would not only help to fund the budget increase proposed but would also create a limit to tax competition without preventing it (states could still compete as to their national corporate tax rates and these would continue to be substantially more relevant for companies).

This tax would also make clear that the internal market is not an instrument for some to lower their contribution to society at the expense of others. Companies are among the primary beneficiaries of the internal market. It is only fair that they should pay back some of the advantages (including tax advantages) that they get from the internal market in the form of a rather small tax to the EU. This is further justified by the fact that most economic

⁷² Even if many good economic and taxation arguments are available to argue that ought to be so, I do not think full replacement of national corporate tax by a European corporate tax would be politically viable at this stage.

⁷³ To set it up with an autonomous tax base would be more complicated, although not impossible, because the EU would likely have to depend on national tax authorities for collection purposes. However, it may be an indirect way of achieving a long sought harmonization of the corporate tax base.

⁷⁴ Further developments can be found in the annex report by Professor José Tavares.

activity in the EU is now inter-Member State. It makes sense for the EU to get a small percentage of the profits generated by the internal market.

This rationale would be reinforced by my preferred structure for this tax. If possible⁷⁵, the revenues from this tax should be distributed between the Member State and the EU in relation to the proportion of the economic activity of the company that is intra-state or inter-state. The reason for this is that the more the economic activity of a company is linked to the internal market the more the taxation of its profits should also benefit the EU. In addition, one might assume that the more a company's economic activity takes place outside its tax residence the more the latter might be a product of tax avoidance and the more justified it would be for the revenue from a marginal European Corporate tax to go to the EU.

It seems paradoxical to be arguing for a European corporate tax, in addition to national taxes, at a time when tax authorities have increasingly given up on corporate taxes for revenue and all national governments are under pressure to lower their existing tax rates on companies. But what this proposal does is to turn that reasoning upside down. Member States are under pressure to lower those tax rates to extremely low levels because of excessive tax competition and not necessarily because those lower rates are more efficient in themselves (in fact, it is well known that excessive tax competition is likely to produce inefficient outcomes). As such, it would not be appropriate to talk about an increase in corporate taxation in Europe with negative effects on economic activity. Since the tax would serve mainly to prevent excesses of tax avoidance one should not expect a negative impact on the overall economy. On the contrary, it might promote a more efficient distribution of resources in the internal market. The distinction between revenues from intra-state and inter-state activity would also enable some states (those that have been most affected by tax competition) to actually compensate, at least in part, introduction of a European tax by lowering their national tax rate without a severe impact on their corporate tax revenues (which are, in any case, severely under pressure in the current corporate tax competition context). There is a final argument linked to the current economic and social context in Europe. Austerity policies have been adopted in almost all Member States, including those not subject to adjustment programs. But most of these austerity policies have focused on other forms of income precisely by fear of driving companies and capital away, to other EU Member States. This is only reinforcing social opposition to these austerity measures and, indirectly, to Europe. Reinstating some social justice by taxing these forms of income at EU level would increase EU legitimacy and help address this problem. The revenues generated by the tax are difficult to predict but could potentially amount to 0.5% of GDP.⁷⁶

An alternative to a European corporate tax might be a tax on corporate shareholders. This would reduce some of the risks of tax competition from outside Europe but it presents another type of tax administration problems and might actually be more politically controversial at this stage of European integration (because it would be imposed on a form of individual income). I am not developing it here.

I am well aware that the politics of this tax will not be easy. It is bound to receive strong opposition from a significant set of economic actors, an opposition that will resonate particularly well in some states in times of economic recession. States that have opposed harmonization are also likely to oppose this proposal even if with more limited effects on their interest. But I think a viable political strategy could be devised on the basis of the following points:

⁷⁵ What follows would again require a more in depth study on the costs and risks of evasion arising from differentiation between the nature of the economic activity of the companies that I suggest for determining how revenues from the tax would be distributed between the EU and Member States.

⁷⁶ Total corporate tax revenues in Member States amount to more than 2.5% GDP.

- The majority of European citizens will certainly favor a tax which is presented as the way to guarantee tax fairness when states can no longer do so. It would help correct some of the increased regressive effects of national taxation systems by ensuring that those that are able to avoid national taxes are made to pay, at least in part, at the EU level.
- Member States which have opposed tax harmonization are also well aware that their opposition will sooner or later be overcome. The pressure to decide by majority in some of these areas is strong and they are aware of it. The present proposal might be a compromise acceptable to them because, while limiting the effects of tax competition, it will be far from eliminating it. Differences between national corporate taxes will continue to be relevant.
- Corporate interests might be the source of stronger opposition. But even these might be “bought in” by a grand bargaining that could involve the type of measures suggested by José Tavares in the annex and a furthering of the internal market in areas such as energy and financial services. If part of the resources of the new EU budget were used for a package of growth policies this would mitigate the opposition of such interests. In addition, it should not be excluded that some companies feel themselves the victims of tax competition. Finally, it cannot be ignored that nothing has created more difficulties for European companies than the current situation in the Euro area. If this small rate were the price to pay for a stable currency and re-establishing access to financing, companies would certainly be ready to accept it.

Other own resources must also be considered. A carbon emissions tax is one such example that again fits the rationale that I have put forward. Most environmental taxes could be justified at EU level both because of externalities imposed in other Member States and because their share has also decreased in Europe as a percentage of GDP and tax revenues. One might also consider introducing some fees in the EU.⁷⁷ This could be the case with respect to projects to be funded through EU project bonds (such as high speed railroads). Once a project is completed a usage fee could be imposed allowing repayment of bonds or funding new projects, or both. A final suggestion might involve a reform of VAT also aimed at reducing carousel fraud that some studies estimate could amount to close to 30 billion Euros yearly. This reform could be used to introduce a modulated VAT as already proposed several years ago in a European Parliamentary Report.⁷⁸ That proposal focused on two separate tax rates (one national and another EU). But it might be possible, and more in line with the link I advocate between revenues and EU generated wealth, to relate the EU VAT rate to certain types of transaction (online sales or, if the VAT reform were to incorporate them, cross-border transactions).

A mix of these different forms of revenue should be enough to fund the budget proposed. It would be fundamental for them to be chosen and designed in light of the general principles mentioned above. That would provide them with strong justification in terms of justice for the EU. It would also make them politically more viable. In this respect, an additional political move to tackle foreseeable opposition to these new resources would be to link them to a reduction (or even replacement) of the current GNI contribution of Member States.

These proposals should be presented in light of a narrative stressing two points: decreased contributions from national budgets to the EU in exchange for taxation of those that have benefited most from the internal market; and reinstating at EU level some of the tax fairness that has been lost at national level.

In democratic terms, such a budget and the new resources would make the Union accountable not only for what it spends but also for the wealth it generates. It would

⁷⁷ I thank Michael Graetz for having brought this possibility to my attention.

⁷⁸ The Langes Report.

distribute 'its' money and not that of the Member States. This would have a profound impact on how the EU would be conceived by its citizens.

b) New and Reformed EU Policies

Union policies also need to be rethought in light of what justifies European integration. The European Union can increase its democratic legitimacy by more closely aligning its policy priorities to the problems that, given the ineffectiveness of Member State solutions, it should address.

The problem with current policies is visible in the clear gap between what EU citizens expect from the Union (as expressed in Eurobarometer surveys) and what the more important policy areas of the Union actually are. But it is not simply a problem of managing citizens' expectations. EU policies have not really adapted to what the EU is today and what its functions ought to be. Fritz Scharpf has famously described a gap between negative integration (economic integration through deregulation of national markets: elimination of national measures restrictive of free movement) and positive integration (economic integration through Community wide re-regulation: adoption of harmonized legislative measures by the EU political process). As a consequence, the Union shapes the economic and social model of Europe without the corresponding policy instruments or political debate, something the current crisis is aggravating.

The Euro has become an even more dramatic example of the EU policy gap. One of the most important instruments of correcting economic and fiscal asymmetries in a monetary union is mobility of the workforce. But the free movement of persons remains the most underdeveloped of all free movement provisions. Nor does the Union have any active policies regarding training, employment or social security. The same could be said of the financial services market. How can we correct underlying economic asymmetries in the Euro area when companies compete under profoundly different conditions in accessing credit depending on their state of origin?

This requires new policies. Among those to be considered, two priorities must be a European employment agency (that could coordinate and facilitate exchange of job offers and demand among the different Member States) and a job training and mobility program that could focus on structural unemployment. The Union could also replace the Erasmus program by Union granted loans to effectively study abroad (i.e. take a degree in another Member State).

But the problem with EU policies concerns more than having the right policies. The structure and character of EU policies also needs to be rethought. Politics remains intergovernmental at the decisive level of EU policy-making. Policy decisions continue, in spite of the enhanced role of the European Parliament, to be a product of intergovernmental bargaining. More importantly, they continue to be often framed in intergovernmental terms. National governments aggregate the preferences of their citizens and EU policies strike a balance between those aggregated preferences. But EU rules are then applied as such to EU citizens. This is in tension with many aspects of constitutionalism and democracy. First of all, it interferes with the mechanisms for political accountability of both national governments and the European Union. It is well known that national governments sometimes transfer unpopular decisions from the national to the European level as a way of transferring the political costs of those decisions. In the second place, the inter-governmental character of EU policies enters into tension with a conception of the EU as a polity that does not discriminate between its citizens. When Member States negotiate national quotas for certain products, often trading the interests of some of their producers for the interests of others (as in any international negotiation), can producers from a particular Member State claim that they are being discriminated against because they are less well treated than those in another Member State as a product of the trade-off

made by their own state?⁷⁹ In other words, some EU policies are still predominantly a result of inter-Member State bargaining and framed as such. Under this logic, it is not important to assess whether such policies treat all EU citizens alike. What is relevant is the legitimacy of the bargaining between Member States. Since, however, EU rules often affect individuals directly they can, in fact, be constructed as discriminating on the basis of nationality. This affects citizens' understanding of what determines the redistributive effects of EU policies and the idea of justice that guides them.

It is unrealistic (and also wrong) to eliminate inter-governmental bargaining from EU policy-making. But one should require EU decisions, whatever the bargaining underlying them, to be designed along EU citizenship and not nationality lines and conform to universality criteria. This would require a higher percentage of Union expenditure to be allocated to policies structured around citizen benefits and rights instead of funds allocated along national quotas.

This reform of EU policies should also transform how the EU interacts with national polities and policies and its role in reforming them. Though EU legislation generally produces direct effects in the Member States⁸⁰, its effective implementation is made by national administrations. The same occurs with EU funds. This dependence on the state can have an important legitimating effect but can equally affect positive and negative accountability with respect to those policies. Moreover, EU structural funds are, for the most part, focused on identifying certain priorities for investment in the Member States. Specific implementation and selection of the projects to be funded is left to the Member States. These funds, as such, have limited, if any, impact at the level of structural reforms and institutional impact in the Member States.

EU structural policies, in particular, should be more closely linked to domestic institutional reforms. In other words, the EU should use its purse to promote deeper institutional reforms at the national level. One example will, hopefully, make this idea more concrete: in the area of education and research, instead of defining themes of research on the basis of which the Union selects research projects deemed worth of funding, the EU could easily use those funds to have a real systemic impact on higher education and research in Europe. It could, for example, make the award of those funds conditional on certain institutional criteria defined so as to reform national higher education and research in a more meritocratic and international direction (in order to access these funds, institutions would have to fulfill or commit to criteria regarding, for example, academic mobility, internationalization of faculty and student bodies).

Increasing the power of the purse and linking it with institutional reforms is also essential in light of the number of regulatory and supervisory powers that the EU exercises with respect to the Member States and that have expanded further with ongoing Euro reforms. In the context of extended powers being attributed to the EU in national economies the Union cannot be limited to using a "stick". It must also provide positive incentives. This comes in the form of new policies but also by rethinking how EU policies may be adjusted to further national reforms with systemic impact.

c) A European political space

⁷⁹ Consider the famous litigation by German importers on the banana CAP regime. Were the negative consequences to that set of economic actors a form of unjustified discrimination or a simple function of the bargaining between national governments in the EU decision-making process? The Court of Justice has showed great deference to all these type of decisions in the CAP regime, accepting the argument raised by the EU institutions that any other approach would unsettle the balance among Member State interests involving trade-offs with other areas of the CAP. But this is not without problems regarding how these decisions are then perceived by affected citizens in different Member States. It requires in reality a reflection on the extent to which nationality can still be an acceptable criterion in designing and applying EU law to EU citizens.

⁸⁰ I leave aside the difference in the extent and nature of these legal effects between Directives and Regulations even if this could also be of relevance for the present discussion.

One hears endlessly about the European democracy deficit, real and imagined. But, as I tried to explain at the start of this report, Europe's real democratic deficit is to be found in its excessive reliance on national politics that have not internalized the consequences of European and global interdependence. Europe can certainly improve its forms of democratic representation and participation but without European politics other democratic developments will either be ineffective or even harmful in legitimacy terms. For example, without proxy politics (organized around transnational and not national lines) any further moves towards a more majoritarian and proportional representation in the Union will simply be perceived as larger states imposing their will on smaller states.

The democratic problem of the Union is also one of effectiveness. A democracy that cannot effectively govern is no democracy. There is no self-government without government. Europe needs a strengthened political authority if it is to become a legitimate and accountable democratic authority.

All this is only made more urgent by the powers being transferred to the Union. A fiscal Union does require a political Union. This problem is particularly acute with respect to the Commission's position. On the one hand, the Commission has lost part of its powers of political leadership to the Council. But, on the other hand, it has acquired significantly more powers with respect to the Member States under the Fiscal Compact and other fiscal crisis related legislation such as the six-pack. To be effective and legitimate, the Commission must be able to rely on the kind of legitimacy that comes with a direct link to the outcome of European elections.

The need for European politics also rises by the increased redistributive effects of its policies. The expanded scope of EU policies and the predominantly majoritarian character of EU decision-making no longer allow conceiving of the Union simply as a regulatory authority. Its policies and forms of decision-making produce redistributive effects that require more than technocratic legitimacy and a different kind of politics from inter-governmental politics. The deliberative and institutional system of the EU should favor proxy politics (where majorities constructed along national lines are progressively replaced by cross-national ideological majorities). Any future institutional amendments should also prevent the emergence of permanent and insulated minorities (*net losers*), the development of rigid and insulated majorities or minorities and creation of pivotal players. It is this that will be capable of securing loyalty from citizens to Union decisions. It assures them that their voice is not limited to the voice of their Member State and that, even if one day you may be in the minority, another day you may be part of the majority. Securing these conditions might require additional institutional reforms. But, as stated at the start of this report, my proposals focus on what can be done even in the absence of Treaty amendments. In any case, any institutional reforms, to be effective in enhancing the Union's legitimacy, must be implemented together with or preceded by changes in the nature of EU politics.

My fundamental proposal for this is "transforming" elections to the European Parliament into an electoral competition for the government of Europe. The most important step in this direction would be for the different European political groups to present competing candidates for the role of President of the Commission before the next election to the EP.⁸¹ The Treaties attribute to the European Council the power to propose the President of the European Commission but its subjection to approval by the European Parliament, and the electoral focus on the choice of a President, will ensure that the "winner" of the elections would be the selected President. This is similar to the situation in several Member States where the head of government is appointed by the head of state but following the result of parliamentary elections.

⁸¹ This proposal has notably been developed in a book by Simon Hix: *What's Wrong With the European Union and How to Fix It*, Polity, 2008.

The cohesion of the Commission would also be reinforced by the fact that the President elect would have much stronger bargaining power *vis à vis* the Member States in selection of the other members of the Commission. One may even consider whether the Commission should not fully reflect the political majority in the EP following the elections. Even if the Treaty states that the list of other members of the Commission to be proposed by the Council to the Parliament is based on suggestions by national governments (Article 17, para. 7, second subparagraph TEU), nothing in the Treaties requires or even suggests that they have to be affiliated or related to the political parties in power at national level. It would be possible, under the Treaties, for all members of the Commission to be suggested by national governments to have to be persons supporting the political program under which the President of the Commission has run for election. If anything, we can say that the link that is now established in the Treaties between the Commission and the Parliament requires that to be the case. This does not put into question the obligation of independence to which the Commissioners are also subject under the Treaties (Article 17 para. 3 TEU). This independence must be interpreted as referring to independence from national governments and any other particular interests. The accountability of the Commission to the European Parliament, imposed by Article 17, para. 8 TEU, makes clear that the Commission is no longer supposed to be an independent technocratic body but a politically accountable one.

I am well aware of the risks this approach involves. The politicization of the Commission is bound to affect its perceived neutrality and the authority it derives from being conceived as a semi-technocratic body. But the reality is that the latter authority is already under attack. The expansion of EU and Commission powers into the core of social and economic policy issues is bound to immerse the Commission in politics. The only question is the nature of this politics. As what is happening in some Member States is already making clear, the Commission will not succeed in preserving an appearance of technocratic neutrality in the face of deeply contested political issues. It will simply come across as a limit on democracy and politics. It will no longer be perceived as bringing reason into the passions of national politics but as passion without politics. In order for the Commission effectively and legitimately to exercise the role required by the new EU governance it will have to embed itself in a political space where the legitimacy of the reason that it will impose on Member States will gain the authority of political deliberation.

A first consequence of transformation of EP elections into an electoral competition for the government of Europe would be promotion of transnational politics. Once each European political group selects a candidate for President of the Commission they must also come up with a political platform or government program. Clearly, these political platforms, in order to be agreed within that political group and to be successful in all Member States, would have to focus on genuinely European issues: issues where citizens are not divided along national lines but across them. The simple need to come up with these European political platforms is bound to generate European politics. The election itself would finally be focused on European issues framed by the competing candidates and their alternative political platforms. Electoral participation is bound to increase in elections since, rather than increasing the powers of the parliament or information campaigns, it is the possibility to choose a government and who would be heading it that is capable of mobilizing people.

The Commission and its President would not simply gain stronger legitimacy. They would gain political capital. EU political authority would also be reinforced. The link established between the election and a specific political platform would provide the Commission and Parliament with a strong political claim in pursuit of the proposals contained in that platform. Just imagine how different the current discussion on the Euro crisis might be if many of the proposals that the Commission has put forward had been at the centre of an engaged and participated debate during the previous election and would, in fact, have been endorsed by the electoral outcome. I am not arguing that national governments and the

Council would become irrelevant in the politics of EU decision-making. Far from it, and they should not. But the current proposal would balance the terms of the debate and would put European politics at the centre of the European debate, on at least an equal footing with national politics.

In this respect, it would also be important to promote a closer relationship between national politics and European politics and improve the way European issues are immersed in national politics. As promised above I advance two proposals with this purpose:

1 - The state of the State in the EU

In the same way that we now have the state of the Union debate in the EP we should organize, in each national parliament, a debate on the state of the State in the Union with the presence of either the President or one of the Vice-Presidents of the European Commission. The debate should have two purposes: first, to allow national parliamentarians to discuss with the Commission the different reports and recommendations regarding the State that it must produce; second, to give them an opportunity also to engage the Commission in its broader policies for the Union. At the same time, it would provide the Commission with access to national political space and help make the latter more sensitive to European issues.

2 - A "state aids regime" for certain budgetary measures.

One could consider introducing in the new Euro governance a regime similar to the rules currently regulating State aids under EU law. This regime could be applied, in particular, to investment expenditures of states subject to adjustment programs. A state subject to such a program might request the Commission to authorize certain expenditures exceeding the agreed limits if they have a clear higher future return, might serve to counteract a negative economic cycle and no other viable budgetary alternative exists. It would be for the Commission to determine if such conditions were met. This regime might also be considered as an alternative (or complement) to the budgetary limits imposed by the Fiscal Compact. The advantage is that such a regime preserves a margin for politics at the national level while at the same time disciplining it under a clear democratic rationale: controlling risks of capture in national political processes and possible democratic externalities for other states.

The effects of the change of paradigm that I propose with respect to EU politics would be profound. In a democratic Europe citizens can disagree about the right policies to respond to the current economic and financial crisis. If they are not presented with alternative EU policies then the only alternative that remains for them is to be for or against Europe. Disagreement on the right European response must take place and be arbitrated in a European political space. The extent to which European citizens from different Member States increasingly feel engaged in national elections in other Member States, particularly those understood as playing a key role in EU policies, is revealing. This signals the extent to which European citizens perceive the EU as shaping their lives. But it also highlights the risk that they will see those lives being determined by national politics in which they have no voice. The only viable alternative is to offer such politics at European level.

A Final Comment on Political Viability

At the start of this report I mentioned that much of what I was going to propose would be considered impossible by many. But I also stressed that the question soon to be faced by national and EU politicians will be which, among competing impossible proposals, is the least impossible of all. I believe the model of governance sketched in this report is both the most politically viable and the only one capable of legitimating the process of European integration in the medium and long term. At a certain point, national politicians will be confronted (are confronted?) with the choice between some sort of fiscal and political Union or letting the Euro collapse. The latter would have incalculable economic and social costs,

very likely putting into question much of what we take for granted in European integration. If the choice favors a political and fiscal Union, the question becomes what is easier for a national politician to explain to their citizens: that they will have to share, to an extent that will never be clearly determined, the risk of other states' debt? Or that the EU budget will have to be increased by taxing forms of revenue avoiding national taxes so that it can have the financial "muscle" to guarantee financial stability in the Euro area and relieve Member States (and their citizens) from providing financial insurance to other Member States? Throughout this report, I have highlighted how the political dynamics might be explored to favor the solutions being proposed. It is also the case that many of the proposals put forward have been conceived so as to be embedded in an overall narrative that allows citizens to make sense of the EU. As such, they have a self-reinforcing effect in that, once in place, they have the capacity to generate a stronger understanding and adhesion to the EU. This results from the links established between democracy and a theory of justice for the EU and the latter two with a renewed justification for European integration, one that focuses on its added value in terms of democracy and justice with respect to what Member States can no longer guarantee. A Union that empowers citizens at the global level, regulates and arbitrates externalities between states, and protects social justice both by reforming the Member States and supplementing them.



DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT C: CITIZENS' RIGHTS AND
CONSTITUTIONAL AFFAIRS

CONSTITUTIONAL AFFAIRS

Institutional Dilemmas of the Economic and Monetary Union

Jean-Victor LOUIS

Abstract

Description of the challenges inherent to the improvement of the constitutional structure of Economic and Monetary Union, including the alternatives for building a differentiated euro area, improving democracy and its government as well as ensuring its representation on the global financial scene.

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LIST OF ABBREVIATIONS

ALDE Group of the Alliance of Liberals and Democrats for Europe

CDU Christlich Demokratische Union Deutschlands

ECB European Central Bank

ECOFIN Council of Ministers of Finances and Economic Affairs

ED Executive Directors (of the IMF)

EMU Economic and Monetary Union

ESM European Stability Mechanism

SPD Sozialdemokratische Partei Deutschlands

SSBs Standards Setting Bodies

TFEU Treaty on the Functioning of the European Union

TEU Treaty on the European Union

TSCG Treaty on Stability, Coordination and Governance in the Economic and Monetary Union

EXECUTIVE SUMMARY

The present EMU setting does not allow for the euro area to achieve the objectives of making the economic union commensurate to monetary union and of realising a banking union, a fiscal union and progresses towards a political union.

Differentiation at the level of euro area countries seems to be the key, at least at short term, considering the difficulties to revise the founding treaties under the procedures provided in Article 48 TEU.

There are two ways forward: differentiation either within or outside the treaties. Both solutions have their limits in EU law as well as in national laws. The solution has to conciliate the specific needs of EMU with the integrity of the single market without compromising the consolidation of the monetary union.

The euro area has to develop democracy and accountability. It has to make progresses towards the building of a true and responsible government.

It is also important to take decisive steps for a better representation of the euro area on the global financial scene.

INTRODUCTION

EMU should not be handled in isolation. One should adopt a global view of a constitutional nature in order to consolidate and democratise EMU. But, as a part of parallel reflections of a number of colleagues, the present comments will nevertheless be addressed to some specific questions that, in the first place, interest EMU.

Since the start of the crises, impressive progresses have been made, in the field of economic governance. A typical example is the 'European Semester' the creation of which has been repeatedly suggested by the Commission - in 2002 and 2004- but which was first organised in 2011. An important legislative work has been done and new mechanisms put in place but the resulting structure is a 'messy one', as underscored by the think tank Bruegel,⁸² a reality which contributes to the 'complicated patchwork image' of the present EU, to quote Jean-Claude Piris.⁸³

A number of instruments have been put in place but they are of a different legal nature and the number of their addressees varies from one act to another.⁸⁴ One can speak about an anarchic differentiation.

This accumulation of norms either legal or political generates a confusion of procedures and responsibilities. The European Semester is a good example despite the proclaimed will to keep procedures distinct.

As underscored by Andrew Duff,⁸⁵ there is a multitude of institutions and organs (European Council, ECOFIN, Eurogroup and its president, Commission and its President and EMU vice-

⁸² Pisani-Ferry, J., Sapir, A. and Wolff, G.B., "The messy rebuilding of Europe", *Bruegel Policy Brief*, 2012/01, Bruegel, Brussels.

⁸³ Piris, J.-C., "The Future of Europe. Towards a Two-Speed EU?", Cambridge University Press, Cambridge, 2012.

⁸⁴ Sadeleer, N. de, "La gouvernance économique européenne: Léviathan ou colosse aux pieds d'argile?", *Europe*, vol. 22, No 4, LexisNexis, Paris, 2012, pp. 4-11 ; Louis, J.-V., "L'union économique et monétaire de Maastricht à la crise", *Revue des Affaires européennes*, vol 19, No 1, Bruylant, Brussels, 2012, pp. 57-83 ; Allemand, F. et Martucci, F., "La nouvelle gouvernance économique européenne", *Cahiers de droit européen*, vol. XLVIII, No 1, Bruylant, Brussels, 2012, pp. 17 foll.

⁸⁵ Duff, A., *On Governing Europe*, ALDE and Policy network, London, 2012, pp. 57-58.

president, Eurogroup working group, Economic and Financial Committee, ESM etc..) in charge of EMU. They build a kind of fragmented government equivalent to a lack of a true government.

Democratic control is insufficient in particular but not exclusively due to the 'summitting' (Martin Schulz)⁸⁶ bias. The recourse to international law agreements plays also a role in this situation.

Rescue mechanisms endowed with considerable means (€700 billion capital and €500 billion lending capacity for the ESM) are notoriously not the indestructible firewall the euro area would need in case of a major crisis, i.e. a crisis affecting the big economies of the euro area.

The present and unfinished structure is unable to achieve the objective that the euro area heads of state and government have adopted for themselves at their meeting of 26 October 2011 after having reaffirmed that 'the euro is the core of our European project': '*We will strengthen the economic union to make it commensurate with the monetary union.*' The present structure is also not able to realise the objective stated by the Euro area Summit of 28-29 June 2012 to 'break the vicious circle between banks and sovereigns', taking into account the links between banking union, fiscal union and political union.⁸⁷ In order to achieve such ambitious objectives, we need a more efficient and democratic institutional setting, able to rally the consent of the citizens, in particular, for realising progresses in the objectives described in the Van Rompuy report.⁸⁸

There are a number of ideas and programmes either official or private intending to show the way forward. All include some degree of differentiation in order to take into account the specific needs of the euro area and the obstacles that actions in this direction would meet in the absence of such differentiation. Nevertheless, it is impossible and in some measure not desirable to make abstraction of the reality of the integration at 27. But loyalty is reciprocal. The Outs could not pretend to paralyse the progresses towards the achievement of EMU.

Banking Union is a good example. The Van Rompuy report of 25 June last⁸⁹ observes that one has to remedy to the shortcomings in the institutional framework for financial stability while taking into account the need for preserving the unity and integrity of the single market. Hence the necessity, for the report, to keep an integrated financial framework - covering all EU Member States - while allowing for specific differentiation between euro area and non-euro area members, a delicate balance to achieve indeed.⁹⁰

After having evoked the alternative between differentiation within and outside the Treaties (1), we will devote a section to democracy and government (2) and we will end by proposing some objectives for the euro area on the global scene (3).

⁸⁶ See Pernice, I., Wendel, M., a.o., "A democratic solution for the crisis. Reform Model for a democratically based economic and financial constitution for Europe", Berlin, WHI-Papers 01/2012, p.8, (quoted infra as the 'Humboldt Report').

⁸⁷ See Véron, N., "Europe's single supervisory mechanism and the long journey towards banking union", *Bruegel Policy Contribution*, Bruegel, Brussels, 2012/16, October 2012, p. 3.

⁸⁸ The report mentioned in the following notes provides for actions in four building blocks: banking union, fiscal union, economic union and democratic legitimacy.

⁸⁹ European Council, The President, 'Towards a genuine economic and monetary union, Report issued on 25 June 2012, SN 25/12, p. 3. English version of 26 June 2012 available at http://ec.europa.eu/economy_finance/focuson/crisis/documents/131201_en.pdf

⁹⁰ See on this dilemma, the proposals of the Commission (infra, note 10) and the specific suggestions of Nicolas Véron, *cit.* (note 6, supra).

1. DIFFERENTIATION WITHIN OR OUTSIDE THE FOUNDING TREATIES

Centralised banking supervision can be realised on the basis of Article 127.6 TFEU, as indicated in the conclusions of the Euro Summit of 28-29 June last and the proposal of the Commission has been presented on 12 September 2012⁹¹ with this same legal basis. It is a first step towards banking union which also includes centralised deposit guarantee and banking resolution scheme in order to sever the link between financial and sovereign debt crises. The legislation on banking supervision requires the unanimity in the Council and formally the EP is only consulted on the matter. This unanimity requirement is one of the most important shortcomings of the Lisbon Treaty and the recent events demonstrate, if it was necessary, that difficulties may come not only from the Member States having not adopted the euro – which is an important obstacle for the definition of rules that meet the specific concerns of the euro area - but also from within the euro area itself.

For other matters, it can be made recourse to article 136 TFEU which has played a great role in the previous legislation on governance but there also are limits: article 136 is related to the coordination of economic policy and budgetary discipline and it is not a revision clause.

The procedure on general enhanced cooperation provided in the Treaties (article 20 TEU and articles 326 to 334 TFEU) may also be used as well as article 352 TFEU, the clause permitting filling a gap in the Treaties, which is also not a panacea. All the steps are not necessarily easy to take. The latter one requires a unanimous vote. It is the reason why one is tempted to look at alternatives.

The alternative to an action under the Treaty, in the absence of a Treaty revision under Article 48 TEU – which, also under the so-called simplified procedure requires the unanimity of the Member States and possibly referenda and constitutional reforms in some Member States - was used for the Schengen and Prüm agreements in the field of free movement of persons. There are limits to this procedure: the international treaty cannot intervene in a matter of exclusive competence of the EU; it has to be compatible with the founding treaties that it may complete for the realisation of their objectives but not contradict. This explains the numerous references to the EU objectives and instruments one can find in the Treaty on Stability, Coordination and Governance in the EMU for the euro area and the temporary feature of its present status as an instrument of international law parallel to the Treaty. The Contracting Parties committed themselves to incorporate its substance within five years in the legal framework of the Union. One finds back this idea but less formally expressed in the Tommaso Padoa Schioppa group report of Notre Europe: 'The new legal structure at 17 [possibly at more in the future] could at a later stage be integrated into the traditional legal structure of the EU'.⁹² It is not a specific objective as for the TSCG and it perhaps is a very optimistic statement because all of the other EU Member States have to agree.

There are also drafts for a treaty revision of a constitutional nature, pleading for the building of a political union which would complete the EMU within a more democratic EU. We refer to the report of the CDU adopted at their Party Congress of 14/15 November

⁹¹ European Commission, Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, 12 September 2012, COM(2012) 511 final with its companion: Proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards its interaction with Council Regulation (EU) No.../...conferring specific tasks on the European Central bank concerning policies relating to the prudential supervision of credit institutions, 12.09.2012, COM(2012) 512 final.

⁹² Auctores varii, *Completing the Euro. A road map towards fiscal union in Europe*, Report of the Tommaso Padoa-Schioppa Group, Notre Europe, Paris, 2012, p. 41.

2011⁹³ with the proposals of a bi-cameral legislator and a president of the Commission elected by universal suffrage, and to the more recent "*Einspruch gegen Fassadendemokratie*" published by Peter Bofinger, Jürgen Habermas and Julian Nida-Rümelin⁹⁴. This latter paper prepared in view of the electoral programme of the SPD in Germany aims at a reform of the Treaty that would create a unified monetary territory for a "*Kerneuropa*", open to other EU countries, a supranational democracy without becoming a federal state. Mrs Merkel also calls for a revision of the Treaties essentially in order to increase fiscal discipline.

We submit to the debate the following reflections:

If, formally, the Schengen agreements and the Prüm Treaty (sometimes called Schengen III) could be invoked as precedents for the conclusion of a separate international agreement among a number of Member States, by hypothesis, those Members of the euro area,⁹⁵ the importance of the content, the political meaning, the links between what is necessary and existing policies, and the consequences for the political configuration of Europe, of the new step towards effective and democratic economic governance all this is without precedent. The more so that all envisaged reforms, like those suggested in the 'Notre Europe' report or in the 'Van Rompuy' report⁹⁶ are part of a package including qualitative steps to be progressively realised, under a pre-fixed schedule. Banking Union, at its final stage, includes elements of Fiscal Union, and Fiscal Union goes hand in hand with more Economic Union and it includes and needs, more Political Union. It is an important progress on the way towards integration which would be impossible to achieve under intergovernmental clothes.

Under the case law of the European Court of Justice, as we have mentioned, there are intrinsic limits to parallel international treaties.⁹⁷ They are no substitutes for the recourse to the normal procedure of revision. In case of emergency, temporary solutions at the borderline of a sound treaty interpretation could be justified, but not dramatic changes in the relations between Member States and the Union as well as in institutional structure. Furthermore one could find advantages for democracy and transparency in following the revision procedure of the TEU, especially the ordinary procedure which includes a convention.⁹⁸ The choice to be made between differentiation within and differentiation outside the founding treaties depends very much on the direction the UK will take in its future relations with the Continent. We need a clarification the sooner, the better. Next weeks, UK partners will know more about the British attitude on the reform in which the Summits of 28 and 29 June 2012 have engaged the EMU. Like on 9 December last, the UK partners will perhaps have to face what was called by Andrew Duff, a 'sudden and inelegant British initiative'⁹⁹ to which they will have to react.

The reform raises question of EU constitutional law but we cannot neglect the impact on national constitutions. National constitutional Courts play a role in the EU debate but it surely is the Constitutional Court of Germany which has mobilised the attention and weighted on the debates. The conditions which were included in 2010 for the financial assistance to Greece took into account a possible negative reaction of this jurisdiction and

⁹³ '*Starkes Europa – Gute Zukunft für Deutschland*'.

⁹⁴ *Frankfurter Allgemeine Zeitung*, 3 August 2012.

⁹⁵ See for a project in this direction, *infra*, the contribution of J.-C. Pirié, *Which institutional solutions for managing the multi-tier governance can be found in the framework of the current EU treaties?*

⁹⁶ Quoted in note (8) *supra*.

⁹⁷ See, for more details, *infra* the contribution of De Witte, B., *European Stability Mechanism and Treaty on Stability, Coordination and Governance: role of the institutions and consistency with EU legal order*.

⁹⁸ 'Humboldt Report', *cit.*, note (5) pp. 8 and 38.

⁹⁹ Duff, A., *cit.* note (4), p. 39.

these mechanisms passed the constitutional test. Since its Maastricht ruling of 1993, each decision of the BVerfG contributes to sketch the vision of the community of stability and of the requirements of democracy. If we know that the German diet (*Bundestag*) has to remain '*Herr seiner Entschlüsse*' (master of its resolutions)¹⁰⁰, the specific meaning of this principle depends on the text which is submitted to the examination of the Court. For it, the parliament must adapt to 'parameters laid down and commitments made', which it 'must integrate into its own planning as factors it cannot itself directly influence'.¹⁰¹ In the hypothesis of the realisation of a fiscal union, it will be necessary to determinate the acceptable limits to the budgetary powers of national parliaments and which is the degree of legitimacy needed for the institution imposing them? The Westerwelle or Berlin Group of some Foreign Affairs ministers¹⁰² has recently observed that national parliaments are to be able to decide on the composition of the budget. This would be an insuperable limit. Are there other ones?

2. DEMOCRATIC CONTROL AND THE QUESTION OF GOVERNMENT

Specific questions are to be considered; among them are the following:

The parliamentary control on EMU: which way to organise the control? Should the EP be responsible or a Euro committee of a mixed composition (EP and National parliaments), in the line indicated by Article 13 of the TSCG? How to assure the representativeness of such a committee? What would be its powers? Is it realistic to confer a decision-making power to such committee or would it be another instrument of dialogue? At first sight, it seems difficult to confer decision-making power to a Committee with mixed and limited membership. The objections of the German constitutional Court expressed in its Lisbon decision about the lack of proportionality of the composition of the EP in relation with the respective populations of the Member States are well-known.

Are there imperious motives for justifying that national parliaments should be the (collective) controllers of the Cyclical Stabilisation Insurance Fund (as proposed by the 'Notre Europe' report)¹⁰³? What teaches us up to now about their specific interests for European affairs, the experience with the role given by the Lisbon Treaty to national parliaments for subsidiarity control?¹⁰⁴ Will the strategic and politicised features of centralised elements of budgetary governance animate the interest of national parliaments' financial committees and succeed in creating national ownership of these debates? What kind of accountability would be needed on new policies: similar to the present monetary dialogue with the ECB or the economic dialogue provided by the six-pack or more invasive? How to graduate the ECB accountability in function of the distinction between monetary policy and prudential supervision? Should the same procedure for parliamentary

¹⁰⁰ German Constitutional Court, 2 BvR 139/12, 12 September 2012, recital 213.

¹⁰¹ German Constitutional Court, 2 BvR 2/08, 30 June 2009, recital 256. The Court added that 'What is decisive is, however, that the overall responsibility, with sufficient space for political discretion, can still be assumed in the German Bundestag' (translation by the BVerfG).

¹⁰² Final Report of the Future of Europe Group of the Foreign Ministers of Austria, Belgium, Denmark, France, Italy, Germany, Luxembourg, the Netherlands, Poland, Portugal and Spain, 17 September 2012, available at <http://www.msz.gov.pl/files/docs/komunikaty/20120918RAPORT/report.pdf>

¹⁰³ Cit. note (11), p.22.

¹⁰⁴ See Becker, P., Pintz, A., "Die neue Rolle der nationalen Parlamenten in der EU", *SWP-Zeitschriftenschau* 3, SWP, Berlin, July 2012. This article gives an interesting view of the way the authors of scientific articles see the experience of national parliaments in testing subsidiarity.

confidential information being provided for prudential supervision as it is the case in Article 19 of the Regulation establishing a European Systemic Risk Board?¹⁰⁵

Should we decisively go a step further in the direction showed by the proposals in the 'Humboldt report'¹⁰⁶ which suggests (as part of a Treaty reform) the attribution to a minority in the European Parliament of the right to 'monitor the working methods of the Commission' and to give to the European Parliament the final say in the decision on deficits? Is this latter point opening an interesting perspective or is it going too far in transgressing the limits between executive powers and control by a parliamentary assembly?

As far as *government* is concerned, the idea to appoint a high-profile Finance Minister is advanced by a number of authorities and specialists.¹⁰⁷ Which role should be conferred to a *Finance Minister* or the "fiscal body such as a treasury office" mentioned in the Van Rompuy report of 25 June 2012? Which legitimacy for this minister? Furthermore, which place will remain in the future for peer' control which has demonstrated both its inefficiency and its ability to survive? Is full automaticity possible in the control of excessive deficits or macro-economic imbalances? The 'Notre Europe' report¹⁰⁸ rightly insists on the necessity for the EU to be *the* actor of the policy. Nevertheless, in this report, the Finance minister should have the main role as an agent (only? mainly?) in case of crisis: 'Sovereignty ends when solvency ends' seems to be the leitmotiv¹⁰⁹ following the views of J.C. Trichet on 'Federalism by exception'. The same idea was expressed by the president of the Bundesbank: '*wenn ein Land die Regeln anhaltend verletzt, verliert es seine Haushaltssouveränität*' (transl.: 'When a country violates continuously the rules, it will lose its budgetary sovereignty')¹¹⁰. What are the checks and balances to such an extraordinary power?

3. THE EURO AREA ON THE GLOBAL SCENE

Article 138 §§1 and 2 TFEU provides for adopting a single voice and unified representation in international financial institutions and conferences. These provisions relate to the Bretton Woods institutions¹¹¹ but also to a number of bodies (Financial Stability Board, Standards Setting Bodies (SSBs), like the most famous Basle Committee on banking supervision) which adopt standards becoming the universal reference for good practice in financial markets, insurance, accountancy, etc.¹¹² Their role in prefiguring EU legislation is

¹⁰⁵ Regulation No1092/2010 of the European Parliament and the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, OJ, L331/2010, 15 December 2010, p.1.

¹⁰⁶ 'Humboldt Report', cit. note (5), pp.22-24.

¹⁰⁷ Maystadt, Ph., *Europe: le continent perdu ?* Avant-propos, Waterloo, 2012, pp. 124 foll., pleads for the creation of a 'Ministère des Finances'.

¹⁰⁸ 'Notre Europe Report', cit. note (11), pp.17 and 21.

¹⁰⁹ Ibidem, p.23.

¹¹⁰ Interview, Börsen-Zeitung, 14 July 2012.

¹¹¹ See ad generalia, Ahearne, A. and Eichengreen, B., "External monetary and financial policy: a review and a proposal", Sapir, A. (ed.) *Fragmented Power: Europe and the global economy*, Bruegel, Brussels, 2007, pp. 128-155; Louis, J.-V., "The international projection of the euro and the international monetary system", Telò, M. (ed.), *The European Union and Global Governance*, Routledge, Abingdon Oxon., 2009, pp. 64-86.

¹¹² See Giovanoli, M. "A New Architecture for the Global Financial Market: Legal Aspects of International Financial Standard Settings", Giovanoli, M. (ed.) *International Monetary Law. Issues for the New Millenium*, Oxford University Press, Oxford, 2000, pp. 3-59; Giovanoli, M., "The International Financial Architecture and its Reform after the Global Crisis", Giovanoli, M. and Devos, D. (eds.), *International Monetary and Financial Law. The Global Crisis*, Oxford University Press, Oxford, 2010, pp. 3-39; Louis, J.-V., "L'Union européenne et la régulation de la finance internationale", Le Barbier-Le Bris, M. (dir.), *L'Union européenne et la gouvernance mondiale. Quel apport avec quels acteurs ?*, Bruylant, Brussels, 2012, pp.271-301.

important, not to say decisive. The strengthening of the competences on economic governance and the creation of a banking union is a strong argument for intending to solve the long-lasting problem of giving to the EU the weight it deserves in international fore. The EP has demonstrated an interest in such questions inter alia by the report prepared by CEPS researchers,¹¹³ a useful document for reopening the debate. For legal as well as political reasons and for the sake of coherence, the EU international representation should reflect the adjustment of competences in the internal sphere. For the representation of the euro area within the Bretton Wood organisation, and especially the IMF, one of the possible solutions would be to provide, at least in a first stage, for a constituency grouping all the euro area members (although the recent creation of the new Belgian-Dutch and, at the initiative of Austria, Central and Eastern European constituencies, grouping a large diversity of members, are not going in that direction)¹¹⁴. For the CEPS report, the euro area constituency should be directed by the director general of the ESM. This suggestion is perhaps not the ideal one, under the present ESM Treaty, as the ESM entirely relies on the expertise of the Commission and ECB for taking its decisions to allow financial assistance, for the negotiation of the memorandum of understanding with the state concerned and for monitoring compliance, all this, wherever possible, with the IMF (Treaty on the ESM, Article 13). The Finance Secretary, referred to in the preceding section, should represent the euro area at the Ministers' level. The orientation of the IMF reform will also have an importance in this context: for example, will the Executive Board become an oversight organ and so cease to be the manager of the Fund, as it is suggested in the so-called 'Palais Royal' initiative on the IMF's reform?¹¹⁵ This would change the way to build the representation of the euro area in the Executive Board. It is time for the EU and the euro area to stop adopting a defensive attitude and actively participating in the debate. The more they will expect and try to postpone decision, the worse will be for Europe the result of the negotiation.

We also are of the opinion that at least the spirit of Article 138 has to be complied with in bodies like the SSBs although these bodies are not adopting legally binding acts. We do not suggest an elimination of national experts from these gatherings but we plead in favour of a better coordination and the expression of common views by a single speaker, for example, under the model of trade agreements negotiations.

We have started by underlining the need for a coherent, efficient and democratic governance of the euro area and suggested questions for a reflexion on this debate. We finish by insisting for a more rational and effective representation of the euro area on the international scene, a representation commensurate to its responsibilities. *'We face the historic task of establishing Europe to become a global player.'*¹¹⁶

¹¹³ European Parliament, Economic and Monetary Affairs Committee, "External Representation of the Euro area" IP/A/ECON/FWC/2010_19 May 2012.

¹¹⁴ There are 24 Executive Directors (E.D.) at the Board. The number of European E.D. varies from seven to eight on this total, depending on the results of the periodic elections. As a first step in the IMF reform, the Seoul G20 Summit meeting of 2010 decides, among other points, 'in favour of a 'Greater representation for emerging market and developing countries at the Executive Board through two fewer advanced European chairs, and a possibility of a second alternate for all multi-country constituencies'. It is in this context that the re-grouping of the Belgian and the Dutch constituencies was decided and the new Central and Eastern European constituency promoted by Austria. Both constituencies include few euro area members and with this move, the objective of the reduction by two of the 'European' Mandates is not completely achieved.

¹¹⁵ Palais-Royal Initiative, *Reform of the International Monetary System. A Cooperative Approach for the Twenty First Century*, a group convened by Camdessus, M., Lamfalussy, A. and Padoa-Schioppa, T., 8 February 2011, pp. 15-16 available at:

http://www.global-currencies.org/smi/gb/telechar/news/Rapport_Camdessus-integral.pdf

¹¹⁶ Foreign Ministers' group on the Future of Europe. Chairman's Statement for an Interim Report, 15 June 2012: 'The time for debate on the Future of Europe is now'. This is true also for financial and monetary affairs. The Statement is available at:

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DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT C: CITIZENS' RIGHTS AND
CONSTITUTIONAL AFFAIRS

CONSTITUTIONAL AFFAIRS

Which lessons to draw from the past and current use of differentiated integration?

Janis A. Emmanouilidis

Abstract

This briefing note starts from the assumption that differentiated integration is already a reality in the EU27 and that the degree of flexibility is most likely to increase in future. The paper lists and analyses nine key lessons from the (recent) past and on that basis draws a number of conclusions for the (near) future with respect to a higher level of differentiation in the area of economic, fiscal and monetary affairs.

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LIST OF ABBREVIATIONS

AFSJ	Area of Freedom Security and Justice
CSDP	Common Security and Defence Policy
EFSF	European Financial Stability Facility
EMU	Economic and Monetary Union
ESDP	European Security and Defence Policy
ESM	European Stability Mechanism
EU	European Union
MFF	Multiannual Financial Framework
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TSCG	Treaty on Stability, Coordination and Governance

EXECUTIVE SUMMARY

This briefing note starts from the assumption that differentiated integration is already a reality in the EU27 and that the degree of flexibility is most likely to increase in future. The paper lists and analyses nine key lessons from the (recent) past and on that basis draws seven conclusions for the (near) future with respect to a higher level of differentiation in the area of economic, fiscal and monetary affairs.

With respect to the lessons from the (recent) past the briefing note argues the following: (1) differentiated integration provides a strategic opportunity as a catalyst for a deepening of EU integration; (2) differentiated integration has not followed a master plan but rather the principle of *functional-pragmatic differentiation* aiming to overcome blockades of certain Member States in specific areas of (potential) cooperation; (3) differentiation has not led to a 'closed core Europe', i.e. it has not resulted in a small, coherent group of Member States, which has formed an exclusive *avant-garde* (actively) separating itself from other EU countries; (4) differentiation organized within the EU framework reduces the (potential) challenges related to a differentiated Europe; (5) risks of differentiation outside the EU are reduced if cooperation follows the notion of an *intergovernmental avant-garde*, which is open to all EU countries willing to join, involves/strengthens the existing EU institutions, refrains from the creation of new parallel structures, and aims to integrate the *acquis* adopted outside the EU into the Union's treaty framework at the soonest possible moment; (6) a limited number of opt-outs are no anathema if this is confined to a restricted number of cases concerning a limited number of Member States; (7) new intergovernmental treaties/agreements since 2010 have followed the notion of an *intergovernmental avant-garde*; (8) differentiation in the context of the euro crisis occurred under exceptional circumstances; and, finally, (9) the euro crisis has provoked a new debate about the potential perspectives and consequences of 'negative differentiation', i.e. the possibility of a Member State to either exit the EU or disassociate itself from certain policy areas.

Concerning the (near) future of differentiation, the paper concludes the following: (1) there is a need to 'de-dramatize' the debate about differentiated integration; (2) the use of differentiation should not follow a specific conception of the EU's *finalité*; (3) any further deepening of cooperation among euro countries should be organized inside the EU framework; (4) the elements of differentiation initiated outside the Union since 2010 should be integrated into the EU sooner rather than later; (5) cooperation organized outside the 'community framework' should be organized along the lines of an *intergovernmental avant-garde*; (6) in the process towards a 'genuine Economic and Monetary Union' EU institutions and Member States need to steer clear of steps fostering the creation of a 'two-tier EU' involving any kind of involuntary second-class membership; and, finally, (7) EU Member States and institutions should, in the long term, aim to decrease the level of differentiation in the EU and especially in EMU – the bulk of Member States, which have a treaty obligation to join the common currency, should be attracted and persuaded to join the euro in the foreseeable future.

1. STARTING POINT AND INTRODUCTION

The euro crisis has put European integration to a major test – more profound and more serious than ever before. The final outcome of the crisis is by no means certain. But one thing can be taken for granted: the responses to the crisis since 2010 have and will most likely continue to lead to a higher level of integration in the framework of the Economic and Monetary Union (EMU) and especially among the countries of the eurozone.

The roadmap aiming at a so-called *Genuine Economic and Monetary Union* due to be adopted by EU leaders at the December 2012 European Council will include additional measures/innovations that will result in an even higher level of differentiation on the basis

of the Lisbon Treaties and eventually maybe even beyond the Union's current legal framework. The final outcome of this process is by no means predictable and its success is by no means certain. However, at the end of day, it seems highly likely that it will lead to some form of *sui generis* fiscal, economic and, ultimately, maybe even to some kind of 'political union'.

But not all EU Member States are able or willing to participate in a further deepening of European integration at the same time and with the same intensity and speed. The current government in the UK seems even willing to enter a path of 'negative integration' aiming to disassociate itself from the country's current level of integration.

As was the case in the past with the common currency (Louis 2001), in the area of social policy (Falkner 1998), concerning integration in the fields of security and defence (Quille 2008; Biscop 2008; CEPS/Egmont/EPC 2010), with respect to the Schengen and Prüm Treaties, or the Area of Freedom, Security and Justice (AFSJ) (Kietz/Maurer 2006; Monar 2011), more intense cooperation among a smaller group of countries or the fact that the EU's *acquis* does not apply equally in all Member States (opt-outs) can help to overcome a situation of stalemate and improve the effectiveness and the functioning of the EU.

But what are the key lessons one can draw from the history of differentiated integration? And what do these lessons tell us with respect to a further deepening in the area of Economic and Monetary Union (EMU)? This briefing note addresses these two key questions: the first part will list and analyse nine key lessons from the (recent) past and the subsequent section will on the basis of this analysis draw a number of conclusions for the (near) future with a special emphasis on the future of EMU.

2. NINE KEY LESSONS FROM THE (RECENT) PAST

Lesson 1: Differentiated integration provides a strategic opportunity

The debates about *directorates*, *triumvirates*, *pioneer* and *avant-garde groups*, *centres of gravity*, *core groups*, *Europe á la carte*, *variable geometry*, *Europe of concentric circles* etc. (for an overview see Stubb 1996; Giering/Janning 2001; Thym 2004; Emmanouilidis 2005 and 2008a; Holzinger/Schimmelpfennig 2012) have been to a large extent characterized by oversimplifications, by threats and fears, and by semantic as well as conceptual misunderstandings, which overshadow the fact that differentiated integration provides a strategic opportunity in a bigger and more heterogeneous European Union (EU). The experience of the last decades has repeatedly proven that closer cooperation between Member States has, at the end of the day, been a (strong) catalyst for a deepening of EU integration.

Differentiated integration and 'multi-speed Europe' are already a reality as the existing EU27 is characterized by different levels of cooperation and integration and the degree of flexibility is most likely to increase further in the future. The central question is thus not whether there will be a 'differentiated Europe', but how it will or rather how it should look like.

However, differentiated integration is no magic potion and no end in itself; it rather is a necessity if the EU wants to remain effective and overcome current and future challenges. At the same time, there is a need to take into account the diverse potential dangers posed by differentiated integration, especially if cooperation is perceived as a 'seed of division' between 'ins' and 'outs' and if it is conducted on a permanent basis outside the EU framework (see also below).

Lesson 2: Differentiated integration has not followed a master plan but rather the principle of functional-pragmatic differentiation

Differentiation within the EU has not followed a single master plan with a predefined idea of the Union's ultimate *finalité*. Differentiated integration has been most successful when it has followed the principle of *functional-pragmatic differentiation* aiming to overcome blockades of certain Member States in specific areas of (potential) cooperation (see Emmanouilidis 2008a). Differentiated integration has been understood and applied as a last-resort mechanism either inside or outside the treaty framework – as an *ultima ratio* if 'progress' could not be achieved with all Member States at the same time and with the same pace.

The idea to apply the means of differentiated integration to create some sort of a 'federal entity' is rather unrealistic and also counterproductive. It is rather unrealistic, because the wider public and increasingly also parts of the (political) elites are not (yet) willing to further surrender/pool substantial national competencies to develop some kind of a "United States of Europe" (Verhofstadt 2006). On the contrary, 'ambitious muddling through' via incremental steps – determined currently by the pressures coming from the crisis – is likely to remain the Union's dominant mantra for the foreseeable future (Emmanouilidis 2012a).

It is counterproductive, because the idea to create some sort of a 'federal union' via instruments of differentiated integration raises suspicions and fears. Eurosceptics use it as a welcome opportunity to argue that differentiation is just another way to dismantle the nation-state of its old prerogatives. Those who are not in the 'core' may feel that differentiated integration is a means to create a 'two-tier Europe' (Piris 2011) from which they are and might continue to be excluded. The reality is obviously more complex. But independent of whether such fears and suspicions are justified or not, they can raise distrust and in the end limit the chances that differentiated integration is constructively employed in practice.

Lesson 3: Differentiation has not led to a 'closed core Europe'

Differentiated integration has not led to an institutionalized 'closed core Europe', i.e. it has not resulted in a small, coherent group of Member States, which has formed an exclusive avant-garde (actively) separating itself from other EU countries. On the contrary, the different areas and forms of differentiated integration (including Schengen/AFSJ; euro; ESDP/CSDP; Charter of Fundamental Rights; Euro Plus Pact; 'fiscal compact treaty'; or *enhanced cooperation* concerning divorce law, the EU patent or the new Financial Transaction Tax) involve diverse groups of different EU countries – although 15 of the 17 countries of the eurozone participate in almost all areas of differentiated integration. Conversely, differentiation within the EU has not led to a coherent 'club of outsiders' including Member States which do not participate in any area/form of differentiated integration.

EU institutions and Member States have very consciously tried to avoid the creation of a 'two-tier EU', which could lead to a (deep) split/rift between 'ins' and 'outs'. EU countries and institutions have adhered to three core principles: (i) avoid the creation of 'insurmountable barriers' between 'ins' and 'outs'; (ii) shun from the creation of permanent, parallel institutions involving only the countries participating in a particular form of differentiated integration; and (iii) secure the involvement of 'outs' as far as practically and politically possible.

However, despite these efforts, the crisis and the reactions to it have increased the perception in many countries outside the euro area that the gap between euro and non-euro countries is growing. The 'pre-ins', i.e. the eight non-euro countries who have a treaty obligation to join the common urgency, feel particularly side-lined as they are not included in the decision-making processes in the Eurogroup and in the preparatory work conducted by the Eurogroup Working Group; they feel excluded from decisions that have a direct and immediate effect on them in the current situation and from decisions affecting the overall future of the eurozone and the EU in general (von Oндarza 2012). They feel that non-euro

countries have since 2010 confronted them repeatedly with a *fait accompli*, which they were not able to influence or reverse.

Lesson 4: Differentiation organized within the EU reduces the challenges of a differentiated Europe

Most institutional, legal and political challenges related to differentiated integration can be eased if cooperation is 'organized' inside the European Union (on the basis e.g. of Article 136 TFEU or through the flexibility instrument of enhanced cooperation). Flexibility within the EU framework: (i) respects and benefits from the Union's single institutional framework; (ii) preserves the prerogatives and powers of the European Commission, the European Parliament and the European courts; (iii) limits the 'anarchic' and uncontrolled use of flexible forms of cooperation; (iv) guarantees a high level of calculability due to the existence of clear-cut rules concerning the inception, the functioning and the widening of differentiated cooperation; (v) is characterized by a high degree of inclusiveness and openness towards Member States (originally) not participating ('pre-ins' and 'outs'); (vi) ensures a high level of democratic scrutiny/legitimacy through the involvement of the European Parliament; (vii) enables the continuous development of the EU's *acquis* in line with the requirements of the EU Treaties; and, most significantly, (viii) reduces the overall risk of a rupture or even confrontational split between the 'pre-ins'/'outs' and the 'ins'.

One rather recent development could have a particular effect on the prospects for differentiated integration within the EU: the application of the instrument of *enhanced cooperation* since the entry into force of the Lisbon Treaty (transnational divorce; EU patent; Financial Transaction Tax) has proven that the strict conditions laid down in the EU Treaties can be met and that the existing legal and institutional provisions can work in practice (Philippart 2003; Emmanouilidis 2005a; Kuipers 2012; von Ondarza 2012). The recent experience makes it rather likely that the instrument of enhanced cooperation, which allows a minimum number of Member States (nine) to cooperate more closely on the basis of a clear set of preconditions, rules and procedures concerning the authorization, operation and widening of cooperation as well as the involvement of 'outs', will be applied in even more cases in the future.

Lesson 5: Risks of differentiation outside the EU are reduced if cooperation follows the notion of an intergovernmental avant-garde

Closer cooperation outside the EU bears a number of potential risks: (i) challenges to the EU's institutional coherence; (ii) lack of democratic scrutiny at both the national and European level; (iii) potential negative spill-overs on other policy areas (e.g. Single Market); (iv) danger of a (deep) split between 'ins' and 'outs' in case the latter feel excluded; (v) potential obstacles concerning the 're-integration' of a cooperation originally initiated outside the EU into the Union's legal and institutional framework.

However, past experience has repeatedly shown that closer cooperation needs in some cases – as an *ultima ratio* – to be organized outside the EU framework in order to make a step forward instead of waiting indefinitely for a small step inside the Union (Schengen/Prüm; social policy; Treaty on Stability, Cooperation and Governance (TSCG) also known as 'fiscal treaty' or 'fiscal compact treaty').

In such cases, EU integration has, at the end of the day, profited if cooperation outside the treaty framework has followed the notion of an *intergovernmental avant-garde*, which is (i) open to all Member States willing to join, (ii) involves or even strengthens the role of EU institutions, (iii) refrains from setting up new parallel institutions outside the Union, and (iv) aims to integrate the legal norms adopted and the cooperation initiated outside the EU into the treaty framework at the soonest possible moment.

Previous cases like the Schengen or Prüm Treaties have proven that the chances to incorporate an *acquis* into the EC/EU framework are higher if the participating states keep the 'outs' constantly informed and involved and if key EU states actively promote a 'quick' incorporation of outside cooperation into the Union's framework. In the past, Member States have concluded intergovernmental treaties outside the Union's framework before a new round of treaty change aiming to use the next possibility to integrate the respective cooperation into the EU's *acquis*.

Lesson 6: Limited number of opt-outs are no anathema

There is no need to 'demonize' the allocation of opt-outs if this is confined to a restricted number of cases concerning a limited number of Member States. In the current situation, three countries have been granted substantial opt-outs: Denmark (AFSJ, EMU, CSDP, citizenship), Ireland (Schengen, AFSJ (opt-in)), and the UK (Schengen, AFSJ (opt-in), EMU).

The granting of opt-outs is a perfect example of a *Europe à la carte* as opt-out countries choose in which fields of cooperation they do not want to participate and in some cases they are even granted the right to 'opt in' providing them the opportunity to join in and implement certain legislative acts despite their opt-out. This form of 'cherry picking' makes the EU more complicated, less transparent, and in some cases even less coherent and less solidary.

However, at the end of the day, even a 'radical instrument' such as an opt-out can result in integrationist dynamics for a number of reasons. First, the attribution of opt-outs has in the past been a necessary political prerequisite for deepening cooperation, as the opt-out country would have not accepted a higher level of integration if it had not been granted an exemption.

Second, the granting of opt-outs has led to an integrationist dynamic including even opt-out countries as the widespread use for example of the opt-in by the UK and Ireland in the area of Justice and Home Affairs has shown (Adler-Nissen/Gammeltopf-Hansen 2010; Funda 2011; Monar 2011; von Ondarza 2012). Yet, the granting of opt-ins has, on the other hand, reduced the pressure on respective Member States to fully join a particular policy area.

Finally, one should bear in mind that the allocation of opt-outs does not mean that an *acquis* adopted will not apply to future Member States, which is a major difference compared to e.g. the instrument of enhanced cooperation, since acts and decisions adopted in the framework of the latter do not form part of the EU's overall *acquis* and are thus 'only' binding for the participating states and not automatically also for future EU countries.

Lesson 7: New intergovernmental treaties/arrangements follow notion of an intergovernmental avant-garde

The response to the euro crisis has led to the conclusion of a number of intergovernmental treaties outside the EU framework (European Financial Stability Facility (EFSF); European Stability Mechanism (ESM); TSCG) and to new arrangements beyond the traditional 'community method' (Euro Plus Pact), which – according to some commentators – could lead to a more permanent 'two-speed' or even 'two-tier' Europe increasing the gap between euro and non-euro countries.

These risks should not be underestimated. However, the new treaties/arrangements have largely adhered to the above-mentioned notion of an *intergovernmental avant-garde*:

- *No new, parallel institutional structure:* The intergovernmental treaties and arrangements put in place since 2010 have not led to the creation of a new parallel institutional framework outside the EU, which could undermine the Union's existing institutional architecture. The 'only' substantial innovation, which took place within the Union's structures, relates to the creation of the so-called *Euro Summit* bringing together the Heads of State or Government of the euro area, together with the President of the European Commission (Article 12 TSCG). But even in this case, EU governments and institutions have been eager to strengthen the links between 'ins' and 'pre-ins'/'outs' by agreeing to a number of provisions: (i) meetings of the Euro Summit should take place after European Council meetings; (ii) the President of the Euro Summit is elected at the same time as the European Council President, which increases the changes that both posts will also in future be held by the same person; and (iii) non-euro countries would participate in at least one Euro Summit per year and in all discussions related to the "modification of the global architecture of the euro area and the fundamental rules that will apply to it in the future" (Article 12.3 TSCG).
- *Strengthening/involvement of existing EU institutions:* The measures aiming to overcome the euro crisis have not led to a weakening of existing EU institutions. On the contrary, key responses to the crisis have strengthened in particular the position of the European Commission, which plays a stronger role in the framework of the enhanced Stability and Growth Pact and a key role in the European Semester, the Macroeconomic Imbalance Procedure, the Fiscal Compact (included in the TSCG), and in the context of national 'rescue programmes' where the Commission is part of the 'troika'. In the framework of a lending of organs (*Organleihe*), the European Court of Justice has been also attributed a key role in the context of the Fiscal Compact (Article 8 TSCG) on the grounds of Article 273 of the Treaty on the Functioning of the European Union (TFEU). However, despite the involvement/strengthening of EU institutions, one should not omit, that the European Parliament has more than once since 2010 run the risk of being politically side-lined – particularly in the early phase of the process aiming to advance the EU towards a *Genuine Economic and Monetary Union*.
- *Involvement of non-euro countries:* EU institutions and Member States (including both the 'ins' and 'pre-ins') have in the course of the crisis actively sought to avoid a rupture or even split between euro- and non-euro countries. The 'pre-ins', have since 2010 exerted strong pressure on the Euro-17 to avoid a decoupling of non-euro countries from major developments in the eurozone, which at the end of the day will have strong repercussions also for countries that have not (yet) introduced the common currency. EU institutions and governments have been eager to keep non-euro countries closely aligned to the enhanced system of economic governance. Six non-euro countries have joined the Euro Plus Pact (Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania) and eight non-euro countries have signed the TSCG (Bulgaria, Denmark, Hungary, Latvia, Lithuania, Poland, Romania, Sweden). It seems likely that additional innovations currently discussed, such as the introduction of a new "fiscal capacity" or the idea that Member States should enter into "individual arrangements of a contractual nature" with the EU institutions, will also foresee the involvement of non-euro countries. However, the 'devil lies in the detail': the 'pre-ins' are e.g. concerned that a separate budget/fund might negatively impact the Multiannual Financial Framework (MFF) (e.g. through a reduction of cohesion funding) and that a new fiscal capacity could provide even more 'assistance' to the current euro-zone members and thus (further) undermine a level-playing field in the EU27 (Emmanouilidis 2012b).
- *Repatriation clause in the TSCG:* The signatories of the fiscal treaty have agreed that within five years, at most, following its entry into force, the necessary steps will be taken to incorporate the substance of the TSCG into the EU's legal framework ('repatriation clause'; Article 16 TSCG). This is a clear indication that Member States aim to integrate legal norms adopted outside the EU into the Union's treaty framework,

which at some not too distant point in time will require an amendment of the Union's primary law.

Lesson 8: Differentiation in the context of the euro crisis occurred under exceptional circumstances

The higher level of cooperation among euro countries since 2010 has been initiated and implemented under very specific circumstances: the unprecedented dangers of the crisis for the common currency and for the EU in general have put enormous pressures on Member States to come up with 'crisis recipes', which required also some particular (re)actions among and concerning in particular the Euro-17 (EFSF, ESM, 'six pack', 'two pack', Euro Summit). At the same time, non-euro countries (grudgingly) 'accepted' more differentiation, as the economic, financial and political costs of a failure to rescue the common currency would have had a (highly) negative impact on them and on European integration in general.

A potential (further) de-escalation of the crisis could change the general conditions with respect to more integration/differentiation in EMU for a number of reasons. First, a crisis de-escalation might reduce the readiness of non-euro countries to accept a higher level of integration/differentiation in the euro area, especially if 'pre-ins' feel discriminated against and excluded by the 'ins'. In this context, the devil again lies in the detail, as euro and non-euro countries have to seek compromise solutions with respect to individual measures, which affect not only euro but directly or indirectly also non-euro countries. One prominent recent example relates to the introduction of an ECB-based "single supervision system" for European banks, which – even if it is applied 'only' to financial institutions in the eurozone – has potential (strong) effects on the banking system in non-euro countries. Second, should the EU be able not only to manage but eventually overcome the crisis, one can expect that 'pre-ins' will eventually foster their efforts to join the common currency in the foreseeable future. Third, from the perspective of the Euro-17, one can expect that an easing of the crisis could to some extent take away pressure from euro countries to further deepen EMU integration at the highest possible speed. As the systemic risk of a euro implosion seems to have declined since the summer of 2012, there are already first signs of fatigue and complacency, which could undermine efforts to continue strengthening the more immediate crisis shields and to further deepen *sui generis* fiscal, economic and (ultimately) political integration (Emmanouilidis 2012b).

Taking into account the potential consequences of a de-escalation of the crisis, there is some reason to believe that the pressures to increase the level of differentiation within the euro area between 'ins' and 'outs' might in the foreseeable future be less strong than in 2010-2012. In the end, a potential introduction of the common currency in more Member States – which is in the interest of both euro and non-euro countries – could in the longer term substantially decrease the overall level of differentiation in the EMU/EU.

Lesson 9: New debate about 'negative differentiation'

The euro crisis has provoked a new debate about the potential perspectives and consequences of 'negative differentiation' (Giering/Emmanouilidis 2003), i.e. the possibility of a Member State either exiting the European Union or disassociating itself from certain policy areas. The speculations about a potential 'Grexit' or 'Brexit' have sparked a widespread debate about the likelihood and about the financial, economic and political costs/benefits of an EU Member State leaving the EU/euro.

An 'EU exit' is legally possible on the basis of the withdrawal clause (Article 50 Treaty on European Union (TEU)), which since the Lisbon Treaty foresees the voluntary exit of a country from the EU (not from the euro!). After the country in question has notified the European Council of its intention to withdraw, the two sides – i.e. the exiting state and the

EU – would have to negotiate and conclude an agreement “setting out the arrangements of its withdrawal, taking into account of the framework for its future relationship with the Union.”

The history of European integration does not provide any precedents and it is thus by no means clear how a withdrawal from the EU would be concretely organized in practice and how a “future relationship” between the exiting country and the EU could look like. However, three principle variants seem possible: (i) association (plus); (ii) partial membership; or (iii) limited membership/associate membership (see also Atilgan/Klein 2006; Bechev/Nicolaidis 2007; Emmanouilidis 2008b; Lippert 2006 and 2008).

Provided that both sides concur, an agreement between the exiting state and the EU could lead to some form of **association (plus)** similar to or going even beyond the status of countries aligned with the Union through the European Economic Area (EEA), which is the most developed framework for relations between EU and non-EU countries (Varwick/Windwehr 2007). Whatever form of bilateral or multilateral arrangement the EU and the exiting state would agree on, one key feature would characterize such a relationship: associated countries do not enjoy the right to participate in the internal process of EU decision-making, which remains the sole privilege of EU Member States.

Going beyond a ‘mere’ association, the exiting country and the EU could also agree on some form of **partial membership** in one or more policy areas, which would allow a country exiting the EU to (continue to) participate in certain policy areas – provided that both sides would agree to such a complex arrangement. ‘Partial members’ would participate or at least have the ability to (strongly) influence the Union’s decision-making process from the inside and would have to financially contribute to the policy-relevant budget. Partial members would thus not be ‘degraded’ to mere recipients of the EU’s *acquis* (like in the case of the EEA), but would be attributed a substantive dimension of EU membership, which was hitherto reserved to full EU members (see Emmanouilidis 2008b).

Ideas along the lines of partial membership have already been proposed in the past. However, these proposals did not address countries exiting the EU but were rather aimed to explore new ways to align neighbouring countries with the EU below ‘full membership’ (e.g. “Security Partnership” proposed by Charles Grant in 2006; “Gradual Integration” proposed by Cemal Karakas in 2005; “Junior Membership” proposed by Franz-Lothar Altmann in 2005; or “Extended Associated Membership” proposed by Wolfgang Quaisser and Steve Wood in 2004). All these proposals, which transcend both the traditional ‘association’ and ‘enlargement paradigms’ have never been put into practice as EU members and institutions have refrained from introducing any kind of ‘alternative forms of belonging’ beneath the level of full and unlimited EU membership. However, the exit of a country from the EU could provide the withdrawing country with enough leverage and the remaining Member States with enough interest to put in place some form of ‘partial membership’ in certain policy areas – provided that both sides hold that they could profit from such an arrangement.

‘Negative differentiation’ must not always lead to the exit of a country from the EU but could rather result in a (further) disassociation from one or more policy areas in the framework of some sort of **limited membership** (Emmanouilidis 2008a), **membership minus** (Lippert 2008) or **associate membership** (Duff 2012). All these concepts have one basic idea in common: the respective country remains (or becomes) a member of the EU but subject to key limitations. The exact nature and institutional details of a limited membership would have to be defined and negotiated among all EU Member States. They could range from an exclusion from certain policy areas through e.g. the granting of (additional) opt-outs leading to a more ‘differentiated *acquis*’ or they could go further including e.g. the introduction of a “formal second class membership” (Duff 2012) laid down in the treaties and involving *inter alia* also a limited participation in the EU

institutions. Any one of these alternatives would make the EU more complex and – in the worst case – even threaten the functioning of the Union.

All of the above-mentioned variants could also open up new perspectives of differentiated integration for non-EU countries beneath the level of a full and unlimited EU membership. The debate about 'alternative forms of belonging' is not new, it is with us at least since the early 1990s, when the countries of Eastern Europe started to knock on the EC/EU's door and many inside the club had their doubts whether the EC/EU would be ready to respond to their neighbours' requests. However, alternatives beyond mere association and beneath full membership were never put into practice due to strong and valid arguments against them on both sides (see Emmanouilidis 2008b). However, an increased level of differentiation might well increase the likelihood that alternative forms of belonging become more realistic in case the boundaries between full membership, limited membership, partial membership or association plus become increasingly diffuse.

3. SEVEN KEY LESSONS FOR THE (NEAR) FUTURE

On the basis of the above analysis, one can ask what lessons EU governments and institutions should draw from the (recent) past for the (near) future of differentiated integration and here especially for the integration and differentiation perspectives concerning the future of EMU. The following seven key lessons seem particularly relevant:

- There is a need to 'de-dramatise' the debate about differentiated integration. One needs to explain to a wider public that 'multiple speeds' is no new phenomenon in the EU and that closer cooperation among those who are willing and able is the right way to proceed as long as differentiation adheres to three core principles: openness, inclusiveness and purposefulness. In other words: differentiated integration should (i) be open to all Member States willing and able to join, (ii) closely involve and align the existing EU institutions and the 'outs', and (iii) be perceived and construed not as an end in itself but rather as a (temporary) means to overcome a situation of stalemate aiming to improve the effectiveness and the functioning of the EU.
- The use of differentiated integration should not follow a specific conception of the EU's *finalité*. On the contrary, a debate about the Union's ultimate finality would be counter-productive in the present situation due to the conceptual schisms among and within Member States. Taking a lesson from history, differentiated integration should rather pursue a functional approach on the grounds of a convincing, future-oriented 'narrative' laying down the need for a further deepening of cooperation especially in the context of EMU as a means to overcome the eurozone crisis.
- Any further deepening of cooperation among euro countries should be organized inside the EU framework in order to (i) benefit from the EU's single institutional framework; (ii) limit the dangers deriving from any form of 'anarchic differentiation'; and (iii) ensure democratic scrutiny either at European and/or the national level. The EU should further exploit the possibilities provided by the instrument of *enhanced cooperation*, while carefully respecting the legal boundaries set by the Treaties, ensuring in particular that enhanced cooperation does not undermine the internal market (Article 326 TFEU).
- Those elements of differentiation, which have been initiated outside the Union since 2010, should be integrated into the EU sooner rather than later. The latter should apply especially to the 'fiscal treaty', the substance of which should be incorporated into the EU Treaties at the soonest possible moment in line with Article 16 TSCG. The amendment of the EU's primary law might require an *ordinary treaty revision procedure* (Article 48 TEU) involving most probably also a European Convention followed by an intergovernmental conference and ratification in all Member States. Alternatively, the European Council could also apply the *simplified revision procedure* – as it has in the

course of crisis already done with respect to Article 136 TFEU –, provided that the amendment is restricted to all or part of the provisions of Part Three of the Treaty on the Functioning of the European Union.

- If it is not possible to organize a further deepening of fiscal and economic integration within the EU's legal framework due to the opposition of individual Member State, EU governments and institutions should once again make sure that cooperation is organized along the lines of an *intergovernmental avant-garde*. In other words, any kind of additional, *ultima ratio* intergovernmental arrangements – along the lines proposed e.g. by Jean-Claude Piris or the Tommaso Padoa-Schioppa group – should be open to all EU countries willing to join, involve or even strengthen the existing EU institutions, refrain from the creation of new parallel structures, and – first and foremost – aim to integrate the *acquis* adopted outside the EU into the Union's treaty framework at the soonest possible moment.
- In the process towards a *Genuine Economic and Monetary Union* EU institutions and Member States need to steer clear of steps fostering the creation of a 'two-tier EU' involving any kind of involuntary second-class membership. In more concrete terms, there is a need to: (i) involve non-euro countries as much as possible in the deliberations and decisions concerning the future of EMU, which could *inter alia* also include a stronger alignment of 'pre-ins' with the work conducted in the Eurogroup and in the Eurogroup Working Group; (ii) refrain from the creation of 'insurmountable barriers', which would make it more difficult for 'pre-ins' to join the common currency in the foreseeable future; (iii) avoid the creation of parallel institutions outside the EU framework excluding non-euro countries. In more concrete terms, EU governments should refrain from setting up a separate parliamentary formation outside the European Parliament (no 'euro parliament' or 'euro commission'; Piris 2011). However, a potential extension of EP rights concerning the euro area might eventually result in some form of distinction between MEPs from euro and non-euro countries in an attempt to enhance democratic legitimacy. Yet, concrete proposals aiming to strengthen democratic accountability along these or other lines cannot be comprehensively discussed and decided before there is more clarity about the concrete additional measures/innovations foreseen in the three main building blocks of a 'Genuine EMU' (integrated financial framework, integrated fiscal framework and integrated economic policy framework).
- In more fundamental terms, EU Member States and institutions should ultimately aim to decrease the overall level of differentiation in the EU and especially in EMU. The bulk of Member States, which have a treaty obligation to join the common currency, should be attracted and persuaded to join the euro in the foreseeable future. The eurozone crisis has proven that the common currency has – next to the internal market – become the core of European integration and the non-inclusion of a substantial number of EU countries should be overcome in the course of this decade.

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DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT C: CITIZENS' RIGHTS AND
CONSTITUTIONAL AFFAIRS

CONSTITUTIONAL AFFAIRS

**European Stability Mechanism and
Treaty on Stability, Coordination and
Governance: Role of the EU Institutions
and Consistency with the EU Legal Order**

Bruno De Witte

Abstract

This note limits itself to analyze one precise legal question: given the fact that EU law has precedence over unilateral or multilateral norms adopted by the EU member states, were the EU member states allowed to conclude those two separate international agreements, and is the content of those treaties compatible with the provisions of primary and secondary EU law? The answers provided to those two questions are positive.

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EXECUTIVE SUMMARY

The legal measures adopted to deal with the Euro crisis have comprised the conclusion of two international treaties between large groups of EU member states outside the EU legal order: the Treaty establishing the European Stability Mechanism and the 'Fiscal Compact'. Separate international agreements of this kind can be seen either as mechanisms that undermine the EU legal order or, alternatively, as useful complements of the 'Community method'. This note does not engage in this political debate, but limits itself to analyze one precise legal question: given the fact that EU law has precedence over unilateral or multilateral norms adopted by the EU member states, were the EU member states allowed to conclude those two separate international agreements, and is the content of those treaties compatible with the provisions of primary and secondary EU law? The answers provided to those two questions are positive.

1. THE PHENOMENON OF 'INTER SE' AGREEMENTS BETWEEN MEMBER STATES OF THE EUROPEAN UNION

1.1. Earlier Examples of Inter Se Agreements

There are numerous examples of international treaties concluded between some but not all member states of the EU (which I will call: 'inter se agreements') ever since the 1950's, in areas such as tax law, environmental protection, defence, culture and education. An early example was the creation in 1960 of Eurocontrol, an international organization charged with common air traffic management tasks by eight European states, including five of the six European Community countries. Although the European Community gradually developed its own aviation regulations, Eurocontrol has maintained its existence as a separate international organization with a complex legal relation to the European Union. The most prominent example of an inter se agreement (that is: an agreement between some but not all the EU member states) was the Schengen cooperation regime, composed of a first Agreement signed in 1985, and an implementing Convention adopted in 1990. The Schengen instruments were expressly presented as an interim arrangement in preparation of a final regime at the level of the European Community, rather than as a separate and rival co-operation regime. The same was true for the Social Policy Agreement concluded, as a separate part of the Maastricht Final Act, between 11 of the then 12 member states; and for the Prüm Convention later on.

1.2. Decline and Revival of the Phenomenon

In current practice, *inter se* treaties between EU member states are principally used for rather mundane matters. They deal with subjects that are not yet absorbed within the scope of activities of the European Union, either because they are of concern only to two or three countries and not to the European Union as a whole (this is typically the case for agreements dealing with the protection of rivers or mountain ranges) or because their subject matter lies outside EU law-making competence, as is the case with culture and education, and (more controversially) with bilateral tax treaties. These agreements are still rather numerous but they usually do not deal with vital matters of foreign policy. In the

course of the evolution of European integration, the importance of *inter se* agreements has declined, and EU member states have increasingly decided to pool their cooperation projects within the European Union's institutional framework. This decline can be illustrated by two changes in primary EU law: the creation of the enhanced cooperation mechanism by the Treaty of Amsterdam (which was designed to make *inter se* agreements *outside* the EU legal framework unnecessary), and the deletion from the TEU and the TFEU of the provisions inviting the member states to conclude separate international agreements in specific fields (former Articles 293 EC Treaty and 34(2)(d) EU Treaty, deleted by the Lisbon Treaty). However, the option of concluding *inter se* agreements always remain present in the toolbox of the EU states' foreign policy, as was illustrated by the recent conclusion of the Treaty setting up a European Stability Mechanism (hereafter: 'ESM Treaty') signed by the 17 euro area countries, and of the Treaty on Stability, Coordination and Governance in the European Union (hereafter: 'Fiscal Compact'), signed by 25 EU member states.

1.3. Legal Conditions for Inter Se Agreements

The fact that the EU member states may, in principle, continue to conclude treaties between themselves does not mean that they are entirely free to do so as and how they wish. *Inter se* international agreements between two or more member states of the EU are allowed, but only within the limits set by EU law obligations. The practical importance of the principle of primacy of EU law over *inter se* agreements between member states was illustrated by a judgment of the European Court of Justice in 2006 that found the application of a Schengen Convention rule to be incompatible with the rights of free movement which third country nationals who are family members of EU citizens derive from Community law.¹ The Court's finding was facilitated by the fact that Article 134 of the Schengen Convention contained an express conflict rule giving priority to Community law, but the ECJ would no doubt have come to the same conclusion with regard to an agreement that does not contain such an express primacy rule. In fact, whereas the Fiscal Compact contains a clear rule recognizing the primacy of EU law (Art. 2.2), the ESM Treaty does not have such a rule – but this does not change the legal reality which is: the undisputed precedence of EU law over conflicting provisions in treaties between its member states. This primacy not only protects EU law as it stands today but also as it might become in the future: if new provisions of secondary EU law will be enacted that conflict with the Fiscal Compact Treaty or the ESM Treaty, those new EU law provisions will prevail.

A number of allegations of conflict with EU law have been made, in relation to either the ESM Treaty or the Fiscal Compact. Some of those allegations, relating to the former instrument, have also been made in the context of a preliminary reference by the Irish Supreme Court in the *Pringle* case, which is currently pending before the CJEU. The main allegations, which I will briefly discuss in turn in Chapter 2, below are: interference with the exercise of (exclusive) EU competences; breach of the no-bail-out clause of Art 125 TFEU or, more broadly, of the essential character of EMU law; conflict with primary and secondary EU law in the field of economic policy (the 'six-pack' essentially); the unjustified 'use' of EU institutions in the implementation of those international agreements.

2. THE ESM TREATY AND THE FISCAL COMPACT: THEIR CONSISTENCY WITH THE EU LEGAL ORDER

¹ ECJ, Case C-503/03, *Commission v Spain*, judgment of 31 January 2006, particularly the recitals 33 to 35.

2.1. A Domain of Exclusive EU Competence?

Inter se agreements are not allowed in matters falling within the EU's exclusive competence. Monetary policy is, in relation to euro area countries, an exclusive competence of the EU (Art 3.1 TFEU); it has been argued, also in the *Pringle* case, that the ESM Treaty deals with monetary policy and is therefore illegal under EU law. However, in the system of the TFEU, the question of financial assistance to member states is clearly located in the Economic Policy chapter (Articles 120 to 126) rather than in the Monetary Policy chapter (Articles 127 to 133), and economic policy is a *shared* competence, in which the Member State have preserved the right to develop their own policies, alone or together with others. With the entry into force, on 1 January 2013, of the new Art 136(3) TFEU, which expressly authorizes the euro states to set up a stability mechanism, the competence issue will be solved beyond any doubt.

2.2. Breach of the No-Bail-Out Clause of Art. 125 TFEU?

Still with regard to the ESM Treaty, it has been argued that it violates the no-bail-out clause of Art 125 TFEU, or at least that it allows for its violation. Indeed, Art 125 states that EU member states shall not be liable for the financial commitments of other member states, and the fact that, under the ESM mechanism, the participating countries guarantee the loans to the beneficiary countries makes them liable for each other's debts, although only indirectly and potentially, and only to the extent of each country's contribution to the Mechanism. So, one could argue – on a strict interpretation of the no-bail-out clause – that there is, indeed, a potential conflict there. But the entry into force of the new Art 136 (3) TFEU, which is scheduled for 1 January 2013, would remove such a conflict anyway, since it explicitly allows the creation of a collective financial support mechanism under certain conditions, in derogation from the general no-bail-out clause. So, the only remaining problem, in my view, is one of sequencing in time: the ESM Treaty has recently entered into force, but the explicit solution for the no-bail-out controversy will be available only on 1 January 2013, when the amendment of Art 136 is scheduled to enter into force. So, if they want to avoid any doubt about consistency with Art 125 TFEU, the organs of the ESM could better wait until 1 January before launching their first support programme.

2.3. Incompatibility with Secondary EU Law?

In relation to the Fiscal Compact, it has been argued that its provisions on budgetary balance duplicate existing provisions of primary or secondary EU law in relation to budget deficits, and that the content of those provisions is different. For example, the TFEU sets the maximum deficit at 3%, whereas the Fiscal Compact reduces that to 0,5% or 1%, depending on the countries. However, it is clear that, whereas these figures are *different*, they are not *incompatible*. Just as the TFEU leaves the member states free to set a 'golden rule' which is stricter under their own constitutional law (as Germany and Spain have done, for example), it also allows the member states to do so *collectively*, by means of an inter se agreement. For the states bound by the Fiscal Compact, the stricter threshold set by the Fiscal Compact will be added, as a matter of international law and their own national law, to the threshold of EU law, but the higher threshold set by EU law will continue to be the benchmark for the monitoring procedures set in place by the TFEU and secondary EU law.

2.4. Unlawful 'Borrowing' of the EU Institutions?

The next controversial question is that of the involvement of the EU institutions under a separate international agreement. As is well known, both the Fiscal Compact and the ESM Treaty provide for certain tasks to be accomplished by the Court of Justice and the European Commission (with minor references also to the EP, the Council and the ECB). There is a major distinction to be made, in this respect, between the Court of Justice and the other institutions. Article 273 TFEU (which has been in the EEC Treaty from the very beginning) allows the member states to submit to the Court of Justice, "under a special agreement between the parties", "any dispute between Member States which relates to the subject matter of the Treaties". The subject matter of the ESM Treaty and the Fiscal Compact is indeed closely connected to the TEU and TFEU, and Article 8(3) of the Fiscal Compact is expressly declared to be a 'special agreement' in the sense of Article 273 TFEU. In the ESM Treaty, that reference is to be found in recital 16 of the preamble. This possibility of giving extra competences to the Court of Justice has been repeatedly used in the past, most famously perhaps in the Brussels Convention on jurisdiction and recognition of judgments (now replaced by the so-called Brussels-I Regulation), which was a separate convention concluded between the member states of the EC in which they created a preliminary reference procedure involving the Court of Justice, similar to but not identical with the general preliminary reference procedure provided by the EC Treaty.

What about the other EU institutions? According to Article 13(2) TEU, the EU institutions shall act within the limits of the powers given to them under "the Treaties" (meaning: the TEU and the TFEU, and no other treaties). This would be a strong textual argument for the view that it is not possible to give any new competences to the Commission, the Parliament, the Council or the ECB under separate international agreements such as these two. The best way to address this problem is, in my opinion, to distinguish between 'competences' and 'tasks'. What Article 13 TEU seeks to convey is that the competences of the institutions are fixed by the treaties; it does not exclude that extra tasks may be given to the institutions as long as those tasks fit within their existing competences.¹ To explain this difference, a parallel can be made with secondary EU legislation, by which new tasks are often given to the Commission, e.g. to further implement a piece of legislation. Those tasks fit within the general constitutional mandate of the Commission but they are *extra* tasks, in the sense that they are not specified with so many words in the Treaties but are being gradually defined as EU law develops. In our case here, this does not happen through secondary legislation but through a separate international agreement, the main difference being that the Commission, the Council and the Parliament are under no obligation to perform those tasks but are free to accept them or not. Now, do those extra tasks fit within the institutions' competences, as defined in particular by the TFEU chapter on economic policy? I would indeed think so. In particular, the role given to the Commission (and the ECB) by Art 13 ESM Treaty, to negotiate and monitor the Memorandum of Understanding with countries benefiting from financial support, is based on an existing model in EU law.² Also, the reporting and assessment role given to the Commission under Art 8 of the Fiscal Compact fits within its existing functions under EU economic policy legislation. One may further note, in this respect, that the plan to give the Commission a formal role in taking states before the Court of Justice for violation of certain provisions of the Fiscal Compact

¹ The Court of Justice has accepted, in the so-called *Bangladesh* judgment of 1994, that the Commission could perform tasks entrusted to it by the member states under a separate international agreement: *European Parliament v Council and Commission*, Joined Cases C-181/91 and C-248/91.

² Namely the model created by Council Regulation 407/2010 of 11 May establishing a European financial stabilization mechanism, OJ 2010, L 118/1, Art. 3 (5).

has wisely been abandoned in the final version of the Fiscal Compact, because that would indeed have involved an additional competence for the Commission.¹ Instead, only the Contracting Parties themselves can take the initiative of bringing a case before the Court of Justice, according to Article 8 (1) and (2) of the Fiscal Compact. In that context, they can “request the imposition of financial sanctions following criteria established by the European Commission in the framework of Article 260 of the Treaty on the Functioning of the European Union”. This clause operates a simple *renvoi* to the criteria elaborated by the Commission in the context of its infringement actions under ‘normal’ EU law, but does not give a role to the Commission in defining financial sanctions under the Fiscal Compact.

2.5. Conclusion

My conclusion is that none of the provisions of the ESM Treaty or the Fiscal Compact is, by itself, in breach of EU law (at least not of EU law as it will stand after the entry into force of the new Article 136(3) TFEU). Later implementation of those treaties may lead either the ESM organs or the member states to act in conflict with EU law, and in that case the normal sanctions for infringement of EU law would apply. This legal assessment does not imply that the choice made by the member states to conclude separate international agreements must be applauded. Certainly with regard to the content of the Fiscal Compact, the adoption of EU legislation would have been preferable – from the perspective of democratic legitimacy and legal stability. But the ESM Treaty and Fiscal Compact are not written in stone. If new EU law is made, in the near or distant future, which contrasts with any of the provisions of these two treaties, then those treaty provisions will have to be discontinued. To put this in more positive terms, when Article 16 of the Fiscal Compact promises that the participating states will take the ‘necessary steps’ for ‘incorporating the substance of this Treaty into the legal framework of the European Union’, that may also mean that the governments will, in the framework of the Council of the European Union, cooperate with the other EU institutions to adopt new rules of secondary EU law that would replace some or all of the provisions of the Fiscal Compact.

¹ Indeed, under current EU law, the Commission cannot bring infringement procedures against a Member State for failure to respect the deficit criteria of the Treaty (Art 126 (10) TFEU).



DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT C: CITIZENS' RIGHTS AND
CONSTITUTIONAL AFFAIRS

CONSTITUTIONAL AFFAIRS

**Is the 'Community Method' still
relevant?**

Renaud Dehousse

Abstract

This contribution discusses the relevance of the so-called 'Community method' in today's European Union. It suggests that despite a number of setbacks in the last two decades, the multiple arrangements described as influenced by the Community method remain the operational system 'by default' of the EU. Discussions on differentiated integration should therefore address the question of its preservation.

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LIST OF ABBREVIATIONS

- ECB** European Central Bank
- ECJ** European Court of Justice
- EU** European Union

EXECUTIVE SUMMARY

This contribution develops the following points:

- 1) Notwithstanding the large number of statements on its alleged obsolescence, the 'Community method' invented by Monnet and his followers remains the main operating mode at the EU level. True, it has been repeatedly challenged over the last two decades; yet, none of the alternatives experienced have proved to be particularly efficient. Its scope has been steadily extended through various treaty reforms, and the response to the eurozone crisis has shown once more that delegation of powers to supranational institutions is near unavoidable when governments intend to reinforce their cooperation in a lasting manner.
- 2) This suggests that its preservation is essential even if a more systematic use of differentiated integration is envisaged. Thus, it seems advisable for the institutional set up of any core group to be patterned along the lines of the current version of the Community method, so that its subsequent extension to new countries can take place without major disruption.
- 3) How could this be done in a consolidated eurozone? Translating the above principles into more concrete decisions requires a distinction to be made between representative institutions (the Parliament and the Council) and non-representative ones, such as the Court of Justice and the European Central Bank. For the latter, nationality concerns, though not completely absent, are not a primary concern: The existing institutions could therefore operate in the framework of a strengthened eurozone. The situation is equally straightforward for the Council, since it would make obvious sense to have only the "in" countries associated to the decisions that will apply to the eurozone.

So far the European Parliament has insisted on its transnational character to resist against any idea of division between MEPs elected "in" and "out" countries. Yet, irrespective of what the treaty may say, MEPs are largely perceived as national representatives, and it is unlikely that governments from "in" and "out" countries will accept that people elected in other countries may have a meaningful role in decisions affecting their interests. If the consolidated eurozone is to be endowed with a strong parliamentary branch, the European Parliament would therefore be well advised to reconsider its position.

INTRODUCTION

Some twenty years ago, British Prime Minister John Major described the so-called 'Community Method' as 'an idea whose time has passed' to explain the need to experiment with new forms of transnational cooperation. Those were the days of the Maastricht Treaty, when intense discussion of 'political union' was already taking place. The Prime Minister's view was not isolated. It was echoed in the works of influential British think-tanks (see e.g. Leonard, 1999) and the European Commission itself found it necessary to define its doctrine on 'new modes of governance' in a much-discussed White Paper¹²¹.

Yet, two decades later, the Community model has proven more resilient than expected. It remains an obvious reference point in discussions on the structuring of the European Union: during the drafting of the constitutional treaty, for instance, a group of members of the European convention chose to present themselves as 'friends of the Community

¹²¹ European Commission 2001

method'. More remarkable still, the main institutional response to the crisis of the eurozone has been an extension of the powers of the Union's supranational institutions: the European Central Bank (ECB), of course, but also the Commission and the Court of Justice (ECJ). This contribution will try to explain this apparent paradox, and discuss what lessons one could draw from it in ongoing discussions on the consolidation of the eurozone. The paper is therefore organized as follows. Section 1 briefly defines the key elements of the model; it is followed by a review of the elements which have been associated with the model's alleged crisis (section 2). Section 3 then discusses the evidence to the contrary and analyses the indicators of its resilience. Finally, section 4 attempts to draw some lessons from this analysis as regards the potential development of some form of differentiated integration.

1. THE ESSENCE OF THE "COMMUNITY METHOD"

One of the most frequently cited definitions of the Community method was given by the Commission in its 2001 White Paper on European Governance:

'The Community method (...) provides a means to arbitrate between different interests by passing them through two successive filters: the general interest at the level of the Commission, and democratic representation, European and national, at the level of the Council and European Parliament, together the Union's legislature.

– The European Commission alone makes legislative and policy proposals. Its independence strengthens its ability to execute policy, act as the guardian of the Treaty and represent the Community in international negotiations.

– Legislative and budgetary acts are adopted by the Council of Ministers (representing Member States) and the European Parliament (representing citizens). The use of qualified majority voting in the Council is an essential element in ensuring the effectiveness of this method. Execution of policy is entrusted to the Commission and national authorities.

– The European Court of Justice guarantees respect for the rule of law'¹²².

In a classical fashion, this definition emphasises the two essential features of the model, namely:

- the *delegation of powers* to supranational bodies, the Commission and the ECJ (to which one might have added the European Central Bank), highlighted from the days of the Schuman declaration as the most original feature of the whole institutional system, and

- its corollary, i.e. the *limitation of member states' sovereignty*, with the Council's ability to decide by majority voting (and thus the necessity for governments to accept the possibility of being outvoted) and the submission to European rule of law, later defined as a form of 'normative supranationalism'¹²³.

Taken separately, each of these elements can be compared to devices used, although generally to a lesser degree, in other international fora. It is their combined use that makes the Community method original¹²⁴.

¹²² European Commission, 2001: 9-10

¹²³ Weiler, 1985

¹²⁴ Dehousse, 2011

2. A MODEL IN CRISIS?

After the 'glorious eighties', largely viewed as marking an apex with the relaunch of the integration process by the Delors Commission, the Community method underwent a period of turbulence. Without going into detail, I will briefly touch on four points that seem essential to understanding its potential in today's and tomorrow's Europe.

First, the difficulties that surrounded the ratification of the Maastricht Treaty brought to light the fact that academic debates on the so-called "democratic deficit" of the EU were echoed by the people. Opinion polls have largely confirmed that the 'permissive consensus'¹²⁵ that enabled the launch of the European venture is now nothing but a memory. Even if the public are still generally pro-Europe, they are now very wary of a political system they do not understand and that sometimes appears to threaten their way of life. Their disaffection with Europe is also expressed in the low turnout at European elections, which reached an all-time low in 2009 with an EU average of just 43%.

Second, around the same time, national governments began to show signs of growing impatience with what they saw as an unlimited increase in the powers of the EU and therefore of the Commission. Recent years have seen an increasing number of counterweights to this power. The 'pillar structure' of the Maastricht treaty was undoubtedly the first expression of this new tendency. While the member states accepted the necessity of common action in areas that are traditionally the preserve of the state, such as foreign policy, security and justice, they refused to see the supranational institutions of the EU adopt a role commensurate with the one they play in the first pillar. Typically, when the need for steadier steering was felt, it was met by setting up *ad hoc* structures (the High Representative for the Common Foreign and Security Policy, the 'Eurogroup' and its semi-permanent president for economic policy), culminating with one of the main innovations of the Lisbon Treaty: the creation of the office of president of the European Council, which has clearly stepped into the initiative and mediation role traditionally devolved to the Commission.

The same phenomenon can be observed regarding policy instruments. The wave of harmonisation that marked the completion of the internal market has been succeeded by a new phase characterised by working methods that impose fewer constraints on national administrations: benchmarking, peer review and mutual monitoring. This approach, first adopted for monetary union, was subsequently promoted by the 'Lisbon Strategy' as the main vehicle for all the structural reforms destined to improve economic competitiveness and modernise welfare systems. It epitomised the new modes of governance at the EU level, relegating the Commission to a secondary role whilst the heads of state and government assumed the role of providing general guidance and control; the impetus was to stem from various policy networks. Together, these moves reflect a desire to break with the broad delegation of powers that is the hallmark of the Community method, and a clear propensity to favour what Helen Wallace (2000) has defined as 'intensive transgovernmentalism'.

Third, over the last two decades a strong dose of parliamentarianism has been injected at the European level. Each Treaty reform has strengthened the European Parliament's financial, legislative and supervisory powers. As a result, the Parliament has evolved from a consultative assembly to a co-legislator in a growing number of areas. Equally importantly, it has acquired considerable influence in the appointment of the Commission.

¹²⁵ Linberg and Scheingold, 1970

The combined effect of all these elements has largely been seen as questioning the usefulness of the Community method for the future of the European Union. Some have interpreted the crisis of the eurozone, which has led to a consolidation of the European Council's leadership role, as a confirmation of this evolution, leading the German chancellor to posit the emergence of an alternative, so-called 'Union method' (Merkel, 2010).

3. AN OPERATING SYSTEM BY DEFAULT?

Despite all the above-mentioned elements, there is no shortage of evidence of the continuing relevance of the Community method.

First, its scope has expanded to a wide range of new areas. The Coal and Steel Community quietly expired at the beginning of the twenty first century, but variations on the basic model defined by Monnet and his aides are now operating in areas such as monetary policy or justice and home affairs – areas traditionally considered to be at the core of sovereignty. Some even discern elements of a community spirit in the field of defence, which is still regarded as an area of 'high politics' that is inherently immune to any kind of functionalist contamination¹²⁶.

Second, the resilience of the Community method owes much to the system's ability to integrate instruments designed to meet new functional needs. The main institutional innovation of the past two decades, the emergence of the European Parliament, has been incorporated by the EU machinery without any major shocks, and so far the same can be said for the spectacular enlargement process that has seen the Union absorb most European states. A complex web of committees and networks run by EU agencies has been created. As a rule, these structures have demonstrated a remarkable ability to socialise newcomers; witness for example the way in which the Parliament has adjusted to the challenge of enlargement¹²⁷.

Third, viable alternatives have failed to emerge. The evolution of the two 'intergovernmental pillars' of the Maastricht Treaty, erected to protect state sovereignty against encroachments from Brussels, is quite telling in this respect. In the realm of justice and home affairs, the initial intergovernmental mechanisms have gradually been superseded by elements pertaining to the Community method. While the foreign policy field has moved at a slower pace, it appears to be following the same trajectory. The fact that willy-nilly, the position of High Representative for Foreign and Security Policy was brought closer to the Commission and that the Lisbon Treaty established the External action service, reflect the widespread belief that the only way to overcome the structural weaknesses of intergovernmental cooperation is to buttress it with elements inspired by the classical operating system of the Union. Likewise, a sense of disillusionment has developed in recent years regarding the open method of cooperation, which has failed to achieve the (excessively) ambitious objective trumpeted in 2000.

And finally, when pressed to invent new devices to respond to the structural problems that undermined the stability of the eurozone, member states have responded with innovations clearly inspired by Community method: the strengthening of the Commission's surveillance of national budgets, the delegation of regulatory powers over the banking sector to the European Central Bank, etc. This development is all the more remarkable as it has taken place against a backdrop of strong reluctance towards greater centralization, as mentioned above. By default, when confronted with a perceived need for reliable forms of cooperation, most governments, whatever their misgivings, have appeared willing to accept some delegation of powers to supranational bodies.

¹²⁶ Howorth, 2011

¹²⁷ Costa, 2011

Together, these elements show the resilience of the Community method: the range of policies to which it applies is today larger than it has ever been.

4. IMPLICATIONS FOR DIFFERENTIATED INTEGRATION

The above remarks are worth bearing in mind in discussions on the institutional structure of differentiated integration.

Let me preface my next remarks with some comments on the politics of differentiation. By definition, discussions on this issue always arise due to some governments' refusal to accept either a consolidation of European discipline in some area, or its corollary, which is the delegation of further powers to supranational bodies. At the same time, we know that even though other governments may be lukewarm, they will prefer to partake in the new project for fear of being excluded. This is likely to result in pressures to lower entry costs in the new system by adopting some loose intergovernmental scheme.

These pressures ought to be resisted for several reasons. First, the very *raison d'être* for differentiated integration is to allow for a quantum leap and, as was mentioned above, the intergovernmental alternatives imagined thus far have failed to demonstrate their ability to deliver substantial policy outputs. Second, differentiation is supposed to pave the way for the Union's future development. If the policy regime it creates is successful, it could be extended to additional countries, provided the latter are 'willing and able' to do what is expected of them. It would therefore make sense for the institutional set-up to offer a blueprint for the kind of governance that is deemed desirable. Finally, at a time of widespread mistrust in political institutions, it is important for the public to understand who is in charge and accountable for what the Union does, or fails to do. The proliferation of institutional fora, each with their own rules, tends to undermine the transparency of decision-making. Parsimony should be the rule: new institutions should be created only when the tasks that are contemplated cannot be entrusted to the existing ones.

How then can existing institutions be inserted into the new, 'differentiated' governance system?

The answer to this question calls for a distinction to be made between two types of bodies: 'non-majoritarian' institutions, for which the main concern tends to be their ability to remain free from external interference (e.g. the judiciary or independent regulators); and representative bodies, whose primary mission is to act on behalf of their constituents. Of course, these are ideal-types. We know that even non-majoritarian institutions derive part of their legitimacy from their representative character. It is no accident that the number of judges at the ECJ has systematically been increased with each enlargement. Recent discussions of a banking union have shown that even the European Central Bank, often described as the most federal institution in the Union since its board comprises fewer members than there are countries in the eurozone, can be perceived as biased in favour of the 'in' countries. That aside, it can be argued that this distinction provides us with a useful yardstick to appreciate what can be done.

Thus, one can say that as a rule, there seems to be no major reason why non-majoritarian institutions could not play their traditional role on matters dealt with in some 'differentiated' setting. It is telling, for instance, that no objection has been raised to the fact that the Court of Justice could be called upon to adjudicate disputes on the implementation of the 'fiscal compact' signed in March 2012, even though some judges are nationals of states that have refused to accept the latter: no one apparently believed this could be detrimental to the fulfilment of its main mission, i.e. to make sure that the law is properly observed

(Article 19 TEU). A similar reasoning can be applied to the Court of Auditors or the ECB, even though we have seen that in the latter case this view has been challenged.

The situation of representative bodies can also be fairly straightforward. Since the Council of ministers is composed of representatives of national governments, it seems logical that ministerial formations dealing with matters of interest to a limited number of countries only be addressed by the representatives of interested parties, as is for instance envisaged in the case of enhanced cooperation (Article 20(3) TEU).

Complications arise, however, when the status of an institution is more ambiguous. Consider for instance the Commission. As long as its members remain faithful to their vow of independence, one may regard it as a non-majoritarian institution and accept that it can address 'differentiated' matters (although it is undoubtedly good policy to have nationals of 'in' states in charge of the relevant portfolio, as has been the case for EMU since the beginning). Yet one cannot entirely disregard the fact that commissioners are politicians, and that since the Lisbon Treaty the elections to the European Parliament are expected to determine the choice of the president, who is now elected by the Parliament. Should one continue along this line of politicization, as several European leaders have now suggested, one would have to reconsider the description of the Commission as a 'non-majoritarian' body, and therefore many of its institutional prerogatives, including the role it can be called upon to play in relation to differentiated integration.

The situation of the European Parliament is also highly problematic. Since changes brought about by the Lisbon Treaty, members of the European Parliament are supposed to represent Union citizens (Art. 10 and 14 (2) TEU) and no longer 'the peoples of Europe', which was interpreted as a reference to their respective countries. Yet national parties play a crucial role in their election, which takes place in national or subnational constituencies, with which they must maintain close links if they intend to be reelected. Irrespective of what the Treaties may say, they are likely to be regarded as their country's representatives by citizens who keep viewing themselves as nationals of their own country rather than as Union citizens, as Eurobarometer surveys have amply demonstrated.

This perception of the Parliament is bound to create problems in the event that the assembly was entrusted with a strong role in the framework of some differentiated integration scheme. How could the German constitutional court, which has objected to the current composition of the European Parliament, accept that the weight of German MEPs be diluted in an assembly in which 'out' countries could enjoy significant influence? A bold proposal – say, a tax on financial transactions – could hypothetically be defeated by a narrow majority wherein MEPs from 'out' countries could play a prominent role. In all likelihood, this would be seen as an attempt by those countries to prevent others from moving forward. It is most unlikely that governments who wish to embark on ambitious projects would accept such a risk.

The European Parliament therefore faces a difficult choice. If it insists on defending its unitary character, and refuses to support the establishment of a parliamentary assembly comprising only members elected from the 'in' countries, two things are likely to happen: member states will insist on a weak parliamentary body, deprived of clear policy-making or control functions, and they will emphasise national parliaments as the main source of legitimacy. An illustration of the combined effect of these two trends can be found in the loose coordination mechanism foreseen by Article 13 of the Treaty of Stability, Coordination and Governance in the Economic and Monetary Union, and the Van Rompuy report has shown that this model is still the dominant one.

If differentiation is to point the way towards what an integrated Europe should ultimately look like, it would be important for the Parliament to be given a strong role. But this will not happen if it sticks to an idealized vision of what it is supposed to represent. By insisting on an idealized vision of a European people in the making, it will provide fodder to those who argue it should be confined to purely symbolic functions.

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DIRECTORATE GENERAL FOR INTERNAL POLICIES

**POLICY DEPARTMENT C: CITIZENS' RIGHTS AND
CONSTITUTIONAL AFFAIRS**

CONSTITUTIONAL AFFAIRS

National Parliaments and the EP in Multi-tier Governance: In Search for an Optimal Multi-level Parliamentary Architecture

Analysis, Assessment Advice

Wolfgang Wessels

Abstract

Faced with a considerable growth of the Union's highly differentiated multi-tier constructions the EP like national Parliaments face a significant challenge: how to adapt to institutional multi-level architecture dominated by governments and especially by the European Council. The study analyses and assesses seven options. The advice: forms of inter-parliamentary dialogues should be widened and deepened, but - given the obstacles set by parliaments themselves - no deeper impact can be expected.

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LIST OF ABBREVIATIONS

- BVerfG** Bundesverfassungsgericht (German Federal Constitutional Court)
- CFSP** Common Foreign and Security Policy
- COSAC** Conference of Parliamentary Committees for Union Affairs
- CSDP** Common Security and Defense Policy
- ESM** European Stability Mechanism
- MEP** Member of the European Parliament
- MP** Member of Parliament
- TFEU** Treaty on the Functioning of the European Union
- TEU** Treaty on European Union
- TSCG** Treaty on Stability, Coordination and Governance

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EXECUTIVE SUMMARY

Background

Analysing the Union's multi-tier constructions options for a multi-level parliamentary architecture constitute a specific challenge. Faced with a dominant role of the European Council in the EU's multi-level polity, the EP like national parliaments have to search for a way to perform their functions of executive control and of adopting binding decisions in central areas of their competence. Such a task is not just a question of self-defence of organisations which might be seen in decline, but is a critical issue of how the EU polity is being shaped in an open and legitimate way through an EU wide public debate.

Aim

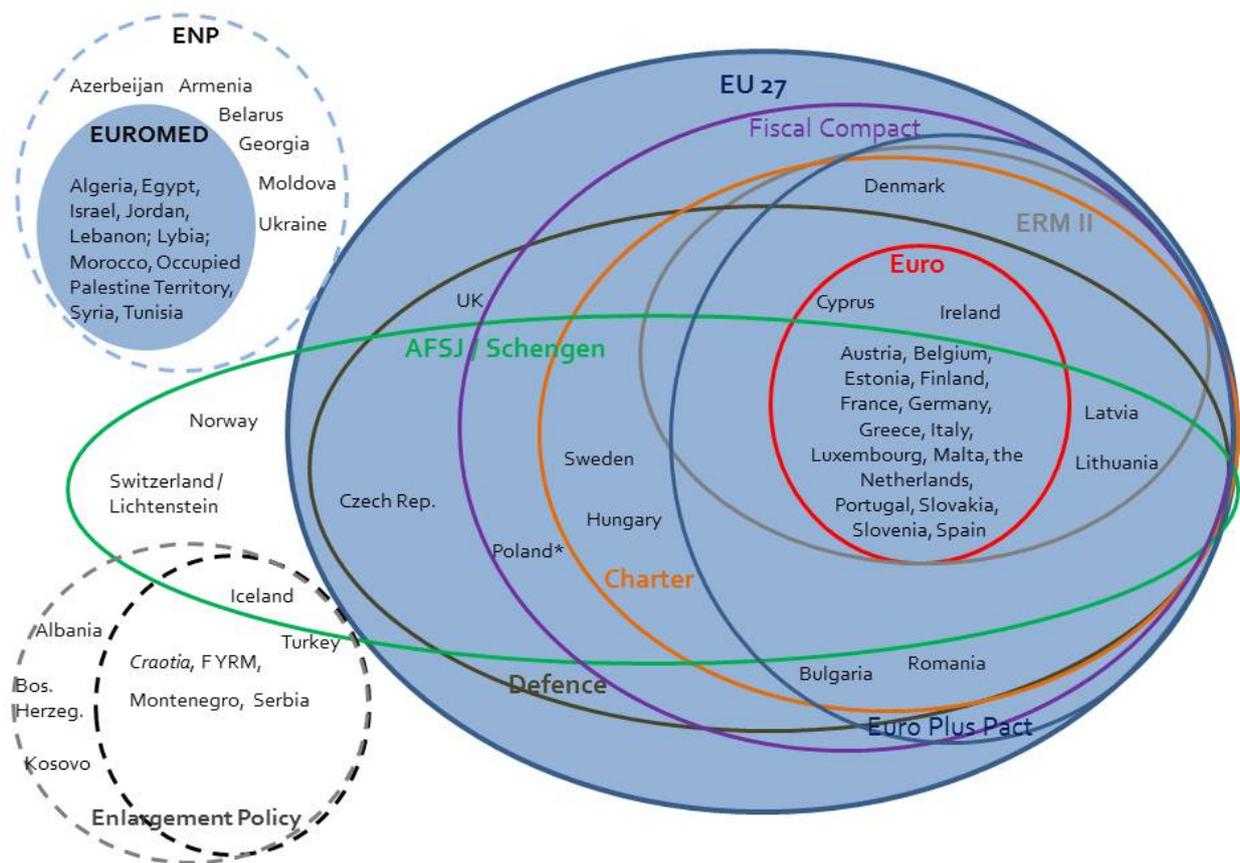
- The study will analyse and assess seven options using as criteria
 - Efficiency and productivity of decision making
 - Legitimacy, promotion of a Union wide debate in a European public space and democratic representativeness
- Discussed are following options:
 - The Traditional Model: No Further Options Needed
 - The Model of Reinforced National Parliaments: Options for a National Way
 - The Subsidiarity Procedure Model: The Option for Pre-Decision Making Influence
 - Towards a Second (Parliamentary) Chamber Model – the Option of Playing Directly on the EU level
 - The EP-Model: the Option of a Supranational Parliamentarization
 - The Dialogue Model – Option for a Multi-level Inter-parliamentary Cooperation
 - The Model of a Mixed Parliamentary Body – Options for Institutional and Constitutional upgrading
- The study will give a hesitant advice: given legal and political obstacles Parliaments of both levels should extend and deepen forms of inter-parliamentary cooperation in form of multi-level dialogues for specific areas of multi-tier governances, however incentives for parliamentarians to use these procedural opportunities need to be improved – otherwise the impact of these efforts will be minimal.

1. THE EVER INCREASING COMPLEXITY OF MULTI-TIER GOVERNANCE: AN ANALYSIS

1.1. Growth and Differentiation of Multi-tier Integration

Forms of multi-tier integration, in which not all member states have the same rights and obligations, have considerably increased in number (see Figure 1). We observe considerable variations of multi-tier governance in several of the Union's exclusive, shared and supporting competences. The Lisbon Treaties have again established additional legal opportunities (see permanent structured cooperation in Art. 46 TEU). Reacting to the crisis years the European Council or the Euro Summit has adopted new treaties outside the EU framework (the ESM and TSCG) which have again increased the relevance and the complexity of differentiated modes of EU governance.

Figure 1: Europe: United (?) in Diversity



* Poland also participates in the Euro Plus Pact

Source: Tekin, Funda (2012, forthcoming).

Academic contributions and political proposals have developed a rich variation of labels like 'multi-speed', 'core Europe', 'variable geometry', 'l'Europe à la carte', 'directorate'. This cacophony tells us that there is neither existing one single form of differentiation nor one master-guiding concept.

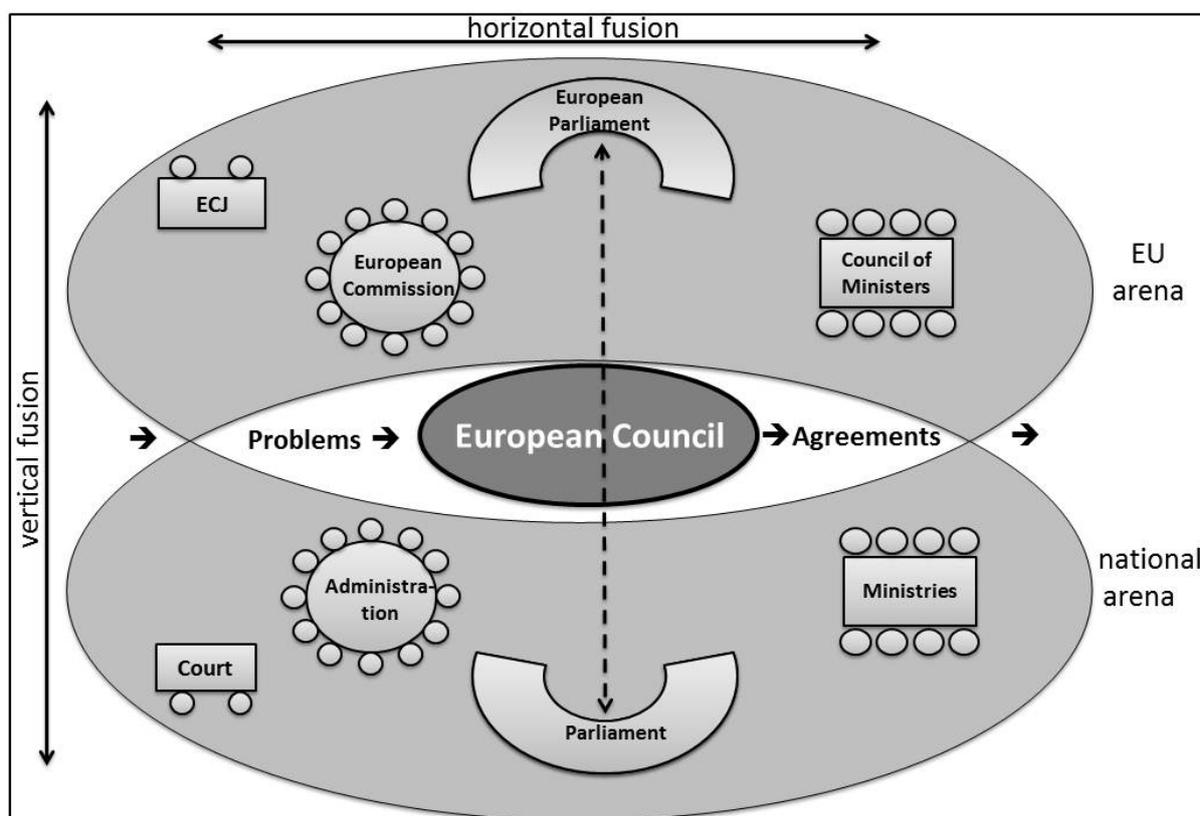
One major explanation for the creation and the evolution of these multi-tier constructions was and is that member governments have in several constellations preferred to pursue imperfect and incomplete forms of solving problems together than to wait in vain for a perfect constitutional and institutional set-up in line with the Community orthodoxy. In most cases they did not reflect if and how EP or/and national Parliaments could get involved in the respective policy-making.

1.2. Challenges for Parliaments in Multi-tier Constellations

For the EP like for national parliaments the complexity of multi-tier governance has considerably increased the difficulties to play an adequate role vis-à-vis the strong multi-level players of the executive branch of government.

Of a key strategic importance is the weak position of parliaments in comparison with the dominant position of the Heads of State or Government in and via the European Council (see Figure 2).

Figure 2: Parliaments in the multi-level system



Source: Wolfgang Wessels (2013, forthcoming).

National parliaments have for a considerable time been regarded as 'losers' or at least as 'latecomers' in the multi-level game the EU level (see Maurer/ Wessels 2001, Maurer 2002, Raunio 2005, Winzen 2012) However, faced with impact of the sovereign debt crisis, national parliaments have – with considerable variations – increased their activities vis-à-

vis their members in the European Council and in the Euro Summit (see Wessels et al. 2012, forthcoming).

As for the EP, Treaty revisions have increasingly strengthened its legislative, budgetary and elective functions. But in most cases of the Union's management of international conflicts and of concluding major agreements to overcome the crisis of the euro zone the EP's impact has been marginal. In decision making on what is still considered to be core areas of national sovereignty and identity the EP lacks the right to a say. In some areas and procedures of multi-tier integration it can exercise its normal functions; in others it is excluded from decision making.

Overall, we observe considerable variations of parliamentary involvement in areas of multi-tier integration. However, it is not premature to conclude that the role of parliaments has generally decreased in procedures of the differentiated integration.

2. INSTITUTIONAL OPTIONS: ASSESSMENT AND ADVICE

Given the weak positions of Parliaments in multi-tier constellations we need to discuss options of how to improve the parliamentary architecture on each level and through multi-level cooperation.

For our assessment of costs and benefits we use the issues of 'legitimacy' and 'efficiency' of decision making as criteria. We are faced with trade-offs and dilemmas between procedural productivity, transparent EU wide debates in a European public space and adequate democratic representativeness. 'A true European sphere has to emerge as the source of legitimacy and political authority at the EU level' (European Parliament 2012: 1; see also Future of Europe Group 2012).

2.1. The Traditional Model: No Further Options Needed

The historical point of departure is the view that framing and making of EU-politics especially in multi-level multi-tier constellation are prerogatives of the executive branch of government. In view of the legitimacy it is then considered that Heads of State or Governments in the European Council are 'democratically accountable either to their national parliaments or to their citizens' (Art. 10(2) TEU). National leaders are then given a high degree of discretion. Their activities are based on an enabling permissive consensus from their citizens. No specific procedures of scrutiny by national parliaments and even less by the EP are needed.

In view of the efficiency criteria, this model assumes that major executive decisions in foreign policy or in reacting to currency turbulences have to be taken discretely. For the procedural productivity a long open public discourse is functionally not adequate; the decisions have to be taken step by step, and not after a lengthy legislative procedure. Reacting to external shocks and internal crises Heads of State or Government as highest representatives of the 'Masters of the Treaty' (BVerfG 2009: par. 298), need or are even obliged to act with a supreme authority of the highest representatives of sovereignty.

This model explains and justifies the key role of the European Council in the EU's multi-level and multi-tier system. Following its basic assumptions, there is no need or even desirability for more formal and extensive functions and powers for the EP or for national

parliaments. Decisive for the legitimacy of the EU system is thus not the democratic input, but the output (see e.g. Scharpf 2005). For the efficiency of decision making parliaments are regarded as an obstacle.

As an additional supporting argument, defenders of this model stress that no Parliament is really representative and equipped for the differentiated set up of multi-tier constructions: In this view the EP is too large and not representative since a considerable number of MEP are involved whose (national) voters are not concerned by decisions taken in forms of a partial integration. The democratic doctrine of 'no taxation without representation' is turned into 'no representation without taxation'.

On the other level national parliaments individually are considered too small and cooperation among them (and the EP) would need separate set ups for each of the many forms of integration (see again Figure 1 above).

Confronting these assumed benefits with often hidden costs the model denies the importance of parliamentary support and – in a broader sense – the need for an open EU-wide debate. These consequences of parliamentary involvement might work only in a medium term perspective but are perceived as absolutely necessary for a stable political system – not at least for the EU multi-level polity.

2.2. The Model of Reinforced National Parliaments: Options for a National Way

One option to overcome the gaps aims at reinforcing the powers of national parliaments of those member states which are part of the differentiated integration.

With the Protocol of the Maastricht Treaty and subsequent changes of national constitutions, national parliaments – each in its own way (see e.g. Maurer/Wessels 2001; O'Brennan/Raunio 2007, Raunio 2005) – tried to increase their influence and control of governmental positions in the Council. Positions of their governments in areas of multi-tier construction were for a long time rarely on the agenda of national parliamentary debates. Major changes came about with the Euro crisis (see Wessels et al. 2012, forthcoming).

The option for a national way to reinforce legitimacy takes up normative claims (and some existing practices of national parliaments) and designs a full involvement of national parliaments in the policy cycle of the European Council – at least for those areas of multi-tier construction in which their rights are affected. Such an option for adapting the institutional architecture implies that parliaments must be involved both before and after respective sessions of the European Council (or the EURO Summit) or of other relevant Council configurations.

Such a model claims a legitimacy bonus as national parliaments are seen as the best representative of their citizens – being closer to their constituencies than MEPs in Brussels/Strasbourg or the Head of Government in a possibly distant national capital.

Major costs concern the limits of these options: We will observe parliamentary debates which are exclusively focussed on national perceptions and interests. As observed in direct elections to the EP empirical evidence lets us expect to have 27 (or 17 or x) national debates without any transnational interactions. Consequences will be parochial, narrow debates which are not helpful for the efficiency of EU decision making. If national

parliaments just formulate and support national preferences, involvement of these legislatures will lead to unproductive blockages in the relevant institutions on the EU level.

A significant shortcoming of such an option is the neglect of the EP. It does not take into account the respective competences. An easy but meaningless way out is to allow participation of MEPs from one's country in parliamentary committees of national parliaments.

2.3. The Subsidiarity Procedure Model – the Option for Pre-Decision Making Influence

Beyond domestic participation and control mechanism, national parliaments might search for direct influence in the Union's policy cycles of multi-tier constructions. The new subsidiarity procedure of the 'early warning mechanism' offers parliaments a channel of direct communication with the Commission in an early decision-preparation stage. These legal opportunities are already open for some procedures of enhanced cooperation and might be extended to other forms of differentiated integration.

The advantage for national parliaments is the opportunity to raise their voice at the beginning of a process in the Union's architecture. For EU institutions the early involvement of possible veto players might be beneficial.

The first experiences with the new procedure however point at major shortcomings.

Empirical evidence demonstrates that a general lack of motivation by members of many parliaments and a lack of coordination of the subsidiarity checks between active parliaments have, so far(2012), prevented a strong voice by national parliaments. Just to present reasoned opinions on Commission proposals does not create strong incentives for MP. The impact of this early warning mechanism remained so far marginal (see e.g. de Wilde 2012, Jancic 2012, Heffler 2012 (forthcoming)). In the present set of institutional and procedural opportunities inside the Union's architecture, national parliaments have remained marginal players on the EU level.

The new procedure is not likely to reduce the gap to the executive branch of government on multi-tier constructions. Given the dramatic economic challenges for national parliaments in the Euro crisis, these Lisbon provisions already look outdated.

2.4. Towards a Second (Parliamentary) Chamber Model – the Option of Playing on the EU level

Drawing lessons from this state of affairs one option in the political and academic debate aims at upgrading the role for national parliamentarians by the creation of a 'second (parliamentary) chamber' (see e.g. speech by the former German Foreign Affairs Minister Joschka Fischer in 2000 at the Humboldt University in Berlin)

Functions and forms of such a new institution for multi-tier constructions are unclear and disputed. A first major issue is the scope of activities: Does each form of differentiated integration need one of those chambers with then varying numbers of participants? Or will there be only one chamber of national MP for all areas of the EU – thus including also parliamentarians from opt-out countries, which would imply major questions of representativeness (see also below).

The size and distribution of seats among the participating states is another open point of conflict. The legitimacy of a 'digressive proportionality' (Art. 14(2)TEU) will be strongly disputed. Thus a major conflict will be about the 'fair' distribution of seats among the involved Member States.

There is another significant issue of legitimacy. It concerns the representative legitimation of few delegated national MP. National parliaments are hesitant or not even empowered (see BVerfG, 2 BvE 8/11, 28/2/2012) to delegate the exercise of their competences to a small group of their members (see also below the case of COSAC).

National parliamentarians would need a full time engagement for EU acts – even if the agenda might be limited to a few areas where national competences are paramount. Such an involvement is difficult to combine with meaningful activities in one's national parliament. The time factor might even be more important, as negotiations with the other two chambers – EP and Council – would be long and complicated. Thus, the efficiency of the Union's decision making might be affected.

For all, not at least for the Union's citizens, the complexity of who makes what decisions when in several different forms of differentiated integration would even more than now increase and the accountability of political decisions would be even further reduced.

2.5. The EP–Model: the Option of a Supranational Parliamentarization

One major model for a parliamentary architecture to react to the perceived democratic deficit aims to upgrade the power of the EP: As 'Citizens are directly represented at union level in the European Parliament' (Art. 10(2)TEU) it fulfils the demanded legitimacy to take binding decisions for European citizens.

As to forms of differentiated integration, the supporters of this model claim that consequences of multi - tier constructions 'must (not lead) to a division of the European Union' (European Parliament 2012). In consequence and in so far as the Union's competences in the respective area are concerned (such as the Euro) 'the European Parliament, therefore, it is the parliament of the Euro' (ibid.) and thus - in analogy – also of other forms of multi –tier constructions.

One way to implement such a model is to use the 'ordinary treaty revision' with a Convention (Art. 48(3)TEU). As this form of treaty making will be a longer and uncertain process, bridging clauses of the 'simplified revision procedures' (Art. 49(7)TEU), Inter-institutional Agreements and working agreements with the Commission could reinforce the EP's position in respective areas.

This model could lead to a Union wide debate on all forms of multi–tier constructions, but so far we find few traces in the available evidence that the EP has promoted the emergence of a real European political sphere needed for a broad consensus. Media attention as well as the political and academic debates in the Euro crisis has put the spotlight on the Heads of State or Government before, in and after sessions of the European Council and on some of the national parliaments and constitutional courts; relevant EP debates only got a limited attention.

One major issue is the democratic representativeness and thus legitimacy of the EP. We find an asymmetry between the executive decision making and parliamentary control by the plenary of EP. Heads of States or Government (e.g. the Euro Summit), Ministers (in the Eurogroup) and civil servants (in the Eurogroup working group) form exclusive circles without attendance of representatives of the opt-out countries; in the procedure of

'enhanced cooperation' the non-participant members can take part in the deliberations without voting (see Art. 330 TFEU); however, in the EP all members vote – e.g. for enabling forms of enhanced cooperation through the consent procedure. Defenders of this model strongly demand that 'any possible differentiated integration scheme must in any event preserve the indivisibility of the Commission and the European Parliament' (European Parliament 2012: 4).

In view of representative legitimacy but also in terms of the Union's efficiency this doctrine needs to be discussed: giving voting rights to MEP whose voters in their national circumscriptions (we do not yet have EU wide lists) are not affected might lead to blockages of decisions needed by the member countries in a multi-tier construction. 'A representation without taxation' is difficult to defend in public debates in concerned member states that might see themselves as victims of a negative influence from outsiders.

A way to reduce this concern might be to prepare parliamentary decisions by committees in which only MEP from the concerned member states are active. However, as long as the final vote has to be taken by the plenary, such an alibi arrangement does not look convincing.

Another major difficulty is the issue of the Union's division and allocation of competences. Multi-tier constructions do not only concern areas and categories of exclusive or shared competences (see Art. 2-6 TFEU). The claim for an exclusive parliamentary representation by the EP will meet strong opposition from national parliaments reinforced partly by Constitutional Courts.

2.6. The Dialogue Model – Option for a Multi-level of Inter-parliamentary Cooperation

To react to shortcomings of models which aim at upgrading parliaments on only one level, another set of options aims at promoting forms of cooperation between national parliaments and the EP in relevant areas. In a coordinated division of labour, parliaments of both levels should jointly exercise a comprehensive participation in the ex-ante preparation and an ex-post scrutiny and control. This model is based on a strategy of a multi-level alliance or coalition of parliaments vis-à-vis power seeking executives in the European Council.

The collected evidence let us observe that parliaments on both levels have pursued several ways to inform each other and deliberate on issues of shared responsibilities (see e.g. Wessels 2000) e.g. through meetings of the Presidents and of select committees.

For assessing this model the experiences with 'the Conference of Parliamentary Committees for Union Affairs' (known as COSAC) is significant. The impact of this informal set-up is so far in most cases marginal both on the EP's as on the national parliaments' side (see e.g. Miklin 2011; Raunio 2009).

For the relevance of the option also for multi-tier forms it is significant that the Lisbon Treaty has not upgraded these arrangements of inter-parliamentary cooperation. Vaguely formulated provisions of the Lisbon Treaty enable 'the European Parliament and national parliaments to determine the organization and promotion of effective and regular inter-parliamentary cooperation within the Union' (Art. 9, Protocol 1). This set-up has only weak rights in the Union's institutional architecture (Art. 10, Protocol 1). Significant are the limits of its authority: 'Contributions from the conference shall not bind national parliaments and

shall not prejudice their positions' (Art. 10, Protocol). Parliaments themselves are not keen to intensify their cooperation beyond forms of dialogues without consequences. They do not intend to delegate their powers to few of their members. National constitutions are also restricting forms of parliamentary delegation (see BVerfG, 2 BvE 8/11, 28/2/2012) A recent creation (and perhaps model for future forms of cooperation) is the Inter-Parliamentary Conference for the Common Foreign and Security Policy (CFSP) and the Common Security and Defence Policy (CSDP), composed of both EU national parliamentarians and MEPs.

In an approach, fine-tuned for a multi-tier construction, Article 13 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, proposes that the EP together with the national parliaments 'determine the organization and promotion of a conference of representatives of the relevant committees of the national Parliaments and representatives of the relevant committees of the European Parliament in order to discuss budgetary policies and other issues covered by this Treaty'.

Following these examples one option is to establish regular dialogues among the relevant committees of several levels. This form of inter-parliamentary cooperation can be organized in flexible procedures adequate for respective set-ups of differentiated integration.

This option is as reasonable as pragmatic and flexible. No treaty revisions are needed. As long as no real powers are given to these bodies, parliaments on both levels do not need to worry about the 'creation of a new mixed parliamentary body which would be both ineffective and illegitimate on a democratic and constitutional point of view' (Draft Opinion of the Committee on Constitutional affairs 2012: 8).

In a first analysis such an option seems convincing. But looking closer we need to be aware that these forms will be of only a limited relevance for the decision making processes in multi-tier constructions. From empirical evidence demonstrated by the above mentioned dialogues we need to conclude that parliamentarians from both levels do not have incentives to engage themselves. In spite of many declarations parliamentarians draw no real benefits from these forms of dialogue as they produce no binding results. Thus even flexible fine-tuned procedures will not overcome major reasons for the irrelevance of a multi-level parliamentary cooperation.

In this line of argumentation I see a trap created by a vicious circle: Parliamentarians of both levels widely share the assessment that just a one-level scrutiny is insufficient but they do not want to upgrade their respective multi-level cooperation. Each level claims a dominant role of parliamentary work. As a consequence we could expect that these forms of cooperation will remain alibi manoeuvre – unless and until more incentives to participate are given.

2.7. The Model of a Mixed Parliamentary Body – Options for Institutional and Constitutional Upgrading

Given this analysis of the insufficient forms of parliamentary dialogues we find proposals in the political and academic debate for upgrading mixed bodies. A specific form would be a French style 'Congrès' which – composed of members of the national parliaments and of the EP – would take specific decisions in the EU's institutional architecture – as e.g. electing the President of the European Council (Draft constitution of Giscard d'Estaing, in Norman 2003: 224) or, in case of a multi-tier construction, the President of the Euro Summit.

Relevant are also joint forms of deliberations for treaty making especially in form of a convention(Art. 48(3) However, such a convention is not a purely parliamentary set-up and it is not a permanent body. Treaties outside the legal framework of the EU treaties are not subject of this treaty provision. One analogy might be to consider a convention of parliamentarians from just those countries who prepare a new treaty with the MEP from those countries.

As each variation of upgrading the legal status of mixed bodies needs a treaty revision this option is not further elaborated.

3. CONCLUSION: PRAGMATIC STEPS WITH LIMITED IMPACTS

Looking at the observed weaknesses of the multi-level parliamentary cooperation in general, I see even more difficulties for strengthening the relation between fewer national parliaments and the EP in multi-tier constellations. My basic assessment is that incentives of parliamentarians of both levels to enter into a meaningful dialogue are limited. Without power there is few incentives to use institutional and procedural opportunities of the multi-level cooperation.

Such a consequence will however have a major negative effect: Without a European political space narrow perspectives on both levels will dominate the discourse and the taking of decisions. Fragmentation and blockages have negative effects.

Given the legal and political obstacle and shortcomings of most options my advice is to widen and deepen forms of political dialogue in all major areas of multi - tier governance. This strategy with all its shortcomings is better than no parliamentary action at all. Let us hope that these forms will really contribute to a Union wide debate. Lessons from existing forms of inter-parliamentary cooperation should be used to develop an optimal architecture within the existing constitutional and institutional framework.

In view of experiences with those intensified forms we will then need to discuss more fundamental options like the creation of a new mixed institution.

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DIRECTORATE GENERAL FOR INTERNAL POLICIES
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CONSTITUTIONAL AFFAIRS

Democracy without the People: The Crisis of European

Joseph. H. H. Weiler

Abstract

The current crisis is European in nature and will only be solved by European solutions. After sixty years EU Institutions could be expected to provide leadership, ideating the way forward and mobilizing support for it. Reality has dashed that expectation. The crisis of the Euro mask a deeper crisis – a veritable legitimacy crisis of Europe as a whole as well as its Institutions. This paper explores the manifestations and reasons for this deeper legitimacy crisis.

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EXECUTIVE SUMMARY

The current crisis is European in nature and will only be solved by European solutions. After sixty years EU Institutions could be expected to provide leadership, ideating the way forward and mobilizing support for it. Reality has dashed that expectation. The Council on more than one occasion was but a rubber stamp to decisions taken in two capitals. Merkel and Sarkozy/Hollande, not Barroso and Van Rompuy are the de facto “Presidents” of Europe. The Commission has been perceived, rightly or wrongly, as a competent executor – precisely the Secretariat role which it had historically proudly rejected. Parliament has been locked in its own echo chamber, seemingly unaware that no one is paying much attention. The indifference to Parliament in the mainstream European press and media throughout the crisis is telling. In respectable polls, there are majorities of public opinion in key Member States displaying skepticism about the role, responsibility and future of Europe.

The crisis of the Euro masks, thus, a father deeper crisis – a veritable **legitimacy crisis** of Europe and its Institutions.

Legitimacy is a political asset particularly critical at times of crisis because it enables governments to adopt difficult and unpopular decisions drawing on their legitimacy resources. By unfortunate confluence of circumstances Europe’s primary sources of Legitimacy have evaporated more or less contemporaneously.

Europe’s “process” or “input” legitimacy – rooted in the habits and practices of democratic governance – have always been weak. We can continue to live in denial but the Lisbon Treaty this. European democracy does not incorporate the most primordial principle of democracy: Accountability. The possibility, as the British say, to “throw the scoundrels out.” There is no moment in the civic and political life of the Union where citizens dissatisfied with the way things are going can replace Euro-government. Switch from a Sarkozy to a Hollande. The problem is structural: Europe is still Governance without Government. Europe also does not respect that other primordial principle of democracy, that voter preference should shape policy, the principle of representation. One cannot correlate systematically outcomes of elections to the European Parliament with the ideological content of European legislation. It should not surprise us, that despite its radical increase in power, voter participation in elections to the EP has declined steadily.

The lack of Input legitimacy has classically been compensated in Europe by **output (result) legitimacy** – Success! Europe has been for much of its life a success story. Successful results legitimate themselves, as many a Roman Emperor new when providing *panem et circenses* to listless Roman crowds. But as the Roman Emperors also knew, the crowd is fickle, and the legitimating effect of success ceases when success is replaced by failure. Europe’s plight is considered a failure, and even if the fault is not of its own making, output legitimating power vanishes with it.

Finally, Europe has always relied for its legitimacy on its powerful **Political Messianism** – the ideal, the vision of the future, the prospect of a Promised Land, of a better “Kingdom” so powerful in its grip on the imagination, that it compensated for the other legitimacy weaknesses. It was possible to be a European Patriot – a Constitutional Patriot -- because of its compelling idealistic vision. This legitimating agency has disappeared too. European citizens today are told they need to support European integration not out of idealism, but out of self-preservation, a politics of fear rather than hope.

It is not only the Euro that needs fixing but Europe’s deeper legitimacy needs restoring.

Preface

Professors are not policy makers or legislators. Our comparative advantage, our direct utility to public life, is not in prescribing solutions but in offering context, explanations, narrative which explain the problems and help the policy and legislator reflect and decide on solutions. It is in this spirit that this note to the European Parliament is offered. Some of the readers may be hoping for a three page – Here is the problem, here is the solution type paper. They will be disappointed. But if they desire a moment of stepping back, thinking more deeply of the problem beneath the immediate problem, they will, I hope, be rewarded.

In these reflections I will first outline the manner in which I plan to use the concept of legitimacy. Typically European legitimacy discourse employs two principal concepts: input (process legitimacy) and output (result legitimacy.) I will add a third, less explored, but in my view central legitimating feature of Europe – 'political messianism'. I will explore, in turn, each of these forms of legitimacy in their European context, and in relation to each show why, in my view, they are exhausted, inoperable in the current circumstance.

My conclusion is also simple enough. The crisis of Europe will require European solutions. But if these are to be successfully adopted, until such time as the Union's legitimacy "own resources" are restored, they will require an employment of legitimacy resources to be found within national communities, the Member States, Member State governments and parliaments. European Institutions need to think, beyond the immediacy of the Euro crisis on a strategy of restoring their own governance legitimacy.

1. ON TWO GENRES AND THREE TYPES OF LEGITIMACY

There are two basic genres – languages, vocabularies – of legitimacy: normative and social. The vocabulary of normative legitimacy is moral, ethical and it is informed by political theory. It is an objective measure even though there will be obvious ideological differences as to what should be considered as legitimate governance. Social legitimacy is empirical, assessed or measured with the tools of social science. It is a subjective measure, reflecting social attitudes. It is not a measurement of popularity, but of a deeper form of acceptance of the political regime.

The two types of legitimacy often inform each other and may even conflate, but not necessarily so. A series of examples will clarify. By our liberal pluralist normative yardstick, German National Socialism of the 30s and 40s was a horrible aberration, the negation of legitimate governance. Yet, socially and empirically, for most Germans almost until the defeat in 1945 it was not only popular but considered deeply legitimate leadership. By contrast, Weimar Democracy would pass our normative test of legitimate government, yet for a very large number of Germans it was not merely unpopular, but considered illegitimate leadership, a betrayal of Germany.

However, in less extreme situations we do expect some measure of conflation between the two. One hopes that if a regime is normatively legitimate, because, say, it practices constitutional democracy, it will enjoy widespread social legitimacy, and that the opposite will be true too: In a regime which fails the normative tests, one hopes that the social legitimacy will be low too. One can imagine complicated permutations of these parameters.

Legitimacy, normative or social, should not be conflated with legality. Forbidding blacks to sit in the front of the bus was perfectly legal, but would fail many tests of normative legitimacy, and with time lost its social legitimacy as well. There are illegal measures that

are considered, normatively and/or socially as legitimate, and legal measures that are considered illegitimate.

For the purpose of this reflection, it is worth exploring briefly the relationship between popularity and legitimacy. If I am a life long adherent of the Labour party in the UK, I might be appalled by the election of the Tories and abhor every single measure adopted by the Government of the Tory Prime Minister. But it would never enter my mind to consider such measures as 'illegitimate'. In fact, and this is critical for one of the principal propositions of this essay, the deeper the legitimacy resources of a regime, the better able it is to adopt *unpopular* measures critical in the time of crisis where exactly such measures may be necessary.

There is something peculiar about the current crisis. Even if there are big differences between the austerity and immediate growth camps, everyone knows that a solution has to be European, within a European framework. And yet, it has become self evident, that crafting a European solution has become so difficult, that the institutions and the EU decision making process do not seem to be engaging satisfactorily and effectively with the crisis, even when employing the intergovernmental methodology, i.e. governments, national leaders and small clubs who seem to be calling the shots. The problem is European, but Europe as such, its own institutions, is finding it difficult to craft the remedies.

I would like to argue that in the present circumstance, the legitimacy resources of the European Union – referring here mostly to social legitimacy – are depleted, and that is why the Union has had to turn to the member states for salvation.

Alan Milward famously and convincingly wrote on the European Rescue of the Nation State. The pendulum has swung, and in the present crisis, it will be the nation state rescue of the European Union.

Moving from the genres of legitimacy to a typology I would like to suggest the three most important types or forms of legitimacy, which have been central to the discussion of European integration. The most ubiquitous have been various variations on the theme of input and output legitimacy. Process (or input) legitimacy – which in the current circumstance can be, with some simplification, be synonymised with democracy. It is easier put in the negative: To the extent that the European mode of governance departs from the habits and practices of democracy as understood in the member states, its legitimacy, in this case both normative and social will be compromised. Result (or output) legitimacy – which, again simplifying somewhat, would be all modern versions of Bread and Circus. As long as the Union delivers "the goods" – prosperity, stability and security – it will enjoy a legitimacy that derives from a subtle combination of success *per se*, of success in realising its objectives and of contentment with those results. There is no better way to legitimate a war than win it. This variant of legitimacy is part of the very ethos of the Commission. Telos legitimacy or political messianism whereby legitimacy is gained neither by process nor output, but by the promise of an attractive 'promised land'.

2. EUROPE, THE CURRENT CIRCUMSTANCES - PROCESS LEGITIMACY AND RESULT LEGITIMACY

This is an interesting time to be reflecting on the European construct. Europe is at a nadir which one cannot remember for many decades and which, various brave or pompous or self-serving statements notwithstanding, the Treaty of Lisbon has not been able to redress. The surface manifestations of crisis are with us every day on the front pages: The Euro

crisis being the most current. Beneath this surface, at the structural level, lurk more profound and long-term signs of enduring challenge and even dysfunction and malaise. Let us refract them through the lens of legitimacy.

As regards process legitimacy, there is the persistent, chronic, troubling 'democracy deficit', which cannot be talked away.

First, although the 'no demos' thesis seems to have receded in recent discourse, its relevance is suddenly more acute than ever. The difficulties, as will be seen, of constructing all manner of 'fiscal union' type solutions for the Euro crisis are in no small measure the result of – yes, no demos – a lack of transcendent responsibility for the lot of one's fellow citizens and nationals. Germans and Dutch and Finns are not saying: "A bailout is the wrong policy." They are saying, "Why should we, Germans, or Dutch, or Finns, help those lazy Italians or Portuguese or Greeks", a very visible manifestation of the no demos thesis of Europe's democracy crisis.

Second, there are failures of democracy that simply make it difficult to speak of governance by and of the people. The manifestations of the so-called democracy deficit are persistent and no endless repetition of the powers of the European Parliament will remove them. In essence it is the inability of the Union to develop structures and processes that adequately replicate or, 'translate,' at the Union level even the imperfect habits of governmental control, parliamentary accountability and administrative responsibility that are practiced with different modalities in the various member states. Make no mistake: It is perfectly understood that the Union is not a state, but it is in the business of governance having taken over extensive areas previously in the hands of member states. In some critical areas, such as the interface of the Union with the international trading system, the competences of the Union are exclusive. In others they are dominant.

Democracy is not about states. Democracy is about the exercise of public power – and the Union exercises a huge amount of public power. We live by the credo that any exercise of public power has to be legitimated democratically, and it is exactly here that process legitimacy fails.

In essence, the two primordial features of any functioning democracy are missing – the grand principles of accountability and representation. As regards accountability, even the basic condition of representative democracy that at election time, the citizens "can throw the scoundrels out" – that is replace the government – does not operate in Europe (Dehousse 1995). The form of European governance, governance without government, is, and will remain for considerable time, perhaps forever such that there is no 'government' to throw out. Dismissing the Commission by Parliament (or approving the appointment of the Commission President) is not quite the same, not even remotely so.

Startlingly, but not surprisingly, political accountability of Europe is remarkably weak. There have been some spectacular political failures of European governance. The embarrassing Copenhagen climate fiasco; the weak (at best) realisation of the much touted Lisbon Agenda, the very story of the defunct "Constitution" to mention but three. It is hard to point in these instances to any measure of political accountability, of someone paying a political price, as would be the case in national politics. In fact it is difficult to point to a single instance of accountability for political failure as distinct from personal accountability for misconduct in the annals of European integration. This is not, decidedly not, a story of corruption or malfeasance but one of structural weakness.

My argument is that this failure is rooted in the very structure of European governance. It is not designed for political accountability. In similar vein, it is impossible to link in any meaningful way the results of elections to the European Parliament to the performance of the political groups within the preceding parliamentary session, in the way that is part of

the mainstay of political accountability within member states (Priestley 2010). Structurally, dissatisfaction with 'Europe' has no channel to affect, at the European level, the agents of European governance.

Likewise, at the most primitive level of democracy, there is simply no moment in the civic calendar of Europe where the citizen can influence directly the outcome of any policy choice facing the Community and Union in the way that citizens can when choosing between parties which offer sharply distinct programs at the national level. The political colour of the European Parliament only very weakly gets translated into the legislative and administrative output of the Union (Bogdanor 2007).

The 'political deficit', to use the felicitous phrase of Renaud Dehousse, is at the core of the democracy deficit. The Commission, by its self-understanding, linked to its very ontology, cannot be 'partisan' in a right-left sense, neither can the Council, by virtue of the haphazard political nature of its composition. Democracy normally must have some meaningful mechanism for expression of voter preference predicated on choice among options, typically informed by stronger or weaker ideological orientation. That is an indispensable component of politics. Democracy without politics is an oxymoron. And yet, that is not only Europe, but it is also a feature of Europe – the 'non-partisan' nature of the Commission – that is celebrated. The stock phrase found in endless student text books and the like, that the Supranational Commission vindicates the European interest, whereas the intergovernmental Council is a clearing house for Member State interest, is, at best, naïve. Does the 'European interest' not necessarily involve political and ideological choices? At times explicit, but always implicit? Thus the two most primordial norms of democracy, the principle of accountability and the principle of representation are compromised in the very structure and process of the Union.

The second manifestation of the current European circumstance is evident in a continued slide in the legitimacy and mobilising force of the European construct and its institutions. I pass over some of the uglier manifestations of European 'solidarity' both at governmental and popular level as regards the Euro-crisis or the near abandonment of Italy to deal with the influx of migrants from North Africa as if this was an Italian problem and not a problem for Europe as a whole. I look instead at two deeper and longer-term trends. The first is the extraordinary decline in voter participation in elections for the European Parliament. In Europe as a whole the rate of participation is below 45 percent, with several countries, notably in the East, with a rate below 30 percent. The correct comparison is, of course, with political elections to national parliaments where the numbers are considerably higher (Menon and Peet 2010). What is striking about these figures is that the decline coincides with a continuous shift in powers to the European Parliament, which today is a veritable co-legislator with the Council. The more powers the European Parliament, supposedly the *Vox Populi*, has gained, the greater popular indifference to it seems to have developed (Buzek 2011). The problem is aggravated by the failure of the European Parliament to dispel the image of a gravy train with weak control over the use of resources for personal gain and a system in which lobbyists roam freely and unfairly and unaccountably impact the legislative process. It does not matter if this is a caricature of reality, but it is a persistent image, recently demonstrated by the Eurobarometer.

It is sobering but not surprising to note the absence of the European Parliament as a major player in the current crisis, but the institutional crisis runs deeper. The Commission has excelled as a creative secretariat, implementer and monitor, but neither as the sources of ideas or veritable political leadership. It has been faithful and effective as 'His Master's Voice'. But most striking has been the disappearing act of the Council. No longer the proud leader of Europe according to the Giscardian design, but an elaborate rubber stamp to the Union's two Presidents – Merkel and Sarkozy – a double failure of institutional legitimacy,

of Parliament and Council, of supranationalism and intergovernmentalism. The resort to an extra-Union Treaty, as a centrepiece of the reconstruction, is but the poignant legal manifestation of this political reality.

The critique of the democracy deficit of the Union has itself been subjected to two types of critique itself. The first has simply contested the reality of the democracy deficit by essentially claiming that wrong criteria have been applied to the Union. But I am more interested in the second type of critique, which implicitly is an invocation of result or output legitimacy. Since the Union, not being a state, cannot replicate or adequately translate the habits and practices of state democratic governance, its legitimacy may be found elsewhere (MacCormick 1997).

In analyzing the legitimacy (and mobilising force) of the European Union, in particular against the background of its persistent democracy deficit, political and social science has indeed long used the distinction I between process legitimacy and outcome legitimacy. The legitimacy of the Union more generally and the Commission more specifically, even if suffering from deficiencies in the state democratic sense, are said to rest on the results achieved – in the economic, social and, ultimately, political realms (Featherstone 1994). The idea harkens back to the most classic functionalist and neo-functionalist theories.

I do not want to take issue with the implied normativity of this position – a latter day *Panem et circenses* approach to democracy, which at some level at least could be considered quite troubling. It is with its empirical reality that I want to take some issue. I do not think that outcome legitimacy explains all or perhaps even most of the mobilising force of the European construct. But whatever role it played, it is dependent on the Panem. Rightly or wrongly, the economic woes of Europe, which are manifest in the euro crisis, are attributed to the European construct. So when there suddenly is no Bread, and certainly no cake, we are treated to a different kind of Circus whereby the citizens' growing indifference is turning to hostility, and the ability of Europe to act as a political mobilising force seems not only spent, but even reversed.

The worst way to legitimate a war is to lose it, and Europe is suddenly seen not as an icon of success but as an emblem of austerity, thus in terms of its promise of prosperity, failure. If success breeds legitimacy, failure, even if wrongly allocated, leads to the opposite. Thus, not surprisingly, there is a seemingly contagious spread of 'Anti-Europeanism' in national politics (Leconte 2010). What was once in the province of fringe parties on the far right and left has inched its way to more central political forces. The "Question of Europe" as a central issue in political discourse was for long regarded as an 'English disease.' There is a growing contagion in member states in North and South, East and West, where political capital is to be made among non-fringe parties by anti-European advocacy (Harmsen and Spiering 2005). The spillover effect of this phenomenon is the shift of mainstream parties in this direction as a way of countering the gains at their flanks. If we are surprised by this it is only because we seem to have air brushed out of our historical consciousness the rejection of the so-called European Constitution, an understandable amnesia since it represented a defeat of the collective political class in Europe by the *Vox Populi* (Fligstein 2008), albeit not speaking through, but instead giving a slap in the face to, the European Institutions.

3. EUROPE AS POLITICAL 'MESSIANISM'

At some level the same could have been said ten and even twenty years ago. The democracy deficit is not new – it is enduring. And how did Europe legitimate itself before it scored its great successes of the first decades? As I hinted above, at the conceptual level

there is a third type of legitimation, which, in my view, played for a long time a much larger role than is currently acknowledged. In fact, in my view, it has been decisive to the legitimacy of Europe and to the positive response of both the political class and citizens at large. I will also argue that it is a key to a crucial element in the Union's political culture. It is a legitimacy rooted in the '*politically messianic*'. In political messianism, the justification for action and its mobilising force, derive not from process, as in classical democracy, or from result and success, but from the ideal pursued, the destiny to be achieved, the 'Promised Land' waiting at the end of the road. Indeed, in messianic visions the end always trumps the means.

Mark Mazower's historiography of 20th-century Europe, insightfully shows how the Europe of monarchs and emperors which entered World War I was often rooted in a political messianic narrative in various states (in Germany, Italy, Russia, Britain and France). It then oscillated after the War towards new democratic orders, i.e. to process legitimacy, which then oscillated back into new forms of political messianism in fascism and communism. As the tale is usually told, after World War II, Europe of the West was said to oscillate back to democracy and process legitimacy. It is here that I want to point to an interesting quirk, not often noted. On the one hand, the Western states, which were later to become the member states of the European Union, became resolutely democratic, their patriotism rooted in their new constitutional values, narratives of glory abandoned and even ridiculed, and messianic notions of the State losing all appeal. Famously, former empires, once defended with repression and blood, were now abandoned with zeal (Lacroix 2002).

And yet, their common venture, European integration, was in my reading, a political messianic venture *par excellence*, the messianic becoming a central features of its original and enduring political culture. The mobilising force and principal legitimating feature was the vision offered, the dream dreamt, the promise of a better future. It is this feature, which explains not only the persistent mobilising force (especially among elites and youths) but also key structural and institutional choices made. It will also give more depth to explanations of the current circumstance of Europe. Since, unlike the democracy deficit, which has been discussed and debated *ad nauseam* and *ad tedium*, political messianism is a feature of European legitimacy, which has received less attention, I think it may be justified if I pay to it some more attention.

The Union needed political messianism precisely because it was not a State. Nation and State are so thoroughly embedded into our consciousness that one does not have to explain to a French or the Italians or the Estonians why, in crisis, one has to mobilize to address the challenges of the nation and State. Political Messianism is the mechanism through which Europe can aspire to that kind of commitment without itself being a nation and State.

4. THE SCHUMAN DECLARATION AS A MANIFESTO OF POLITICAL MESSIANISM

The Schuman Declaration is somewhat akin to Europe's "Declaration of Independence" in its combination of vision and blueprint. Notably, much of its text found its way into the preamble of the Treaty of Paris, the substance of which was informed by its ideas. It is interesting to re-read the declaration through the conceptual prism of political messianism. The hallmarks are easily detected, as we would expect in its constitutive, magisterial document. It is manifest in what is in the Declaration and, no less importantly, in what is not therein. *Nota bene*: European integration is nothing like its European messianic

predecessors – that of monarchies and empire and later fascism and communism. It is liberal and noble, but politically messianic it is nonetheless.

The messianic feature is notable in both its rhetoric and substance. Note, first, the language used – ceremonial and “sermonial” with plenty of pathos (and bathos).

World peace cannot be safeguarded without the making of creative efforts proportionate to the dangers which threaten it...The contribution which an organised and living Europe can bring to civilization is indispensable...a first step in the federation of Europe [which] will change the destinies of those regions which have long been devoted to the manufacture of munitions of war...[A]ny war between France and Germany becomes not merely unthinkable, but materially impossible...This production will be offered to the world as a whole without distinction or exception...[I]t may be the leaven from which may grow a wider and deeper community between countries long opposed to one another by sanguinary divisions...With increased resources Europe will be able to pursue the achievement of one of its essential tasks, namely, the development of the African continent.

It is grand, inspiring, Churchillian one might even say with a tad of irony. Some old habits, such as the ‘White Man’s Burden’ and the missionary tradition, die hard. But it is not just the rhetoric. The substance itself is messianic: A compelling vision which has animated now at least three generations of European idealists where the ‘ever closer union among the people of Europe’, with peace and prosperity an icing on the cake, constituting the beckoning promised land (Piodi 2010).

It is worth exploring further the mobilising force of this new plan for Europe. At the level of the surface language lies its straight-forward, pragmatic objective of consolidating peace and reconstructing European prosperity. But there is much more within the deep structure of the Plan.

Peace, at all times an attractive desideratum, would have had its appeal in purely utilitarian terms. But it is readily apparent that in the historical context in which the Schumann Plan was put forward the notion of peace as an ideal probes a far deeper stratum than simple Swords into Ploughshares, Sitting under ones’ Vines and Fig Trees, Lambs and Wolves – the classic Biblical metaphor for peace. The dilemma posed was an acute example of the alleged tension between Grace and Justice which has taxed philosophers and theologians through the ages – from William of Ockham, Friedrich Nietzsche and the repugnant but profound Martin Heidegger.

These were, after all, the early 50s with the horrors of war still fresh in the mind and, in particular, the memory of the unspeakable savagery of German occupation. It would take many years for the hatred in countries such as The Netherlands, Denmark or France to subside fully. The idea, then, in 1950, of a Community of Equals as providing the structural underpinning for long-term peace among yesterday’s enemies, represented more than the wise counsel of experienced statesmen.

It was, first, a “peace of the brave” requiring courage and audacity. At a deeper level, it managed to tap into the two civilisational pillars of Europe: The Enlightenment and the heritage of the French Revolution and the European Christian tradition. Liberty was already achieved with the defeat of Nazi Germany – and Germans (like their Austrian bretheren-in-crime) embraced with zeal the notion that they, too, were liberated from National Socialism. But here was a Project, encapsulated in the Schuman Declaration, which added to the transnational level both Equality and Fraternity. The Post WWI Versailles version of

peace was to take yesterday's enemy, diminish him and keep his neck firmly under one's heel, with, of course, disastrous results. Here, instead was a vision in which yesterday's enemy was regarded as an equal – Germany was to be treated as a full and equal partner in the venture – and engaged in a fraternal interdependent lock that, indeed, the thought of resolving future disputes would become unthinkable (Munoz 2008). This was, in fact, the project of the enlightenment taken to the international level as the Kant himself had dreamt. To embrace the Schuman Plan was to tap into one of the most powerful idealistic seams in Europe's civilizational mines.

The Schuman Plan was also a call for forgiveness, a challenge to overcome an understandable hatred. In that particular historical context the Schumannian notion of peace resonated with, was evocative of, the distinct teaching, imagery and values of the Christian call for forgiving one's enemies, for Love, for Grace – values so recently consecrated in their wholesale breach. The Schuman Plan was in this sense, evocative of both Confession and Expiation, and redolent with the Christian belief in the power of repentance and renewal and the ultimate goodness of humankind. This evocation is not particularly astonishing given the personal backgrounds of the Founding Fathers – Adenauer, De Gaspari, Schumann, Monnet himself – all seriously committed Catholics. The mobilising force, especially among elites, the political classes who felt more directly responsible for the calamities of which Europe was just exiting, is not surprising given the remarkable subterranean appeal to the two most potent visions of the idyllic "Kingdom" -- the humanist and religious combined in one project. This also explains how, for the most part, both conservative and progressive could embrace the project.

It is the messianic model that explains (in part) why for so long the Union could operate without a veritable commitment to the principles it demanded of its aspiring members – democracy and human rights. Aspirant States had to become members of the European Convention of Human Rights, but the Union itself did not. They had to prove their democratic credentials, but the Union itself did not – two anomalies, which hardly raised eyebrows.

Note however, that its messianic features are reflected not only in the flowery rhetoric. In its original and unedited version, the declaration is quite elaborate in operational detail. But you will find neither the word 'democracy', nor 'human rights'. A thunderous silence. It's a 'Lets-Just-Do-It' type of programme animated by great idealism (and a goodly measure of good old state interest, as a whole generation of historians such as Alan Milward and Charles Maier among others have demonstrated).

The European double helix has from its inception been Commission and Council: an international (supposedly) a-political transnational administration/executive (the Commission) collaborating not, as we habitually say, with the member states (Council) but with the governments, the executive branch of the member states, which for years and years had a forum that escaped in day-to-day matters the scrutiny of any parliament, European or national. Democracy is simply not part of the original vision of European integration.

This observation is hardly shocking or even radical. Is it altogether fanciful to tell the narrative of Europe as one in which 'doers and believers' (notably the most original of its institutions, the Commission, coupled with an empowered executive branch of the member states in the guise of the Council and COREPER), an elitist (if well-paid) vanguard, were the self-appointed leaders from whom grudgingly, over decades, power had to be arrested by the European Parliament? And even the European Parliament has been a strange *vox populi*. For hasn't it been, for most of its life, a champion of European integration, so that to the extent that, inevitably, when the Union and European integration inspired fear and caution among citizens, (only natural in such a radical transformation of European politics)

the European Parliament did not feel the place citizens would go to express those fears and concerns?

The political messianic was offered not only for the sake of conceptual clarification, but also as an explanation of the formidable past success of European integration in mobilising support. They produced a culture of praxis, achievement and ever-expanding agendas. Given the noble dimensions of European integration, one ought to see and acknowledge their virtuous facets.

But that is only part of the story. They also explain some of the story of decline in European legitimacy and mobilising pull, which is so obvious in the current circumstance. Part of the very phenomenology of political messianism is that it always collapses as a mechanism for mobilization and legitimation. It obviously collapses when the messianic project fails, when the revolution does not come. But interestingly, and more germane to the narrative of European Integration, even when successful, it sows its seeds of collapse. At one level the collapse is inevitable, part of the very phenomenology of messianic project. Reality is always more complicated, challenging, banal and ultimately less satisfying than the dream that preceded it. The result is not only absence of mobilisation and legitimation, but actual rancour.

Democracy was not part of the original DNA of European Integration. It still feels like a foreign implant. With the collapse of its original political messianism, the alienation we are now witnessing is only to be expected. And thus, when failure hits as in the euro crisis, when the Panem is gone, all sources of legitimacy suddenly, simultaneously collapse. This collapse comes at an inopportune moment, at the very moment when Europe of the Union would need all its legitimacy resources. The problem is European, and the solution has to be at the European level. But for that solution to be perceived as legitimate, for the next phase in European integration not to be driven by resentful fear, the architects will not be able to rely, sadly, on the decisional process of the Union itself. They will have to dip heavily into the political structure and decisional process of the member states. It will be national parliaments, national judiciaries, national media and, yes, national governments who will have to lend their legitimacy to a solution which inevitably will involve yet a higher degree of integration. It will be an entirely European phenomenon that – at what will have to be a decisive moment in the evolution of the European construct – the importance, even primacy of the national communities as the deepest source of legitimacy of the integration project, will be affirmed yet again.

As for the Institutions of the Union and the Union institutional agenda, the writing is on the wall. Can a new compelling, future oriented vision be presented? Simply to say "Political Union", or simply to use a utilitarian argument – we need Political Union to save the Euro, will not be a convincing basis for a new Telos oriented legitimating narrative. And as regards process – it is the politicization of the Union which will be the key to capturing convincing political legitimacy.

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DIRECTORATE GENERAL FOR INTERNAL POLICIES

**POLICY DEPARTMENT C: CITIZENS' RIGHTS AND
CONSTITUTIONAL AFFAIRS**

CONSTITUTIONAL AFFAIRS

Democratic Challenges Arising from the Eurocrisis: What kind of a constitutional crisis is Europe in and what should be done about it?

Mattias Kumm

Abstract

The central cause for the crisis in Europe is not an undisciplined spending by profligate states, but the asymmetric structural symbiosis between states and banks.

Furthermore the public cost of bank-bailouts are to a significant extent the result of genuinely European risks, for which it would be appropriate to hold the European Union as a whole accountable. And given the significant role of the Commission in monitoring national budgets, the case for having the European elections turns into a genuine competition for a European government has gotten even stronger.

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LIST OF ABBREVIATIONS

ECB	European Central Bank
ECJ	Court of Justice of the European Union
EFSF	European Financial Stability Facility
EFSM	European Financial Stability Mechanism
EMU	European Monetary Union
EP	European Parliament
ESM	European Stability Mechanism
FCC	German Federal Constitutional Court
GDP	Gross Domestic Product
MS	Member States
OMTs	Outright Monetary Transactions
PIGS	Portugal, Italy, Greece, Spain
SGP	Stability and Growth Pact
TFEU	Treaty on Functioning of the European Union
T-Bills	US Treasury Bill

INTRODUCTION

It may be obvious that there is a crisis in Europe, but it is less obvious how to best understand it or what needs to be done to overcome it. This uncertainty is reflected in uncertainty over nomenclature: Is it a Eurocrisis? Is it a sovereign debt crisis? Is it a banking crisis? The choice of nomenclature in describing the crisis is often connected to a basic hypothesis about the primary cause of the crisis. Each of these hypotheses gives a different account of the problem that is at the heart of the crisis, and the constitutional problem it is connected to. And with each diagnosis comes a different approach to therapy. The first part of the paper argues that the primary cause of the crisis is a banking crisis. At the heart of the crisis lies the asymmetric structural symbiosis between states and banks, in which states are lenders of last resort for banks and banks are lenders of last resort for states. Once it is understood that at the heart of the crisis lies a problem of organizing the financial sector in a way that internalizes liabilities, the question who should bear the losses and how solidarity should be organized in Europe appears in a new light. In the second part I show why the crisis further strengthens the case for two important reforms: First, the European Union has to be able to raise its own resources, rather than organizing European solidarity through interstate transfers ("No" to a Transfer Union, "Yes" to an Economic Justice Union). Second, the European parliamentary elections needs to be turned into a genuine competition for a European government.

1. THREE ACCOUNTS OF THE CRISIS

1.1. A Eurocrisis as a result of faulty constitutional architecture?

For those who refer to the crisis as a *Eurocrisis*, the original sin is believed to be the architecture of the EMU. The EMU was an attempt to create monetary integration without deeper fiscal and political integration. That, however, was a misguided project destined to fail, because the problem of asymmetric shocks can't be effectively addressed. In case of a national crisis, like the bursting of a housing bubble in Ireland or Spain created by an influx of speculative capital, capital flows would seize abruptly, creating an economic shock that a state would not be able to effectively respond to. There would be no option to national devalue the currency on the national level given a common currency. Thus it is not possible to increase productivity without having to make politically difficult distributive choices like cutting salaries or public pensions. Nor is there sufficient labour mobility to ensure that surplus labour moves to areas where there are more jobs - notwithstanding a legal regime of free movement the informal cultural barriers to free movement. There are no significant federal transfers (for example in the form of social security payments) to soften the shocks that exist in federal systems (notwithstanding the modest role played by structural funds).

This is the classical critique of the EMU from economists like Hans-Werner Sinn or Martin Wolf articulated in the early 90s. It was an analysis that was in part shared by other analysts who continued to support the EMU, because they believed that, given political resistance to further integration in the form of a political and economic Union at the time, the EMU would create spill-over effects that would in due course create dynamics that would tip the scales in favour of deeper integration.

If this is the correct diagnosis of the crisis, the suggested therapy would be to complement the monetary Union with a fiscal and political Union, or to give up on a common currency (with variations of proposals suggesting a Northern Euro and/or a Southern Euro).

There is clearly something in this analysis that is right. But the analysis is nonetheless too general. Asymmetric shocks are not inevitable. They are the result of aggregate human actions. Institutions and policies can be designed in such a way as to make it highly unlikely that they will happen (asymmetric shocks are not natural phenomena like volcano eruptions or asteroid strikes). If the designers of the EMU believed that the Euro would work, it was because they believed that they had created a legal regime that would make asymmetric shocks improbable. The preparatory period in which the fiscal and economic discipline of each joining state was to be tested, in conjunction with the Maastricht criteria and the Stability and Growth Pact, were to ensure fiscal stability and provide incentive for reform, address problem of current account imbalances by restructuring of the economy and ensuring greater economic symmetry for the long haul. So the question is: What exactly went wrong? Why did the expectations of those whose designed the EMU turn out to have been misguided? Why did legal regime not prevent shocks from happening? What accounts for the specific asymmetric shocks the EU has suffered since 2008? What went wrong in the PIGS countries (and those that might join them, like Cyprus to Slovenia?).

1.2. A sovereign debt crisis as a result of profligate spending of some states?

One answer to this question is given by those who would refer to the crisis as *a sovereign debt crisis*. The original sin leading to the crisis is not structure of constitutional system, but violation of its constitutional rules. Profligate spending of a number of states, in violation of Maastricht requirements concerning excessive government deficits under Art. 126 TFEU, as further specified in the Protocol on the Excessive Deficit procedure, is at the heart of the problem. Instead of undertaking structural reforms, macroeconomic imbalances between states were enhanced by the weaker states exploiting lowered borrowing costs as a result of Euro membership, violating their legal obligations under EU Law. The sovereign debt crisis is also a rule of law crisis.

Even though this account is ultimately unpersuasive, it does highlight a set of uncontroversial facts. The rules relating to fiscal discipline in the Treaty of Maastricht have been widely violated. On some counts 23 out of 27 countries are in systematic violation of its fiscal obligations under EU Law. Currently there are 21 states against which there are ongoing excessive deficit procedures. States chose an easy path to finance debts using the new common currency, which made borrowing cheaper for most, because lenders did not have to hedge against devaluation.¹²⁸ Greece was allowed to join the club for political reasons, even though it was widely suspected, that the figures were fudged. When Germany and later France violated the rules, the Commission won an excessive deficit procedure case before the ECJ against the negligent Council, which was countered by a revision of the SGP strengthening the discretion of the Council. With France and Germany getting away with impunity, it was clear that they would later lack the authority to insist on other states sticking to the rules.

For those who follow this analysis the therapy consists of some combination of two things. First to insist that national fiscal discipline is tightened up and that the supervision and European enforcement mechanisms are strengthened. (This is effectively what the Fiscal

¹²⁸ Yet the EMU provided no guarantees against a sovereign default or "restructuring". On the contrary, the no bailout clause in Art. 123 TFEU made it clear that a default risk remained. Yet the differences in yields between German and PIGS government bond at the time before 2008 were marginal, suggesting that the market assumed the marginal risk of default to be negligible. There are only two possible explanations of that behaviour. Either markets believed that in a crisis strong states would bail out struggling states, notwithstanding Art. 123 TFEU. Or they believed that default was unlikely (but why would they? The European provisions requiring fiscal discipline were widely discarded and the historical record provides no basis for such a belief).

Pact does). Second, a permanent emergency regime – beyond what the original Art. 122 II TFEU offered as a loophole - has to be established, that allows struggling states access to capital provided by other Member States, but only subject to further intrusive conditions relating to structural reforms and only as a last resort. This is what the newly introduced Art. 136 III TFEU in conjunction with the ESM does.¹²⁹ In this way a modicum of solidarity in the form of transfers between states and effective mutualisation of debt balances the common commitment to austerity.¹³⁰

Note how this therapy comes with high costs: First, creditor states are asked to exercise solidarity for what is cast as the failure to act in a responsible and disciplined way by the debtor state. Why should states who did a better job and are not plagued by such problems help out? Even within a national community solidarity with those that are worse off is difficult to get political support for, if those that are to receive state aid through transfers can plausibly be cast as slackers who are just failing to get their act together and act responsibly. Here, too, the tendency in past decades has been to tie aid to demanding conditions. Transfers are resented, whenever the need of the recipient side is easily connected to his/her own failure to make responsible choices. Second, countries struggling to meet requirements by the Fiscal Pact or the Conditions imposed by the ESM in conjunction with access to credits are likely to resent the EU and the leading states experienced as “imposing” highly contentious policies on them. This is easily cast as a form of economic imperialism in strong tension with democratic self-government. Incompatible positions between creditor states, who are reluctant to subsidize what they imagine to be irresponsible behaviour, and debtor states, whose citizens rebel against hardship in part grounded in external impositions, may turn out to be toxic and lead to significant political turmoil, first in Member States struggling to meet austerity requirements, but ultimately for Europe as a whole. Structurally organizing solidarity in a way that makes it appear as money flowing from virtuous states to states who fail to do their homework has already fostered resentful nationalism on all sides. It undermines and does not foster European solidarity.

But the problem is not just that the prescribed therapy fosters resentment on all sides. The problem is that the diagnosis is itself seriously flawed. The diagnosis starts from a set of uncontested facts, but it draws the wrong conclusion from them. There may be a regrettable lack of fiscal discipline and a violation of European legal requirements by Member States. But *fiscal discipline turns out to be a remarkably inaccurate variable to*

¹²⁹ First this led to the establishment of the EFSF and EFSM as a preliminary remedy. The EFSF and EFSM were based on Art. 122 II TFEU, which was argued by some to be in violation of the no-bailout clause of Art. 125 TFEU (“a MS shall not be liable or assume commitments of other public authorities...”). This claim is countered by two legal arguments in favour of legality: 1. This falls under the “external circumstances” exception, which allows temporary measures to be taken to address “severe difficulties” caused by “natural disasters or exceptional occurrences beyond its control” (something of a stretch since this was no unfounded speculative attack by financial markets) and 2. This does not constitute EU bailout, but sovereign decisions by nation states to provide support outside of EU mechanism, to which the bailout provision does not apply. The new Art. 136 para 3 TFEU, that authorizes the establishment of the ESM, solves this problem of a proper legal basis by effectively gutting the no-bailout clause.

¹³⁰ Those who share this analysis may well debate among themselves how much austerity/budgetary discipline is due (what type of sacrifices can plausibly be demanded of a self-governing Member State?), how much solidarity in the form of transfers between states and mutualisation of debt risks should be incurred (when does the moral hazard issue become too great?) and whether the balance was struck correctly in the ESM and Fiscal Compact. But notwithstanding differences in this regard (social democrats tend to be in favour of more lenience and greater debt mutualization, conservatives emphasize tough love and pulling yourself up by the bootstraps with aid only as a last resort), the issue is cast as striking a balance between disciplining states not to engage in profligate spending and to bring about reforms increasing productivity, thus decreasing the probability of asymmetric shocks in the future, while at the same time providing for a modicum of solidarity between states as a last resort in the form of the ESM.

predict which state is likely to get into trouble. The lack of fiscal discipline and noncompliant behaviour with EU norms simply does not explain the crisis: Ireland and Spain were among the most disciplined of the Member States, significantly more disciplined than, say, Germany. Portugal's numbers were largely comparable to France. And even when we take the Member States against whom the charge of profligate spending is most plausibly levelled, Greece as exhibit A and, as a significantly less severe case, Italy, there remains a puzzle: Greek overall debt is significantly lower than that of Japan, a country that is placing bonds on the market at historically low yields. And Italy's debt is lower than that of the US, whose T-Bills are also selling for record low yields. So what is going on?

1.3. It's the banks, stupid! On the structural symbiosis between states and banks

The central cause for the crisis in Europe is not undisciplined spending by profligate states, but the asymmetric structural symbiosis between states and banks. Under the current European regime states are lenders of last resort for banks and banks are lenders of last resort for states. That symbiotic relationship must be loosened. Banks must be regulated in a way that ensures that the financial sector does not depend on massive tax-payer financed transfers. And the ECB in cooperation with the ESM must function as a lender of last resort for states.

1.3.1. States as lenders of last resort for banks

Because of serious structural deficiencies in how the financial sector has been regulated, banks can generally depend on being bailed out by states. The scale of the problem is such, that the sovereign debt crisis can be, to a large extent, understood as a knock-on effect of a banking crisis. Effectively this means that in the financial sector major risks are socialized, whereas profits remain privatized. This formula should not be put off as populist rhetoric. It is a straightforward description of reality. Here it must suffice to invoke one figure and one example to substantiate the strength of the relationship between sovereign debts and bank bailouts. According to Commission statistics the Commission authorized 4, 5 Trillion Euros of state aid to the financial sector between Oct. 2008 and Oct. 2011. That is more than a third of the EU's GDP and more than six times the original capital stock made available by MS to the ESM to bail out states. If you wiped out more than 30% of public debt across the Euro area, there might still be a Greek public debt problem, but there would be no problem with Portugal, Ireland, Spain, Italy or for that matter Cyprus and Slovenia. As a concrete example take the most recent Member State facing serious problems: Slovenia. In August the major rating agencies Moody's and Standard & Poors have massively lowered the Slovenian credit ratings and thereby significantly raised their financing costs.¹³¹ Why? Slovenia was regarded as a model country when it joined the EU in 2004 and when it introduced the Euro in 2007. Slovenia's overall debt remains well under 60% of GDP. The main reason for the negative outlook and significantly higher financing costs are bad credits of major Slovenian banks. The three largest banks in Slovenia reportedly needed a capital injection to be provided by the state to the tune of 8% of GDP. In conjunction with lower growth prospects and higher lending costs the markets are losing confidence that Slovenia will be able to keep a grip on its financial situation going forward. The story of Ireland and Spain are similar. Ireland raised its debt/GDP ratio by 25% overnight when it the government decided to assume all bank debts in a dramatic decision at the height of the banking crisis. Spain has recently applied for help under the ESM to the

¹³¹ http://www.moody.com/research/Moodys-downgrades-Slovenias-government-bond-rating-to-Baa2-from-A2--PR_252281

tune of 100 Billion exclusively to ensure that money was available to bail out its banks (ultimately the required amount was reduced to 59 Billion).

1.3.2. Banks as lenders of last resort for states

The problem is further exacerbated by the fact that it is not within the ECB's mandate to serve as a lender of last resort for states. Even though its core point to ensure that states are prevented from simply printing money to cover ever-increasing debts is well understood and appreciated, there are two consequences connected to this institutional choice. First, this opens up states to the possibility of successful speculative attacks by financial markets. This very possibility may, in times of high uncertainty and great financial market liquidity, create insecurity and volatility (a central bank in the background credibly pronouncing that as a last resort it would buy government debt in unlimited amounts makes all speculative attacks futile). This risk, which was believed to exist for Euro area states, but not the US or Japan, is likely to be priced into bond yields, translating into higher lending costs for states. Second, given that in the absence of a central bank the capital markets and banks in particular are the lenders of last resort for states, states have an incentive to make it attractive for banks to buy sovereign debt. Partly this is done by exempting sovereign debt from capital requirements that generally apply to banks' proprietary trading. In Europe the ECB makes available credit for banks at a very low rate, that banks use to invest in sovereign debt, which in turn was used as security for further credit. Given that rules on capital requirements did not apply to banks as sovereign debt purchasers, banks could gain considerable leverage. This means that in case of sovereign debt restructuring banks are more likely to facing severe problems. The reason why Greek restructuring presented a serious problem for other countries was that major European banks, French and German banks among them, were significantly exposed to Greek sovereign debt. This would have meant that in case of a Greek default those banks, too, would have needed to be bailed out by their respective governments. This was a core mechanisms through which contagion across the European economy was feared to proceed. A case in point: The reason why Cyprus is applying for protection under the ESM is directly related to the losses of Cypriot banks incurred as holder of 22 Billion of Greek debt by the Greek restructuring in March 2012. As a result of this restructuring Cypriot banks had to be bailed out by the Cypriot government, ultimately forcing the government to consider protection under the umbrella of the ESM.

1.3.3. From diagnosis to therapy

On this diagnosis the basic structure of the therapy appears to be clear, even if a great many issues of detail might remain contested and complicated. The solution would have to have two basic prongs.

a) What a Banking Union must seek to achieve

First, the financial sector and banks in particular have to be regulated in a way that ensures that public to private sector transfers seize to be necessary. Risks should be allocated with management, shareholders and debt holders of banks, not the public. On the one hand this can be done by lowering the probabilities of difficulties from arising in the first place. This requires stronger capital requirements as in the new Capital Requirement Regulation and Directive, which in its present form still criticized as insufficient by the Basel Committee. Also in discussion are the legal separation of a bank's core financial and commercial activities and its proprietary trading and other risky activities on the other (see High Level Expert Group Report/Barnier from October 3 2012). Furthermore the supervision of these rules must be improved (whether the ECB should and legally can play a central role in this context, as is currently proposed, is a contentious issue). Second, in case difficulties do

arise, it is necessary to ensure that banks of any size can be restructured or wound down in a way that limits taxpayer liability (see the Commissions proposed Bank Recovery and Resolution Directive). Also in discussion is a European insurance scheme that banks would be required to maintain.

b) The ECB (in cooperation with the ESM) as a lender of last resort

Second, the ECB, in conjunction with the ESM, would have to be able to credibly serve as a lender of last resort. This would ensure emergency funding for states in the absence of functioning markets. To prevent states from abusing this mechanism or inappropriately relying on it instead of making appropriate efforts themselves, a link between debt-purchasing through the ECB and conditionality requirements by the ESM should be established.

There are three ways of doing this, that can only be described and assessed in very basic terms here. The point here is not to provide a comprehensive legal and political analysis, but gain a deeper understanding of the options available and the types of concerns they would need to address.

1. Make ECB official lender of last resort by changing constitutional prohibition on ECB buying state debt directly on the primary market. This is something that would leave an institution like the ECB, that is not independently democratically legitimated, whose independence is protected by strong constitutional rules and not embedded in strong national cultural context too powerful. Given the requirement to amend the Treaty, it is also politically not feasible.

2. The Draghi solution (presented Sept. 7, 2012): The ECB engages in outright monetary transactions (OMTs), purchasing sovereign debt on secondary market, to undercut "severe distortions" in government bond markets not justified by fundamentals. It would only do so if a state in cooperation with ESM (and EFSM) supervision. In this way it would thus effectively cut borrowing costs of debt-burdened euro-zone members. The ECB would become fully effective backstop, providing the institutional assurance that the Euro is in fact irreversible and thus discouraging speculation against it.

There are two problems with this approach. First, it is a contested question whether these policies are covered by constitutional mandate of ECB. The German Constitutional Court in *obiter dictum* has already implicitly challenged Draghi's policies as *ultra vires* (see German Constitutional Court decision not to grant interim relief against the ratification of the ESM and Fiscal Treaty of Sept. 12 2012, recital 276-278 – the issue will come up in the court's decision on the merits). The court claimed such policies are in violation of the ECB's mandate to prioritize price stability over other objectives objective (Art. 127 TFEU) and amount to a circumvention of the prohibition to buy sovereign debt directly (Art. 123 TFEU). The ECB argues that it's policy is driven by concerns to effectively keep interstate rates low and that Art. 18 of the ECB statute explicitly authorizes the kind of OMTs the ECB expects to engage in. Second, beyond legal issues there are also policy concerns. Because the ECB only buys debt on the secondary market, banks continue to profit as middle-men to the detriment of the public. They take a cut, buying debt from the state and selling it to the ECB at a higher price, thus increasing cost for public. Not surprisingly on announcement of Draghi's policy share prices of major European banks shot up (Crédit Agricole and Société Générale was up 8, 44 and 7.76% respectively on the day, Deutsche Bank went up 7%).

3. An alternative or complementary path would be for the ECB to recognize the ESM as commercial partner under Art. 18 of ECB Statutes. This would allow the ESM to lend money from ECB with which it can buy ailing states debt on the primary market, which it then deposits as security with the ECB. Decision to make buy government debt would thus be

made by the Governing Council. Here, too, there are complicated legal issues that would need to be worked out. On the one hand the ESM does not need to apply for a bank license (Art. 32 para IX ESM). On the other hand Art. 21 of ECB Statute prohibits lending money to public entities. Yet is plausible to argue for a narrow interpretation of Art. 21 and insist that the ESM does not fall under its scope. Unlike any other public entity that Art. 21 appropriately applies to, the ESM is a lending institution which not only financially, but also politically represents all participating Member States, thus ensuring appropriate checks and balances.

This may well be the most attractive solution. It cuts out the middle-man (banks) and reduces costs for public. Like the Draghi plan, the plan requires political endorsement through mechanism of ESM as well as ECB involvement, but it would put the ESM in charge. It, not the ECB, would be the policy agenda setter. This solution is one which would neither inappropriately empower the ECB, nor does it make it easy for political forces to effectively capture the levers of the printing press. On the other hand the question remains whether markets would trust a stop-gap mechanism that effectively required the potentially strife-torn Governing Council of the ESM to authorize purchases of sovereign debt. But in the end it might not matter whether option 2 or 3 will effectively define European practice. What is far more important is that one or the other is effectively adopted and legally endorsed.

2. WIDENING THE PERSPECTIVE: CONSTITUTIONAL REFORMS?

2.1. "No" to a Transfer Union, "Yes" to a Social and Economic Justice Union

2.1.1. On legacy loss allocation

The correct analysis of the crisis is not only important in order to understand what needs to be done to avoid it in the future. Besides taking measures to ensure that states are adequately supplied with capital in cases of dire need and that in the future the financial sector can no longer count on bail-outs from the taxpayer, the correct analysis also provides the key to the question how to appropriately allocate losses incurred. If there is one thing that economists agree on it is that to move out of the crisis rather than have it draw on indefinitely, these losses have to be allocated quickly. Only once that has occurred, can Europe move on. But who should pay for the mess? If the crisis were the result of profligate spending of some states, then it seems logical that these states should first of all bear the burden of their actions before they could count on European support and that this support would come with further strict conditions attached. This, in effect, is what the ESM and Fiscal Compact are meant to ensure. But if, as argued above, the sovereign debt crisis is to a large extent the result of a banking crisis, the answer may turn out to be very different. There is something arbitrary in burdening the states in whose jurisdictions the banks requiring bail-outs happen to have their seat. The banking crisis would not have had the intensity and structure if it were not for the European common currency and European freedom of capital guarantees. The EU has exercised its concurrent competencies over the area of banking and financial markets and is in the process of deepening its involvement in the sector by the establishment of a Banking Union. Furthermore the bank-bailouts themselves have considerable cross-border positive externalities. Given the interdependence of the banking sector the failure of major banks in one state would have had difficult to control contagion effects across Europe. Under such circumstances it seems more plausible to allocate financial public sector risks resulting from financial sector failings

with the European level. The costs of bank-bailouts are to a significant extent the result of genuinely European risks, for which it would be appropriate to hold the European Union as a whole accountable.

2.1.2. From interstate transfers to the EU's own resources

But if the European Union as whole rather than individual states like Spain, Ireland or Slovenia be held accountable for the costs of the bank-bailouts, the mechanism through which to organize this European responsibility should not be inter-state transfer mechanisms, such as those foreseen by the ESM. *This money should be paid for by genuinely European funds, raised by European taxes or levies.* The way money is raised and the channels through which it is spent comes with its own political presumptions and burdens of justification. It should not be understood as a neutral technical device. There is something deeply incongruous and misleading in first having individual states bail out banks and then transferring money from one state to another so that stronger states support weaker states to help them fulfil that task. This mechanism misguidedly creates the impression that stronger states have to bail out weaker ones, because they can't handle their responsibilities, even when the original responsibility is more properly ascribed to the European Union from the beginning. Inter-state transfer mechanisms corrode solidarity in Europe, because they give the misleading impression that one state has to ultimately pay for the failures of another.

Note how interstate transfers corrode solidarity even in established federal systems, where in other contexts policies can rely on a background of national solidarity. Take the example of Germany's Länderfinanzausgleich, which, can be roughly described to work as follows: Rules of fiscal federalism in Germany allocate most federal taxes to the federal government that spends its money in line with federal policies. Here the question how much money has flown from one state to another is generally not a high profile political issue: federal taxes for federal policies help create and sustain a federal political community and its policies. A part of the federal taxes, however, is awarded to states. Now a small portion of the amount awarded to states is again redistributed between states according to certain criteria connected to need. As of last year the Bavarians have to pay 3 billion Euros of the money originally allocated to them in the distributive pot, while the happy-go-lucky "poor but sexy" city-state of Berlin receives 3 billion. The nifty Baden-Württembergers support the socially generous and undisciplined Bremeners, etc. There is a lot of political theatre and a great deal of animosity and resentment that is on parade in the annual process of re-allocation. This inter-state reallocation creates significant resentment and effectively undermines solidarity. The reason for this is at least in part that Bavarians assume that the money originally allocated to them is what is rightly theirs, and they don't want to have to exercise solidarity for the fact that other states apparently can't get their act together.

Whether or not the Bavarians and Baden-Württembergers have a point is not the issue here. The point here is that the mechanism through which money is distributed comes with assumptions about whose money it is that is distributed. Once money originally allocated to A flows from A to B, A assumes it is its money and what needs to be justified is that B should have it. If money is distributed to all those living in A and B according to criteria determined in line with a jointly decided policy followed by C, and money is raised by applying general criteria related to the policy benefits bestowed, then the question how much money flows from A to B becomes moot or at least secondary. Then the question becomes a different one: is this a policy for which C (rather than A and B) should exercise its competencies (assuming they legally have it)? If so, is it a good policy, worth the money that is spent on it? And is the money raised according to appropriate criteria? The way flows of money are channelled, determines the nature of the debate.

Moreover, it is not a good argument to insist that a sufficiently strong identity – an identity that Europeans may be claimed to lack - is a prerequisite for the EU to raise its own resources. Identity may well be relevant for the allocation of competencies and the definition of policies. But once it is decided and accepted that competencies should be allocated and policies defined on a European level with regard to a particular set of issues, then it is unlikely that funding these policies in line with *criteria that are meaningfully connected to the economic benefits bestowed* would be regarded as unacceptable. Genuinely European resources, best raised from taxes or levies that burdens actors and transactions that are profiting financially from the internal market (e.g. shareholders, corporations, transactions with strong cross-border dimensions like certain financial transactions), appropriately connect regulatory responsibility with financial accountability. Furthermore prioritizing the taxing of actors and transactions whose tax-burdens have been reduced as a result of competitive pressures to lower tax rates to attract capital and mobile actors to national jurisdiction (or prevent capital flight) would reflect the promise of the European Union to ensure the fair distribution of burdens in the context of globalization. The European Union should not become a Transfer Union (this is not about transfers from one state to another), it should become an Economic Justice Union, in which the European Union accepts financial liability for the consequences of its regulatory responsibilities and is able to raise its own resources to do so.

2.2. Why the elections to European Parliament should be turned into a genuine competition for a European government

But it isn't only on the level of finances that Member States have inappropriately insisted on controlling the channels through which resources are funnelled. Member states, and in particular the executive branch of Member States have also captured the European political process and have successfully prevented autonomous European legitimacy resources to be mobilized. Think of the many emergency Council meetings in Brussels in the past two years, where late at night or early in the morning exhausted prime-ministers and chancellors declared agreement on another new mechanism or policy through which the crisis is to be addressed. Think of the ESM in which the Board of Governors, composed of the economics ministers of participating states, calls the shots. Throughout the crisis the European Parliament has not been publicly present. Conflicts were cast as inter-state conflicts, Germany and France against Greece or Spain, donor countries against receiving countries, even though in all of these countries there were structurally similar divides between left and right, that would have allowed for coalition building and the introduction of a very different kind of debate about the kind of Europe that is desirable. Why did those cross-national debates about alternative futures for Europe not take place? Furthermore Europe appeared not only as deeply divided along state lines, the ultimately agreed upon solutions were also cast as inevitable, without alternative, necessary. If you don't like these results, you're inclined to become a Eurosceptic. There is no public representation of an alternative Europe that you could support. Yet it should be clear from the above discussion, there is much that is disputed about how to understand the crisis, what its causes are and what kind of resolution might be desirable. There is also the real danger that the solutions offered might not, in the end, work. Who is going to be held accountable then? How might Europe recover from such a blow?

It is high time to be serious about proposals endorsed among others by current President of the European Parliament Martin Schulz and Wolfgang Schäuble to make the elections for the European Parliament genuine European elections for the choice of the President of the European executive. For this to happen, it would be sufficient for the different European political groups to present competing candidates before the next election. If the election campaign would focus on this, the European Council would, in practice, have to appoint the

winning candidate. Such a shift is of fundamental importance and the reasons sometime invoked against it are not persuasive.

It is of fundamental importance, because we should not be surprised to see that European citizens disagree about the kind of policy measures that are the best response to the financial crisis and other political issues that the EU rightly addresses through legislation. It is a mistake to insist, as national politicians invariably do, when they defend the measures taken at late night Council meetings under the current regime of executive dominated intergovernmentalism, that there is no alternative to the decision they have made. For many citizens that is the reason why they turn their back on Europe: They do not like the policy choices generated on the European level, and there is no alternative personnel and menu of policy options present to engage with on the European level, so they associate Europe with those policy choices they deem undesirable. If faced with a genuine choice in personnel, programmes and policies, disgruntled citizens would be able to articulate their dissent not by turning away from Europe and seeking refuge in populist recipes. They might instead, as European citizens, vote or mobilize for an alternative Europe, personified in a different President, committed to different policies. Tying the outcome of the European elections to the determination who will be the next Commission President will lead not only to a surge of interest in European parliamentary elections and allow the Commission to more effectively fulfil the functions assigned to it, it is also likely to be the best antidote to the spread of nationalist populism and Euroskepticism.

Furthermore under the Fiscal Treaty and other fiscal crisis related legislation like the Six-Pack the Commission gains considerable powers to intervene in the budgetary processes of Member States, once they have shown themselves unable to meet the strict budgetary requirements imposed on them. For those powers and the discretion that comes with these powers to be exercised effectively and legitimately, the Commission must be able to rely on the kind of legitimacy that comes with direct link to the outcome of European elections. Budgetary questions were at the heart of the historical parliamentary struggles for control over a democratically unaccountable executive – they are the inner sanctum of parliamentary prerogatives - and it is unlikely that national Parliaments will give much weight to a Commission that is seen as the instrument of the collective executives of Member States.

The arguments against such elections are ultimately not persuasive. The current role of the national executives in the European decision-making process is not something that enhances the democratic legitimacy of that process. It is the result of the executive branches having captured the European decision-making process, with the accountability to national parliaments, even though not without significance, ultimately limited for structural reasons. The claim that small Member States would lose too much influence is also misguided. On the contrary, a stronger Commission President might be a more plausible counterweight to the tendency of two or three large states effectively dominating the decision-making process in Europe. The claim that European elections can't be meaningful, because statistics relating to electoral participation clearly indicate that European citizens are just not interested in European elections, that there are no genuine European parties and there is no robust European public sphere etc. gets it the wrong way around. The issue is one of sequencing: Only once European elections are appropriately structured to allow citizens to choose between different leadership personnel, programs and policies are the incentives in place to develop an interest in elections, to restructure parties around European agendas and to have the media focus more strongly on European themes. Finally the degressive proportionality of the allocation of parliamentary seats in the EP, does not – contra the German FCC – suggest that it can't play a central legitimizing role. On the contrary, in conjunction with the weighted voting in the council such an institutional choice

is appropriately sensitive to the nature of the European Union as a Federation of nation states.

3. CONCLUSION

There are those that might be wary of a European Union that can raise its own resources through taxes or levies and that establishes genuine electoral politics at the heart of the European political system. Would this not effectively turn the EU into a state? Of course one could point to all kinds of ways in which the EU would still remain distinguishable from the classical state like France or Britain: Its limited competencies across a wide range of core areas of political concern, from social security to defence. Its correspondingly relatively low budget in terms of Europe's GDP, compared to national budgets in terms of their national GDP. The remaining very powerful role of the Council in the European legislative process. This would clearly not be a European superstate (however one might imagine that).

But we should not mince words: It would be a significant shift. For those conceptually wedded to a *sui generis* account of the EU¹³², those who insist on making sense of the EU in terms radically different from federal systems, it might come as a shock that there is more conceptual and political continuity between the EU and traditional political forms than they might have thought. But our thinking about how to progressively develop the European Union for it to become better should be unburdened by ontological pre-commitments concerning its nature. Following in Jean Monnet's footsteps, we should simply ask whether, given the values we are committed to, a particular reform would enable the European Union to function better to serve its citizens as a framework for self-government than available alternatives. If a European Union that can raise its own resources through taxes or levies and that establishes genuine electoral politics at the heart of the European political system would make it a better Union, effectively overcoming the crisis and making its recurrence unlikely, while reflecting its basic values, then that is the direction in which it should constitutionally evolve. If that makes the European Union appear more like a federation of nation states, so be it.

¹³² Attempts to work out in conceptual and normative terms how to make sense of Europe's *sui generis* character include a "conflicts of law" approach (Christian Jörges) or „democracy" (Kalyso Nicolaidis), or the idea of „constitutional tolerance" (Joseph Weiler), or some accounts of "constitutional pluralism" (Maduro, Kumm, Halberstam). Those approaches and conceptualizations might well remain relevant, but to the extent they do, they would remain so because they describe features that are relevant in federal settings more generally.



DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT C: CITIZENS' RIGHTS AND
CONSTITUTIONAL AFFAIRS

CONSTITUTIONAL AFFAIRS

Is the EP legitimate as a parliamentary body in EU multi-tier governance

Andrea Manzella

Abstract

The latest developments of the European governance are characterized by three major changes.

The first transformation concerns the resort to the international law to bypass the block of the new measures for monetary stabilization. The second change implies interference in the constitutional law of the Member States, in order to enhance their financial homogeneity. The third change concerns the institution of a permanent inter-parliamentary cooperation between the European Parliament and the national representative Assemblies. In all these changes in the European economic governance, the European Parliament is called to play an essential legitimizing role.

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LIST OF ABBREVIATIONS

- FC** Fiscal Compact
- ESM** European Stability Mechanism
- TFUE** Treaty European on the Functioning of the Union
- EP** European Parliament

EXECUTIVE SUMMARY

The latest developments of the European governance are characterized by three major changes. The first transformation concerns the resort to the international law to bypass the block of the new measures for monetary stabilization. The second change implies interference in the constitutional law of the Member States, in order to enhance their financial homogeneity. The third change concerns the institution of a permanent inter-parliamentary cooperation between the European Parliament and the national representative Assemblies. In all these changes in the European economic governance, the European Parliament is called to play an essential legitimizing role.

The use of international law to establish the European Stability Mechanism (ESM) and especially the so called Fiscal Compact has created a mechanism for strengthened cooperation "by other means". The new governance reaffirmed that also the States excluded from the co-operation, through the European Parliament, can have a *droit de regard* on the cooperation space they do not participate in. No alteration in the composition of the European Parliament is thus foreseen in the functions that are assigned to it by the FC. In this respect, a formal equality of the "ins" and "outs" is admitted.

The interference with constitutional orders of the Member States occur under three procedures: the "European semester"; the "balanced budgetary position"; the abandonment of the rule of unanimity for the entry into force of both international Treaties.

The scrutiny by the EP of the various task carried out in the new governance by the Commission is also a form of increasing transparency playing favour of national parliaments. In this way, both levels come to contribute to the overall legitimation of the European governance.

The third change in European governance concerns the relationship between the EP and national parliaments. Parliamentary cooperation stretches and strengthens the parliamentary links within EU, by involving not only the European Parliament, but also strongly connecting the national parliaments.

The new challenges of European governance have thus not damaged the role of the EP. The inevitable need for verticalization and centralization of the decisions in times of crisis and the curtailment of the procedures prior to deliberation have surely not eliminated the procedures of parliamentary scrutiny.

IS THE EP LEGITIMATE AS PARLIAMENTARY BODY IN EU MULTI-TIER GOVERNANCE?

1. DEVELOPMENT OF THE EUROPEAN GOVERNANCE

The question that motivates this paper can easily be reversed. The point that mostly raises interest today is to see whether the new forms of European economic governance can

reach a *de jure* and *de facto* legitimacy and if and how the European Parliament can contribute to this need of renewed legitimation.

In fact, the changes in the European governance under the pressure of the crisis have reached levels that require such re-legitimation. The debate about the ways of reaching legally viable options for a pan-European referendum is not accidental: it's merely directed towards relieving the Member States' governments, parliaments and courts of the increasing responsibilities towards concerned public opinions.

No one should underestimate the impact of decline of trust in political institutions that has already led to democratic setbacks in several Member States. There is a widespread perception of a kind of "induced" democratic deficit, attributed to the distance between high level decisions made by Union's institutions and the governments of the Member States themselves. Those are bitter fruits of a so-called "executive federalism". This is certainly a serious concern and should bring about urgent and feasible political remedies - presuming no change in the Treaties - the main consideration focuses on the upcoming elections of 2014 (starting with the election procedures: art.223, TFEU).

However, while trying to avoid a damaging split between political statements and legal analysis, the new European governance per se has elements that, if properly exploited, can place it in the framework of a full, renewed legitimation. A legitimation where European Parliament is the primary actor, at both levels of input and output.

The latest developments of the European governance are characterized by three major changes.

The first transformation concerns the resort to international law to bypass the political blockages to the new measures for monetary stabilization. The second change impacts national constitutional law of the Member States, driven by the need to achieve their financial homogeneity.

The third relates to the institution of a permanent inter-parliamentary cooperation between the European Parliament and the national representative Assemblies.

In all these changes the European Parliament is called to play an essential role of legitimizing link.

2. STRENGTHENED COOPERATION "BY OTHER MEANS"

The resort to international law to establish the European Stability Mechanism (ESM) and especially the "Treaty on stability, coordination and governance" of the economic and monetary Union (the so called Fiscal Compact) has created a mechanism for strengthened cooperation "by other means".

Within those new rules we can easily find the four legislative principles that in the Treaties regulate the enhanced cooperations (see art.20, TUE and 326-334, TFEU).

First: the prevalence of the community objectives in the assessment of the agreements between Member States (see 1st par. of the "preamble" to the FC: "conscious of their obligation, as Member States of the European Union, to regard their economic policies as a matter of common concern" and article 1(1): the "achievement of the European Union's objectives for sustainable growth, employment, competitiveness and social cohesion."; legal basis: Article 121(1), TFEU).

Secondly: the inviolability of the common institutional framework (see art.2(1) FC: "This Treaty shall be applied and interpreted by the Contracting Parties in conformity with the

Treaties on which the European Union is founded"and art. 2(2), FC: "insofar as it is compatible with the Treaties" themselves).

Thirdly, the character of temporal subsidiarity as a measure for accelerating integration, adopted only in the last resort when contrasted with the ordinary procedures (see art.16 FC: "Within five years, at most, of the date of entry into force (...) the necessary steps shall be taken (...) with the aim of incorporating the substance of this Treaty into the legal framework of the European Union.").

Fourth: the open character of the cooperation and the condition of equality of all EU Member States irrespective of the enhanced cooperation adherence period (see art.15 FC: "This Treaty shall be open to accession by Member States of the European Union other than the Contracting Parties").

This way, the mentioned four principles determine an intermediate legal area between the international law of the treaties (which still governs the relations between Member States where there EU law is not in force or the use of its procedures is not binding) and the constitutional system of the Union (in addition to the mentioned art. 2 of the FC on the conformity with the founding Treaties, see par. 7 of the "preamble", "the objective (...) is to incorporate the provisions of this Treaty as soon as possible into the Treaties on which the European Union is founded").

This "enhanced cooperation" achieved by international treaty is a symptom of reduced contradiction between the intergovernmental and the Community procedures within the Union's legal system. Instead, here we have the interpenetration of the Community law's principles and the *inter se* treaty initiative of the Member States formally taken outside of the founding Treaties. On one hand, this is a sign of a strong phenomenon of bringing the activities put in place by the Member States into the legal framework of the Union (see mentioned art.16, FC, on the future "incorporation"), a *de facto* sign of their structural transformation into the "Community States". On the other hand, this can also be interpreted as a sign of the substantial homogeneity between the intergovernmental actions taken in the sphere of international law of the treaties and the Community actions, both taken in the same teleological context: the objectives of the Union.

If this form of governance is a new example of the rather uneven process of the European integration whose Constitution can be seen as a flexible "legal system of integration" (Smend), it also raises a rather tricky question.

Like all the hypotheses of enhanced cooperation that might follow the form prescribed by the Treaties, also this *de facto* enhanced cooperation, established by the means of international law, carries in itself a political contradiction.

The contradiction lies in the dynamism of the "move forward" (De Witte) and of the propulsive drive to integration (which here reaches the paradox of using the international sovereignty of the Member States to advance the community's supranationality) and the necessity to comply with the stability of a single institutional framework (art.16 TEU)

The new governance properly rejects any "contagion" by the natural participatory limitation foreseen in the FC cooperation with the European Parliament as a whole. On the contrary, it is reaffirmed that also the States excluded from such co-operation, can have through the European Parliament, right of scrutiny over the field of cooperation in which they don't take part. No change in the composition of the European Parliament is thus foreseen in the functions that are assigned to it by the FC (see art.2, where it refers to the procedural law of the EU "whenever the adoption of secondary legislation is required"; art. 4, which refers to art. 126 of the TFEU: "consultation of the EP on the rules and definitions for the application of the provisions of protocol N°12 on excessive deficits"; art.11: participation of

the EU institutions on the coordination of the major economic reforms; art.12(2): relations of the EP with the Euro Summits, in general, in all the specific functions assigned to the Commission, with respect to which the EP can assert its ordinary control powers: see, in particular, art. 7. In this respect a formal equality the participating and non-participating States admitted.

This equality is nevertheless limited by the general principle of sincere cooperation (see art .4, TEU: "(...) the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties") and, by analogy, by the specific measures regarding the enhanced cooperation (see art.327, TFEU: the States out do not hinder its implementation by the participating States).

The institutional indivisibility of the EP - which should be seen as a current guarantee of unity within differentiation and as future guarantee of the reunification of States and rules in the planned "incorporation" - is also preserved in what is one of the most significant elements of the new governance: the inter-parliamentary cooperation (see n. 4). In this case, the differentiation - which is inherent to the very concept of enhanced cooperation - is obtained by limiting the participation only to the national parliaments of the Contracting parties. Indeed, the composition of the relevant EP Committee remains unchanged and in the "Conference" in accordance with art. 13 it is called to "discuss" budget policies and other matters within the FC with the "relevant" Committees of the national parliaments of the Contracting Parties.

It seems clear that whatever will be the EP actions in the new framework of European governance (and a contrasting comparison with the Council and the Commission already can already be seen), the constitutional balance instead suggests that the EP assumes a highly legitimizing role in this atypical aspect of the European governance: in the preservation of the single institutional framework of the EU; in maintaining unity within the diversity among "ins" and "outs"; in being the pivot for the involvement of national parliaments in the process of elaboration of the EU budget policies.

3. IMPACT ON THE NATIONAL CONSTITUTIONAL ORDERS

The impacts on the constitutional orders of the Member States are manifest in three procedures: the "European semester" (Ecofin, Sept. 7th, 2010); the "balanced budgetary position" (art. 3(2) FC: "through provisions of binding force and permanent character, preferably constitutional"); the abandon of unanimity for the entry into force of the Treaty on stability (art.14(2) FC: "provided that twelve Contracting Parties whose currency is the euro have deposited their instrument of ratification").

It is not difficult to realize that this atypical "enhanced cooperation" (which moreover is extended to 25 out of 27 Member States of the Union: a near-unanimity that rather singles out the two exclusions), the EU ventures in the aspects of sovereignty of the Member States considered thus far intangible.

Through the mechanism of the "European Semester" the public finance documents of each Member State are submitted to a preliminary check, defining a "new time frame for compliance" (Rizzoni) which, even if founded on a pre-existing legal basis (art.121 and 148, TFEU), practically ends up by having an impact on the traditional budgetary powers of national parliaments, which still are the heart, albeit weakened, of the parliamentary democracy.

With this architecture of control - which includes constraints "of permanent nature, preferably constitutional" (art.3(2) FC) and independent institutions "responsible at national level for the observance" of restraints - is established an institutional structure that

predetermines the core of parliamentary decisions. The declared "full respect of the parliamentary prerogatives" (*ibid*) is therefore carried out under the influence of these new rules and institutions.

The departure from the unanimity for the entry into force of the FC Treaty characteristically signals the shift from a regime of international law to a constitutional regime (Weiler). As we already have seen, the indication of a "constitutionalization" gets confirmed when in the light of the ratification procedure follow in examining the typically constitutional contents of the pact. The apparent paradox, is that this "constitutionalization" takes place through the means of an atypical international treaty.

The substantial restriction on parliamentary budgetary powers, the standardization of the financial constitutions of the Member States and the abandon of the principle of unanimity are the signs of a trend of constitutionalization which is very difficult to explain via the theory of the multi-level governance. What we witness here can be rather described as a mix of European constitutional legislation with national constitutional orders that takes place on the same regulatory level.

In the Articles 4, 2-3 of the TEU we find the fundamental rule of this mix: the "mutual respect" of the Union's constitutional identity and of the constitutional identity of the Member States. It is this aspect that marks an important link (at least in meaning that of the constitutional importance that "stability" can have in the 'community's decision-making processes) between both constitutive elements of the EU legislation. The dynamic line is both included in the positive expression of "sincere cooperation" and in the negative expression "abstention" from obstructive measures: both denoting a "respect" not only in the structure of the mutual assignments, but also in the Union in action.

Through the changes introduced in the EU governance on the legal basis grounded on the principle that the "economic policies" are "a matter of common interest", the constitutional identities of the Union and of the Member States "get closer" while still respecting each other. Nevertheless without any concept of hierarchy or separation that would rely on technical arrangements, there is a common regime driven by the aim of eliminating the institutional differentiations incompatible with stability of the euro area. This common regime reaches its exponential subjectivity with the establishment of the "Euro Summit" with its own president (see art.12(1) FC).

Now the question that stands before us is: beyond the formal aspect of the legal basis in the articles of the TFEU, which legitimation of these changes has the constitutional relevance? And what is the contribution of the EP to this legitimation?

Following our argument, the legitimizing contribution of the EP can not be limited to a mere quantitative accounting. On this subject, there's a significant common observation expressed by the early analysts of the new governance (established besides FC also through the Six Pack, the ESM and the initiative of amending the art.136 of the TFEU). The observation is that the role played by the EP in the elaboration process of the new governance is not at all reflected in the role that the EP is assigned in the related procedures.

But in this observation it is possible to find an indication of the fact that the EP 'was more interested in the result of "constitutionalization" implicit in the new measures than in its later role of participating in the implementation of the mechanisms. Nevertheless in this context, one shouldn't minimize the degree of political and institutional involvement of the EP in the new procedures, especially while taking realistically into account the reluctance to assign a role to the EP in the initiatives that do not involve all Member States (Tosato).

In this sense - in the "economic dialogue" with the Council and the Commission, as part of the preventive, corrective and sanction procedures included in the Six Pack (with its culmination in the 'European semester') - the EP can introduce not only the vision of its majority on the economic and financial policies of the Union, but also can put behind its institutional weight of budgetary authority (Art.310-324, TFEU).

On the other hand, one shouldn't underestimate the obligation bestowed on the President of the Euro Summit to inform the EP after each meeting (see art.12(5) FC).

In the same way, departure from the principle of unanimity for the entry into force of the FC is an affirmation of the majority principle, a principle that, among the political institutions of the Union, is completely fulfilled only in the EP.

In other words, the statement that in the new governance "the EP discusses, but does not decide" (Fasone) is true, but the EP's "powers to control the decisions, even if not to adopt them" (Bonini) remain unaltered.

At a time when, as we have seen, the constitutions - which are integral part of EU's identity - get closer, the institutional control by the EP on the various activities carried out in the new governance by the Commission translates also through increased transparency playing in favour of the national parliaments.

4. INTER- PARLIAMENTARY COOPERATION

The third change in European governance concerns the relationship between the EP and national parliaments.

Both article 13 of the Fiscal Compact and (a meaningful repetition) paragraph 4 of the document of President Van Rompuy (referred to in point II(4), of the European Council Conclusions of June 28th and 29th 2011) use the concept of "inter-parliamentary cooperation." This concept is used with the express purpose to "strengthen the democratic legitimacy and the accountability", in order to compensate and balance a "more integrated fiscal and economic decision-making process."

As for the legal basis of this "inter-parliamentary cooperation", both texts precisely refer to Title II of the "Protocol N°1 on the role of national parliaments in the Union". But it's also possible to identify here the influence of the "Convention method" as a strong legal basis. It's on such kind of assembly, principally composed of "representatives of national parliaments" and "of the European Parliament" that art .48 of the TEU bases the "ordinary revision procedure" of the Treaties.

However, this is not an unexplored procedure. The "Convention method" was already tested successfully in drafting both the Charter of the Fundamental Rights of the EU (now annexed to the Lisbon Treaty "with legally binding force") and the Treaty establishing a Constitution for Europe (signed in Rome on October 29th 2004, but then "suspended" with the later French and Dutch referenda). The reference to "parliamentary cooperation" in the latest European texts is thus not a generic clause of parliamentary control. Instead, it refers a specific and well-known procedure.

This repeated reference seems indeed to indicate a kind of "third way" for democratic participation and legitimation within the Union: it takes a path different from the increase of the powers of the European Parliament and from increasing the interference in the EU decisions by the national parliaments (referred to in other parts of the Lisbon Treaty).

In short, it's acknowledged that there is a need to restore an institutional balance strongly upset by the natural process of "verticalization" of decision-making enhanced by the financial and economic crisis: through the hegemony of the European Council. But the

privileged solution is not the same as in the past: that is to "quantitatively" increase the powers of the European Parliament. Instead, we witness a qualitative shift through the strengthening of the legitimacy of the European Parliament through contamination - and almost by a transitive virtue - in assemblies including national parliaments (even in the hitherto taboo area of the common defence).

On the other hand, national parliaments acquire a new "participatory" role (the term correctly indicates very permeable juxtapositions) in the life of the Union. And this happens not only in the fields of parallel competence or in the areas of supportive and coordinatory competence (art. 4 and 6, TFEU), but also in the much more problematic field of economic policy (art. 5, TFEU).

The reference model (in the Protocol N°1, in the Fiscal Compact as well as in the announced Compact for Growth and Jobs) is the Conference of the Commissions specialized in the object of the decision-making process. But a precise model can only be achieved through a "panachage" among the different procedures (the main being the COSAC) and through the texts that followed each other. The Conference is made up of the President and the two Vice-Presidents of each specialized Commission (and of all the Chambers of the 27 States): this way the participation of the various majorities and oppositions at national level is guaranteed. The nature of the work of the Conferences is advisory: they can "submit the "contributions" deemed "useful" to the "attention" of the decision-making bodies (therefore, opinions and guidance documents are not binding: but, of course, they have the authority which derives from the "consensus" they have been adopted with).

Parliamentary cooperation stretches and strengthens the link of the parliamentarization of the EU, involving not only the European Parliament, but also strongly implicating national parliaments as co-promoters of the policies, as subjects which are bound together by common limits (like the balanced budget) and as subjects being part of conferences and conventions. Therefore, we can speak of an "European parliamentary system", because of these increasingly tight connections between the European Parliament and national parliaments.

The enhanced cooperations, the structured cooperation in defence matters (especially after the demise of the WEU), the Euro area and the other variations deriving from the "International Treaties" seemed to point towards parliamentary dimensions of variable geometry based on a pivot of the European Parliament.

The "European semester" had been one of the steps (quite 'hidden at first sight) of this "inter-parliamentary cooperation." In fact, it's pretty obvious that the financial plans that Member States share and submit to the Commission in the first half of the year take into account their "parliamentary sustainability" within their respective Chambers of reference: therefore, ultimately, everything will be decided within a "long-distance dialogue" between the parliaments of the Member States (and the European Parliament) as budget authorities.

But now this thread seems to lead to a new perspective. Now we can legitimately ask ourselves if the increasing use, in the new texts, of a parliamentarism by committees should not ultimately result in a real new representative institutional dimension. It would lead to easing of the pressure exerted by the national Chambers and the constitutional courts, as well as to the balancing of the verticalization occurred in the economic governance of the Union.

The objections to a so called "Chamber of the National Parliaments" remain valid, as that would certainly distort and complicate the decision-making process of the Union. There is still distrust towards the ambiguous procedure of subsidiarity scrutiny. It's a sign of the times that in June 2012, for the first time, the threshold of one third of national parliaments was reached to request the Commission to review its project of a directive on the right of

strike. Considering these objections, we can ask ourselves if the new perspective could take a form of some sort of "Assembly of the Conferences."

In short: that would be a flexible organizational structure for the inter-parliamentary cooperation, a sort of "prismatic" Chamber, that would ensure both "regularity" and "effectiveness" (the two requirements of Art. 9 of the Protocol N°1) of the various forms of the inter-parliamentary cooperation. Such model would somehow reflect the variable structure of the Council of the Union).

As already mentioned, the institutionalization of the Conferences in a unique structural framework would not alter their advisory function, as their political role which would certainly be higher than the legal one.

The full inclusion of the inter-parliamentary cooperation in the decision-making process of the Union, would, however, have a curious consequence. The national parliaments, which in the state institutions acting as highest subjects of representative democracy, would instead assume form and functions typical of participatory democracy (see Art.11 TEU) in the European decision making process. This is a further sign of the link between the different forms of the democratic principles of the Union.

5. THE ROLE OF THE EP

The new challenges of European governance have thus not diminished the role of the EP. The inevitable need for verticalization and centralization of the decisions in times of crisis and shortening of the procedures leading to deliberation have surely not eliminated the scrutiny aspects of parliamentary procedures. Those procedures increasingly characterize contemporary parliamentarism and, by linking it to the need for enhanced transparency and justification coming from the electorate, they qualify it as a permanent factor of legitimation.

The right to vote and stand in elections to the EP (recognized by art. 39 of the Charter of Fundamental Rights and by Art.20(2)b of the TFEU), is very interesting in this respect. It is no coincidence that it opens the Charter of Rights which is dedicated to European citizenship - must indeed be considered as a link between the parliamentary democracy and the democracy of rights, the *jus activae civitatis*.

In short, there is indivisibility in the design of the "democratic principles" codified in Title II of the TEU. The representative democracy, on which the work of the Union is based (art. 10 TEU), is inseparable from participatory democracy (such as the Citizens' Initiative: regulated by art.12(4), TEU and art. 24(1), TFEU, and implemented by EU regulation n. 211/2011) and both from a part of the fundamental rights of EU citizens (art. 9, TEU). Article 2 of the Treaty announces us the values ("respect of democracy, respect of equality, respect of human rights") which are found in the normative concept of European citizenship (Art.20-24, TFEU; Art.39-46, Charter of Fundamental Rights) with the same "foundational" function.

This foundational value connects the Art. 2 and Art. 49 of the TEU (EU membership, subject to compliance with the values in Article 2). We can say, then, that the enlargement of the Union corresponds to an extension of the statute of European citizenship to other people.

In other words, the objective foundation of the Union on the value of the rights has an immediate subjective implication: defining the field of European legal citizenship. The citizenship of the Union, which complements but does not replace national citizenship (Art. 9 TEU) constitutes therefore - because of this commonality of values - the link between the constitutional identity of the Union (Art.2 TEU) and the identities of the Member States (Art.4 TEU). On the other hand, the core of European citizenship is the principle of equality

(Art.9 TEU) in all its forms of non-discrimination (art.20-26, Charter of Fundamental Rights).

One of the effective consequences of the effective enjoyment of the rights as EU citizens (Art.19(1) TUE; art. 47, Charter) is the possibility to elect "direct" representatives to the European Parliament (art. 10(2) TUE); the possibility to "participate" in democratic life of the Union (Art.10, Art.11(3) and 11(4) TEU): those are the three pillars of the democratic legitimation of the Union. These concepts are direct translation of the principle of equality that are the essential elements of the "sense of belonging", which is 'the prerequisite of all constitutional communities.

Why is representative democracy a fundamental value (art.10(1)TEU) in this legitimizing (and "constitutionalizing") triad? Why is the European Parliament the linchpin of this representative democracy?

The answer to this question lies in the general character of the representation in the European Parliament, compared to the collective nature of participatory initiatives and to the individual character (public or private) of the protection of rights in the courts. In other words, European citizenship is fully represented in the European Parliament and also enriched by the "active contribution" of the national parliamentarians who participate in the inter-parliamentary cooperation (see art.12(1)f TEU). On the other hand, the EP plays a role both in the process of the participatory democracy expressed by the ECI (with the public hearing provided for in Art. 11, Reg 211/2011) and in the promotion of the rights of the Union (Art. 25 TFEU).

This centrality of the European Parliament does not seem to be challenged by the repeated claims concerning the democratic deficit when compared to common parliamentary standards: both because of its representative system with degressive proportionality and is a result of separate national elections.

As basis of the first objection, the same principle of the respect of "national identities" of the Member States and of their "equality before the Treaties" is decisive. This respect it would be illusory if the Member States' representativity in the European Parliament would not be granted, even at the minimum level. Moreover, common experiences on electoral and comparative law show that the relation between territory and political representation almost always escapes the strict criteria of proportionality based on the population parameter.

On the second objection, the fact that the European Parliament takes its decisions by the majority principle clearly demonstrates that it overcame its original electoral division: in defining the organism, the final decisional melting prevails over the initial diversification that owes to its election on a national basis.

It's obvious that the same principle of variety of national constitutional identities, for now (until the planned uniform procedure is put in full operation, Art.223 TFEU) necessarily leads to an electoral system that does not correspond to a unique and predetermined model. But what is most important is the unification of the active and passive electorate, based on the equality of all citizens of the Union.

If we wanted to find an appropriate definition of the European Parliament, this would be: "political institution of the citizenship". A notion, which obviously is independent from the *demos*, but which, in legal terms and with respect to the latter, has a higher value of legitimacy. A "legitimizing" citizenship represents an a fundamental aspect of multi-level legislation.

Without of parliamentarism of dialogue, of scrutiny and of cooperation between the European Parliament and national parliaments, the current European governance really

would resemble to an intergovernmental alliance that like a steel cage falls on European society, forcing it to find an alternative road, without the breeze and the hopes of constitutionalism.

The opposite approach is translated by the voice of the anti-European populisms that is on increase everywhere and also by all those who - except for the democratic system on paper - do not see its warm-heartedness, its hospitality and the sense of belonging actually needed for a political community.

Since all legitimacy starts from the popular vote, it is clear that we need to focus on it to deal with the European malaise, which the Great Crisis has led to a terminal stage.

With the constitution unchanged, before 2014 the States could develop all the potential yet unexplored deriving from art 223 of the TFEU to achieve an electoral system for a post-national democracy (Report Duff), through the "uniform procedure" or the "common principles" and the creation of a pan-European constituency with a significant number of pan-European MPs. Another way to overcome the present divisions through the European parties would be a presentation, in each national district, of the same national leader who is also candidate for the presidency of the Commission and of the Council. Another option stems from the implementation and intensification of an inter-parliamentary cooperation through the common nomination of the *rapporteur* by the Conference of the "relevant" Committees of the European Parliament and by the national parliaments. Also citizens' initiative should better intersect with the parliamentary functions and enhance the combination of participatory and representative democracy.

Talking about the "political" Union while thinking only of the spill-over effect of the of the reinforcement of the economic and monetary institutions would be repeating a mistake. A new political Europe can only be born by strengthening the citizen's right to vote: the basis and the legitimation of every democratic political community.

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DIRECTORATE GENERAL FOR INTERNAL POLICIES

**POLICY DEPARTMENT C: CITIZENS' RIGHTS AND
CONSTITUTIONAL AFFAIRS**

CONSTITUTIONAL AFFAIRS

New institutional solutions for multi-tier governance?

Gian Luigi Tosato

Abstract

This paper outlines possible amendments to the Treaties aimed at facilitating the operation of flexibility mechanisms within EU law. Considering that differentiation is both a reality and a necessity in the process of European integration and that it would be preferable to keep differentiated initiatives inside rather than outside EU law, it is suggested to (i) introduce flexibility at primary law level, (ii) increase flexibility at secondary law level, (iii) enact an exit clause for flexible initiatives.

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EXECUTIVE SUMMARY

Differentiated integration, being both a reality and a necessity in a Union of 27 members (soon 28), can take place within or outside EU law. The second solution, albeit not per se illegitimate, is not ideal as it can cause multiple difficulties of a normative and institutional character. Thus, there is scope for Treaty changes aimed at facilitating flexibility mechanisms within the EU.

Firstly, it is suggested that the Treaty revision procedure be modified. At present, in the absence of a general consent, MS willing to make (even minor) Treaty amendments, are confronted with the unpalatable alternative of either abandoning the project or to pursue it outside the EU. The proposed change would provide that, within the limited scope of the simplified revision procedure, a Treaty amendment enters into force for the ratifying States when a specific target of ratifications has been achieved (for instance, four-fifths of the MS representing not less than two-thirds of the EU's population). This proposal does not impinge on the basic institutional structure of the Union as it would apply only to the subject matters of art. 48(6) TEU (internal policies and actions). It could be considered as an upgrade of the simplified revision procedure, introducing a form of flexibility (of enhanced cooperation) at primary law level.

Another set of Treaty changes could address the flexibility mechanisms at the secondary law level (enhanced cooperation, the euro area system, constructive abstention).

The onerous conditions, currently applicable to enhanced cooperation, could be relaxed. The blocking power of the Commission (save in the CFSP area) could be removed, at least when a request is submitted by at least nine States (matching the minimum number of art. 20(2) TEU). Likewise, the requirement for a unanimous approval of the Council in the field of CFSP could be replaced by a majority vote, thus eliminating the veto power of each MS. Furthermore, the scope of enhanced cooperation could be extended to the flexibility clause in art. 352 TFEU. It would thus be possible to overcome the barrier posed by the unanimity requirement within the Council. This solution is not precluded by the present wording of the Treaty, but an ad hoc amendment would dispel any legality doubts.

With regard to the Euro area, the specific measures under art. 136 TFEU are presently limited to the budgetary discipline and the coordination of economic policies. The scope of art. 136 could be expanded to cover all aspects relevant to the realisation of a fully-fledged EMU, including the establishment of a central budget for the Euro area, with its own resources and spending procedures. The constructive abstention procedure could also be improved. This procedure is currently applied only in the CFSP area; it could be granted a more general scope, thus providing an extended form of opting-out.

A further proposal aims at enacting an exit clause for flexible initiatives. Currently, several Treaty provisions take care of entry problems, while exit questions are generally overlooked. It is thus suggested that new provisions are inserted in the Treaties regulating such questions. A model could be drawn from the rules governing the permanent structured cooperation (art. 46 TEU). The new provisions, besides offering a general frame of reference, would concurrently resolve the controversial problem of the exit from the Euro.

Admittedly, the proposed Treaty changes require the consent of all MS. However, MS can be less reluctant to accept minor amendments touching upon specific subject matters. Furthermore, even MS generally opposing differentiated integration projects may prefer to keep them within rather than outside EU, to preserve some control that they would otherwise lose.

1. PROPOSED TREATY CHANGES TO INCREASE FLEXIBILITY WITHIN THE EU

It is the purpose of this paper to suggest possible amendments to the existing Treaties aimed at facilitating the development of differentiated (under its various names: flexible, multi-tier, multi-speed, variable geometry) integration within the EU legal order. These suggestions are based on two logical premises: the first being that differentiation is both a reality and a necessity; the second, that it would be preferable for differentiated integration initiatives to take place inside rather than outside of EU law.

Throughout its history, European integration has been characterized by differentiation. Schengen, Euro, Pruem are typical references in this respect. More recently, in connection with the euro crisis, there has been a proliferation of multi-tier developments; an intensification of this trend is to be expected in the near future if a "genuine" economic and monetary union is going to be implemented (as suggested in the Four Presidents' Report of June 2012). In a Union of 27 members (soon to become 28), it appears increasingly difficult to advance the integration process with the participation and consent of all Member States. In view of their cultural, social, economic and political diversities, the one-rule-fits-all principle is ill-suited in several instances. Of course, uniformity would be preferable; but, contrary to widespread fears, differentiated solutions have not proved thus far to undermine the functioning of the Union. To the contrary, new integration avenues, initially pioneered by a limited "avant-garde" group, have subsequently been absorbed within the common "acquis" of the Union.

Differentiated integration can take place within or outside of the EU legal framework. The first route has been followed in the case of the (so called) Six Pack and Two Pack, the EFSM, the amendment to art. 136 TFEU, the Commission's proposal concerning a Single Supervisory Authority for the banking sector. All these acts are based on mechanisms provided by the Treaties. The second alternative is exemplified by the Fiscal Compact and the ESM treaties, which have been concluded by some (not all) Member States in their capacity as subjects of international law. Such "external" solutions (generally prompted by the lack of unanimity blocking the EU normal procedures) are not *per se* illegitimate, provided that they do not conflict with EU law. Nevertheless, the existence of parallel systems outside the Union can be the source of multiple drawbacks in terms of functionality and transparency, threatening the coherence of EU law and its institutional framework. These risks could be avoided (or, at least, substantially reduced) if differentiated projects were pursued within the Union.

The two premises illustrated above lead to a logical inference. If differentiation is necessary to further the integration of Europe and if differentiated integration is best pursued within the EU legal order, it is worth considering how to remove obstacles that hinder the attainment of this objective. Thus, it is suggested that existing mechanisms in EU law could be revised with a view to (i) introduce flexibility at primary law level, (ii) increase flexibility at secondary law level and (iii) enact exit clauses for flexible initiatives.

2. INTRODUCING FLEXIBILITY AT PRIMARY LAW LEVEL

At present, Treaty amendments are subject to a strict unanimity rule. This rule dates back to the founding treaties and was left unaltered by the Lisbon Treaty. Art. 48 provides for a simplified revision procedure alongside the ordinary one, but it does not depart from this onerous requirement calling for a unanimous decision of the European Council and the

ratification by all Member States in accordance with their internal constitutional procedures. The rigidity of this mechanism might have been justified at the dawn of the European integration, when the Communities encompassed only the six founding States. At present, however, it is certainly untenable, as Treaty changes have to accommodate the heterogeneous aims of a group of 27 sovereign entities. Any revision can be easily blocked by the veto power vested in each Member State.

Forceful attempts to overcome this problem have been made in the past by the draft Treaty adopted by the EP in 1984 (the "Spinelli draft"), as well as by the draft Constitution prepared by the Commission's services and submitted to the European Convention at the end of 2002 (the "Penelope text").

The Spinelli draft (art. 82) provided that, once the proposed Treaty had been ratified by a majority of the Member States representing two-thirds of the total population of the Communities, "the governments of the Member States which have ratified shall meet at once to decide by common accord on the procedures by and the due date on which this Treaty should enter into force". It is not entirely clear whether the envisaged entering into force of the Treaty would have applied only to the ratifying States or also to the non-ratifying States. Although the wording of the provision is not unambiguous, the first interpretation appears to be prevalent. The Penelope text laid down a more elaborated solution. The proposed Constitution was accompanied by a separate Agreement, which provided that the Constitution would enter into force for the ratifying States while the States refusing to do it had to leave the Union. Crucially, the separate Agreement was to become effective and binding for all Member States once ratified by a majority of five-sixths.

As is well known, both projects were ultimately unsuccessful. The Spinelli draft was rapidly cast aside, while the Commission's suggestions were not included in the final text of Constitution adopted by the European Convention. As to the Lisbon Treaty, a remote trace of the two proposals may be found in art. 48 (5) TEU. Pursuant to this clause, if four-fifths of the Member States have ratified a Treaty amendment within two years from its signature, the matter shall be referred to the European Council. The clause (incidentally applying only to the ordinary revision procedure) does not specify the powers held by the European Council in this case. It is certain, however, that it cannot decide the entry into force of the amendment for the ratifying States or, *a fortiori*, for all Member States including those whose ratification is still missing. As already indicated, the unanimous consent requirement remains firm in the Lisbon framework.

Against this background, is any change to the present legal framework unrealistic? Perhaps, there is room for a minor improvement, provided it takes place within well-defined boundaries.

What is suggested here is to modify the simplified revision procedure under art. 48 n. 6 TEU establishing that a Treaty amendment within the scope of this clause (i.e. limited to internal policies and actions of the Union) enters into force for the ratifying States when a specific target number of ratifications has been achieved: for instance, four-fifths of the Member States representing not less than two-thirds of the population of the Union. This change would amount to introducing a form of "enhanced cooperation" at primary law (Treaty) level. As in the case of the ordinary "enhanced cooperation" procedure, the Treaty amendment would only apply to the participating States, yet allowing them to make use of the institutions and mechanisms laid down in the Treaties without prior approval by non-participating States.

The above proposal, albeit deviating from the unanimity requirement for Treaty changes, does not impinge on the basic principles and institutional structure of the Union in that it

applies only to the subject matters set out in art. 48 n.6. This constitutional change would be a natural development of the distinction between ordinary and simplified revision procedure and could be considered as an upgrade of the latter.

Although limited in scope, the proposed revision would significantly improve the existing framework. At present, in the absence of a general consent, Member States willing to make Treaty amendments, even of relatively minor importance, are confronted with the unpalatable alternative of either abandoning the project or pursuing it outside the EU legal order. The latter path was recently followed in the case of the Fiscal Compact and the ESM Treaty; but, as already stressed, this is not an ideal solution because of the complications linked to the presence of parallel autonomous systems. The suggested change would allow to bring similar cases of differentiated integration within EU law.

The introduction of a flexibility mechanism at primary law level would not constitute an absolute novelty within the Union. It already exists in connection with the various opt-out/in solutions, the most relevant example of which is represented by the Eurogroup. The two cases, though, are not entirely homogeneous. The opt-out/in mechanisms imply the agreement of all Member States to a development at Treaty level which applies only to some of them; by contrast, the flexibility proposed here does not require the prior consent of the States not taking part in the new initiative.

3. INCREASING FLEXIBILITY AT SECONDARY LAW LEVEL

Another set of proposed Treaty changes concern the existing flexibility devices at the secondary law level with the aim to improve their scope and functionality. Reference is made in this regard to the enhanced cooperation procedure (articles 20 TEU and 326-334 TFEU), the power to adopt specific measures for the Eurogroup (art. 136 TFEU) and the constructive abstention mechanism which currently applies only to the CFSP area (art. 31 n. 1 TEU). These devices could play an important role in furthering differentiated integration projects to take place inside rather than outside the Union; and yet, thus far, they have been exploited only to a very limited extent. Therefore, it is worth considering whether their utilization could be facilitated by a targeted reform of the relevant Treaty clauses. Such reform would match the intention expressed by the States parties to the Fiscal Compact to make active use of the enhanced cooperation procedure and the special legislative power available within the euro area (see the preamble and art. 10 of the Fiscal Compact).

At present, the enhanced cooperation device is subject to a very stringent regime. The onerous procedural and substantive conditions laid down in the Treaties renders somewhat inflexible what was meant to be a flexibility instrument of a general application. A contradiction which was highlighted by commentators since the introduction of the enhanced cooperation scheme in the Union framework by the Amsterdam Treaty (see G. Gaja, CML Rev. 1998, 855 ff.). Unsurprisingly, this legal tool has been completely neglected for more than a decade and has been subsequently employed only in two instances (transnational divorce and the nascent EU patent). It is thus quite appropriate to consider how to relax the existing restrictions in order to allow the enhanced cooperation to fulfill its designated function.

First, the veto power attributed to the Commission should be reconsidered. At present, the interested States may request the Commission to issue a proposal, but the Commission is under no obligation to proceed. Thus, the commencement of the procedure (save in the CFSP area) is left to its discretionary evaluation. If the Commission decides not to fulfill a request, it is merely obliged to give reasons for its negative decision. The blocking power so

vested in the Commission could be removed, at least when a request is submitted by a certain number of States (possibly nine, matching the minimum number required for the admissibility of an enhanced cooperation project). A comparable innovation could also be extended to the field of the CFSP. In this particular ambit, the Commission is only asked to provide an opinion, but the project must be approved by a unanimous decision of the Council. The unanimity requirement may constitute a hardly surmountable barrier; it could be replaced by a qualified majority vote, thus eliminating the veto power currently held by each Member State.

A second element worthy of reconsideration is the relationships between the enhanced cooperation procedure and the flexibility clause in art. 352 TFEU. These two mechanisms would be mutually fortified if applied in combination. Recourse to the residual competence under art. 352 TFEU is subject to a unanimous decision of the Council. This requirement appears extremely problematic, as the exercise of powers not explicitly conferred by the Treaties is likely to face the opposition of one or more Member States. The problem could be overcome by implementing art. 352 TFEU measures by means of an enhanced cooperation initiative. The proposed interaction between the two mechanisms is not precluded by the wording of the relevant Treaty provisions, so that it could possibly be implemented without the need of Treaty changes. Nevertheless an *ad-hoc* amendment would clear the ground from any legality doubts.

Let us turn now to the special legislative power provided by art. 136 TFEU to ensure the proper functioning of the EMU. The specific measures which can be adopted under this clause are presently limited to the budgetary discipline for the Euro Area States and the coordination of their national economic policies. The normative scope of art. 136 TFEU could be expanded to cover all aspects relevant to the realisation of a fully-fledged EMU. Once amended, art 136 TFEU would provide the legal basis for implementing in full the building blocks outlined in the already mentioned "Four Presidents' Report". Amongst other things, it would allow for the establishment of a central budget for the Euro area, endowed with its own resources and spending procedures.

A development of this kind would be of great importance. The survival of the EMU requires a degree of solidarity between Euro Area States. At present, this is achieved through the EFSF/ESM funds. Unfortunately, as the resources for these funds flow directly from national treasuries, any financial assistance provided by these special mechanisms is perceived by the public opinion as an improper transfer of money from one State to another. The creation of a fiscal capacity for the EMU should hopefully dispel such negative perception. Solidarity initiatives in support of Euro Area States in financial difficulties would consist of EMU resources, originating from European taxes or some form of collective debt issuance. A detailed analysis of the various implications of this reform is beyond the scope of the present work. Suffice it to say that its implementation would be extremely difficult on the basis of the existing EU framework. It would certainly exceed the present scope of art. 136 TFEU and it is doubtful that it could be implemented through the combined operation of articles 136 and 352 TFEU. Hence the need for a Treaty change, which could be effected by expanding the amendment to art. 136 TFEU recently adopted to provide a legal basis for the creation of the ESM fund.

An improvement to the flexibility devices at the secondary law level could also cover the constructive abstention procedure. As previously mentioned, this procedure is currently applied only in the CFSP area; it could be granted a more general scope, thus providing an extended form of opting-out. Pursuant to the constructive abstention regime a State is exempted from applying specific CFSP measures but does not bar their adoption and their becoming binding for the other Member States. This procedure could offer a useful complement to the enhanced cooperation and, perhaps, result in a simplified manner to

achieve the same objectives. However, the structural differences between the two procedures should not be overlooked: the first requires a cooperative attitude of the dissenting State, while the second can be implemented (save in the CFSP area) even in the absence of said attitude.

4. ENACTING AN EXIT CLAUSE FOR FLEXIBLE INITIATIVES

Flexibility devices at primary or secondary law level give rise to both “entry” and “exit” problems. The former are duly regulated by the Treaties. There are several provisions ensuring that Member States wishing to join a new or an existing flexible initiative are welcome to do so at any time, provided that they satisfy all the relevant conditions (see articles 20 TEU and 328 TFEU, with regard to the enhanced cooperation; art. 140 TFEU, with regard to the monetary union; art. 46 TEU, with regard to the permanent structured cooperation). Besides, any discriminatory treatment would infringe a fundamental principle of EU law (art. 2 TEU). By contrast, provisions addressing “exit” problems are generally missing, with the exception of those relating to the permanent structured cooperation in the defense area.

The implications of this lacuna are currently debated with particular regard to the monetary union. The Lisbon Treaty, whilst providing for the withdrawal from the EU, contains no provision for the exit from the euro. Does this imply that an exit from the euro may not be effected separately? That it is only possible to leave the Union in its entirety? Whatever the preferred solution (the commentators are divided on this issue), the silence of the Treaties gives rise to considerable difficulties. Notably, the recent decision of the German Constitutional Court on the ESM/Fiscal Compact deals with a somewhat analogous problem. The German Court observes that the termination of the Fiscal Compact by one of the Contracting States, although not provided in the treaty itself, is always possible under customary international law: by mutual agreement or, even, unilaterally in the event of a fundamental change of the relevant circumstances (BVerG, Judgement of 12 September 2012, par 318 f.).

It is suggested here that new provisions be inserted in the Treaties to regulate the “exit” problems outlined above. The proposed amendment would offer a general framework of reference for any flexible initiatives and concurrently resolve the delicate and controversial matter presently discussed in connection with the monetary union. A model for the new provisions could be drawn from the rules laid down by art. 46 TEU for the permanent structured cooperation. Art. 46 TEU, analogously to art. 50 TEU regulating the withdrawal from the EU, establishes that any participating State may unilaterally decide to leave the permanent structured cooperation; however, in addition this clause also provides that the participation of any Member State may be suspended if it does no longer fulfill the relevant criteria and commitments. A similar scheme, with appropriate adaptations taking into account the varieties of flexible initiatives, could be applied on a more general basis to achieve the pursued objective.

5. CONCLUDING REMARKS

The proposals delineated in the preceding paragraphs aim to strengthen the flexibility mechanisms within EU law to avoid differentiated integration initiatives being realised outside of the EU legal framework. However, the suggested reforms can be questioned from the point of view of their necessity and feasibility. It may be held that the Treaties are

already equipped with a suitable set of flexibility devices, which need to be properly implemented rather than revised. Moreover, any Treaty change requires the agreement of all Member States, including those who generally oppose differentiation within the Union. Hence it may be considered unrealistic to assume their consent to the enhancement of the flexibility mechanisms already provided in EU law.

I fully support the idea that the existing flexibility mechanisms should be exploited to the maximum possible extent, which has not been always the case. But their use cannot be stretched beyond certain limits, as evidenced by the fact that from time to time differentiated integration initiatives are carried out outside of EU law. Thus, the proposed Treaty amendments appear desirable if not necessary. As to the second objection, it is certainly so that any Treaty revision poses special difficulties. However, I wonder whether a distinction is to be made between revisions having an impact on the general institutional structure of the Union and minor, well targeted amendments touching upon specific subject matters. The reluctance of the States to embark upon a new revision process, after the collapse of the Constitutional Treaty and the laborious accomplishment of the Lisbon Treaty, probably applies to the first category of revisions not to amendments of the second type. The validity of this assumption seems to be confirmed by the swift approval of the recent amendment to art. 136 TFEU (providing a legal basis for the creation of the ESM fund).

Furthermore, it is not necessarily true that any improvements to the flexibility mechanisms of EU law will meet the opposition of those Member States which are generally against promoting a closer integration of Europe. These States may prevent a Treaty change because of the veto power currently granted to them. But they are not in a position to block differentiated initiatives from taking place outside of the EU, as recently exemplified by the Fiscal Compact and the ESM Treaty. Thus, keeping new developments within the EU could prove advantageous to both participating and non-participating States. The former would be entitled to make use of the institutions and procedures of EU law; the latter would be able to exert a control that they would otherwise lose if new projects were to be realised outside of the Union framework.



DIRECTORATE GENERAL FOR INTERNAL POLICIES

**POLICY DEPARTMENT C: CITIZENS' RIGHTS AND
CONSTITUTIONAL AFFAIRS**

CONSTITUTIONAL AFFAIRS

EU Differentiated Integration and the Role of the EU Political Economy

Vivien A. Schmidt

Abstract

This note argues that multi-tier governance is complicated by the multiple speeds and variable boundaries of the EU's many 'policy communities' as well as by the varieties of its member-states' political economies, all of which have been exacerbated by the eurozone crisis. The report discusses how to improve the modalities of multi-tier governance while providing new tools for governing the European political economy. It contends that multi-tier governance in the EU 'region-state' needs to go beyond the uniformity and unanimity rule while rebalancing its institutions at the same time that it needs to find new sources and ways to finance economic solidarity and promote social solidarity.

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LIST OF ABBREVIATIONS

- CAP** Common Agricultural Policy
- ECB** European Central Bank
- ESM** European Stability Mechanism
- EP** European Parliament
- GDP** Gross Domestic Product
- IMF** International Monetary Fund
- CSDP** Common Security and Defense Policy
- EMF** European Monetary Fund
- EP** European Parliament
- CEECs** Central and Eastern European Countries

EXECUTIVE SUMMARY

Background

As a result of the eurozone crisis, the EU's highly complicated multi-tier governance is likely only to become more complicated in forms, types, and levels of governance. That crisis is also pushing the EU into deeper monetary, economic, and political integration. This presents major challenges not just for the EU's political and economic governance but also for democracy and legitimacy. In order to consider how to respond to these challenges, the report begins with a consideration of what the EU is. It then discusses various reforms of the EU's institutional rules and relationships as well as some ideas about how to increase democratic legitimacy. It ends with proposals for how to improve the EU political economy through measures promoting economic as well as social solidarity. The conclusion returns to questions of legitimacy.

Aim

The EU's multi-tier governance needs to be understood for what it is in order even to consider how to remedy its problems. The report therefore begins with a discussion of the EU as a multi-speed, variable boundary union in which membership is already highly differentiated. Rather than seeing the EU's future in terms of a super-state, two-speeds, or *à la carte*, the report calls this a 'region-state,' as a regional union with a 'soft core' of member-states in overlapping policy communities. For such a polity to function appropriately, the report argues that the EU needs to replace the unanimity rule by supermajorities with opt-outs and allow prospective EU members, neighbors, and European non-members voice if not also vote in the communities in which they participate.

A rebalancing of EU institutions is also needed to remedy excessive intergovernmentalism and technocracy arising from eurozone crisis management. The report notes that this has sidelined the EP in many areas and straight-jacketed the Commission. The question is how, then, should the EU democratize so as to legitimize? Not via election of a Council President, which is premature; rather, through election of the Commission President—and possibly even the Commissioners—via EP elections in 2014 with election campaigns across the member-states to spur political debate. The added benefit would be an increase in the democratic legitimacy of the Commission, which could thereby exercise greater flexibility in implementation while reorienting EU policies in conformity with the EP electoral majority. That said, politicization is no panacea, in particular if the eurozone crisis continues.

The challenges for the EU also arise from the need to find ways to 'govern' the EU political economy in the midst of the eurozone crisis that take into account the fact that European member-states have such different varieties of capitalism and welfare states. Solutions for the North do not necessarily work in the South or the East of Europe, especially to restart growth or produce competitiveness. This requires doing everything possible in terms of economic solidarity (e.g., Eurobonds, EMF, banking union). The EU also needs to accept that one-size-fits-all austerity solutions do not work. Deficit reduction is too fast and what counts toward the budget deficit too all-encompassing (e.g., why not exempt growth enhancing economic and social investment?). And where are the carrots instead of just sticks to encourage structural reforms? Or why has the Troika not mandated governments

under its supervision to ensure that budget cutting not interfere with the EU's own goals for 'Social Europe'?

To move forward, the report suggests that the EU consider deeper integration in its multi-varied capitalism by creating new 'enhanced cooperation' zones, e.g., 'labor mobility zones,' 'public services zones,' or even 'immigration zones.' It also proposes to redeploy the structural funds, transform the CAP, and introduce automatic stabilizers such as unemployment insurance. It additionally recommends new revenue streams derived from the EU's value added, such as a financial transaction tax, a cross-border transaction tax, and even solidarity tax.

The report concludes with a discussion of how to think about legitimacy in terms of more effective 'output' policies, increased 'input' participation, and more balanced 'throughput' governance processes.

1. MULTI-TIER GOVERNANCE IN AN INCREASINGLY DIFFERENTIATED POLITY

The EU is a multi-speed, variable boundary union in which membership is already highly differentiated in the EU's many 'policy communities,' such as the eurozone, Schengen, CSDP, and so forth. Even the Single Market, which can be seen as the 'community of communities' to which all members of the EU belong, is likely to become increasingly differentiated internally once the use of 'enhanced cooperation' expands, as it must if the EU is to continue deepening integration. Moreover, once the eurozone moves forward with a banking union, not to mention some form of mutualized debt along with other initiatives, the EU's variability will become even greater. Differentiation between eurozone countries and the rest will only increase the EU's variable geometry. Set this against a background of already highly differentiated national varieties of capitalism, growing disparities between North and South, with some countries additionally subject to Troika (IMF, EU commission, ECB) oversight, and it should be obvious that multi-tier governance of the EU political economy is no simple matter.

1.1. Beyond Uniformity and Unanimity

In this complicated set-up, what is clear is that the uniformity ideal of the past, when member-states thought to move forward in lockstep, has long been dead, buried first with the Maastricht Treaty and opt-outs for the UK and Denmark, and then over and over again with opt-outs in subsequent treaties. The federal super-state exists only in the minds of the most extremist (and blind) of the Euro-skeptics. The EU needs to accept a current and future reality of highly differentiated integration. So what is the EU becoming? A 'two-speed' Europe? A 'hard core' and a 'periphery'? Or is the EU condemned to Europe *à la carte*?

All of these possibilities fail to deal with the fact that the EU already has a 'soft core' of members who remain part of all the policy communities of the EU. This overlapping membership in communities ensures that differentiated Europe is not centrifugal Europe.

The EU as Region-State:

- Rather, it makes the EU what I have called a 'region-state', a regional union of member-states with differentiated membership in many overlapping policy

communities.¹³³ Barroso may prefer to call it a 'federation of nation-states,' as Jacques Delors and many others before him, but what's in a name? Region-state at least enables us to avoid the politically charged 'f' word.

- But what is important is the conceptualization of the EU as a form of polity that requires a very special kind of governance, one that allows for increasing differentiation even as it ensures further integration.

A number of reforms of the EU's multi-tier governance would be required for the EU to be able to move forward more rapidly in its differentiated integration. Most generally, the decision rules would need to change.

End the Unanimity Rule:

- First out would be the unanimity rule, in which any single country's veto can block agreements, or at the very least force the EU to delay, dilute, or abandon initiatives to which a large majority feels is committed.
- Ironically, UK Prime Minister Cameron's veto in December 2011 of the 'Fiscal Compact' may very well have inadvertently put an end to this rule, since twenty-five member-states went forward outside the treaties with that same agreement.

Supermajorities plus opt-outs:

- In place of the unanimity rule should be supermajorities made up of fourth-fifths or more of members plus opt-outs.
- Notably, this is not the same as qualified majority voting, since sovereignty may be at issue and the policy cannot be imposed on the dissenting member-state(s).
- Rather, the opposed member-state(s) would be given the option to withdraw from the discussions and opt-out of the initiative—assuming, of course, that the opt-out did not deleteriously affect the proper implementation of the initiative. Where it did, ways would need to be found to accommodate the member-state while ensuring the proper operation of the directive.

The Convention Method for Treaty Reform:

- When it came to any major Treaty-based reforms, moreover, the EU could adopt the approach of the Constitutional Convention of the mid 2000s, by mandating wide-spread citizen consultations in all member-states first, followed by a Convention to work out the final recommendations, which would then be considered for adoption by the Council and the European Parliament. The rule of supermajorities plus opt-out would then apply.
- This approach would have the benefit of avoiding the uncertain results of one-off referenda, in which one or two 'no' votes had in the past thwarted a positive majority, without thereby denying citizens *qua* citizens a voice in EU treaty-making.

Voice and Vote for Partial EU Members or European Non-Members:

- Additionally, in this highly differentiated 'Europe of communities,' candidate and prospective members (e.g., the Balkans, Turkey), European non-members who participate in the Single Market and other policy communities (e.g., Norway and Switzerland), or even members who may drop out in the future (e.g., the UK) should be assured a place at the table in those EU

¹³³ Vivien A. Schmidt *Democracy in Europe* (Oxford: Oxford University Press, 2006)—translated and updated as *La Démocratie en Europe* (Paris: La Découverte, 2010). See also: Vivien A. Schmidt, "The European Union: Democratic Legitimacy in a Regional State?" *Journal of Common Market Studies* vol. 42, no. 4 (2004): 975-999

'communities' of which they are members, with the right to speak and even vote in the particular policy sector in question.

- This would ensure that the agreement of new standards and rules would not be imposed on these non or not-as-yet members, but would be democratically legitimated through their voice and vote in those communities of which they are a part.
- It would also guarantee the continuing power of attraction of the EU, since the 'in' or 'out' of membership would no longer be as politically important an issue for those inside or outside.

1.2. Can the EU Politicize so as to Legitimize its Institutions?

In addition to changing the voting rules, the current imbalance among institutions of EU governance needs to be righted. eurozone crisis management has led to an excess of intergovernmental decision-making paired with rising technocracy. Both the European Parliament and the Commission have been affected.

Although 'Merkozy,' in which the Franco-German couple seemed to be making all the decisions—or was it just Germany—is now over, the sidelining of the European Parliament on major decisions remains. EP engagement in all aspects of policymaking is fruitful not only to improve policy, by providing additional ideas and perspectives, but also to provide further legitimation for such policy.

The Importance of Political Debate:

- Without political debates that clarify the issues, making the case for or against, policies cannot be fully legitimated in the eyes of the citizens.
- The lack of EU level debate on the eurozone crisis, related to the increasing intergovernmentalism in decision-making, has been a serious problem for legitimacy.

The Drawbacks of Intergovernmental Bargaining:

- Member-state leaders might not find this argument persuasive because they see themselves as the most democratic of representatives, since they are directly elected by and speak for their citizens.
- But what they fail to recognize is that leaving the bulk of decision-making to the intergovernmental bargaining of the European Council and EU Summits—however crucial this may be in the heat of the crisis—is actually the least democratic of processes.
- Intergovernmentalism on its own gives those leaders with the greatest bargaining power because from the most economically powerful countries an undemocratic advantage in the closed door negotiating sessions of the Council.

So how can the balance of EU democratic legitimacy be redressed? And how would more democracy be institutionalized? Through an elected European President—of the Council or the Commission? By shifting the balance toward the European Parliament? By allowing more discretion to a re-empowered Commission?

The Dangers of Council President Election by Universal Suffrage:

- The election of the Council President via universal suffrage, as German Finance Minister Wolfgang Schäuble suggested in May 2012¹³⁴ and the CDU proposed in its Leipzig Conference in November 2011, would certainly appear to confer the greatest legitimacy on the Council while bringing the EU closer to the people. But it is premature.
- The danger in the short term is that in the absence of a mature European citizenry with a common sense of identity as a '*demos*', the election becomes a plebiscite, with the winning candidate the one with the greatest name recognition—a pop star, a football hero—who would win over less colorful but more competent and seasoned politicians.¹³⁵
- Moreover, without any thought to the powers the Council President would exercise, having the legitimacy of popular election would either give that person too little power, assuming the job remains as it is currently constituted, as organizer of meetings and broker of compromise among the EU-27 leaders, or too much power—at least in the view of some member-state leaders.
- And however the power game would work out within the Council, it would consecrate the 'European Union Method' (as Merkel called intergovernmentalism in her speech in Bruges in November 2010), thereby further eclipsing the 'Community Method' of joint decision between the Council, Parliament, and Commission.

The Benefits of Commission President Selection via EP Elections:

- In contrast, the selection of the Commission President via European Parliamentary elections—the preference of major EP party groupings for the EP 2014 elections—might work to the advantage of all institutions.¹³⁶ In particular, it would be likely to reinforce the EP's legitimacy as well as that of the Commission President.
- Having presidential candidates campaign across the member-states would certainly spur interest, as would national party lists that could present their national candidate for Commissioner.
- It would also help build up European political parties.
- And all of this would in turn serve not only as a way of galvanizing citizen interest (long in short supply) in the only directly elected body of the EU, with greater citizen participation reinforcing EP legitimacy.
- It would also ensure that the elections themselves would help bring real (left/right) political debate back into the EU policymaking process, thereby helping gradually to politicize the EU.¹³⁷ Equally importantly, it would serve as a first step to ensuring that the Commission gained a kind of democratic legitimacy of its own as initiator and implementer of EU legislation.

This said, we should note that democratizing the EU via EP elections is no panacea, especially if the eurozone crisis continues or worsens. The EP elections of the Commission

¹³⁴ Evoked in his Charlemagne prize speech in May 2012. See also: David Marquand, *The End of the West: The Once and Future Europe* Princeton and Oxford: Princeton University Press, 2011, p. 137

¹³⁵ In a recent essay that suggests alternative scenarios for the future of the EU in 2020, I farcically suggested that in a future *dystopiEU* the winning candidate would be David Beckham. See Vivien A. Schmidt, "Can the EU Bicycle turn into a Jet Plane by 2020? Two Pathways for Europe" *German Marshall Fund EuroFuture Series* (forthcoming Sept. 2012).

¹³⁶ It was originally proposed by conservative party leaders for the 2009 elections, and taken up more recently also by Social Democratic party leaders.

¹³⁷ For a persuasive argument for why the EU should be politicized along similar lines, see: Simon Hix *What's Wrong with the European Union and How to Fix It* Cambridge: Polity Press, 2008.

President could themselves become a losing gamble were they to remain what they have long been, second-order affairs of little interest to citizens, and if the candidates do not invent better narratives with fuller visions of what the EU is and where it is going. The gamble would be lost entirely, however, were the only interest to come from the political extremes, leaving the EP with a thinning center hemmed in by extremists of the right and left. Under these circumstances, such elections would politicize only to delegitimize the Commission and the EP. But this does not mean that reforms should not be attempted, since they are needed not just for the EP but for the Commission as well.

The problem for the Commission today is that Council crisis-decisions have straightjacketed the Commission with regard to eurozone governance. Although the Commission has increased its responsibilities as a result of the crisis management duties conferred on it by intergovernmental decisions of the Council, it has lost administrative discretion, given how narrowly the Council has defined the rules it is to apply. As a result, it is largely forced to impose one-size-fits-all numerical targets and automatic rules to the eurozone.

The Benefits of Representative Legitimacy for the Commission:

- With greater representative legitimacy, the Commission would be able to legitimately exercise more flexibility when implementing Council policies, and to engage in real 'economic governance' by tailoring policies better to the differing economic growth models of the member-states.
- Moreover, by tying the Commission more directly to the EP through its election, it would become more accountable to the EP politically, and thereby expected to reorient EU policies in conformity with the EP electoral majority (as any national government does). This would give it the legitimacy to introduce some political orientation to its implementation of the 'European Semester,' whether in a more progressive or conservative direction.
- Although some might worry about the politicization of the Commission, they fail to recognize that in the eyes of the citizens, it is already politicized (with the choice of Barroso as Commission President). At least this would clarify such politics at the EU level, rather than leaving it to the mercy—and calendar—of national elections.

The lack of politicization also has its costs. Fiscal compacts are no way to rule the EU, whether the Stability and Growth Pact, the 'Six pack,' the 'Fiscal Compact.' If this continues, I can imagine future agreements with names like the 'Pact for Stable Growth,' the 'Super Pact for Sustainable Stability,' and the 'Super Growth and Sustainable Stability Pact,' all more and more explicit about the numerical targets, the fines, and the sanctions for the increasing number of member-states now subject to excessive budget procedures and under the surveillance of the Troika (IMF, ECB, EU Commission).

Where technocratic automaticity is the rule, the EU Commission will come to be despised as the hard-nosed implementer of impossible rules that only bring greater misery to an increasingly impoverished EU citizenry.

2. MULTI-TIER GOVERNANCE IN AN INCREASINGLY DIFFERENTIATED POLITICAL ECONOMY

Beyond the changes in decision rules and the improvement of legitimacy are other questions related to the substance of the governance of the political economy of the EU. And here, the most significant question is how to promote deeper integration that respects the diversity of EU member-states' political economies—and helps them all to grow.

2.1. Solving the eurozone Crisis

I leave aside particular recommendations for how to remedy the problems of the eurozone, other than to suggest that everything possible needs to be done with regard to forms of 'economic solidarity.' This means not just the ECB as lender of last resort but Eurobonds, an EMF (European Monetary Fund), a banking union, and more. All of this represents a challenge for multi-tier governance in terms of how this would work between the eurozone members and the rest. For the moment, the mechanics of this is either in the midst of discussion or remains matters of speculation. Instead of going into these, therefore, I focus instead on how European multi-tier governance has been working today with regard to EU political economy and what could be done in the future to make it work better.

2.2. Taking Account of the EU's Many Varieties of Political Economy

The challenge for multi-tier governance today, in light of attempts to ramp up EU wide fiscal consolidation, is finding ways to 'govern' the EU that takes into account the fact that European member-states have such different varieties of capitalism, with different growth models, financial market profiles, production systems, labor markets and wage-bargaining systems, pension and health care arrangements, systems of taxation, and so on. Applying one-size-fits-all solutions here too cannot possibly work. The polemic on deficit versus surplus countries does not need any further elaboration here. But austerity programs that demand rapid deficit reduction along with structural reforms do.

Different Political Economies Require Different Remedies:

- Solutions for the North do not necessarily work in the South because even macroeconomic policy does not have the same effects given the different ways in which business and labor are organized and interact.
- Northern 'coordinated market economies' with corporatism can flourish under 'ordo-liberal' conservative macroeconomic policies because their corporatist labor-management relationship can coordinate wages accordingly—based on relationships of trust, cooperation, and hard bargaining.
- This is not the same in Southern 'state-influenced' market economies because they are often missing the deep corporatist coordination and trust that makes it possible for the wage market to respond appropriately. But even if it could, the Troika-imposed or 'voluntary' fiscal contraction policies in these countries plus Ireland are contractionary, while internal wage

devaluation in the place of currency evaluation spells major problems for the long term, politically as well as economically.¹³⁸

- For the Central and East European 'dependent market economies,' such problems are compounded by the fact that they are largely dependent on foreign direct investment for any kind of growth.
- For Continental countries in North and South alike, moreover, dualized labor markets mean that across-the-board austerity only increases the risks of unemployment and poverty for the already marginalized poor and jobless. F
- Finally, thinking that all countries can achieve Northern levels of export-oriented growth if they just stick to the German 'Culture of Stability' spells a 'Culture of Decline' for much of Southern Europe and, arguably, some CEECs.

The plans for the European Semester suggest that the Commission will pay attention to countries' differences. But the rules to be applied, which are based on the numbers set out in the Stability and Growth Pact and refined in subsequent agreements, do not allow for much flexibility. There may be ways around this, however.

The Need for Flexibility in Applying the Rules: If there were to be flexibility in what counts toward the budget deficit, in how fast it is to be reduced, or which part of the accumulated debt is to be addressed, then the 'fill-in-the numbers' approach might still work. If the EU Commission had the legitimacy of EP elections and an EP majority behind it, it would notionally be able to discount the deficit in the following ways.

Deductibility of Economic Investment: For example, why not leave off the balance sheets growth-enhancing investments in infrastructure projects, education, training, research and development?

Deductibility of Social Investment: Why not make any efforts toward improving skills and human capital deductible as part of the 'social investment' initiative of the EU that seeks to promote growth in knowledge-based economies?¹³⁹

Carrots and not just Sticks: Beyond this, why not give the EU Commission carrots as well as sticks to encourage structural reforms, say, to provide project financing and poverty relief in exchange, or even just to ensure that budget cutting for countries under 'Troika' orders not interfere with the EU's own goals for 'Social Europe.'

3. IMPROVING EU POLITICAL ECONOMIC MULTI-TIER GOVERNANCE

Our discussion so far has addressed only the eurozone crisis. What of deeper economic integration, which has gotten lost in the crisis? For this, we need to consider using enhanced cooperation effectively as a tool for progress in continued, albeit differentiated, political economic integration. And the EU also requires new initiative to restart the EU economy, including new ideas to move forward along with new revenue streams for the EU level.

¹³⁸ See, e.g., Klaus Armingeon and Lucio Baccaro, (2012) "The Political Economy of the Sovereign Debt Crisis: The Limits of Internal Devaluation," *Industrial Law Journal* 41/3: 254-275.

¹³⁹ Claudio de Vincenti, ed. (2011) *Fair, Robust, and Sustainable: A Recipe for Europe's Growth* Rome: ItalianiEuropei/FEPS. <http://www.feps-europe.eu/en/publications-books>

3.1. Using Enhanced Cooperation Effectively

For deeper integration in this multi-varied capitalism, the principle of 'enhanced cooperation' as revised in the Lisbon Treaty could prove immensely helpful in those areas such as labor markets, social services, and individual cross-border citizen concerns where the Single Market has hit the limits of integration. So far, enhanced cooperation has been used in only one instance, for divorce of cross-border couples. This fails to deal with the potential of enhanced cooperation, and reflects the still strong assumption that uniformity is necessary as a guide to further integration. What is needed instead is a recognition that only with greater differentiation is deeper integration now going to go forward in the more socio-economically sensitive areas.

Possible Enhanced Cooperation Zones: Why not create new 'enhanced cooperation zones?' These could include:

'Enhanced labor mobility zones,' in which member-states with reconcilable arrangements in pensions, health care systems, and labor contracts created a more integrated labor market through harmonization and/or various forms of reciprocal arrangements.

'Public services zones,' in which countries with strong state-delivered services, such as medical care, developed new cross border mobility agreements?

'Immigration zones,' for countries with similar immigration policies and needs.

And why not fiscal policy zones?

Note that in some cases, such zones would require dispensation from the Lisbon Treaty requirement that nine countries participate.

3.2. New Initiatives to Restart the EU Economy

The EU also needs to do more to restart the European economy while providing for EU citizens in greatest need.

New Project Bonds: Project-bonds could be used for new infrastructure projects such as the European Railway System, renewable energy, and environmental sustainability as well as newly designated industrial revitalization zones and advanced technology development cooperation groups.

Structural Fund Reform: The structural funds need to be reformed so as to be immediately accessible by the member-state regions in need, without the current bureaucratic hurdles. The large unused portions of the structural funds (those regions in greatest need often access the least, often less than 10% to which they

are entitled) could even be leveraged as funds for the European Investment Bank to use for projects in the countries at risk.¹⁴⁰

CAP Reform: The CAP (Common Agricultural Policy) should be slowly transformed, beginning with a cap on big outlays to rich farmers—through the equivalent of a ‘millionaires’ tax. While part of the fund could remain to promote sustainable agriculture, the bulk of it should be slated for a poverty alleviation scheme for all citizens.

Automatic Stabilizers: Other automatic macroeconomic stabilizers need to be added to ensure that where eurozone member-states no longer had the capacity to protect the welfare of their own citizens, the EU would kick in. These stabilizers include an unemployment insurance fund that worked across borders plus a EU employment agency to facilitate cross-border movement. More generally, the EU needs to promote the ‘social investment’ welfare state,

But all of this would require much more money for the EU Commission and related agencies. The funds cannot come from a significant increase in member-states’ contributions.

New Revenue Streams: Instead, they could find new revenue streams derived from the value-added that the EU as a whole provides for member-states via the Single Market as well as the eurozone.

Financial Transaction Tax: One source could be the much-discussed tax on financial trades (the so-called Tobin or ‘Robin Hood’ tax on financial transactions)¹⁴¹—to add to funds for banking and financial market failures pledged by member-states, to pay for unemployment insurance, and/or poverty alleviation.

Cross-Border Transaction Tax: Another would be a cross-border transaction tax on goods and services¹⁴² that could pay for the spillover effects of the Single Market, geared to environmental, urban, and social problems.

A Solidarity Tax: Additional funds might come from a ‘Solidarity Tax’ levied on all citizens and residents of the EU, which could add to the converted CAP funds targeted for poverty alleviation, and would have the added advantage to build a sense of citizen-to-citizen solidarity. This, plus the financial and cross border transaction generated taxes, would ensure that no one could claim any longer that the EU was a ‘transfer union’ in which one or more member-states paid for the rest.

¹⁴⁰ See proposal by Stephanie Griffith-Jones, Matthias Kollatz-Ahnen, Lars Andersen, and Signe Hansen, “Shifting Europe from Austerity to Growth: A Proposed Investment Program for 2012-2015,” FEPS-IPD-ECLM Policy Brief (June 2012). http://www.feps-europe.eu/en/news/132_a-proposed-investment-programme-for-2012-2015

¹⁴¹ Algirdas Semeta, the E.U. commissioner for taxation, has already proposed legislation that would levy a fee of 0.1 percent on the value of all stock and bond trades, and of 0.01 percent on all derivatives trades. France and Germany have proposed such a tax, which could be done via enhanced cooperation. Eleven members were already agreed as of October 10, including France, Germany, Austria, Belgium, Estonia, Greece, Portugal, Slovakia, Italy and Spain. Where the money would go, however, remains in question, but looks as if it would flow into national coffers, which defeats the purpose of this tax for providing additional EU revenue.

¹⁴² Suggested by Miguel Maduro. See <http://www.project-syndicate.org/commentary/the-euro-s-crisis-of-democracy> and his latest position paper for the D-G for Internal Policies, Policy Dept. C, Citizens’ Rights and Constitutional Affairs: “A New Governance for the European Union and the Euro: Democracy and Justice.” PE 462-484 (Sept. 2012).

4. TOWARD A MORE DEMOCRATICALLY LEGITIMATE EU POLITICAL ECONOMY

With all of these new EU revenues and responsibilities, citizens would naturally expect more democratic access to decision-making on the grounds that there be 'no taxation without representation', while the member-states would expect greater guarantees of fiscal probity from one and all. Indeed, in order to make any of the above work, the EU itself needs deeper political integration. For this, the election of the Commission President via EP elections, as noted above, is a beginning to ensure more democratic representation and participation. But beyond this, innovative leadership via the Council in the direction of at least some of the initiatives described above is a *sine qua non*. But in addition, new narratives and better communication to the public that explain what the EU is, multi-tier governance. In short, multi-level governance in a highly differentiated EU political economy also requires multi-level democracy to promote greater legitimacy.

The problems for the EU' democratic legitimacy can best be considered in terms of three mechanisms: 'output' legitimacy depends upon policies that work; 'input' legitimacy, on extensive citizen participation and effective elite-citizen communication; and 'throughput' legitimacy, on governance processes carried out with efficacy that are open, accessible, and transparent.¹⁴³ The question for the EU is therefore not only whether it can get the economics right—thereby ensuring more 'output' legitimacy—but also whether it can get the politics right—by providing greater 'input' legitimacy through new democratic avenues of citizen participation and better communication by political elites. However, it would also need to generate greater 'throughput' legitimacy via governance processes that are more balanced, meaning less intergovernmental and technocratic.

¹⁴³ For more on these democratic legitimizing mechanisms, see: Vivien A. Schmidt "Democracy and Legitimacy in the European Union Revisited: Input, Output and 'Throughput.'" *Political Studies* (forthcoming 2012). Note that Prof. Joseph Weiler in his paper suggests a fourth principle of legitimacy, 'purposive', linked to 'political messianism.'

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DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT C: CITIZENS' RIGHTS AND
CONSTITUTIONAL AFFAIRS

CONSTITUTIONAL AFFAIRS

The Challenges of Multi-Tier Governance in the EU

Budgetary Solidarity in a multi-tiered Union

Iain Begg

Abstract

This briefing note reviews the logic behind budgetary solidarity in the EU and appraises possible approaches to achieving it. It focuses on macroeconomic stabilisation as a facet of solidarity and reviews the constraints on introducing a more extensive system, whether for the EU as a whole or for the euro area.

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LIST OF ABBREVIATIONS

- EC** European Council
- ECB** European Central Bank
- EFSF** European Financial Stability Facility
- EFSM** European Financial Stabilisation Mechanism
- EGF** European Globalisation Adjustment Fund
- EIB** European Investment Bank
- ESM** European Stability Mechanism
- IMF** International Monetary Fund
- SGP** Stability and Growth Pact

EXECUTIVE SUMMARY

Background

Since the onset of the financial crisis that started in 2007 and has since evolved not only to become the sovereign debt crisis, but also a challenge to the euro itself, the **adequacy of EU budgetary – and other – solidarity mechanisms has been questioned**. Although extensive governance reforms have been undertaken, especially since the spring of 2010, the **absence of sufficient fiscal capacity** is an obstacle to a more substantial role for the EU (or euro area) level in either **macroeconomic stabilisation or solidarity policies**.

The EU has various existing instruments that can contribute to solidarity, including the EU budget itself. The budget does provide net **fiscal transfers**, though not always purely on the basis of relative prosperity or immediate solidarity needs, and a solidarity motivation is prone to clash with *juste retour* reasoning. Overall, the EU clearly falls well short of the **range and scope of instruments** that are routine within other systems, whether federal or unitary models, and much of the theoretical analysis of **fiscal federalism cannot convincingly be applied to the EU**.

In particular, the small size of the EU budget means that it **cannot stabilise the EU** as a whole. However, once it is recognised that the **stabilisation challenge is at the level of the Member State**, the ability of the EU level to act is greater – for arithmetic reasons, most so for smaller Member States. An inevitable difficulty, however, is that **transfers for stabilisation purposes also have distributive effects**.

Options and challenges

Options for a fresh approach to solidarity include some **pooling of stabilisation capacity**, using forms of **debt mutualisation** to lower the borrowing costs of Member States facing acute problems, and **explicit, but temporary transfers** for solidarity purposes. Several proposals for such mechanisms have previously been put forward, often using a **relative worsening of unemployment as an eligibility criterion**.

In addition, there is now a momentum in favour of a separate **fiscal capacity for the euro area** which would function in parallel to the EU budget. The primary purpose of such a mechanism would be stabilisation, but it could be broadened to encompass **an explicit solidarity function**. There are, nevertheless, risks of accentuating **cleavages between Member States** and thus the unity of the EU.

A major challenge for a new euro area fiscal capacity is **how to raise revenue**, in the absence of a tax base of its own. A **financial transactions tax** has been discussed, but has various drawbacks, notably its uneven incidence across Member States. Using a **corporate income tax to fund new fiscal capacity** could be a more promising solution, but would require careful planning.

There are concerns about reinforced fiscal capacity at EU level, especially if the availability of solidarity-related transfers aggravates **moral hazard problems** and deters structural reform. A possible solution for the foreseeable future is to **make solidarity transfers temporary**, and to **avoid permanent equalisation schemes**, at least until there is greater **clarity about political and fiscal union**.

The core message of this briefing note is that the **fiscal status quo is not tenable**, but that a **wide-ranging debate about budgetary solidarity is needed**, both in the EU as a whole and in the euro area.

1. BACKGROUND

The severe crises that have affected the EU since 2008 have tested the capacity of the EU to provide solidarity to Member States experiencing acute economic difficulties. New mechanisms have had to be invented at short notice and difficult political choices have had to be made about how and when cross-border flows of funding are justified. With fiscal consolidation on the agenda nearly everywhere, the need to curb public expenditure has cast a shadow over the negotiations on the next Multiannual Financial Framework for the period 2014-20.

It has, however, become increasingly clear that the current mechanisms for delivering solidarity are inadequate for a union – especially a monetary union – that aspires to be deeper.

1.1. Solidarity in the context of public finances

Solidarity is associated in Article 80 of the treaty with ‘the fair sharing of responsibility, including its financial implications, between the Member States’. When discussed in budgetary terms solidarity is usually understood as net flows of financial resources, which can be the outcome of grants, loans or revenue payments.

- Solidarity mechanisms exist in all budgetary systems as a result of explicit distributive policies, the incidence of the tax system or access to loans on different terms
- Their fairness can be assessed in a variety of ways: at the level of the Member State or some other territorial unit, or at the level of the individual or household
- Inter-personal or inter-household fairness, in turn, can be assessed in terms of horizontal equity (treating units in identical circumstances equally) or vertically (outcomes linked to the prosperity of the unit). Progressive taxation is an illustration of a budgetary mechanism that targets vertical equity, while proportional taxation tends to treat units of the same level of prosperity equally
- However, in the EU setting, where social protection (broadly defined) is a competence of the Member State, it can be argued that the EU should not have a direct role in offering solidarity at the level of the household or individual, not least because social provision is normally the outcome of profound debates and political choices.

The inference to draw is that main role for the EU level in relation to solidarity should be in countering shortfalls in fiscal capacity. Two distinct interpretations of fiscal capacity can nevertheless be envisaged:

- Stabilisation of public finances aimed at smoothing public spending over the economic cycle, so that Member States affected by economic shocks can maintain acceptable levels of social spending in aggregate.
- Distributive transfers aimed at raising social provision in less prosperous territories (regions or Member States in their entirety) so long as they meet eligibility criteria.
- Although net resource flows are needed in both cases, a key difference is that the first is intended to be temporary support until a macroeconomic shock is resolved. More severe shocks such as those experienced by the Member States now subject to ‘programmes’ are acute versions of this motivation. By contrast, distributive transfers are predicated on an equalisation motivation and continue indefinitely. In

most national systems, an equalisation principle lies behind inter-governmental transfers and sub-national government, but can nevertheless provide a degree of automatic stabilisation if the design of the system is such that formulae for equalisation are sensitive to relative shifts in prosperity over the economic cycle.

1.1.1. Existing mechanisms

The EU already has a range of solidarity mechanisms.

- They encompass, first, those provided for in the treaty, notably the EU budget itself and the emergency funds for disasters set out in Article 122 or for resolving balance of payments problems set out in Article 143.
- Second, the crisis has seen the creation of new mechanisms that were initially *ad hoc* (EFSF, EFSM), but will become treaty based once the amendment to Article 136 establishing the ESM is fully ratified.

Member States also have access to IMF loans and can obtain loans on favourable financial terms from the European Investment Bank (EIB). In addition, the European Central Bank's (ECB) 'unconventional measures', though constrained by the prohibitions on monetising public, have offered short-term help to Member States which, to the extent that they hold down borrowing costs, provide de facto fiscal benefits.

1.2. The EU budget as a solidarity mechanism

It is an open question whether the EU budget acts as a solidarity mechanism. On the one hand, there are clearly net fiscal transfers which arise for three distinct reasons:

- The incidence of sectoral expenditure policies (above all direct payments under the CAP) which accrue in an unbalanced way to Member States with relatively larger agricultural sectors.
- The deliberate spatial targeting of Cohesion policies
- On the revenue side of the budget, the incidence of own resources and, above all of corrections

These fiscal transfers are not always from richer to poorer Member States or from those with a robust fiscal position to those facing budgetary difficulties. Unlike typical intergovernmental transfers inside nation states, solidarity is only embraced indirectly, as the dominant political narrative for the EU budget is *juste retour*. The EU budget has a limited capacity to offer solidarity, in the sense of a response to an unexpected problem (such as a natural disaster), but has no pretensions

On the other hand, the motivation for EU spending has to be examined. In practice, the limited range of spending from the EU budget is a combination of allocative transfers and payments that have distributive aims. What is clearly missing is any explicit top-down stabilisation capability. Instead, it is transfers within Member States, alongside private financial flows and official financing through central banks that fulfils this function.

To some extent, CAP spending is justified by solidarity, not so much to individual Member States, but to less wealthy farmers. However, the spending is not that well-targeted, insofar as rich farmers or landowners effectively receive substantial transfers.

Cohesion Policy spending is often adjudged to be for distributive reasons, reflecting the Article 174 goal of reducing regional disparities. There is a reasonably persuasive case to be made that for part of its history the intervention logic for the policy has been one of 'compensation', especially the moves in the 1980s to bolster Cohesion Policy to offset the competitive effects of the single market, and the further expansion of the policy in the early

1990s to enable weaker economies to cope with monetary union. However, Cohesion Policy is considered by the Commission to be primarily an allocative policy, a perspective that has been reinforced by the alignment of Cohesion Policy with the Lisbon/Europe 2020 strategies. In this sense, the development of disadvantaged regions has a logic of increasing the aggregate output of the EU. It is also worth recalling that the reasoning behind the introduction of the Cohesion Fund in 1994 was to enable fiscally constrained Member States to maintain levels of public investment.

In addition, certain smaller budget lines such as the European Globalisation Adjustment Fund (EGF) can be interpreted as solidarity measures designed to support groups affected by the currents of globalisation

2. WHAT IS LACKING AND OPTIONS FOR CHANGE

The EU is, by common consent, neither a typical federation, nor easy to define as some other form of political entity. For this reason, much of the standard economic analysis of fiscal federalism, with its presumption of a powerful federal or central government, cannot convincingly be applied to the EU (Begg, 2009). Its distinctive nature, the wording of relevant treaty articles and the political constraints that inhibit any significant expansion of the EU budget all impose limits on how much budgetary solidarity can plausibly be achieved. Yet the governance shortcomings exposed by the sovereign debt crisis mean that change cannot be avoided.

2.1. The principal gaps

Compared with nation-states, whether federal or unitary, the EU lacks many of the mechanisms that typically underpin budgetary solidarity. As the 1977 MacDougall report showed the scope of potential solidarity mechanisms depends on how close integration is intended to be. These include:

- Resources for stabilisation purposes which, in a multi-level system, imply that asymmetric economic developments will trigger net flows from such funds. It is worth noting that the 1970 Werner Report included a plan for monetary union in which there would be a limited central budget for this purpose. MacDougall went further suggesting that 5-7% of GDP would be needed.
- Transfers for distributive purposes that boost current public consumption in recipient areas or assisted areas or at the interpersonal level. Such transfers are a defining feature of national social protection systems, but are ruled out at EU level.
- Equalisation grants akin to the *finanzausgleich* systems in Germany or Austria which can transfer horizontally without directly implicating the highest tier of government.
- Short-term solidarity funds that provide assistance in bad times, but with the expectation that the fund will be replenished in good times.
- Integrated tax and benefit systems which, acting as automatic stabilisers, lead to resource flows
- Mutualisation of risk in which guarantees or other instruments are used to redistribute the effective cost of borrowing. Ideally designed such mutualisation (whether in the form of Euro-bonds, deposit insurance or some other instrument) would drive down the aggregate cost of capital

Compared with this list, an EU budget of just 1% of GDP is very restrictive and cannot achieve much by way of redistribution or stabilisation. However, it is important to note that this conclusion refers to the Union as a whole and that compared to individual Member States, the EU budget is a much larger pot of money. For the smaller Member States,

especially, relatively small amounts from the EU budget can potentially have quite large stabilising effects. Clearly, for larger Member States, the arithmetic is less compelling, but it should also be recalled that larger Member States already have more heterogeneity which diminishes the risk of a shock affecting the whole country.

2.1.1. A changing landscape

The likely acceleration of euro area integration, including the possibility of variants on fiscal and political union which exclude other Member States or oblige them to opt-in, points to influences on how solidarity may evolve. It has already shown that it can lead to additional challenges, as with the adoption of the Fiscal Compact via a separate treaty and with an as yet uncertain consolidation into the EU treaty. Further themes that are likely to surface include:

- Whether, and if so how, to have a common euro area budget (excluding the non-participating countries), with the possibility that it might include some of the elements discussed in the previous section.
- The arguments for allowing Member States that choose to use enhanced cooperation to elect to pay their contributions to the EU budget partly by new common taxes – particularly using a financial transactions tax (FTT) for this purpose.
- Loan instruments limited to Member States fulfilling specific eligibility criteria, which could be (as with the EFSF) euro area membership, but might also include agreement on pooling resources for project purposes.

2.2. Options for change

Among the many ways in which the budgetary solidarity in the EU could be recast, the most likely is through a common approach to stabilisation. In the absence of a stronger commitment to solidarity at the level of the individual or household, the EU faces a variant on the *Samaritan's dilemma*, to use a term coined by Buchanan (1975): net contributors fear that the transfer would lead to free-riding in the form of a deficit bias in public finances in net recipient countries, and other forms of moral hazard. Yet part of the economic efficiency case for transfers could be to forestall damaging imbalances or the prospect of financial contagion from countries threatened by default.

2.2.1. Approaches to stabilisation

Budgetary solidarity can be justified economically when there is a risk of shocks that affect only part of the Union, but the region or country hit by the shock lacks the means to deal with it. As with personal insurance, the issue for any government is whether it can insure against the shock and a usual assumption is that smaller, poorer or less diverse economies will be more vulnerable. The US, for example, would be expected to be able to cope with an extreme storm such as Hurricane Sandy, whereas Haiti would not. The simple explanation is that when risks are pooled across a larger economic unit, the cost of a particular contingency is small as a proportion of the total insurance capacity. It follows that lower tiers of governments are less able to insure themselves against asymmetric shocks, whereas in a centralised tier of government, the risks are pooled across countries/regions of the whole economic territory.

There is an extensive literature on how best to structure such mechanisms using different sorts of inter-governmental transfers (for a good overview, see Boadway, 2004). Issues that have to be confronted are how to avoid free-riding by participants or how to ensure that the beneficiaries do not engage in more risky behaviour precisely because there is an insurance mechanism. There is also a plethora of managerial challenges. These questions

have been especially studied by the World Bank and the IMF and valuable lessons are distilled in a comprehensive handbook (Boadway and Shah, 2008). However, a drawback of much of the academic and policy literature remains, as noted above, that it assumes a powerful central government which can exercise control over lower tiers and has the financial muscle to do so.

Solidarity can also be achieved by using the credit-worthiness of fiscally robust member States to guarantee the borrowing of the weaker. This can have positive-sum game outcomes for economic growth, although at the level of the household, there can be a distribution away from savers to borrowers because of lower interest rates. Even so, the scope for different forms of loan or loan guarantees to be used for solidarity purposes needs to be considered.

2.2.2. Past proposals

Several contributions to the literature in the 1990s examined possible schemes for achieving stabilisation as part of a development of the EU's fiscal constitution – for an overview, see Majocchi, 2003. Thus, an analysis by Italianer and Vanheukelen (1992) demonstrates that a substantial degree of stabilisation could be attained with a fund that need not be larger than 0.2% of GDP. In this schema, although their analysis is based on relatively limited shocks, flows can be triggered rapidly by monitoring a readily collected indicator such as the unemployment rate. If, in addition, the system is set up to balance over an economic cycle, its resources can be 'recycled', keeping down the total cost to the public purse. In a development of this proposal by the Commission (Commission, 1993), a deviation of the unemployment rate from a trend would be the criterion. There is, however, a potential objection that such a short-term scheme would not be enough to stabilise an enduring problem such as that affecting Greece since 2010.

There is, again, a tension in this regard between stabilisation and (re)-distribution. A pure stabilisation system would be designed to avoid 'rewarding' a delinquent Member State for bad policy choices by providing permanent transfers, but as Mélitz and Vori (1993) show, it will be hard to prevent at least some net transfer. A possible solution was proposed by von Hagen and Hammond (1998) who construct an approach in which an intricate econometric methodology is used to determine eligibility for transfers aimed at stabilisation. They argue that it has the potential to avoid such drawbacks, but note that the methodology they propose will not be easy to use routinely and that some form of simplified eligibility rule would be needed to make it practical to implement. The trouble with resorting to simplification is that it would make the system less attractive and may, in particular, result in permanent transfers rather than temporary relief of a shock.

2.3. The euro area

The European Council meeting held on 18th October 2012 concluded that a fiscal capacity for the euro area was needed, although its wording is circumspect. The conclusions do not explicitly signal how this fiscal capacity will function, despite noting that it should be 'unrelated to the preparation of the next Multiannual Financial Framework'. The interim report of 12th October 2012 from the 'Four presidents' observes that there are many ways of centralising budgetary policy and providing for what it calls 'fiscal solidarity against adverse macroeconomic and financial shocks' but does not elaborate beyond stating that the 'EMU's unique features would justify a specific approach. The statement suggests that the main rationale for a fiscal capacity appears to be stabilisation.

In the light of this guidance, it is worth asking, first, what the unique features are and, second, what approaches are likely to conform to these unique features. The most striking

of the unique features is that while monetary policy is unambiguously at the euro area level, the original Maastricht model for EMU assigned fiscal policy and structural policies at the level of the Member State. Fiscal policy was, however, constrained by the Stability and Growth Pact and, to a lesser extent, by the Broad Economic Policy Guidelines. The governance reforms since 2010 – notably those now dubbed the six-pack and the two-pack – are expected (subject to improved implementation and, especially, compliance) to strengthen the central oversight of budgetary policies, but leave formal competence for budgetary policy with the Member States.

This approach contrasts with arrangements in other currency areas where the federal government (or central government in unitary systems) is the level at which macroeconomic stabilisation takes place. It is also, generally, the source of transfers motivated by solidarity, although in some systems, such as Germany or Austria, there are also 'horizontal' equalisation payments through which richer regional-level governments transfer resources to poorer ones. In both respects, arithmetic matters. Federal or central governments typically spend 20+% of GDP and raise an even higher proportion of taxes, distributing the latter to lower levels of government. The debate around the EU budget, by contrast, is about whether it should be changed by a fraction of a percentage point from its current level of just over 1% of GDP. These figures need not bind the euro area indefinitely, but it is hard to see how the gap between 1% and 20% (or even the 5-7% proposed 35 years ago in the MacDougall report) could be bridged.

A second distinctive feature of the euro area is that it has currently no tax base of its own, bearing in mind that most of the revenue of today's EU budget is in the form of national contributions. Many Member States oppose significant new tax powers as part of the EU budget settlement for 2014-20, so that if a euro area fiscal capacity is to be countenanced it is most likely to require additional national contributions.

Despite these reservations, there is no reason why a mechanism similar in character to those reviewed above should not be feasible for the euro area. Choices will have to be made about the scope of a system and there will inevitably be a need for conditionality in allowing access to it.

2.3.1. Euro areas taxes: solidarity on the revenue side?

It remains to be seen whether an FTT will be used, as discussed above, to allow some Member States to substitute for their GNI contributions to own resources. If not, then an FTT assigned to the euro area in the same way as customs duties are assigned to the EU budget could become a potential source of revenue for new euro area budget. The considerable national differences in the tax base could, though, be a problem because the yield of an FTT is not necessarily linked to either overall prosperity or the economic cycle. This problem could be mitigated by following the same proposal as for the EU budget of deeming the yield from FTT to be national and allowing it to be used to offset a GNI-based contribution.

However, a more promising alternative could be to accelerate the harmonisation of corporate taxation, already on the agenda as part of the fiscal compact. Taxes on profits are intrinsically anti-cyclical effects, and much more so than many other potential own resources, because of the well-known sensitivity of profits (the tax base) to the economic cycle. It is also difficult to determine precisely where corporate profits arise, as opposed to where they are declared for tax purposes. Agreeing a common definition of the tax base will be tricky, because of the continuing inability to harmonise exemptions, but there is a clear single market logic to having a single corporate tax regime. Extrapolating from current national yields, the potential revenue from such a tax – wholly assigned to the euro area level – is at least 2% of GDP. This would comfortably exceed the estimates of what is

needed for a limited stabilisation capacity and could also be a source of tax backing for more elaborate crisis resolution funds.

There would have to be a formula for distributing unused revenue to back Member States, but there are already principles for doing so for seigniorage revenue earned by the ECB (based on a GNI key) that could be applied. Plainly, any pre-emption of corporate income tax for euro area stabilisation/solidarity purposes would be at the expense of national tax receipts and would be resisted, but if the euro area is serious about requiring a fiscal capacity, it is an option that makes sense.

2.4. Constraints and challenges

Many obstacles can be identified to a broadening of budgetary solidarity. They include the restrictions written into the Treaty provisions, political reservations and the vexed issues of how burdens are shared in any political economy of solidarity.

If part of EU the budget is used for stabilisation purposes, it will not be possible ex-ante to determine the national incidence of that part of the budget. Consequently, there would have to be prior agreement to exclude this component of the budget from both *juste retour* reasoning and from the formulae used to calibrate corrections, notably the UK one. Any problems in this regard would be eased if a stabilisation capacity were (as the four presidents' report envisages) entirely separate from the EU budget, since it would not be subject to the path dependency that pervades the latter.

While a separate euro area arrangement is alluring, it is not without complications. Greater differentiation in solidarity mechanisms may provoke concerns about accentuating cleavages between groups of Member States, undermining the unity of the EU, yet may be necessary to overcome blocking minorities, causing tensions. Moreover, if integration of revenue collection occurs – in the form of new euro area taxes – some Member States may argue that this would let the genie of EU taxes out of the bottle; by the same token such an evolution would be attractive to the European Parliament which has long called for genuine own resources at EU level.

A key issue – frequently seen during the crisis of the last four years – is moral hazard, particularly where solidarity deters corrective action. There is also the thorny problem of liability when interventions go awry. If there are failings in bank supervision, for example, taxpayers will (as has been seen throughout the crisis) to contribute to the costs of bank resolution. Hence, the absence of a European tax-payer is likely to prove a difficult issue that will need to be addressed.

3. CONCLUSIONS AND SEQUENCING OF ACTIONS

As the crisis has unfolded, the shortcomings of the EU's fiscal constitution have been exposed and there can be little doubt that the status quo is not tenable. An effective monetary union needs some top-down stabilisation capability and the intensity of the crisis in some Member States calls for novel measures to assure solidarity.

Equally, the sheer difficulty of reforming the EU budget gives little grounds for optimism that much will change for the 2014-20 MFF. There will, no doubt, be some innovations to accommodate new priorities or the most pressing of needs, but it is politically unrealistic to expect the budget to be transformed radically and rapidly, let alone by the start of the MFF in 2014. Indeed, the effect of tough times has been to make many Member States more resistant to change.

Despite the ambiguity that continues to surround the term 'fiscal union' there are some facets of public finance reform that now seem likely to be pursued, including the creation of a separate fiscal capacity for the euro area. Although budget solidarity is expected to be

highlighted as part of such a fiscal capacity, the primary motivation – as articulated by the European Council – is to contend with asymmetric shocks.

Nevertheless, all transfers have some distributive effects, so that it is likely that a stabilisation mechanism will also have effects on distributive solidarity. At times, moreover, a stabilisation mechanism could have a perverse distributive effect by providing a flow of funding to a relatively richer Member State

A key question for any new sort of fiscal capacity is whether it should be explicitly designed only to provide temporary support for Member State affected by a specific shock, or should also provide permanent income support for the less prosperous. The principle behind the former is an insurance one in which the Member State only becomes eligible for a transfer if a criterion, such as an asymmetric fall in GDP or rise in unemployment, is fulfilled. There are many details to work out about how to avoid the standard insurance problems of adverse selection and moral hazard, but blueprints for schemes of this sort are readily available.

A further issue is whether the stabilisation should be applied at the level of the EU or euro area, or at that of the Member State. Asymmetric shocks, by definition, arise at the level of particular territories within the Union. The focus should therefore be on what an intervention at the EU or euro area level can do to stabilise activity at lower territorial levels, and not on stabilising the supranational level through budgetary policy. Dealing with symmetric shocks is, in any case, primarily a role for monetary policy.

A permanent transfer system, whether through horizontal equalisation or top-down inter-governmental mechanisms would constitute a much more profound deepening of the EU and seems unlikely in present circumstances. This suggests that for this decade, the most promising answer is to concentrate on developing mechanisms that can offer budgetary solidarity as insurance against shocks, rather than distributive transfers. But as the notions of fiscal union and political union are fleshed-out, a broader conception is a subject that can be expected to return.

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