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What's next for European integration?

Because of the Covid-19 pandemic, the EU has made a clear break with its flawed economic governance. But more reforms are needed

Already in the decade preceding the Covid-19 pandemic, the EU's economic governance suffered from a range of problems. By mandating austerity and structural reform policies, the Eurozone came to be characterised by 'governing by rules and ruling by numbers,' with the wrong rules and numbers, which didn't work. This led to what I have called the EU's 'crisis of legitimacy,' in which doubling down on the procedural rules led to poor economic performance and increasingly toxic politics.

Fortunately, the EU's pandemic response represents a new beginning. Most notable among initiatives are the European Central Bank's Pandemic Emergency Purchasing Program (PEPP) and the European Commission's Next Generation EU, focused on investing in the green transition and the digital transformation while addressing social inequity, accompanied by the Resilience and Recovery Fund (RRF) to provide investment funds for countries in need.

All of this constitutes a massive achievement, and a major break with the past. But to ensure a brighter future for the European economy, much more needs to be done. New ideas call for an enhanced role for 'state' actors — EU and national — as public entrepreneurs to promote growth and provide investments for greening the economy, digitalising society, and ensuring greater social equity.

Commission industrial policy and the European Semester

The EU has made a great leap forward through the Next Generation EU and the temporary Resilience and Recovery Fund (RRF). But this needs to be reinforced through the development of permanent EU level debt that could provide investment funds for all member-states on a regular basis. Think of a permanent RRF as an EU wealth fund, akin to national

sovereign wealth funds, which issues debt on the global markets to use to invest through grants to the member-states in education, training, and income support; in greening the economy and digitally connecting people; as well as in big physical infrastructure projects.

It could also be used to invest in EU level cross-border endeavours as well as for redistributive purposes through a range of innovative EU funds, including an unemployment reinsurance fund, a refugee integration fund (for countries taking in higher numbers of asylum seekers), an EU fund for just mobility (focused on brain drain), or even a poverty alleviation fund.

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At the same time, the ECB should move from an almost exclusive focus on the primary objectives set out in its Charter to the secondary objectives. This could mean giving itself a target of full employment on a par with fighting inflation; ending 'neutral' bond-buying (meaning stopping buying the bonds of polluting industries); creating green bonds for the environment; or even providing so-called 'helicopter money' to offer direct support to households in need. Finally, it would be extremely useful to create an EU safe asset while solving the problem of national debt overhang (since debt restructuring by country is not feasible) by having the European Stability Mechanism buy a portion of the sovereign bonds held by the ECB.

The next question is how to ensure that these new industrial and social policy initiatives succeed. For this, the European Semester — the annual cycle of economic and fiscal policy coordination — is the ideal vehicle for oversight and assistance. But only if we rethink both its purpose and its rules. The rule of 'rules and numbers' mandating austerity and reform policies should be permanently suspended, to be replaced, say, by a set of 'fiscal standards' to assess sustainability in context.

If this is not feasible, then a much more flexible set of rules needs to be developed, focused on counter-cyclical economic policy, with more fine-tuned assessments of where individual member-states sit in the business cycle in relation to deficits and debt as well as growth outlook and prospects of meeting investment targets.

Moreover, public investments (industrial and social) deemed to benefit

the next generation should not be counted toward deficits or debt (known as the Golden Rule for public investment). In fact, in this environment of extremely low interest rates and extensive quantitative easing, public debt itself could be ignored if it is sustainable (meaning the government can borrow at a rate lower than the average rate of growth of GDP).

The obstacles to reform

The EU faces several possible obstacles and stumbling blocks with regard to implementing some of these new ideas. Political divisions remain in the EU Council, in particular between the so-called Frugal Four Plus, who insisted that the RRF be temporary, and had opposed any grants at all. If the RRF fails to deliver on growth or if the extra investment is not used wisely in the main countries targeted (Italy and Spain), enthusiasm will wane, and the likelihood of creating a permanent fund will diminish. In addition, the austerity hawks are likely to be back, in particular once the pandemic is over and things get back to some kind of new normal.

With an increasingly intense election cycle coming up, and major contests in Germany and then France, not to mention other countries, the future politics of the European Council may have an impact on any further positive movement on the ideas just discussed. Pandemic fatigue has set in, with at the moment growing dissatisfaction with current governments due to continued lockdown measures and slow vaccine rollouts.

In large part because of obstacles and stumbling blocks — economic, legal, and political — we need to think flexibly not only with regard to the future Eurozone economic governance but also in terms of the future of the EU itself. How do we make any of the ideas just discussed possible, given the existing political differences among member-states along with the institutional and legal obstacles? I can't see the member-states moving forward in lockstep, toward any kind of 'United States of Europe,' a deeply integrated 'real social and economic union,' or even toward a 'hard core' around the Eurozone.

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Rather, we need to be prepared to rethink integration as more differentiated. I tend to think of such differentiation in terms of a '*soft core*' Europe, made up of overlapping clusters of European countries participating in the EU's many different policy communities, all administered by a single set of EU institutions, with voice for all member-states in all

communities, but with vote only in those in which they actively participate.

Possible pathways forward

The Eurozone is only one of such many policy communities, and even it would need to allow for further differentiation. For example, we could envision that were some member states to block a permanent fund, member states willing to move forward could use enhanced cooperation to pledge their own resources to an EU budget. Their representatives would then be the only ones to vote on the budget and its use, although everyone could discuss it (no separate Eurozone Parliament, then, but separate voting for MEPs in a deeper budgetary union).

This said, there can be no differentiation in the EU's core commitments to the rule of law. And the EU needs to do more to reinforce citizen representation and participation. For the Eurozone in particular, this at the very least demands more involvement of the European Parliament through the co-decision method in Eurozone decision-making and of national parliaments in the European Semester. The ECB would also benefit from enhancing its accountability and transparency while democratising the process. One such way could be to increase ECB accountability to the European Parliament, say, through formal requirements for ECB-EP dialogues.

Turning Eurozone treaties into ordinary legislation, moreover, would help break the stalemate that makes it impossible to change such legislation (given the unanimity rule), and ensure that they would be subject to political debate and possible alteration. But the European Parliament would also need to find more ways to bring national parliaments into EU level decision-making. And the EU as a whole must devise new means of encouraging citizen participation at all levels.



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