TOWARDS A DEEPER EMU

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AN ASSESSMENT OF POLITICAL DIVISIONS WITHIN THE EU

Juha Jokela

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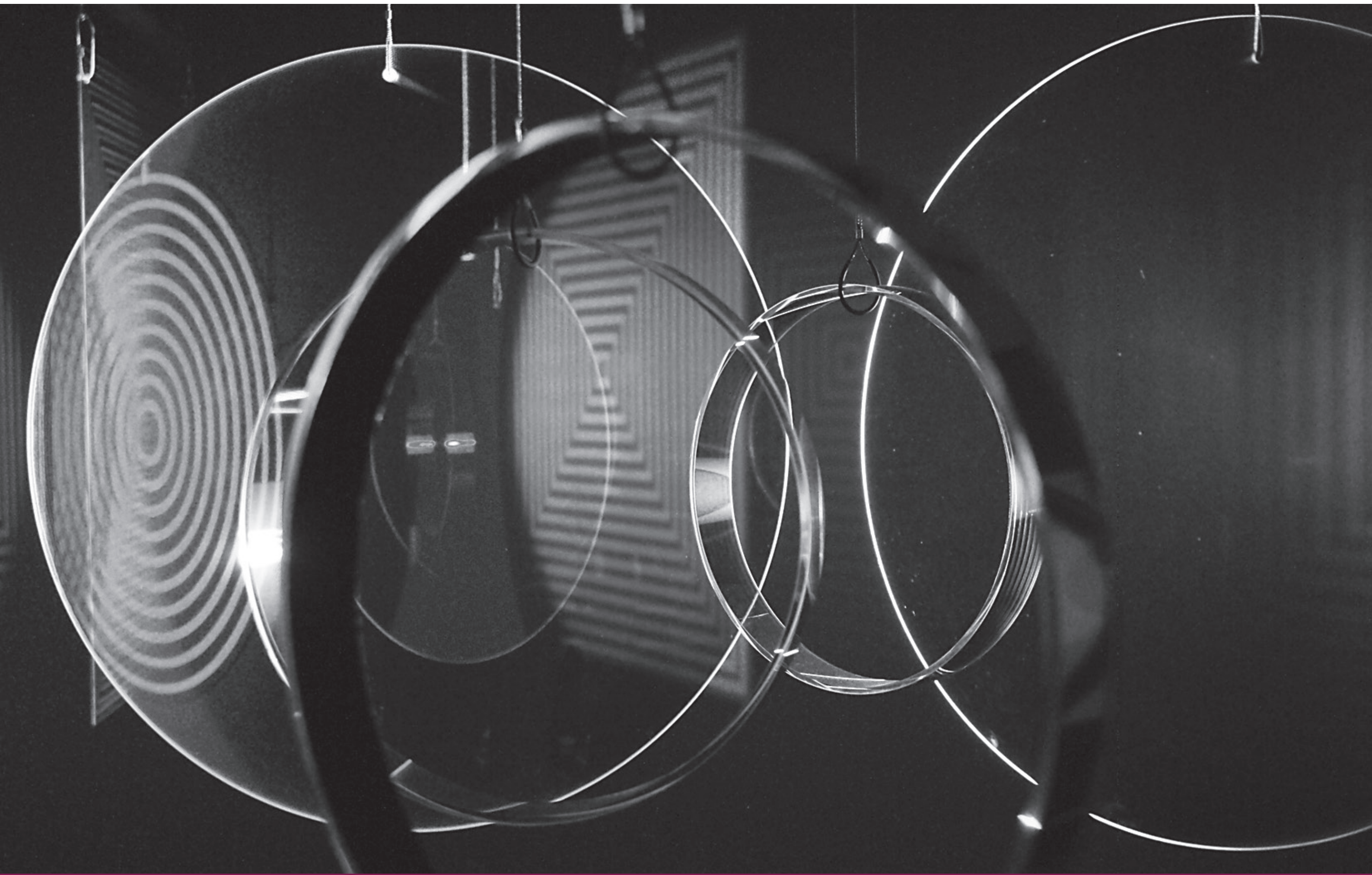

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TOWARDS A DEEPER EMU

AN ASSESSMENT OF POLITICAL DIVISIONS WITHIN THE EU

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- The extraordinary political decisions taken to tackle the financial and economic crisis, and to reform and reinforce the EMU have opened up some old wounds and created new political dividing lines in the EU.

- The EU has witnessed the re-emergence of the north-south divide as a key marker of distinct political and economic visions and imperatives within the EU. At the same time, the division between the east and west is diminishing.

- The importance of the political dividing line between euro and non-euro EU members has also increased, yet it is not clearly defined. The uneven burden-sharing between euro and non-euro countries in providing financial means to tackle the crisis is, however, shaping the contours of EU politics.

- Despite the British reluctance to join the current political processes propelling a deeper economic integration, no other profound preconditions for the EU's future development have been established by the member states. Yet the depth of the reinforced EMU is currently under consideration in many member states.

- The strengthening of the populist and Eurosceptic political movements has led to the resurrection of the anti-EU and pro-EU political dividing line in many member states. This is increasingly reflected at the EU level, and might constrain the EU's future development.

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Introduction

Policymakers, observers and the media have referred to a vast number of divisions in crisis-torn Europe. The EU is divided between north and south or creditors and debtors. Some have emphasised the emerged division between anti-EU and pro-EU forces. Significantly, these divisions are also manifested within the eurozone, in the form of the current differences between the French and German views, and the increasing role of the populist movements in many euro countries. Yet others have highlighted the boundary between the eurozone and the rest of the EU, and suggested that the euro countries now form the core of the Union. Relatedly, some of the non-euro members are distancing themselves from the EU – most notably the UK – while many others aim to secure their influence in the Union, even if euro membership may have been put on the back burner.

The objective of this briefing paper is to analyze these European political divisions in the light of the extraordinary crisis decisions and plans to further reform the Economic and Monetary Union (EMU). The paper argues that despite the British reluctance to join the current political processes propelling a deeper economic and political integration, no other profound red lines or preconditions for the EU's future development have been established by the member states. As the latter have demonstrated their will and ability to sideline the UK, the ongoing processes are constrained by a lack of support from the European electorates.

Still united in diversity?

The deepening of European integration has always resulted in tensions among European Union member states. The plan to establish a European defence community in the 1950s eventually collapsed due to French opposition. In the 1980s, the UK agreed upon the formation of the single market, but hesitated to move towards a deeper economic and monetary union, and resisted steps taken towards a political union. In the process leading up to the Maastricht Treaty and the establishment of the European Union, the member states agreed to retain control over their economic policies. All of them, with the exception of the UK and Denmark, however, agreed to transfer their monetary policies to the EU over time; yet France and Germany clashed over the nature of the monetary union in the making. While Germany pushed for a monetary policy set by an independent European Central Bank (ECB), the French wanted to see a degree of political discretion over the ECB.[1] The treaty-based opt-outs, and temporal variation in joining the final stage of the EMU, led to arguments suggesting a temporal divide between a two-speed EU or the more permanent one of a two-tier Europe.

Relatedly, member states have occupied different positions vis-à-vis EU enlargement. Those in favour of deepening the process expressed reservations towards the rapid expansion of the EU in the 2000s. A substantially greater number of members were able to limit their ability to steer the European project towards an "ever closer Union", and gear the process towards a somewhat "looser Union" promoted by the UK. This reasoning finds some support in the general problems related to the effectiveness of EU decision-making and the recognized need to streamline the Union before and after the 2004/07 enlargement. The enlarging EU – with its 15 member states and 13 candidate countries – nevertheless managed to agree upon a major reform of the EU, namely the Constitutional Treaty, signed in Rome in 2004. However, two founding members of the EU – France and the Netherlands – which decided to put the treaty to a referendum, resulting in its rejection in 2005, ultimately wrecked the ratification process.

Since then, the road maps for deeper integration have faced some significant hurdles and exposed diverse opinions and political cleavages among the member states as well as the EU institutions. While most of the innovations of the Constitutional Treaty were incorporated in one form or another into the ensuing Lisbon Treaty, the absence of political unity among the member states has contributed to the sense of a disunited EU. This has also been reflected in the implementation of the Lisbon Treaty and the ensuing inter-institutional debacles and infamous turf wars in Brussels.

Concurrently, the EU was hit by the global financial crisis, which manifested itself in Europe through

1 For more on this, see Erik Jones 2012, *Bringing Stability to Europe: Why Europe needs a banking union*, FIIA Briefing Paper 117. Available at http://www.fiia.fi/en/publication/295/.

banking and sovereign debt crises that rapidly destabilized the monetary union. The extraordinary political decisions taken to tackle the crisis and reform and reinforce the EMU have opened up some old wounds and created new political dividing lines in the Union. In so doing, the so-called euro crisis turned into a political one, potentially threatening the European project. As the President of the European Council, Herman von Rompuy noted in 2011: the EU was facing an existential crisis.

Resurrection of the north–south divide

The recent years of multiple crises have witnessed the re-emergence of the north–south divide as the most significant marker of distinct political and economic visions and imperatives within the EU. At the same time, the division between east and west or new and old members has diminished. Even if the eastern enlargement is a milestone in the post-Cold War unification of Europe, the newcomers changed the political dynamics of the EU. Their entry impacted the allocation of funds under the Common Agricultural Policy, the EU's Structural Funds and the Cohesion Policy, while the lower labour costs had an impact on the economic dynamics of the Union.

In terms of the EU's foreign policy, the newest members' transatlantic inclinations and complications with Russia further challenged common EU positions and policies in this field. The peak of this division occurred on the eve of the enlargement in 2003. The US aspirations to wage war on Iraq proved to be a highly divisive issue for Europeans. Consequently, the US referred to the "old" and "new Europe" as a key marker in European foreign policy.

The ongoing financial and economic crisis has, however, re-directed the focus away from the east–west division towards the north–south division. Importantly, the main challenges related to the economic and political future of the EU have not originated from the new member states but from the old ones. Although the newest members have also been severely hit by the crisis, the relatively smaller size of their financial sectors and economies in general has not led to similar market speculation on the posed systemic risks, as has been the case with the southern EU economies, Ireland and to some extent the UK. Moreover, many of them, such as the newest euro members Estonia (2011) and Latvia (2014), have been able to accommodate themselves to the crisis and are currently recovering from it. Against this background, the current key marker of difference in the EU, in terms of distinct economic and political imperatives, is argued to be the one of north and south.

On a general level, the key boundary between north and south is based on national economic indicators and a political system's stability and ability to deliver accordingly. Importantly, the suggested geographic boundary between north and south is misleading because sound economic and political performance varies over time and space, as the shift from the east–west to north–south division suggests. Importantly, the ongoing crisis has also changed the key features of this divide.

Until the current crisis, wealthier EU members were willing to show an arguably remarkable degree of solidarity with their less well-off neighbours in the south and east. This resulted from a combination of self-interest and trust in positive development.[2] In return, wealthier economies gained regional economic and political stability, which was important for their economic expansion. The current crisis has dramatically altered this feature of the European project. The richer EU members' power and influence over the poorer ones has increased as a result of decisions taken to stabilize the single currency.

The strict conditionality of the rescue loan programmes (also extended to the ECB's OMT bond-buying programme) as well as the increased surveillance powers of the European Commission over national economies, and semi-automatic sanctions related to the failure to follow tighter fiscal rules, have been seen to empower the healthy euro economies in the changing European economic governance system. Accordingly, the so-called creditor countries are dominating the EU's economic decision-making, while the debtor countries have

2 Federico Steinberg 2013, *A New Union of Creditors and Debtors*, Real Instituto Elcano Expert Comment 19/2013, Elcano: Madrid. See also Michele Comelli 2012, *Creditor vs debtor countries in the EU: a problem of legitimacy*, Aspenia online, available at https://www.aspeninstitute.it/aspenia-online.

little option but to follow policies pushed through by the creditors.

Importantly, the creditor-debtor divide is most concretely manifested within the current eurozone. First, non-euro members have opted out of the loan programmes initially agreed bilaterally and then within the established stability funds. While non-euro EU members do participate in the programmes through their IMF contributions, and some have provided bilateral assistance, such as the UK in the case of Ireland, the financial burden of the loan programmes has predominantly fallen on the well-performing euro economies. Similarly, the conditionality, increased macro-economic surveillance and consolidated fiscal rules apply first and foremost within the euro area, and their impact on national economies has been greatest in the weakest euro economies. Also the fact that some other parts of the strengthened EU economic governance only partially apply beyond the euro area, directs attention to the assumed dividing line between the euro area and rest of the EU.[3]

3 The crisis funds (i.e. the temporary European Financial Stability Facility and the permanent European Stability Mechanism) were founded by the euro countries and they are only open to them. The two-pack legislation enhancing established economic cooperation processes and clarifying procedures for dealing with countries that are in severe difficulties only affect the euro countries. The six-pack legislation which, together with the European economic semester, forms the backbone of the increased EU-level macro-economic coordination concerns all EU members, yet the euro members are subject to tighter rules and semi-automatic sanctions. The so-called Fiscal Compact (Treaty on Stability, Coordination and Governance) was signed by all EU members except the UK and the Czech Republic, yet it is binding for the non-euro signatories only when they join the single currency, unless they decide to declare it binding beforehand. The initial Euro Plus Pact, was joined by six non-euro members. The most recent developments related to the banking union (Single Supervisory Mechanism and Single Resolution Mechanism) are open to all EU members, yet they are likely to advance first in terms of the euro area. This theme will be further elucidated in forthcoming publications in this Briefing Paper series.

Consolidation of a two-tier EU?

The recent years of crisis have underlined the division between the eurozone and the rest of the EU. The European project is currently seen to advance largely in terms of consolidating and reinforcing the EMU. In this respect, the eurozone and creditor countries have assumed political leadership, yet they hold different views on the speed, depth and governance structures of the reinforced EMU. However, at the same time than the euro countries are more or less eagerly accelerating their pace in moving towards deeper integration, some of the non-euro countries are searching for the brake pedal. Consequently, the level of differentiation between the euro area and rest of the EU is arguably increasing, and potentially developing into a more permanent feature of the European project.

The political dividing line between euro and non-euro EU members is *not*, however, clearly defined. Yet some of the concerns related to it are significant for the EU's future development.

The macro-economic policy imperatives within the euro area have diverged. It was hoped that the victory of socialist François Hollande in France would result in a relaxation of the tight economic policy favoured by Germany on stabilizing the euro and resolving the EU's economic crisis. These hopes have largely proved to be premature, however, and the landslide victory of Angela Merkel's CDU/CSU has further reinforced the policy of fiscal consolidation and structural reforms within the euro area.

Moreover, the centre-right parties in the euro countries seem to share a more common European political agenda than the centre-left parties. These parties are divided on the issue of solidarity in the euro area. Whereas the centre-left parties in the debtor countries would like to see a significant increase in common burden-sharing in resolving the crisis, and reforming the EMU, the leftist parties in the creditor countries often hesitate to take further steps to increase joint liabilities or assign significantly greater funds to jobs and growth production beyond their national borders.

Moreover, the euro area has continued enlarging during the years of crisis. Estonia joined in 2011, and Latvia is joining in 2014. The principle of openness of the third phase of the EMU consequently remains valid, yet the ongoing reforms might lead to tighter entry criteria. Furthermore, the overall objective that all EU member states which do not have a treaty-based opt-out will join over time has not changed, yet in practice more permanent de facto "opt-outs" can be envisaged. These are mainly related to domestic political constraints, such as those witnessed in Sweden, which rejected euro membership in a referendum in 2003. As such, they cannot be deemed to prevail over time. The assessment of the success and benefits associated with the single currency might change in due course among European governments and electorates.

Importantly, the governments of the non-euro EU members have voiced their aspirations *not* to be sidelined in the EU. Even if Poland is carefully weighing the economic costs of euro membership, it has however emphasized its dedication to the EU and the single currency. Indeed, the idea of enhanced "associated membership" of the euro area was highlighted in Warsaw during the Polish EU Presidency.[4] The Presidency was seen at least partly disadvantaged by the Euro Group's powerful position in ECOFIN, yet this Council configuration was formally chaired by Poland.

At the same time, Denmark's EU policy is under review and observers have identified an increasing Danish interest in re-considering the Danish opt-outs secured in the EU treaties. Denmark and Sweden, among other non-euro members, have examined the impact and potential benefits of the first phase of the banking union, and they have not ruled out participation in the future if the representation of non-euro members is secured to their satisfaction. Finally, and as suggested earlier, non-euro members are also participating in some elements of the enhanced macro-economic surveillance processes.

Nevertheless, the fact that the non-euro countries do not share the financial burden of the European Stability Mechanism or the ECB's bond-buying programmes has been reflected in their relative power and influence in the ongoing processes. This has had a significant impact on the mindset of the EU decision-makers in the creditor countries. The advice dispensed by non-euro countries such as the UK on how to manage the crisis and respond to the broader European and global concerns of the "euro crisis" has been greeted with frustration and annoyance in the creditor countries. France, for instance, has suggested that instead of giving advice the UK is more than welcome to share the financial burden of the crisis or otherwise keep its mouth shut. A similar logic seems to be hindering the establishment of the banking union, which is open to non-euro countries as well. Their worries related to their representation in the relevant decision-making systems have been noted, yet the full decision powers are reserved for those who also carry the financial burden of the new mechanisms and who are fully incorporated in the emerging EMU governance structures; in other words, the euro countries.

Relatedly, it has been suggested that the deepening euro area might have a broader impact on EU decision-making. The envisaged deeper integration of the euro countries may lead to the increasing convergence of their interests in other EU policy areas as well, such as regulation related to the single market.[5] As a result of the potentially more unified Euro Group's powerful position in the EU law-making system, the political dynamics of the EU might change direction and start working against the non-euro countries. To date, the response to these reservations has been rather straightforward. The road map to a deeper and genuine EMU emphasizes that the single currency remains open for all EU members to join, and in so doing they would secure a role in the decision-making.

Moreover, there is also very little evidence of a potential spill-over effect of the Euro Group's interests across different EU policy fields. The interests of the euro area seem to be diverging in terms of the development of the single markets and the EU's social dimension, for instance. Moreover, the Euro Group is not unanimously behind the financial transaction tax proposal, which is currently being pushed forward within the enhanced cooperation mechanism. What is more, the application of this decision-making mechanism requires the consent of all member states.

4 Pawel Swieboda and Ryszard Petru 2012, *"Associated membership": Anchoring the pre-ins in the Eurozone*, demosEUROPA – Centre for European Strategy: Warsaw.

5 Grant, Charles 2012, "A three-tier EU puts single market at risk", *The Financial Times*, 26 October.

Against this background, the most significant rift between the eurozone and non-euro countries seems to originate from the UK, and its traditional reluctance to move towards an "ever closer Union". In the past, the UK has played an important role as one of the key architects of European integration by reducing the speed of integration and securing special arrangements. The Labour Party's return to power in 1997 geared the British EU policy towards a more constructive path. It emerged as a key player in the establishment of the CFSP, the CSDP and the enlargement policy. Even though Prime Minister Tony Blair committed the UK to the Constitutional Treaty, his Chancellor and successor Gordon Brown stymied Blair's ambition to consider euro membership.

The EU's current crisis has, however, served as a catalyst when it comes to alienating the UK from the EU. The inclusion of the pro-European Liberal Democratic Party was initially expected to balance the Eurosceptic tendencies of the leading Conservative Party in the coalition government.

However, the current UK government has initiated several interrelated processes aimed at establishing a new settlement with the EU. First, it pushed through legislation making any transfer of powers from the national to the EU level subject to a national referendum. Second, the UK government has launched a so-called balance of competences review aimed at analyzing in detail the impact of the EU on sectoral policy areas in the UK. The review will constitute the backbone of the UK government's aspiration to advance the subsidiarity principle and repatriate powers from Brussels. Third, Prime Minister David Cameron has promised to negotiate a new settlement with the EU, which will be put to the British people in the form of a referendum with a simple "yes" or "no" question on staying in the EU under the new pact or leaving the Union altogether. This most recent turn in the UK's EU policy is clearly linked to the crisis and the resulting developments.

The recent years of financial, economic and political turmoil in the EU have empowered the Eurosceptic forces in Britain in general and in the Conservative Party in particular. Prime Minister Cameron's policy rationale is related to the management of these forces within and outside his party, which is increasingly losing ground to the populist and Eurosceptic UK Independence Party (UKIP). On the other hand, the UK has clearly been sidelined in the EU. The EU members' decision to nullify the British veto by setting up the so-called Fiscal Compact as an intergovernmental treaty outside, yet closely connected to, the EU framework, marks an important development related to the current crisis. It suggests that the EU is prepared to move ahead with or without the UK. Relatedly, the UK has been increasingly concerned about the political weight of the euro area and its largest economies in the EU.

Finally, the road maps to a deeper and genuine EMU envisage a treaty change at least in the mid-term perspective, which would arguably enable Prime Minister Cameron and the UK to have a say in the future direction of the EU as well as negotiate a new settlement.

The success of Cameron's aspirations is in question. In order to fulfil his promises, he needs to persuade other EU members to engage in a treaty change, concur with his vision – which seems to be rather far removed from that of other EU members – and secure a victory in the next general election in the UK in 2015. While the Prime Minister himself has suggested that he believes that the UK belongs in the EU, many have questioned his ability to manage the process and secure a positive outcome in the referendum. To date, Cameron's aspirations have garnered very little support within the EU. Currently, there seems to be scant appetite for a treaty reform among the member states, particularly the major one envisaged by Cameron.

It is noteworthy that there seems to be rather limited support for the UK's aspiration even among its traditional partners in the EU, yet the Netherlands has also flagged up the competence question and German Chancellor Angela Merkel has suggested during her election campaign that the time is ripe to consider whether the EU could give something back to the member states. Both Germany and the Netherlands are, however, deeply committed to the EMU reforms, and they have not argued for any major overhaul of the current EU system, other than reinforcing the EMU as envisaged in the plans approved by the European Council. It remains to be seen, therefore, whether a compromise that would satisfy the UK government and the electorate will emerge.

Euroscepticism is dead. Long live Euroscepticism!

Populist and Eurosceptic political movements have been on the rise in the EU member states during the financial and economic crisis. While their political power base and objectives are diverse, they share some commonalities. In short, many of them are anti-EU and anti-immigration. The re-emergence of the Eurosceptic populist movements in several EU member states has been largely seen to reflect European electorates' dissatisfaction with the EU, as well as the increasingly limited capabilities of national governments to manage their economies in the light of deepened European integration and globalisation. The anti-immigration tendencies of many of these movements have also contributed to the perception that they are intent upon reversing the European project and globalisation, and restoring national sovereignty. Such elements in the current wave of Eurosceptic populism vary over time and space, however.

The UK has often been seen as the home of distinctly Eurosceptic movements in the EU, which have not ebbed away since the polarized national debates on joining the EU. The anti-immigration tendencies of the UK movements have increased in recent years. In many continental EU countries such as the Netherlands, France and Denmark, the immigration debate has been a characteristic of the rise of populist movements, which have also provided a haven for Eurosceptics. In some EU countries such as Finland, the emergence of a major Eurosceptic populist party has been fuelled by the protest mentalities highlighted by the EU crisis and the unpopular Finnish contribution to the rescue loan programmes. The party has also given a voice to popular anti-immigration personalities.

The resurrection of the anti-EU and pro-EU political dividing line in several old EU member states is a significant development which is likely to shape the EU's future development to some extent. These movements are also increasingly operating transnationally, which may serve to increase their power base in the future. The chair of the Finns Party (previously the True Finns Party) is a well-known figure in the UK, for instance, where he has participated as a guest speaker in the Conservative Party Conference as well as at UKIP events. As a former MEP, he is well-networked and involved in the current mobilization of populist parties and movements in Europe in the light of the approaching European Parliament elections.

While Euroscepticism appears to unite the majority of the populist movements in Europe, their ability to form a united front in EU politics is in doubt.

First, due to the EU member states' electoral and political systems it is rather unlikely that populist parties would be able to take control over several member states' governments. Those who make it into their national governments will be constrained by political responsibility and coalition partners.

Second, even if the populist parties are on the road to a landslide victory in the next European Parliament elections, their ability to work towards a joint political agenda or form a coherent political group or groupings in the Parliament is likely to prove rather difficult given their different political objectives.

Finally, the populist and distinctive Eurosceptic movements have expanded particularly in the creditor countries and in the UK. In the debtor countries, the political protests have been channelled through loose anti-globalization movements as well as the radical left and extreme right. The stance that these movements adopt on the crisis and the current plans to deepen European integration draw on a rather different political milieu than that found in populist movements in the creditor countries. Concurrently, the centre-right and centre-left parties seem to be increasingly better prepared to face the challenge of political protest and populism. Yet dissatisfaction among the EU member states' electorates cannot be overlooked. The years of crisis, related extraordinary developments and current plans for deeper economic integration have already led to a critical evaluation of the democratic legitimacy of the EU and the nature of the political union needed to guarantee it.[6]

Conclusion

The recent years of financial, economic and political turmoil have both highlighted some old political dividing lines in the EU and established new ones.

6 This topic will be the subject of a FIIA Briefing Paper published later in the series.

Most of these seem to be in flux, however. That is to say, their boundaries have not been defined or cemented in the light of the recent extraordinary crisis decision or the ongoing re-construction of the EMU. Yet the political divisions are likely to be manifested in ensuing European and national elections, and thus shape the processes suggesting a deeper economic integration. That said, the most significant division related to the deepening of the EU, and one which also seems to prevail over time, is the UK's reluctance to move towards an "ever closer Union". While this may have some ramifications for the reconstruction of the EMU, the EU member states have already demonstrated their ability and willingness to move forward without the UK.

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