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A multi-tiered Europe? The political consequences of the euro crisis

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Executive summary

The November 2012 Allianz-CER forum discussed how the eurozone crisis was changing the shape of the EU. Participants took it for granted that we were already living in a multi-tier EU. They did not, however, agree on the number and nature of the emerging tiers. Some thought that the euro would be only one amongst several emerging clusters. Additional clusters would evolve around foreign policy or immigration, and they would all overlap. Other participants, however, were convinced that the EU would fall apart into a eurozone core and an increasingly marginalised group of euro 'outs'.

Many participants thought that the euro would require stronger economic governance to survive, including a fiscal union and a much bigger central budget. In such a scenario, the barriers to entry into the single currency would increase, turning euro pre-ins into permanent outs. Some participants thought that a banking union consisting of common supervision and a deposit insurance fund would be enough to make the euro sustainable. This minimal solution would have less severe implications for the structure of the EU.

Many people at the event worried that in a multi-tier EU the single market would fragment, or that it might even be rolled back. The euro area, which would inevitably dominate economic policy making in the future, did not comprise Europe's more liberal countries, such as the UK, Denmark and Sweden. Some participants also saw opportunities in multi-speed economic integration, where a smaller number of countries would agree to remove regulatory barriers among themselves. But business leaders warned that such growing complexity would make the single market less useful for them.

The prospect of the UK seeking to renegotiate its membership or even leaving the EU altogether was a big concern at the forum. Some of the British participants thought that a referendum on some sort of 'new deal' between London and the other EU countries could be won. But they conceded that the UK's role within the EU was already changing. British influence was waning and British candidates no longer stood a chance of getting top EU jobs.

Almost all participants agreed that the euro crisis was eroding public support for the European project. The very solutions that were suggested to save the euro put people off: they undermined national sovereignty, gave more powers to Brussels bureaucrats and generally made the EU harder to understand. Some participants thought that EU leaders and parliamentarians needed to explain the EU and current policy initiatives better. Others hoped that improved institutions would help the people to like the EU again, for example a eurozone parliament with real powers to tax and spend or a directly elected Commission president. Others again thought that the EU needed a completely new narrative to restore its legitimacy. But rather than building an ambitious new vision, the most important message should be that the EU delivered clear benefits for its citizens.

Report on the discussion

Two-tier, three-tier or multi-tier?

Multi-tier Europe is a reality. All participants at the November 2012 Allianz-CER Forum agreed on this. Only 17 of 27 EU member-states share a single currency and, according to former Italian Prime Minister Giuliano Amato "we cannot expect all EU countries to join the euro, so this division is permanent". The UK and Ireland do not participate in the Schengen area of borderless travel. Smaller groups of European countries have got together in the past to run military missions. EU countries have started using the treaty clause on 'enhanced co-operation' to implement policies that not all member-states want to take part in. One enhanced co-operation on divorce law is in force; two others – on a financial transaction tax and on an EU patent – are in the works. "We had better get used to this", said former Austrian Chancellor Wolfgang Schüssel, "this is our future."

Participants disagreed, however, on the number and nature of the different tiers, cores, caucuses or clusters, and what their implications would be for the euro and the EU.

Amato thought that the euro would be only one among several "clusters" that would make up the future EU. Other clusters would evolve around foreign policy or co-operation on policing and migration. The foreign policy and defence cluster could be as important as the eurozone cluster, and it could even have its own budget, Amato speculated. These building blocks of a multi-tier Europe would not be created through intergovernmental agreements but through vertical integration that involved EU institutions. And they would overlap. The result would be a European Union that "looks more like a Picasso than an Expressionist painting", Amato concluded.

Michael Leigh from the German Marshall Fund of the US supported Amato's argument, saying that EU countries had many cross-cutting interests. The UK and France, for example, shared views on nuclear energy and the use of force in foreign policy. But Germany and France did not share these views. Sony Kapoor from the Re-Define think-tank explained that individual countries' interests counted much more in EU policy-making than membership of any well-defined groups. "The Poles are blocking a green deal [on carbon emissions], the Austrians are against the savings tax directive, a whole group of countries has watered down the services directive." The basis for policy-making in the EU was not clusters but the lowest common denominator, he said.

However, several participants thought that the EU was changing from a flexible and fluid entity into a more rigid multi-tier structure. David Miliband, former British foreign secretary, argued that there had never been a homogenous European Union. "In the past we had informal networks and hierarchies based on countries' size and wealth and whether they were founding members or late joiners." The European Commission had always acted as a counter-force to any hierarchies, treating all countries equally and standing up for the interests of smaller and newer member-states. Today however, there was a clear separation into euro members and non-members and the Commission was too weak to do anything about it.

Charles Grant, director of the Centre for European Reform, predicted that the EU would dissolve into three tiers: the eurozone, the pre-ins [countries that still aspire to join the euro] and the outs [countries that have decided never to join the euro]. The euro countries and the pre-ins would develop their own institutions, in addition to the European Commission.

Several participants thought that any multi-tier structure would eventually end up as a neat separation of euro ins and outs. Stefan Lehne from Carnegie Europe warned that a "fluid border between the tiers will not hold, more and more business will be sucked into the core". He predicted that the second tier would be marginalised and that a separation into two distinguishable tiers would "destroy the EU as we know it".

Philippe Legrain, one of the Commission's policy advisors, also argued that the integration in the euro cluster was qualitatively different from other areas of integration. "The core is deeper. Spill-overs into other [non-currency related] policy areas are inevitable and other countries will eventually withdraw into some form of associate membership."

Participants with hands-on experience of EU policy-making took issue with the idea that the EU's new structure was the result of deliberate design. Miroslav Lajčák, Slovakia's foreign minister, cautioned that the crisis demanded swift action and therefore made it almost impossible for EU countries to come up with well thought-out solutions that were acceptable to all. He warned that deepening within the eurozone core should not come at the expense of future widening of the eurozone. The more the euro countries worked together in terms of banking union, fiscal union and other initiatives, the harder it would become for other EU countries to join the single currency in the future. "We have to be careful that we do not turn pre-ins into outs", he warned.

Richard Corbett, a former MEP who now advises Herman Van Rompuy, rejected the assumption that the EU needed new institutional structures to reflect the emerging tiers. The eurozone was not some sort of super-cluster that was closed to others. "There are no avant-gardes in the EU, only arrière-gardes: the Danes are not in European defence, Spain and Italy do not share the EU patent and

Great Britain stays outside Schengen. But most issues are dealt with at the EU level of 27." Corbett suggested that, rather than setting up new institutions, the Council should ask those countries not taking part in a particular initiative to refrain from voting on it. But the Council would remain the main locus of EU decision-making and the European Parliament and the European Court of Justice would keep their established roles. The only exception, Corbett said, would be decisions where EU governments commit taxpayers' money.

Will the single market fragment?

How will a multi-tier Europe affect the economic achievements of the EU? Many participants worried that the separation between euro ins and outs would lead to a damaging fragmentation of the single market. Miliband warned that in a multi-tier Europe the single market would not be deepened and might even be rolled back. He said that the eurozone – without more liberal countries such as the UK, Sweden and Denmark – would slow the drive for supply-side reforms. Meanwhile, vested interests would be strengthened because the European Commission [the traditional guardian of the single market and competition] was becoming weaker.

Grant thought that within a three-tier EU, a caucus of eurozone members would discuss and agree their positions ahead of EU-level meetings and then impose their views and wishes on the non-euro countries. Many of the current eurozone members were not great fans of open markets and liberal trade policies, he said, and cited Mario Monti's observation that "those who believe most in economic integration [open markets and competition] are not in the euro. And those who are in the euro, do not believe in economic integration."

John Kerr, who used to represent the UK in the EU as well as the European Convention, looked specifically at how the outs could safeguard their interests in the emerging banking union. The UK and other non-euro countries feared that the euro countries – represented by the ECB – would form a caucus within the European Banking Authority (EBA). Britain would struggle to stand up for the interests of the City of London. Kerr thought that British demands for a blocking minority in the EBA would not be heeded. "New banking regulation will in practice be decided by the ins and pre-ins. Then there will be a split in the single market for financial services."

Economic opportunities in a multi-tier Europe

Katinka Barysch from the Centre for European Reform observed that most participants appeared rather pessimistic about the impact of reforms that were currently being implemented in many eurozone countries: "You assume that in a few years' time the eurozone core will still be slow, uncompetitive, protectionist and inward looking." Might there not be a scenario where a reformed and enlarged eurozone embraces competition and open markets and hence acts as a driving force for economic growth in Europe?

Some others also saw economic opportunities in a multi-tier Europe. Schüssel thought that deeper economic integration in the eurozone could lead to a new push to complete the single market: energy, services, e-commerce, defence procurement and workers' mobility were all areas that were yet to be addressed. Schüssel cited expert estimates that the completion of the single market could add 1.5-2 per cent to the EU's growth rate. Paul Adamson from E!Sharp added that the full implementation of the services directive alone would increase EU GDP by €340 billion. Schüssel also thought that economic projects among smaller numbers of countries could lead to "different economic regions" in the EU and therefore foster competition. For example, the Central and East European countries might get together to harmonise taxes on a lower level. Wolfgang Ischinger, global head of Allianz government relations, agreed with Schüssel and quoted Allianz Chief Economist Michael Heise who predicted that the EU would emerge strengthened from the current crisis.

Daniel Gros, director of the Centre for European Policy Studies, also argued that economic integration at various speeds need not be a bad thing. If all countries still participated in the single market, and some countries decided to go further with integration, then there should be overall economic benefits. "If the countries in one tier are reducing regulatory barriers among themselves, then that is also good for the outsiders." Gros questioned whether there would be any demand for rolling back the single market, even within an inner group that lacked the allegedly liberalising influence of the UK. "Businesses object to change because they write their business plans based on the status quo. But once liberalising measures are adopted and implemented, there is a new status quo. Business does not usually call for the return of trade barriers."

The EU's outside trading partners seemed to share that sanguine view, at least for the time being. Peter Chase from the US chamber of commerce said that as long as the euro countries integrated among themselves without creating new barriers for others, the rest of the world would be fine with this. "Multi-tier Europe could work more like a series of free trade agreements", he said. But Peter Witt from Siemens said that business would struggle with the complexity that would result from multi-speed economic integration. "The proliferation of free trade agreements around the world has made it almost impossible for businesses to know what has been agreed and with whom." Business liked the single market because it was homogenous.

Does the eurozone need an economic government?

Amato argued that the logic of the single currency would lead to economic policy-making migrating to the centre.

The euro crisis was forcing many countries to implement austerity. That only left the supranational level to take care of growth-boosting policies, Amato argued. New eurozone-level institutions should be able to borrow money and then deal with asymmetric shocks in the euro countries. Such a shift of responsibility to the centre implied that the euro would "only survive as a quasi-federal entity".

Ulrike Guérot from the European Council on Foreign Relations in Berlin also thought that a bigger eurozone budget would be needed to deal with economic shocks. She also advocated the idea of European unemployment insurance. In addition to evening out economic activity across Europe, such a scheme would help build a European identity, she thought.

Gros took issue with the idea that the eurozone needed some sort of economic government to survive. He explained that economic governance had two elements: the first was rule-setting, for example the stability and growth pact or, more recently, the fiscal compact. The second element was daily management of the economy. This management was done by national governments and their ministries, within a common EU framework but independently of the centre.

Gros recounted that already the Werner Plan of 1969 had advocated "a common centre for economic decision-making". Since then, every economic crisis in Europe had elicited calls for shifting economic governance to the supranational level. The reason why this had never happened, said Gros, was that it was simply not necessary.

The only exception he made was banking and finance – a sector where tensions tended to build up over the economic cycle, and cross-border spillovers were significant. Therefore, the eurozone needed a common deposit insurance fund, equivalent to the US Federal Deposit Insurance Corporation (FDIC), and detailed monitoring of big European banks. But the solution to the euro crisis did not lie in detailed economic decision-making at the euro-level. It was enough to put in place common financial supervision and stabilisation mechanisms to prevent such crises recurring.

Gros also disputed the need for a big federal budget to stabilise the eurozone economy in case of shocks. He explained that the US federal budget – which was generally cited as a model – did not provide much shock absorption, it only helped to equalise incomes across the nation. Housing booms and busts in the US were just as geographically concentrated as in the EU. The big difference, argued Gros, was that the US was a banking union. When the housing bubble burst in, for example, Nevada, house owners there could no longer pay their mortgages and local banks got into trouble. But then the FDIC stepped in to guarantee saving deposits and Freddie Mac and Fannie Mae took over toxic assets. The problems of banks in Nevada did not spill over into the state budget of Nevada.

The EU, Gros argued, could set up the eurozone equivalent of the FDIC for €80 billion. There was no need for a big eurozone budget, nor would €80 billion warrant setting up a new apparatus to ensure democratic legitimacy. "Most bank bail-outs, which are much bigger, are done behind closed doors. Voters never find out how much they actually paid."

Dangerous political consequences

Not all participants were so sanguine. Miliband warned that economic necessities and political realities were pointing in opposite directions. To save the euro, the European governments would have to do many things that they could not "sell to their voters". The current self-defeating austerity drive had already destabilised politics in Greece and elsewhere. To save the euro, the member-states now had to rapidly share sovereignty, encourage labour migration and increase counter-cyclical spending. But none of these things were popular, or even feasible. Miliband asked whether ultimately "in saving the euro, we will destroy the EU".

François Heisbourg, special advisor to the Fondation pour la Recherche Stratégique in Paris, took an even more alarmist view. He warned that the austerity drive in the eurozone could lead to developments that might ultimately destabilise Europe and the wider region. He thought that this could happen as early as 2013, with France and Greece as potential trouble spots. If France implemented budget cuts and Hartz IV-type labour market reforms, unemployment would shoot up and – with no light at the end of the tunnel – the French would turn against their government and against the EU. "If we enforce the fiscal compact in France, we will enter the Spanish spiral [of falling GDP, growing debt and renewed need for austerity]. But we are not as patient as the Spaniards", he warned.

Heisbourg also feared that further austerity in Greece, where GDP has already fallen by almost a quarter, would lead to a political crisis. Political collapse in Greece could spill over into fragile Balkan countries, which would spell the end of their EU accession aspirations. In the resulting strategic void, Russia may seek to strengthen its regional power. "Without growth, we will destabilise European politics, and strategic ruptures are bound to happen in such situations", he concluded.

The British, French and German questions

The emergence of a multi-tier EU poses specific challenges to the biggest member-states, Germany, France and the UK. Participants all seemed to agree that Germany is now the pivotal nation in the EU and that it would be at the heart of any emerging core based on the euro. Beyond this broad agreement, there was remarkably little debate about Germany's role in a multi-tier EU.

Most participants took it for granted that Germany would push for stronger central budgetary oversight in return for more central eurozone financing. However, some cautioned against German plans to negotiate a new treaty as the legal basis for such changes. Kerr recommended to the Germans not to go for a treaty until and unless it was absolutely necessary. Pragmatic co-operation and progress was much preferable. "This is not the time to dream dreams and have visions."

Heather Grabbe from the Open Society European Policy Institute asked whether France would be willing to go along with Germany's federalist plans. Heisbourg thought not. He predicted that French politicians would heed the lessons from 2005 [when French voters rejected the EU constitutional treaty in a referendum]. "Federalism: we have been there, done that and seen what happened."

Heisbourg explained that nevertheless France's role in the EU was about to change fundamentally. France had had a special role in the EU by building a bridge between Germany and the UK, especially on questions of foreign policy and defence. If France was sucked into the euro crisis, it could no longer play this role and the UK would be more likely to move to the margins of Europe. France would then feel rather uncomfortable in a German-run continental EU.

The question of if, when and how the UK might leave the EU or re-negotiate its membership occupied many participants. Miliband thought that the domestic political dynamics in Britain were pushing the country inexorably to the exit. The Conservative prime minister, David Cameron, was following demands of his eurosceptic party base to either get a 'better deal' from the European Union or leave altogether. "The UK is dealing itself out of the game", Miliband said. Long-standing allies, such as Denmark or Poland, felt let down by London which was pursuing a strategy dictated by domestic necessities.

Participants were doubtful whether the other EU countries would be willing to re-negotiate British membership, especially on sensitive issues such as labour law. Kerr predicted that "Britain can already devalue its currency. If it now also wants to opt out of EU labour rules, the other EU countries will say: never." But others indicated that Britain's European partners would go to some lengths to keep the country in. "We need Britain in", said Schüssel, "we need their liberal, open approach. The EU would be a sad story without the UK." Steven Everts from the EU High Representative's office asked how much the other liberal countries were ultimately willing to compromise to keep Britain in and the single market intact.

Two of the British participants showed some optimism about Britain's future in the Union. Kerr said that Europe should not be disheartened by current opinion polls, which showed that a majority of Britons wanted to leave the EU. He recounted that in 1973, a full 64 per cent were against Britain joining what was then known as the Common Market. In a referendum only two years later, 66 per cent voted in favour of Britain remaining a member. "The British are an inherently cautious and conservative people", Kerr said and predicted that in a referendum on membership a majority would choose the status quo.

Michael Maclay from Montrose Associates also begged the other Europeans to "not give up on us". He conceded that the eurosceptics' *Schadenfreude* over the euro crisis made it very hard for the pro-Europeans in the UK to get a hearing. But Europe was not a priority for most British voters. And if negotiations with other EU countries allowed David Cameron or his successor to convince voters that Britain was getting a 'better deal', most Britons would probably accept it.

In the meantime, participants said, the fact that the UK was not a member of the euro – together with the threat that it might withdraw further form the EU – was already changing the nature of the UK's membership. In 2012 there was a discussion whether British MEP Sharon Bowles could continue chairing the European Parliament's committee on economics and finance. Some argued that only a person from the eurozone should chair this influential body. Kerr thought this was a "harbinger of something sad and inevitable": further marginalisation of the UK. UK candidates would no longer be in the running for top jobs in the EU.

Waning public support for the European project

Most participants agreed that the euro crisis was eroding public support for the EU, its institutions and policies. Grabbe predicted that the very measures currently being implemented to save the euro would alienate people further: "These measures will just create lots more eurocrats with more powers, but they will not do anything for growth in the near future." Miliband explained that the euro crisis reinforced an existing trend towards declining trust in public authority generally, at the national and supranational level. Similarly, Schüssel argued that "the six-pack, two-pack, fiscal compact… all these agreements undermine governments' ability to determine their countries' own fate." Ischinger warned that the emergence of a multi-tier structure would erode the EU's legitimacy further: "Voters do not understand what the EU is even today. If we make it more complicated, it will be even harder to explain and it certainly will not inspire."

Amato suggested that giving Europeans a vote on the new structure of the EU would get them back on board. "If we go federal, we need to change all national constitutions and we need referendums on these." Amato seemed to assume that such referendums could be won. But others were not so sure. Heisbourg thought that most people around Europe did not like federalism; and if the "federalist experiment" failed, the result might be rising nationalism. Lehne agreed. He reminded participants that after the lengthy and acrimonious adoption of the Lisbon treaty, most Europeans agreed that there should be no more deepening for the time being. Now the eurozone was heading toward much deeper integration, and fast – but that integration was "based solely on fear", not on the wish of the people to build a stronger European Union. As such, it would not be sustainable.

Others were a bit more optimistic. Gros thought that the crisis had produced urgent and overblown demands for accountability and legitimacy. Once things had calmed down again, and the EU returned to 'normal' business of enforcing budget rules and policing the single market, such demands would die down.

Some participants thought that more transparency would go a long way in getting Europeans to like the EU again. Lajčák said that EU leaders were so focused on trying to find solutions to the euro crisis that they forgot to explain them to their voters. "We need to turn euro speak into something that our grandmothers can understand."

Kerr also thought that the way EU business was conducted behind closed doors, especially the crisis summits on the euro, was damaging EU legitimacy. "Now we have black limousines dumping leaders in front of a Brussels building. Then they emerge 18 hours later with a complicated press statement." He thought that a European congress made up of national MPs from the EU countries would generate the kind of public debate that would re-connect Europeans to the EU. The congress would hold discussions in public and national MPs would be better at explaining the issues to their voters at home than MEPs.

Guérot also opted for more transparency. She said the EU could use new technologies to translate debates in the European Parliament or the Council immediately in the national languages of the member-states and then spread them on the social media sites that younger people frequent.

Several participants suggested that it was really mistrust among EU governments that made it so hard for the people to believe in the benefits of the EU today. The euro crisis had led to a lot of antagonism and suspicion between creditor countries and debtor countries. Creditor countries did not believe that their aid was being put to good use, especially since reform efforts seemed to have slackened in some countries as soon as support was forthcoming. Recipient countries, on the other hand, did not really see the multi-billion euro bail-outs as European solidarity, not least because they were coupled with conditions for harsh austerity that have depressed growth. "Once trust among EU countries is broken, the green shoots of recovery will not restore it", warned Grabbe.

An institutional fix?

Many participants thought that the answer to the EU's legitimacy problem lay in improving its institutions. The traditional solution to legitimacy issues in the EU had been to give more powers to the European Parliament. But several participants were not sure this was the right way forward in response to the euro crisis and the emergence of a multi-tier Europe.

Schüssel questioned whether the European Parliament was at all suited as a countervailing force to stronger central European institutions. "The traditional role of parliaments is to control the executive, to make sure that it does not spend too much. But the European Parliament always wants more spending, more power, more control. They say this is their mandate but European voters do not support that, they do not even turn out to vote."

The eurozone crisis posed fundamentally new challenges to democratic representation in the EU. Guérot explained that the German government considered it undemocratic to let all MEPs vote on business that only pertains to the eurozone. It therefore advocated a 'eurozone parliament' consisting of MEPs from only eurozone countries. Guérot also wanted to see much more power for this new parliamentary body. Assuming that economic management and spending power would migrate to the eurozone level, she advocated a eurozone-level parliament with real powers to tax and spend. "If you want the Germans to go further into mutualisation, including banking union, we need a fully-fledged parliamentarisation of the budget process. Responsibility and legitimacy have to be at the same level."

Others doubted that eurozone countries would accept such a massive transfer of power to the eurozone level. There were also questions whether national parliaments would not be better suited to bestow legitimacy on controversial decisions taken at the eurozone level. Kerr used the example of a newly established eurozone banking supervisor telling a country to close down a teetering bank. Such decisions would be so controversial and wide-ranging that they would have to be put in front of the national parliament concerned. Legrain also wanted to see a stronger role for national MPs. He suggested a new council consisting of MPs from the budget committees of euro-area parliaments as a counterweight to the euro group of finance ministers.

Other participants put their hopes not so much in the European (or eurozone) parliament but in an elected European Commission. Grant explained that the Lisbon treaty had given the European Parliament the right to vote on the candidate that EU governments put forward for the job of Commission president. However, since voters seem somewhat disconnected from the European Parliament, that mechanism did not appear to change the president's image as a 'eurocrat'. Some therefore advocated that Europeans should directly elect the Commission president [whose role might then also be merged with that of the Council president].

Kapoor, however, doubted that such an election would provide "real choice" for Europeans. "If Merkel campaigned for the job of Commission president, would French conservatives vote for her over a French socialist?" Some were not even so sure that the Commission required direct democratic legitimacy. Corbett argued that it was the job of the Commission to enforce rules that national governments have previously agreed. Today, peer pressure amongst eurozone governments and the markets were helping to enforce such rules. If anything, the need for the Commission to get a direct mandate was reduced.

A new narrative for the Union

Some participants thought that no institutional fix would restore legitimacy as long as the Union had no convincing message to tell the people. Grabbe said that the award of the Nobel Peace Prize to the EU in 2012 had "sealed the era of the EU as a peace project. Today the Union needs a new narrative."

Miliband argued that "the biggest reason for lack of trust in the EU is the lack of delivery, not the lack of democracy". He surmised that if the euro crisis had been handled better, the EU would still be more popular. Kerr agreed. He suspected that most Europeans thought that the EU was a body that "was not doing very much" apart from writing a new treaty once in a while. The EU should try to produce more tangible results, for example by resolving 'frozen conflicts' in the Caucasus, bringing stability to the Balkans or supporting the Syrian opposition. Kerr said the euro crisis was not a good excuse for not delivering results elsewhere.

Lajčák argued that ultimately the way to make European citizens feel better about the EU was to restore the trust of the markets in the euro project. Once markets had calmed down and growth returned, Europeans would also support the European project again.

Schüssel finally summed up the EU's new role as follows: "If it was NATO's task to keep the US in, the Russians out and the Germans down, then it is the EU's task to keep France and Germany together, the South up and the Brits in."

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