

A stylized map of Europe composed of a grid of grey dots, with several dots highlighted in red to represent specific countries or regions.

# On the Way to a Fiscal or a Stability Union?

## The Plans for a »Genuine« Economic and Monetary Union

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- Besides acute crisis management issues, the EU started a process of identifying possible reform steps to deepen the integration of the Economic and Monetary Union (EMU) in 2011. This engagement concerning the systemic character and risks of the Eurozone crisis began relatively late.
- A mapping of missing elements in the Maastricht architecture of EMU done by Herman van Rompuy, José Manuel Barroso, Jean-Claude Juncker and Mario Draghi in 2012 presented four comprehensive building blocks that would have to be implemented in order to realise their »vision for a stable and prosperous EMU«.
- These ideas for expanding the today's monetary union to a fiscal union have been refined by own plans of the European Parliament and the European Commission. However, their scope has been stripped-down intensively by the heads of state and government at their European Council summit in December 2012.
- Since then, the reform debate on establishing a »Genuine Economic and Monetary Union« transformed into a conflict between two groups of Member States gathering around France on one side and Germany on the other. The latter camp seems to have gained the lead with its »stability approach« against all kinds of mutual liability, financial rebalancing and social coherence. Elements still under consideration for 2014 are a Banking Union, stronger economic policy coordination, contractual agreements between Member States and the EU, a fiscal capacity, the democratic legitimation and the social dimension of EMU.



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## 1. Introduction: The Euro-crisis as the Background of the EMU Reform Debate

For several months, the abbreviation »GMU« has haunted the debates at conferences and meetings on the crisis of the European Monetary Union (EMU). The EU has never lacked acronyms and the Eurozone crisis has brought a rich harvest of new coinages, such as EFSF (European Financial Stability Facility), ESM (European Stability Mechanism), MOU (Memorandum of Understanding) and OMT (Outright Monetary Transactions). Now we have GMU, short for »Genuine Monetary Union«. Alternatives offered by the dictionary for »genuine« would be »straightforward«, »authentic« or, above all, »serious«, but they would have had ironic undertones. But what is a »genuine« monetary union?

At the latest with the spread of the Eurozone crisis to Italy and Spain, whose refinancing costs skyrocketed on the announcement of a »haircut« in Greece from which the private sector did not escape unscathed, the conviction began to grow that Europe would not be able to cope with the crisis solely by readjusting existing governance instruments. The governments of the euro Member States, at their meeting on 26 October 2011, asked Herman van Rompuy, President of the European Commission and chair of the Eurogroup, to work out possible steps to deepen integration in the Monetary Union. The focus was to be on closer economic convergence and improved fiscal discipline. Limited Treaty changes were also to be discussed concerning the deepening of EMU (Euro Summit 2011: 10).

This belated realisation pointed, first, to the systemic character of EMU's crisis, which at this point had been simmering for two years. Previously, the only take on the crisis officially recognised by the EU institutions had been the transgressions of individual Member States against European regulations and the latter's ineffectiveness. Discerning fundamental shortcomings in the architecture of the Monetary Union and a desire to rectify them did not, however, lead to the abandonment of the crisis-mode adopted in 2010, characterised by solidarity based on credit, strictly conditional on austerity measures. Furthermore, the faith of the heads of state and government in the European Council in tightening up the existing framework of budgetary controls through a stricter interpretation of the Stability and Growth Pact, underpinned by sanctions remained unshaken. This is reflected, on

one hand, in the continuing unchanged demands made to crisis-countries Cyprus, Greece, Ireland, Portugal and Spain to lower wage costs, cut social services and implement privatisation (Busch et al. 2012). On the other hand, the growing tangle of new instruments, procedures and institutions of European economic governance indicates the inadequacy of piecemeal tinkering with the existing architecture of the euro zone, in particular in terms of a thematic orientation towards limiting public debt – based on an understanding of the current situation as a »sovereign debt crisis« – by means of the European Semester, the Six-Pack, the Two-Pack, the Euro-Plus Pact and the Fiscal Compact (Hacker 2013a; Hacker 2013b).

Only the ever more apparent failure of the pure austerity course, with its economic errors and social upheavals, but also the attendant surge in political protest, which found an important voice with the election of François Hollande as President of France, led to an intensification of work on plans to complete the existing EMU as a »genuine« monetary union in 2012.

In Section 2 we present a historical outline of the relevant events, together with the plans presented and discussed up to the end of 2012. In Section 3 we present the changed emphases of the reform debates in 2013. Six central building blocks from the discourse on a »genuine« EMU are considered critically in Section 4, before concluding in Section 5 with a discussion of the lines of conflict and prospects for moving forward.

## 2. The EU's Draft Reforms: Presentation and Critique

### 2.1 The First Quadriga Report and Its Political Reception

At the meeting of the European Council on 28–29 June 2012 Herman van Rompuy presented his first report on deepening EMU integration, in whose drafting he had consulted, besides Commission President José Manuel Barroso and Chair of the Eurogroup Jean-Claude Juncker, the President of the European Central Bank Mario Draghi. »The report proposes to move, over the next decade, towards a stronger EMU architecture, based on integrated frameworks for the financial sector, for budgetary matters and for economic policy« (Van Rompuy 2012a: 1). The four presidents identify four central building blocks

in the architecture of the euro zone that would have to be implemented in order to realise their »vision for a stable and prosperous EMU«:

(i) An integrated financial framework, in other words: a banking union with mandates for European supervision and for restructuring and depositing guarantees safeguarded by the European Stability Mechanism (ESM).

(ii) An integrated budgetary framework that ties stringent state budgetary policy with joint debt management, through the emission of common bonds. Explicitly mentioned is the possible establishment of a debt repayment fund (Van Rompuy 2012a: 6). Complete fiscal union implies the development of a fiscal capacity to manage economic interdependencies, for example through a joint budget.

(iii) An integrated economic policy framework, to promote sustainable growth, employment and competitiveness on the basis of the European Semester and the Euro-Plus Pact, in particular with regard to labour mobility and tax coordination.

(iv) Strengthening the democratic legitimacy and accountability of the new joint decision-making mechanisms in the areas of finance and the economy.

The Quadriga Report met with mixed reactions, but on a number of key points it deviates from the currently dominant crisis management. Thus, a banking union is proposed that would, by means of the ESM, be propped up by a safety net. In the – probable – event of restructurings and liquidations of financial institutions, it would have at its disposal the mechanism introduced to supply states in refinancing difficulties with emergency loans and guarantees. The principle of Community liability introduced de facto in circumvention of the »No bailout« clause of Article 25 of the EU Treaty is highly contentious; even more so its extension to private-sector banks. In view of Spain's banking problems the possibility of indirect bank recapitalisation via the EFSF/ESM was agreed at the June 2012 euro-state summit against German opposition and only under strong pressure from Italy and Spain (Euro Summit 2012).

With regard to the integrated budgetary framework the four presidents by no means talk only of strengthened budgetary controls, but also of the need for a fiscal

union, with the option of joint issuing of debt securities. Coordination and convergence are to be promoted explicitly beyond budgetary concerns in a number of economic-policy areas with a view to reducing imbalances. The relatively clear plea for a higher degree of European responsibility and transnational solidarity is complemented by a reference to improved integration of the European and national parliaments.

The proposals for completing EMU by increasing Communitisation made here for the first time by a powerful, albeit informal committee must have annoyed, to say the least, states which back the austerity policy propagated by the German government. Thus Finland's finance minister Jutta Urpilainen positioned herself against any kind of Communitisation shortly after the summit at the end of June: »We cannot agree to joint responsibility for the debts, national economies and risks of other countries« (quoted on *FAZ.net*, 6 July 2012). German Chancellor Angela Merkel expressed a similar view in a government statement at the EU summit: »I fear that the summit will once again talk too much about all kinds of ideas for possible joint liability, and much too little about improved controls and structural measures« (quoted in *Die Zeit Online*, 27 June 2012). It is not the aim of these governments to establish a fiscal union, but rather a »stability union«, with a view to establishing central budgetary control, including the right to intervene in national budgets.

Accordingly, the conclusions of the European Council speak surprisingly openly about »differences of opinion« that became evident in the debate on the Quadriga Report. This was merely taken note of, however, and the four presidents were asked to work out their proposals in more detail by the end of 2012 (European Council 2012a: 3).

## 2.2 First Amendments at the October Summit 2012

At the meeting of the European Council in October 2012 Herman van Rompuy laid out an Interim Report that further developed the building blocks of a »genuine« EMU presented in June against the background of individual talks with the governments of all Member States, as well as the President of the European Parliament. The integrated financial framework by means of a banking union was retained in every particular; it was emphasised that

»the establishment of an integrated financial framework is necessary for the achievement of a genuine economic and monetary union« (Van Rompuy 2012b: 2). It was also made clear, however, that at the same time there must be »more effective fiscal discipline« because otherwise taking over banking sector risk could give rise to negative incentives (Van Rompuy 2012b: 3). In the area of an integrated budgetary framework the Interim Report refers, first, to the innovations of the Six-Pack and the Two-Pack, either already adopted or in the process of legislation. The latter plan on the ex-ante coordination of national budget plans is already a crucial prerequisite for the introduction of a form of Community bond. There was also further clarification of the idea of a fiscal capacity for the euro zone. While a symmetric shock that affects all countries at the same time should be tackled by means of monetary-policy measures, for an asymmetric shock a central budget is proposed with which »a form of limited fiscal solidarity« would be enabled through »elements of fiscal risk sharing«. The difference with the ESM is worked out clearly: »The European Stability Mechanism is a crisis management instrument and was not designed to perform such a shock absorption function« (Van Rompuy 2012b: 5). For the first time, the idea of bilateral contractual agreements between the EU and individual Member States on structural reforms is invoked, including prior coordination and central »macro-prudential« supervision by Brussels. In order to enhance democratic legitimacy reference is made to the possibility of an interparliamentary conference to improve cooperation between the European and national parliaments, as proposed by the Fiscal Compact (see Schäfer and Schulz 2013).

The October summit took note of the Interim Report and asked the four presidents to present a detailed roadmap at the December summit, complete with deadlines for the implementation of individual elements of the »genuine« EMU. In the conclusions some aspects of the Interim Report are repeated, albeit with reservations (European Council 2012b: 6ff). Thus banking union is not classified as a non plus ultra of any further integration. Instead, mention is made of prudence with regard to the allocation of competences for supervision, restructuring and liquidation between the supranational and national levels. The heads of state and government refer in great detail to the instruments of budgetary policy supervision, the Six- and the Two-Pack, as well as the Fiscal Compact, whereas they mention fiscal capacity only in passing as a mechanism to be explored. Bilateral Treaty partnerships

and ex-ante coordination of economic-policy reforms were touched on briefly, whereas the forms of joint debt management mentioned in the Interim Report, including the issuance of Eurobonds and so on, were not addressed.

## 2.3 The Resolution of the European Parliament

At the end of November 2012 the European Parliament laid out its own plans on the future of EMU. The Resolution of 20 November (based on the Thyssen Report), adopted by a large majority, called for a leap in the direction of a federal Europe. For the Parliament, this includes enabling a banking, fiscal, economic and political union. The MEPs criticised the fact that the President of the Parliament was not invited to the meetings of the Van Rompuy group and called for more comprehensive accountability and a strengthening of Parliamentary control and consultation rights. They also mentioned closer involvement of national parliaments if more rights were to be transferred to the European level within the framework of the new economic governance (European Parliament 2012).

With regard to banking union the MEPs called for the establishment of an integrated oversight mechanism and the rapid implementation of new directives on deposit guarantees and on the restructuring and liquidation of financial institutions. The latter point involved »open[ing] up in the medium-term the creation of a single European recovery and resolution regime« (European Parliament 2012: Annex). As part of a fiscal union the European Parliament proposed a gradual rollover of excessive debt into a redemption fund and listed detailed targets for a European Social Pact, such as a European youth guarantee to combat youth unemployment and the implementation of a social protocol. With regard to possible institutional changes the MEPs emphasised that even a framework for closer coordination for the Monetary Union would have to be based on a Treaty design for the EU as a whole: »The currency of the Union is the euro and its parliament is the European Parliament« (European Parliament 2012: Annex).

Table 1: A blueprint for a deep and genuine EMU as presented by the European Commission

			A blueprint for a deep and genuine EMU Launching a European debate	Secondary law	Treaty change
ALL ALONG THE PROCESS	SHORT TERM	Within the next 18 months	1. Full implementation of <b>European Semester</b> and <b>Six-pack</b> and quick agreement on and implementation of <b>Two-pack</b>	✓	
			2. <b>Banking Union</b> : Financial regulation and supervision: quick agreement on proposals for a <b>Single Rulebook</b> and <b>Single Supervisory Mechanism</b>	✓	
			3. <b>Banking Union: Single Resolution Mechanism</b>	✓	
			4. Quick decision on the next <b>Multi-annual Financial Framework</b>	✓	
			5. Ex-ante <b>coordination of major reforms</b> and the creation of a <b>Convergence and Competitiveness Instrument (CCI)</b>	✓	
			6. Promoting <b>investment</b> in the <b>Euro Area</b> in line with the Stability and Growth Pact	✓	
			7. <b>External representation</b> of the <b>Euro Area</b>	✓	
	MEDIUM TERM	18 months to 5 years	1. <b>Further reinforcement of budgetary and economic integration</b>	✓	✓
			2. <b>Proper fiscal capacity</b> for the <b>Euro Area</b> building on the CCI	✓	✓
			3. <b>Redemption fund</b>		✓
			4. <b>Eurobills</b>		✓
	LONGER TERM	Beyond 5 Years	1. <b>Full Banking Union</b>		✓
			2. <b>Full fiscal and economic union</b>		✓
			<b>Political union: Commensurate progress on democratic legitimacy and accountability</b>	✓	✓

Source: European Commission 2012b.

## 2.4 Blueprint of the European Commission

On 28 November 2012 the European Commission presented a »blueprint for a deep and genuine economic and monetary union« (the so-called »Blueprint«). Building on a balanced analysis of the shortcomings of the current EMU architecture and evaluating previous measures as unsatisfactory for overcoming the crisis, it proposed short-, medium- and long-term steps to enable a political union (European Commission 2012a: 13ff):

(i) Within the next 6–18 months the banking union should be realised, including an integrated supervisory and resolution mechanism. In order to improve economic-policy governance an instrument for convergence and competitiveness should be introduced that provides for

direct contractual arrangements on the implementation of structural reforms between the EU and individual Member States.

(ii) Within the next 18 months to five years further budgetary and fiscal-policy coordination by means of a proper fiscal capacity for the euro zone, a redemption fund and common issuance of short-term government debt, so-called eurobills, should be achieved.

(iii) For the period beyond five years, autonomous euro area budgeting should be established for EMU that can absorb economic shocks. Furthermore, the fiscal-policy conditions for the common issuance of public debt, so-called Eurobonds, should be put in place.

The Commission argues that the short-term measures can be implemented within the framework of secondary law (see Table 1), whereas for the medium and long term, amendments to the Treaty are necessary. It also offers proposals to strengthen democratic legitimacy and governance in EMU (European Commission 2012a: 40ff):

- Thus the European Parliament should be more closely involved in the European Semester and the establishment of the main features of the economic and employment policy guidelines.
- In the wake of a Treaty amendment the economic and employment policy guidelines could be transferred to the regular legislative procedure, and a new competence could be adopted for reviewing national budgetary plans in accordance with European obligations in the co-decision procedure.
- Institutional amendments should be striven for in the direction of a segregation of euro members within the three EU institutions, for example, by means of a deputy commissioner responsible for the economy, finances and the euro; an expansion of the functions of the Eurogroup in a council for the euro area; and a Euro Committee in the European Parliament. The European Commission recognises the importance of cooperation with the European Parliament and national parliaments, but it considers an interparliamentary assembly, as proposed in the fiscal treaty, to be inappropriate for increasing democratic legitimacy.

## 2.5 Quadriga Report II and Its Compression at the December Summit 2012

Van Rompuy presented the Report, revised with Barroso, Juncker and Draghi and taking into account direct consultations with the Member States, at the meeting of the European Council on 13–14 December 2012 (Van Rompuy 2012c). In it, in accordance with what the report was supposed to address, a time-bound three-stage plan is proposed for realising a »genuine« EMU, with the following main components:

(i) By the end of 2013 the planned banking union should be largely in place, with an integrated oversight mechanism, rules for deposit guarantees and the option of direct bank capital recapitalisations via the ESM. A

framework should be established for the prior coordination of economic policy reforms envisaged in the Fiscal Compact.

(ii) By the end of 2014 the banking union should be completed with a mechanism and authority for winding up banks and a new instrument for implementing structural reforms should be introduced with contractual arrangements between the EU and the individual Member States. Temporary financial support should be available for the Member States from a new common budget to enable compliance with adjustment measures.

(iii) After 2014 a fiscal capacity should be established in EMU able to absorb country-specific economic shocks by means of an insurance system. Furthermore, the coordination of economic policies between the Member States should be improved, in particular in the areas of employment and taxation.

In contrast to what might be supposed concerning these far-reaching proposals, the EU's December summit ended disappointingly, in particular given the high expectations. The fanfares »Roadmap for the completion of EMU« consists of little more than declarations of intent. Only in the area of banking union are the conclusions concrete and call – by reaffirming the conclusions of the October summit –, after agreement has been reached on an integrated supervisory mechanism in the ECOFIN Council, for swiftly bringing about agreements on proposals for directives on the restructuring and liquidation of banks, on one hand (by the end of March 2013) and for deposit guarantee systems (before June 2013), on the other (European Council 2012c: 3f).

Consensus was not reached on all topics arising from banking union, but the presidents of the European Council and the European Commission were again assigned the task of review. By the June 2013 summit, after consultations with the Member States, a concrete roadmap was to be worked out with deadlines, presenting the options for shaping European policy in four areas:

- (i) ex-ante coordination of Member States' major economic-policy reform plans;
- (ii) EMU's social dimension, including social dialogue;

(iii) direct contractual arrangements on competitiveness and growth between the EU and individual Member States;

(iv) solidarity mechanisms to support contractual arrangements.

Furthermore, the euro Member States wanted to reach agreement on rules of procedure for their meetings, introduced by the Fiscal Treaty, by the March summit of 2013. The European Parliament and the national parliaments were called upon to give impetus to the interparliamentary conference also mentioned in the Fiscal Treaty, at which EMU-related issues would be discussed. To allay fears of some non-members about an irreversible evolution of a core architecture of the euro zone with its own set of instruments and institutional structures, the Heads of State and Government emphasise that »[t]he process of completing EMU will build on the EU's institutional and legal framework« (European Council 2012c: 2).

Even if the three reports presented at the end of 2012 differ in the extent to which they deepen EMU, they each develop and deepen the four building blocks of the first Quadriga Report of June 2012. However, the clear commitment to the medium-term establishment of a fiscal union with elements of common debt management, the establishment of a fiscal capacity for the Monetary Union as the preliminary stage of a euro zone budget and the first steps towards a political union were scrapped at the summit meeting by a group of critical states around Germany (Bloomberg, 6 December 2012). Apart from the commitment to establish a banking union and the usual emphasis on implementing the new budgetary policy guidelines this involves a reorientation of the plans being pursued by the European Council. All that remains is the aspects of ex-ante coordination, direct contractual arrangements and appropriate incentive mechanisms mentioned fleetingly for the short term and as a means to an end by the abovementioned reports. Intended as preliminary stages of close fiscal and economic-policy integration they were re-interpreted by the December summit for its own purposes. This is a considerable setback for the scope of possible reforms of EMU (Rodrigues 2012: 1f).

The social dimension of EMU integrated in the conclusions at the instigation of the French government represents a completely new aspect of the debate and

must be regarded in light of the urgent political problem of higher youth unemployment rates. The references in EU documents from this time on to maintaining the social market economy, the preservation of the European social model and the need for a »differentiated, growth-friendly« budgetary policy (European Council 2012c: 1) are the sole evidence of a new standpoint in the EMU reform process, which initially was expected to be comprehensive, but by the end of 2012 was trimmed back.

### 3. The Reform Debate after Its Reorientation in December 2012

#### 3.1 Preparatory Work by the European Commission

On 20 March 2013 the European Commission presented two Communications on three of the four constituent units of the conclusions of the December summit of 2012; they can be considered to be the precursors of concrete legal acts.

The »Communication on the ex-ante coordination of plans for major economic policy reforms« (European Commission 2013a) concentrates on the abovementioned first point from the December Conclusions. On the basis of Article 121 (1) and Article 12 of the Fiscal Treaty major economic policy reforms are defined as an area of general interest in EMU and in future are to be subject to ex-ante coordination, binding for all euro Member States. This is relevant in particular in the areas of trade/competition, financial markets and political economy. The coordination process is to be steered via the European Semester, in terms of which the Member States are to submit plans for major economic reforms with the national reform plans of the European Semester to the Commission. The Commission is supposed to evaluate whether effects are to be expected on other Member States or on the euro zone as a whole from the reforms; whether each member state is strengthening its competitiveness with them; and whether they have implications for the EU's social dimension. The Commission is to make proposals for improvement and the Council is to make recommendations for amendments, to be issued to the Member States regularly within the framework of the European Semester.

In the Communication on a Convergence and Competitiveness Instrument (European Commission 2013b)



points 3 and 4 of the December conclusions are dealt with together. Accordingly, EU bodies are regularly to negotiate direct agreements with each EMU member state, in which the relevant state will commit itself to the manner and time frame in which it will implement the country-specific recommendations from the European Semester, including the procedure against excessive economic imbalances. The European Commission is to work out the agreement on the basis of its country monitoring and negotiate it with the relevant member state, while the Council is to conclude the agreement. This programme for structural reforms is to be endorsed by the relevant member state's parliament. Financial support will be made available to Member States as an incentive to carry out implementation in accordance with the agreement, funded by a new earmarked source in the EU budget, which is not supposed to be a component of the Multi-annual Financial Framework. States' level of payments into this »solidarity mechanism« would be oriented towards national GDP or paid at a flat rate in accordance with the agreement.

On 14–15 March 2013 Herman van Rompuy informed the European Council about the current status of work on the roadmap for a »genuine« EMU. The heads of state and government were emphatic concerning the conditionality of any deepening of integration: »Any new steps towards strengthening economic governance will need to be accompanied by further steps towards stronger legitimacy and accountability« (European Council 2013a: 9).

### 3.2 New Differences concerning Banking Union

The March summit urged rapid agreement on an integrated oversight mechanism (Single Supervisory Mechanism or SSM) and, building on that, by summer 2013 agreement on a directive for the restructuring and resolution of banks, as well as on a directive on deposit insurance. The Commission also announced the outline of a legislative proposal for an integrated resolution mechanism (Single Resolution Mechanism or SRM), which was to be adopted within the current term of office of the European Parliament. It is intended to protect tax payers and to be based on contributions from the financial sector (European Council 2013a: 10). On 19 March 2013 an agreement was reached between the Council and the European Parliament on integrated

banking supervision. This is to be established by March 2014 under the umbrella of the ECB and to supervise institutions with balance sheets worth more than 30 billion euros or more than 20 per cent of a country's economic output, as well as all banks that in future draw funds from the ESM. The joint supervision by the ECB is a condition of the ESM recapitalising banks (European Commission 2013c). Around 150 banks are thus to be centrally supervised in future, while smaller banks will remain under the supervision of national authorities.

Surprisingly, in May, German finance minister Wolfgang Schäuble went public with a two-stage plan for the further development of the banking union. In an article published in the *Financial Times* he welcomed the creation of a central supervisory authority at the ECB, but opposed plans for a central resolution authority because it was not compatible with the European treaties (*Financial Times* 15 May 2013). According to Schäuble, the law allowed only a resolution mechanism based on a network of national authorities and even then only if three conditions were met: (i) the SSM must be established and viable; (ii) common standards for resolution mechanisms had to be agreed by means of a directive; and (iii) capital adequacy requirements in accordance with Basel III had to be complied with by EU banks. In fact, Schäuble thereby opposed the outline of a proposal for a regulation, already announced by the Commission, on an integrated resolution mechanism (»we shall assess it with an open mind«). The dispute entered a second round after the publication of plans for the SRM by the European Commission in July 2013 (European Commission 2013d). In a letter dated the day after publication, written to Commissioner Michel Barnier, Schäuble points out what he regarded as the considerable risks. The proposal would ignore the legal, political and economic realities. Because the SRM would be responsible only for members of the euro zone the German finance minister feared that it would have a divisive effect on the Single Market and warned against endowing the Commission with a central decision-making competence, in the event of bank liquidations obliging Member States' budgets to seek financial assistance until a resolution fund was set up. As an alternative, Schäuble revived his proposal for, initially, the mere coordination of decentralised member state resolution authorities (BMF 2013). In his answering letter to the German minister Barnier defended the proposed regulation and emphasised the value of the resolution mechanism for the Single Market as a whole and the

need for a central decision-making authority. However, he acknowledged that this should be an independent agency and not the Commission. He also referred to the envisaged partial bail-in of shareholders and creditors in the event of bank liquidation. Member state budgets would only have to take a hit if other financial resources were exhausted (European Commission 2013e). The Commissioner referred to the European Council of June 2013, which had conceded that the completion of a banking union within the current legislative period of the European Parliament was a »top priority« (European Council 2013b: 9).

### 3.3 Franco-German Plans

After consultations between Germany and France the two governments published a position paper on 30 May 2013 entitled »Together for a Stronger Europe of Stability and Growth«. With it, despite continuing disagreements on their understanding of the EMU crisis and their evaluation of ways to overcome it, the two governments fulfilled a promise made in January 2013, when they had announced a contribution to the further development of EMU in the run-up to the June summit of the European Council. Besides a number of current aspects of the efforts against youth unemployment and to promote growth Merkel and Hollande took a position on the key policy areas of the roadmap plans: with regard to banking union they called for an agreement by the end of June on the operational criteria of direct bank recapitalisation and the conclusion of negotiations on the directives on institutional restructuring and resolution, as well as on deposit insurance. Despite Wolfgang Schäuble's public criticism of an integrated resolution mechanism its establishment by the end of the current European legislative period was called for, although hedged as an »integrated resolution board involving national resolution authorities and allowing quick, effective and coherent decision-making at the central level« (German Government 2013: 6).

With regard to the two Communications proposed by the European Commission a two-step chronological arrangement is laid down for future plans: thus consideration has first to be given to whether there is a common basic understanding in the euro zone of relevant factors in closer economic-policy coordination and what specific indicators and problem areas have to be discussed. For example, possible policy areas are mentioned that in

future may have to be subjected to ex-ante coordination. It is not difficult to guess, on the basis of known positions in the European Council bodies, which government probably introduced which aspects. From Germany's standpoint the priority was certainly labour and product markets, as well as external competitiveness; from France's standpoint it was the social dimension, including pension policies and social inclusion, as well as the public sector. Agreement had probably been reached on the coordination of corporate taxation and education and training systems. Concerning policy areas and indicators, at the behest of France and Germany the heads of state and government were to consult in autumn 2013. Thus the adoption of a »roadmap« effectively failed at the June summit.

Only in a second step, namely at the end of 2013 – according to the Franco-German paper –, are the Member States to address the key aspects of the instruments proposed by the European Commission for convergence and competitiveness, including the establishment of solidarity mechanisms. It is emphasised that all euro zone Member States are to be taken into consideration to allay France's fears of being pilloried as a result of this procedure because of poor economic results. There is agreement on the development of a solidarity mechanism based on financial incentives, although the governments have nothing more to add in the joint paper on what will be done, to what extent, under what conditions and using which resources. Similarly rudimentary remain the paper's concluding reflections on the institutional arrangement of the European governance structure (German Government 2013: 9ff). The sole innovation here is the idea of setting up structures within the European Parliament dedicated specifically to the euro zone (for more details see Roth 2011).

The Franco-German declaration nullified the original time schedule of the December 2012 summit, which envisaged a time-bound »roadmap« for implementing a »genuine« EMU by June 2013. This can be attributed to the long-drawn-out conflicts on banking union, the wait-and-see attitude adopted in the run-up to the general election in Germany in September 2013, but most of all to the basic differences of opinion between the European partners on the substance and orientation of individual reform elements. The joint government paper cannot gloss over the fact that the main line of conflict between Germany and France remains in place. François Hollande

wants measures and procedures to boost investment and strengthen the social dimension, while also continuing to adhere to the original idea of a proper budget for the euro zone to enable it to implement an anti-cyclical economic policy. At the same time, he opposes a centralisation of competences in Brussels on decision-making about reforms in the Member States. Angela Merkel, in contrast, has never accepted the establishment of a fiscal capacity to absorb imbalances in the euro zone and is ready at most to give her assent to a low-threshold – in other words, limited in terms of extent and duration – solidarity mechanism in exchange for clearly defined structural reforms (Euroactiv.de 1 July 2013). Incomparably more important in Germany is to make existing recommendations in the European Semester more binding to increase competitiveness.

### 3.4 Disappointment Arising from the June Summit 2013

Against this background of fundamental differences of opinion on key policy areas the European Council was unable to deliver at the summit on 27–28 June 2013 with regard to the planned agreement on a »roadmap«. Herman van Rompuy updated the heads of state and government concerning the current state of work and consultations (Van Rompuy 2013). The original four building blocks no longer provided a compass for a »genuine« EMU, as had been the case one year previously (see Section 2.1); instead, he reported on the four policy areas set out at the December 2012 summit.

First of all, the Council President detailed the social dimension of EMU, the only area in which, in the run-up to the June summit, there were still no official proposals and Communications. He acknowledged that rising unemployment rates, resulting from the crisis management adopted in many states, growing poverty and social exclusion were undermining the EU's economic potential and social cohesion. Van Rompuy asserted that although social policy would remain the province of the Member States, the lack of cross-border coordination affects the EMU's functioning and stability. Furthermore, EMU's basis of legitimacy was under threat: »Indeed, high and persistent levels of unemployment and social exclusion weaken citizens' support for the monetary union« (Van Rompuy 2013). He thus proposed that the procedure for eliminating macroeconomic imbalances should be furnished with

additional social indicators; a scoreboard for social affairs and employment should be implemented for economic monitoring in the European Semester; and coordination of social and employment policy in the sense of social investment (on this see European Commission 2013f) should be improved.

With regard to ex-ante coordination of economic-policy reform plans they were not merely to concern the efficiency of labour, product and services markets, but also the public sector, tax systems, education and training systems, pension and health care systems and the investment climate and social inclusion. The policy areas listed for enhanced economic-policy coordination should also be reflected in the contractual arrangements, in that measures on improving efficiency should be agreed between the EU and individual Member States. The focus, however, should be on identifying structural deficits on labour, product and services markets. There was constant talk of »pacts for competitiveness, growth and employment«. The Franco-German proposal of obligatory conclusion of such pacts for all euro-states, with voluntary participation by all EU countries was accepted. As a decisive reason for the introduction of partnerships it was alleged that »[i]ndeed, there is a gap between the recommended course of policy actions set out in the context of the European Semester and their actual implementation at the level of Member States« (Van Rompuy 2013: 6). Ex-ante coordination was to be embedded in the European Semester and the contractual arrangements would heighten its recommendations. For both instruments the importance of national identification and responsibility was emphasised and, accordingly, the role of national parliaments and the social partners was highlighted. The social dimension was also to be taken into consideration with regard to the two instruments. The European Parliament was to be involved only in the contractual arrangements.

With regard to probably the most controversial issue, the solidarity mechanism, the possible problem of »moral hazard« was addressed and the German line of a targeted, strictly conditional instrument that was time-bound and limited in extent was repeated. Financial support was to be available, accordingly, only to states that otherwise would be unable to fund the agreed structural reforms. The affected member state was also to commit itself to a time-bound implementation of individual measures; failing that, the financial support would be withdrawn.

Surprisingly and without precedent Van Rompuy backed away from the idea of financial transfers or subsidies in his Report, stressing the benefits of financial support on the basis of loans. This would avoid putting pressure on the budgets of individual Member States, support would be provided in the decisive initial phase of growth-generating reforms and the condition of repayment of loans would increase the pressure – which would be greater than in the case of subsidies – for national responsibility within the meaning of the intended incentive structure (Van Rompuy 2013: 7f).

Thus the various aspects of the interim results of work on the »genuine« EMU are not reflected in detail in the conclusions of the European Council. Based on the points of consensus available so far the Commission would like to expand its Communication on ex-ante coordination into a concrete proposal by autumn 2013 and submit the pending Communication on the social dimension of EMU. With regard to the contractual arrangements and the solidarity mechanism there is talk of a convergence of positions among the heads of state and government, but at the same time it is emphasised that »further work is required on these issues in the coming months« (European Council 2013b: 11). Clearly, agreement has been reached on strengthening EMU's social dimension. In comparison to the document presented by Van Rompuy, however, it does not speak of new indicators but of supervision and coordination of social and employment policies. The role of the social partners and the social dialogue on the subject is emphasised.

As far as further work planning is concerned, the Franco-German proposal of a division will be complied with: thus the October summit will address the basic understanding on joint indicators and policy areas for stronger coordination of economic policy, as well as EMU's social dimension. Only the December summit is to take decisions on this and on this basis also to establish the first features of the contractual agreements and the solidarity mechanism (European Council 2013b: 11).

### 3.5 Postponements prior to the December Summit 2013

On October 2, 2013 the European Commission launched its long-awaited communication on the social dimension of EMU (European Commission 2013g). Similar to the

proposals made by Van Rompuy in his updated report at the June summit, the Commission highlights that a functioning EMU must be able to tackle »problematic developments« related to social and employment policies. Therefore, additional indicators shall be integrated in the existing macroeconomic imbalance procedure as well as in a completely new »social scoreboard«. It is proposed that indicators like the long-term unemployment ratio, youth unemployment rate, real gross disposable income of households and the S80/20 ratio measuring inequality feed into the European Semester. »The employment and social indicators for the scoreboard should capture the key phenomena for each country and identify the most serious problems and developments at an early stage and before the country diverges too strongly from its past performance or the rest of the EU« (European Commission 2013g: 6f). But since no targets are set, it is primarily an exchange of best practices and performances within the meaning of the Open Method of Coordination (OMC). Besides the introduction of social indicator, the Commission wants to encourage labour mobility and social dialogue should be strengthened on a European level. In contrast, automatic stabilizers to offset asymmetric shocks in EMU, such as European unemployment insurance, are not pursued, since this would go beyond the current competences of the EU and would require substantial amendments of the treaties in the opinion of the Commission. The communication is still in favor of an insurance system to absorb macroeconomic shocks and reaffirms the ideas developed in the »Blueprint«. However, the introduction of any kind of fiscal capacity is shifted to the far future.

»Shifting things to the future« could have been as well the slogan of the European Council in October 2013. The planned first step of discussing the relevant policy fields and indicators for stronger European coordination was postponed to the December summit. It is more than questionable, whether the heads of state and government will then find the time to decide on step two of the agenda, to take decisions on the CCI. In the field of the social dimension, Member States welcomed the Commission's proposal and plan to decide on a range of indicators already in December in order to use them for the European Semester in 2014. It is important to note that the conclusions of the European Council speak of an employment and social scoreboard »in the Joint Employment Report«, like mentioned in the Commission's communication, but they do not explicitly refer to the

idea of enhancing the MIP procedure by auxiliary employment and social indicators (European Council 2013c: 14).

On the banking union, the October summit was silent as well. For 2014 a stress test by the ECB was announced. This served as the background to recall the urgency to find final agreements on the controversial issues of guidelines for a direct recapitalisation by the ESM, the Single Resolution Mechanism and the Bank Recovery and Resolution Directive by the end of the year.

## 4. Critical Evaluation of the Reform Plans

If one compares the proposals discussed at the June 2013 summit with the four building blocks for restructuring EMU put forward by the four presidents, little has remained of the attempt to eliminate the systemic deficiencies of the Maastricht EMU construction.

No progress can be discerned in the current plans with regard to the often mentioned need for common debt management of the euro zone, better coordination of tax policies and the strengthening of democratic legitimacy. While the debt repayment fund and Eurobonds have also fallen out of the debate, together with a fiscal capacity to absorb economic shocks in specific countries, intense work is on-going on new control instruments by means of an ex-ante coordination of economic-policy reforms and contractual arrangements. The line of conflict between supporters of a fiscal union and of a »stability union« is clear.<sup>1</sup> The closely intertwined issues of Community liability and national sovereignty form the lynchpin of a growing controversy, which affects everything that we shall examine in what follows.

### 4.1 Banking Union

Initially, the clearest progress at the European level can be discerned in the creation of an integrated financial framework, the banking union. The agreement on a European supervisory mechanism and the build-up of the European Banking Authority (EBA) at times gave cause for optimism that even the complicated issues of restructuring and resolution, as well as deposit guarantees could be

dealt with at the latest by the June summit. This did not come to pass, however. After the German government strongly advocated the rapid introduction of a banking union in summer 2012, it applied the brakes, since when the project started to make progress in real terms.

Germany's opposition to any kind of joint liability is well known. The crisis is interpreted primarily as the budgetary policy failures of individual countries. The transient swerve towards agreement to an integrated financial framework can be explained only in terms of the increasing pressure of the European partners to consent to a Community liability going beyond state aid via loans from the EFSF and ESM safety nets. This was in response particularly to the Spanish banking crisis, Italy's refinancing problems and the new French President's advocacy of Eurobonds. For Angela Merkel agreement with the European partners in the banking union was easier to sell in the coalition supporting her than entry into joint debt management (*Financial Times Deutschland* 14 June 2012). Furthermore, the German government went on the defensive at the June 2012 summit because the domestic opposition parties the SPD and the Greens had made their agreement to the ESM (necessary for a two-thirds majority) in the Bundestag and the Bundesrat dependent on Merkel's successful advocacy of a growth and employment pact in Brussels. Italy's Prime Minister Mario Monti and Spanish Prime Minister Mariano Rajoy, with the support of France's new government at the summit meeting, used this to make Merkel's urgently needed domestic success dependent on concessions on access to EFSF and ESM funds (The European 29 June 2012). Thus a recapitalisation of Spanish banks by the EFSF became possible and, most likely, the joint position of the euro-states on the prospect of recapitalising banks by the ESM: »When an effective single supervisory mechanism is established, involving the ECB, for banks in the euro area the ESM could, following a regular decision, have the possibility to recapitalize banks directly« (Euro Summit 2012: 1).

Against this background it can also be explained why the German finance minister has tried to play for time when it comes to the banking union. Even the common banking supervision, originally planned for the beginning of January 2013, was postponed due to the stubborn intervention of the German government in Brussels in summer 2013. German Chancellor Merkel cosied up with French President François Hollande at the European

1. Ansgar Belke (2013) derives from this a widening gap between northern and southern Europe.

Council in October 2012 and adhered to the principle »better safe than sorry« (»Gründlichkeit vor Schnelligkeit« – *Der Spiegel Online* 19 October 2012). Schäuble's two-stage plan presented in May 2013 for a European resolution mechanism and his objections to the corresponding Commission plan put off the banking union well into the future. The first building block of the vision of a »genuine« EMU was not integrated into the four key policy areas for the »roadmap« at the December summit of the European Council in 2012, perhaps because the heads of state and government believed they had already almost achieved the goal of successful agreements on the integrated financial framework. The attitude of the German government shows, however, how fragile the June 2012 compromise on the banking union is. This is dramatic because the integrated financial framework as a first step is a necessary condition for overcoming the crisis (Véron 2012) in order to break the vicious circle of bank bailouts, sovereign debt and refinancing costs. Plans for a common resolution fund provided by the banks themselves will not be enough in the short-term, as such a project takes several years. Already for 2014, the ECB has announced to conduct a stress test for banks across the EU. No doubt, if you enable a common supervision, you should be featured as well with a common resolution mechanism ready by the time, bad loans and toxic assets might be detected.

#### 4.2 Economic-policy Coordination

Ex-ante coordination of major economic-policy reform plans represents a proposal for the creation of an integrated economic-policy framework that is worthy of discussion, which would extend the existing European Semester from budgetary-policy coordination to general economic policy. However, at the outset of evaluations of the »genuine« EMU a quite different focus was established. Thus the first Quadriga Report for the June 2012 summit talks of labour mobility and tax coordination and puts the emphasis of an amended economic-policy governance on the introduction of joint debt management and a fiscal capacity. Only after protests from Germany, Finland, the Netherlands and a number of other states against entry into a liability union did Van Rompuy's Interim Report talk of »ex-ante coordination« of structural reforms and a central »macro-oversight« (Van Rompuy 2012b). With reference to Article 11 of the Fiscal Compact, which already calls for the ex-ante coordination of

economic-policy reform plans, it finds itself central to stage 1, to be implemented by the end of 2013, in the second Quadriga Report of December 2012 (Van Rompuy 2012c: 4, 13). Even the European Commission would like to implement ex-ante coordination quickly, although in its blueprint it links it closely to a fiscal capacity (European Commission 2012a: 17f, 32). This link was later dropped when a group of states around Germany reinterpreted a separate budget for the euro zone to mean a solidarity mechanism for successful structural reforms.

The cross-border externalities of reforms implemented by individual states in an economic and monetary union have undoubtedly been underestimated in the euro zone so far. However, it is difficult to imagine a central planning body in Brussels that, in all good faith, could scrutinise and balance the reform plans of 17 countries in such a way that a common European interest could arise from the process, and one that at the same time did not run counter to legitimate national decision-making. It remains unclear on what basis reform plans would be evaluated. If – as might be expected – the existing system of fiscal and macroeconomic supervision were taken as the measure we can be sure that state budgetary restrictions and a fixation on price competition would predominate. The European Semester already has these features, dominated by an imbalance between consolidation requirements arising from the tightened up Stability and Growth Pact and the employment and social policy goals of the Europe 2020 Strategy, such as an asymmetric approach to current account imbalances in favour of surplus countries within the framework of macroeconomic supervision (Degryse 2012; Hacker 2013b).

Generally, it would also have to be decided what kind of economic-policy reform counts as »important« or »major« and who is authorised to make such a classification. The Commission's Communication on this issue remains relatively modest, with its reference to policy areas requiring ex-ante coordination, namely reforms of product, labour and services markets, taxation and financial markets, not to mention fairly convoluted in the area of political economy (European Commission 2013a: 3f). The dispute between France and Germany – each representing a group of countries – concerning the right course of action to deepen the EMU has led, since mid-2013, to a certain overdetermination of ex-ante coordination, under the aegis of which general reforms in the public sector, education and training systems,

pension and health care systems and the areas of investment climate and social inclusion are now also supposed to belong (Van Rompuy 2013).

France, Italy, Belgium and Austria in particular are calling for social and education policies to be more closely coordinated at European level. However, the governments of these countries link this to their notion of a distinct social dimension of EMU beyond the fixation on competitiveness and structural reforms and, at the same time, have not given up their demand for a fiscal capacity in a position to transfer funding. This is diametrically opposed to the views of Germany, the Netherlands and some northern and eastern European states that regard ex-ante coordination as an instrument for setting out structural reforms to boost competitiveness along the lines of the approach to the crisis pursued thus far. France's acknowledged interest in integrating virtually all national reform projects in a European coordination cycle will boomerang if – as is already the case in the European Semester – in the process of defining indicators and targets budgetary considerations become the dominant consideration.

### 4.3 Contractual Arrangements

Because the European Council and the European Commission no longer really believe in voluntary commitments within the framework of open policy coordination contractual arrangements are under discussion as a possible way of increasing member state commitments. Both the second Quadriga Report and the Commission's Blueprint refer to direct contractual arrangements between Member States and the EU, while the Communication on the Convergence and Competitiveness Instrument (CCI) goes into more detail. This is supposed to offer a way out of the alleged transposition deficit affecting policy recommendations beyond the regulatory level. In the background here are the unpleasant experiences with Member States' failing to comply with common regulations or to heed targets and recommendations made by EU bodies. Jörg Asmussen, executive board member of the ECB bemoaned recently, that only ten per cent of the country-specific recommendations in the European Semester are implemented by the Member States (*Der Spiegel Online* 27 October 2013).

There was no talk of contractual arrangements at the outset of the reform process to restructure EMU. Only the

reluctance of the group of states around Germany with regard to every aspect of joint liability subsequent to the June summit in 2012 and its simultaneous advocacy of improved control mechanisms and commitments to structural reforms have made this idea a central consideration. In both the Commission's Blueprint and the Quadriga Report of December 2012 contractual arrangements, which are supposed to be implemented in 2014, are still closely tied to the establishment of a fiscal capacity. This is intended to provide states with financial support in implementing bilaterally agreed reform projects (European Commission 2012a: 25f): »The implementation of contractual arrangements and the associated incentives would support a convergence process, leading in stage 3 to the establishment of a fiscal capacity to facilitate adjustment to economic shocks« (Van Rompuy 2012c: 9).

This cleavage, on one hand, runs parallel with the one related to ex-ante coordination concerning the issues to be included, while on the other hand a new cleavage has arisen around the question of transferring national sovereignty or establishing it more firmly within the European framework. France in particular is against the Commission being given too strong a role; according to President Hollande, the influence and reform demands of Brussels with regard to member state policies already go too far in the European Semester (The Telegraph 29 May 2013). This contradicts the demand orchestrated by France that new processes should not be confined to structural reforms to improve competitiveness on markets for products, labour and services. The broadest possible spectrum of policy areas is thus desired, but more binding agreements are rejected. Germany, by contrast, is very much in favour of tightening up reform obligations by means of bilateral agreements between the EU and individual states. Besides France, many northern and eastern European states are sceptical of a stronger role for the Commission, for example, as laid down in the Blueprint and the Communication on the Convergence and Competitiveness Instrument.

It must be asked whether the »naming, shaming and blaming« of the Stability and Growth Pact's open coordination instruments, the Lisbon Strategy and its Open Method of Coordination and economic and employment policy guidelines, and the Europe 2020 Strategy within the framework of the European Semester have really had little effect on member state policymaking. Although scholars bemoan the fact that in particular in the area of

European employment and social policy one might have hoped for more from the formulation of common objectives it has to be said that substantial policy approaches have been rolled out with the help of European governance instruments in all Member States. This applies, for example, to the concept of flexicurity in labour market policy, the three-pillar pension system in policy on provision for old age and new ideas on avoiding and reducing poverty and social exclusion. As a rule, the closer »soft« coordination mechanisms come to the realm of »hard« European legislation the more teeth they acquire (Hacker 2010: 349ff). This applies in particular to the Stability and Growth Pact, which is closely bound up with EMU, whose criteria over time have by no means always been undermined. Before the outbreak of the global financial crisis the average budget deficit in the euro zone stood at only 0.7 per cent (in 2007) and thus was well within the framework of the 3 per cent criterion. In the same year before the crisis the average debt level also remained around a relatively low level of 66.4 per cent of euro zone GDP (Eurostat 2013). However, if European governance instruments were relatively effective in normal times are direct contractual arrangements worth the effort?

The interesting thing about contractual arrangements is the inherent opportunity they provide to abandon the »one-size-fits-all« strategy pursued in European policy coordination hitherto in favour of more customised policy orientations and recommendations. Too often in the past it has turned out that planning in Brussels has taken little account of conditions on the ground in the target countries. This is particularly so in the crisis when consolidation requirements have ignored the economic performance of the affected countries. This is apparent in, for example, disrupted economic cycles in Portugal and Greece which could not cope with the one-sided requirements of austerity policy, although Ireland has fared better. In Greece in particular the crisis would probably have been alleviated if, instead of programmes of across-the-board cuts they had concentrated on overhauling the ramshackle tax and contribution systems. The unfocused gaze of European target agreements on the diverse socio-economic circumstances in the EU always risks damaging developed institutional paths in the Member States. A strong private pension pillar, for example, is susceptible to this, because it is not required to take account of existing pension arrangements. It has long been pointed out that when setting European goals the varieties of capitalism or the different kinds of welfare state should be taken into

account (Scharpf 2002: 660ff). The CCI could achieve this, although there is the danger that a country-specific focus might lead to fragmentation. It would be better to form country groups on a socioeconomic and institutional basis, with cluster-specific goals.

The legal basis of contractual arrangements remains unclear. Will they go further than recommendations and be actionable before the ECJ? Furthermore, on what economic-policy basis will the agreements be concluded? As already mentioned with regard to ex-ante coordination there is a danger that the dominance of budgetary-policy consolidation pressures will be used to make direct contractual arrangements into a platform of »austerity for all« Member States in the euro zone.

#### 4.4 Fiscal Capacity

Nothing more has been said since the December summit of 2012 about an independent fiscal capacity for the euro zone, which would be needed to absorb asymmetric economic shocks in individual Member States. More than any of the other instruments that have been discussed this long overdue desideratum would be capable of completing EMU's unfinished architecture. It is a long-standing cause for complaint that ECB monetary policy and member-state wage policy bear the whole burden of dealing with asymmetric shocks in the euro zone. In contrast to the United States there is nothing in EMU to counterbalance monetary policy at the Community level, which shapes macroeconomic policy. Only a system of financial transfers that absorbs regional economic shocks by means of a central budget could overcome the current fragility of the euro zone (De Grauwe 2006). A common budget for the Monetary Union represents the »missing link« needed to enable considerable progress to be made towards a fiscal union (Rodrigues 2013).<sup>2</sup>

The Quadriga Report of December 2012 and the Commission's Blueprint lay out in detail the need and utility of a fiscal capacity, proposing as a possible model for its implementation the establishment of a European unemployment insurance. Preliminary work has already been done on this, which would only have to be resumed

2. Several models of a transnational fiscal equalisation and stabilisation mechanism exist, which need not take the form of a European budget. For an overview, see Pisany-Ferry et al. (2013) and Deutsche Bank Research (2013).



(Dullien 2008; Dullien/Fichtner 2013). However, the advocates of a »stability union« clustered around Germany would find such a mechanism objectionable because it would involve real financial transfers between the EMU Member States. Similar to the initially very open plans for Community bonds via a debt repayment fund, eurobills and Eurobonds, after the European Council meeting of December 2012 a fiscal capacity is not to be found in further documents on a »genuine« EMU.

The so-called solidarity mechanism that has taken its place represents a much more modest attempt at cross-border financial policy, in terms of both scope and function. Naturally, it can be considered to be the nucleus of a fiscal capacity along the lines of a separate budget for the euro zone that may come into being at a later date. But this should be clearly specified and envisaged as a real prospect, as demonstrated by the second Quadriga Report and the Commission's Blueprint. In its current description in the Commission's Communication on CCI of March 2013 it appears to be no more than a means of rewarding neo-liberal structural reforms. The only interesting thing about it is the newly formulated approach to financial support as an incentive for certain member-state policies that breaks with the sanction-based approach pursued hitherto. There can be no hope of macro-governance on this basis, however. And if the bases of the solidarity mechanism are to be found in the abovementioned instruments of ex-ante coordination and contractual arrangements the Member States would in addition be rewarded for using political economy solely for the purpose of budget consolidation and boosting competitiveness.

Instead of concentrating on the reforms needed to deepen EMU and on working out possible forms of fiscal capacity and its political and legal feasibility the heads of state and government are arguing about possible issues of moral hazard involved in offering financial »rewards«. This is despite the fact that a relatively modest sum of 10–20 billion euros is in question (European unemployment insurance would require three times as much), and in every document on the subject the strict conditions governing access to and the scope and duration of individual payments are emphasised. This led to the absurd proposal in Van Rompuy's Interim Report of June 2013 to forgo financial transfers and replace them by loans for the start-up funding of structural reforms. In contrast to earlier versions (see Van Rompuy 2012b: 5) the difference from the European Stability Mechanism would be

suspended. Thus the idea of a euro zone budget would be dead and buried, at least for the time being.

#### 4.5 Democratic Legitimation

The ideas put forward so far on strengthening democratic legitimation with regard to the plethora of new procedures and instruments of economic governance can be considered very rudimentary. The European Council's summit declarations are limited to calling for closer cooperation between the European and national parliaments and thus merely repeat corresponding passages from the Fiscal Compact or Protocol I of the Treaties: The establishment of an interparliamentary conference is under consideration. The European Commission takes a different view, making clear in its chapter on political union in the Blueprint that although cooperation between parliaments would be welcome it would not ensure the democratic legitimacy of EU decisions: »That requires a parliamentary assembly representatively composed in which votes can be taken. The European Parliament, and only it, is that assembly for the EU and hence for the euro« (European Commission 2012a: 35).

The Blueprint provides some – also implementable in the short term and without a Treaty amendment – sound advice on strengthening democratic legitimation within the framework of the newly emerging EU economic governance, which to date have not been addressed in further detail. They all seem to move in the direction of boosting the European Parliament's information and consultation options within the framework of the European Semester (European Commission 2012a: 42f). Why this has yet to progress beyond the level of theoretical announcements remains to be seen. No one is preventing the Commission and the Council from involving the European Parliament more closely in the European Semester. All of the proposals on institutional adaptation by way of Treaty changes submitted by the Commission basically envisage a strengthening of the Eurogroup within formations of the Council, in the Commission by means of an EMU financial administration and in the person of a vice-president responsible for the euro, as well as in the European Parliament through the establishment of a »euro committee« whose authority would exceed that of other committees. The Franco-German paper also puts forward ideas on separate euro zone structures within the European Parliament.

Already in the first Quadriga Report of June 2012 the aspect dealt with last – democratic legitimation and accountability – feels like merely going through the motions. The formulas familiar to readers of European documents concerning the importance of involving parliaments and the social partners are woolly compared to the detailed formulas on expansion of technical powers and competences of the Commission and the Council. In fact, both national parliaments and the European Parliament are becoming increasingly marginalised within the framework of the new governance structures. In the plans for a »genuine« EMU reference is made to the need to involve the European Parliament only within the framework of contractual arrangements (Van Rompuy 2013: 6); nothing of the kind is mentioned with regard to ex-ante coordination and the solidarity instrument. And when it comes to including national parliaments the increasingly used formula »national ownership« of the intensity of structural reform sounds rather derisory and is not accompanied by any concrete proposal on solving the growing democratic deficit (Van Rompuy 2013: 6). It is becoming very clear that the focus of deliberations on EMU reform is of a functional and technocratic nature.

#### 4.6 Social dimension of EMU

It was French President François Hollande, who helped the suffering states in the south of Europe to have a voice with their complaints about the negative social consequences of the dominant austerity course. Whilst the crisis management led by Germany, reacting to increasing levels of unemployment and exploding youth unemployment rates, consisted of higher labour market flexibility and mobility, the discontent of austerity was taken seriously on a European level since the French government convinced its partners to include the »social dimension« as one of the four columns of EMU reform projects at the European Council in December 2012 (European Council 2012c: 4). Socialist parties and trade unions all over Europe focused politically on the unprecedented high levels of unemployment among young people in several European States and have been successful in increasing the public awareness for the social consequences of the crisis course so far.<sup>3</sup>

3. The Party of European Socialists (PES) carried out a huge pan-European campaign for a »European Youth Guarantee«, see <http://www.youth-guarantee.eu>.

This was helpful in forcing the heads of state and government to implement an immediate action programme to decrease youth unemployment rates of over 50 per cent, like in Greece and Spain, in the first half of 2013. Its main elements are a »Youth Guarantee« to bring young people back to work or into education or training within four months and a »Youth Employment Initiative« of six billion euros, reallocated in the communities budget for investment and mobility schemes (European Council 2013b).

Nevertheless, the progress beyond this action plan is rather modest. The communication of the Commission on the social dimension of EMU was awaited for a long time and when it was published in October 2013, it disappointed all people who hoped for a broader approach. Expectations have been high throughout the year 2013, especially after a »Non-paper«, possibly written by DG EMPL, was handed around in Brussels and the member States' capitals in spring, proposing reinforced social coordination and surveillance through a scoreboard of employment and social indicators with minimum social standards<sup>4</sup> or national floors. Featured with objectives and benchmarks, nearly the whole economic governance framework of EMU is mirrored by a social governance attempt to tackle social imbalances, to enable a social impact analysis and to increase the power of social actors in EMU, namely the EPSCO ministers, the social partners and the European Parliament. Moreover, the »Non-paper« takes the social divergences of EMU as a potential threat to its functioning and surviving and argues for this reason to extend the planned contractual arrangements with a social domain as a first step to build up an automatic stabiliser function with a common fiscal capacity (Non-paper 2013).

Only few elements of these useful ideas to establish a true European Social Model survived in the Van Rompuy update report of June 2013 and the Commission's communication. Auxiliary social indicators are welcomed, but they should have no consequences with regard to the economic governance process. Although it is proposed by the Commission to use these indicators not only in the European Semester but as well in the MIP, no objectives, thresholds or minimum standards are envisaged (European Commission 2013g). And even this toothless

4. Besides a youth guarantee, a minimum duration and minimum replacement rates of unemployment benefits, a minimum income and a minimum wage are suggested among other objectives.

approach was contested by the German government in autumn 2013 with the argument that structural and competitiveness reforms should not be deranged by a social dimension.

As a majority of Member States is in favour of new initiatives to tackle social imbalances in EMU, it is likely that a social scoreboard will be implemented and used in the European Semester in 2014. Due to the protest of the German interim government this will, however, not amount to a change of the biased policy approach in the crisis management (Hacker 2013b).

## 5. Starting Out like a Tiger, Ending Up as a Bedside Rug: The »Genuine« EMU Will Not Be a Fiscal Union

Although the critics of the Maastricht Treaty, who called attention to the risks of monetary integration without fiscal and political integration, long went unheeded, the current crisis has reopened the debate on the structure of EMU. At least, there is – and this is confirmed by the process concerning a »genuine« EMU – a debate on the shortcomings of the architecture of the Monetary Union. Even five years ago it would have been unimaginable to read about demands for Eurobonds, a common budget or a banking union in key EU papers. And even in the face of the disastrous consequences of austerity policy the always merely hesitant discussion of Europe's social dimension is gathering momentum again, albeit haltingly.

The EMU crisis unexpectedly offers, in the face of the possible collapse of the common currency, an opportunity to deepen integration through a banking union, fiscal capacity, common debt management and a social union. It is clear that this would be accompanied by more common regulations, tightened controls and the transfer of national sovereignty to supranational level. Equally, this path of further deepening can be pursued only if there is also the impetus of democratic legitimation with regard to the relevant decision-making. This is as clear in the first plans drawn up by the four presidents in June 2012 as in the revised version of December 2012 and the Commission's Blueprint.

The course of the lines of conflict and discussions concerning »genuine monetary union« laid out in this paper demonstrates the dangers of the process, however.

Within only a few months the proponents of a »stability union«, who are counting on a continuation of the unilateral course of budgetary controls and competitiveness, have been able to dismiss, marginalise or put on the backburner what is compelling about a fiscal union, as well as the opportunities it would offer. Again and again, specific proposals for improving the EMU architecture founder on fundamentally divergent approaches to the question of joint liability between Member States. That applies both to the controversy about the restructuring and resolution mechanism of the banking union and to plans for common debt management or a fiscal capacity for the euro zone.

All that remains is the technocratic elements for gradual adjustments of the existing governance structure. And because, with the European Semester, the Fiscal Compact and other instruments, this is out of kilter (Busch 2012; Hacker 2013b) a reshaping of what is already in place constitutes the lowest common denominator of Member States. First and foremost, this means: structural reforms, budgetary consolidation, tightened controls and sanctions. The elements of ex-ante coordination of economic-policy reforms, direct contractual arrangements between each member state and the EU and financial rewards for faithfully implementing structural reforms by means of a solidarity instrument, which remain for a »genuine« EMU are basically already part of the coordination cycle of the European Semester or at least imaginable. Now the range of subjects of coordination is to be extended and the bindingness of common objectives is to be tightened up. Anything beyond that, which could really contribute to change capable of correcting the barely discussed bias in EU economic governance, is scarcely discernible. And the urgently needed project of a banking union will never come to fruition unless progress is made in fiscal and political integration (Véron 2013: 6).

The German government has been enormously successful in Brussels, suppressing almost everything that does not conform with its model of a »stability union«, in which each state helps itself and thus a transnational community cannot emerge. Thus the fiscal capacity has been remodelled into the unambitious solidarity mechanism; the banking union is coming to grief or largely degenerating into mere routine coordination by national authorities; and Community bonds have become a dead letter. On the latter, the Commission even produced a green book in 2011 (European Commission 2011).

However, at the latest since Chancellor Merkel made her position absolutely clear around the time of the European Council in June 2011 («No Eurobonds as long as I live») the topic has been taboo.

Since the change of government in France the supporters of a »stability union« around Germany, Finland and the Netherlands have encountered stiffer opposition. This is due to the obvious failure of austerity policy, the altered power constellations as a result of changes of government and the opportunity sensed by the European institutions to expand their competences far beyond the budget policy framework. The attempt by the French government, together with representatives of the European Commission, to shoehorn the social dimension – which was not mentioned until the December summit of 2012 – into the negotiations on the »genuine« EMU is commendable and, in principle, correct. The EU has for too long been perceived solely as a common economic area and positive, market-shaping integration has fallen too far behind negative, market-creating integration (Höpner/Schäfer 2010). It is thus high time to bolster and further develop the European Social Model. However, this process will miscarry if there is not also a clear correction of the reparation mode that EMU has pursued thus far.

As long as austerity policy remains dominant, sovereign debt problems retain the focus of attention as against macroeconomic imbalances and the European Semester shows a neoliberal bias, the augmentation and upgrading of the social dimension with regard to EU coordination policy will be rather a hindrance than a help. Although there are already forward-looking plans to incorporate the social into the European Semester, such as the upgrading of the EPSCO Council as against the ECOFIN Council or the establishment of a scoreboard of social indicators (Van Rompuy 2013: 2f; European Commission 2013g), instruments and objectives (Bsirske/Busch 2013), as things stand today and with the current alignment of the instruments of economic governance all social aspects will remain in the shadow of budgetary consolidation and measures to increase competitiveness. The measures presented and discussed here, such as ex-ante coordination and contractual arrangements, would only exacerbate the dependency of progress in the social realm on financial conditions (Daly 2012: 283), thus forcing it to justify itself and cementing the hierarchical subordination of social policy. This

impression is strengthened with a look on the Commissions' Communication on the social dimension of EMU in October 2013. Although the monitoring of new social and employment policy indicators is recommended, it shall be ensured at the same time that these indicators do not influence the country-specific recommendations and sanction-based fiscal coordination. In the Press Memo for this Communication, the Commission responds to the question of possible consequences if a Member State would violate the indicators of the newly proposed social scoreboard: »There will be no automatic consequences. The scoreboard is an analytical tool to observe divergence from historical trends or from the EU average« (European Commission 2013h).

The work-in-progress of the European Social Model can continue successfully only if the original plans for a fiscal capacity, common debt management and a completely integrated banking union are realised. Only the consistent correction of the defective Maastricht currency architecture (see, for example, Hacker 2011; Busch 2012) can clear the way for Europe's social dimension. Unfortunately, there appears to be no prospect of that at present.



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