

## A BIG LEAP FORWARD: INSTITUTIONS AND POLICIES FOR A VIABLE EURO AREA

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CONTRIBUTION TO THE PANEL

### ***“Reform of the euro, financial and budgetary perspectives of the European Union”***

*Economic and Monetary Union (EMU) reform is critical for a viable Euro area but is taking place against a backdrop of political constraints. As a contribution to this on-going discussion, this paper situates the reform debate in the context of the main lessons from the Euro crisis and the current economic and political cycle, and discusses the different elements of the reform agenda. The focus is on the main critical reform and institutional issues which remain as stumbling blocks.*

## **1. Exiting the crisis: the politics and economics of EMU**

### **1.1. What have we learned? Taking stock of the crisis**

The euro area crisis was in many ways an accident waiting to happen. It took an (admittedly major) external shock to trigger the unwinding of imbalances accumulated in the first decade of the euro, reveal the vulnerabilities of the euro area and expose its design faults. The crisis prompted action to safeguard the common currency and remedy its weaknesses. Today, at a time when reform efforts are well under way but very much incomplete, it is useful to situate the on-going debate about the next steps necessary for a viable euro area in the lessons of the crisis itself and in the context of the initiatives already initiated. This helps understand the urgency of completing the reform effort as well as the obstacles it is facing.

The crisis originated in excessive US subprime mortgage lending whose consequences on the market for asset-backed securities contaminated the European banking system before triggering a severe recession in the Euratlantic economy; this then spread to the rest of the world as international financial markets responded by tightening credit globally. It found a fertile ground in Europe not only because of the exposure of its banking sector to toxic US banking products, but also because of a combination of domestic fiscal imbalances, real estate bubbles, and competitiveness losses. European banks proved vulnerable due to their exposure to domestic and cross-border credit risk, as well as insufficient capital and liquidity.

The true nature of the crisis was however for a long time misread in Europe. As the trigger of the acute phase of the euro area crisis was the Greek fiscal derailment, fiscal issues took precedence over the crisis' banking sector origins, whose liabilities ended up on public balance sheets as governments bailed

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out the banks or guaranteed deposits. This guided the post-2009 policy response: it focused initially almost exclusively on fiscal retrenchment, while its systemic nature and the weaknesses of an incomplete European banking union took time to be addressed. Whereas the US stress tests of May 2009 restored confidence in the banking system, paving the way for the ensuing recovery, forbearance prevailed in Europe at least until mid-2012 (when Spain launched its bank recapitalisation programme and banking union took centre stage on the policy agenda) and in fact for much longer.

The overall policy response exhibited all the flaws of the existing EU institutional and political architecture. Key decisions were taken under duress, with significant lags compared with market and economic reality; they were typically reactive rather than proactive, prone to reversal, and too costly for both borrowers and lenders alike. Major mistakes were made, both economically and politically; it was an expensive and dangerous trial-and-error process. Ultimately however, the will to save the common currency prevailed.

## 1.2. Fixing the bicycle while riding it: main reform initiatives during the crisis

The policy response during the crisis moved gradually from fire-fighting to reforming the euro area. A reform agenda was already sketched out in the October 2010 Task Force report on the economic governance in the EU and its follow-up 2012 report<sup>1</sup>. As the initial reading of the roots of the crisis was focused on a failure of fiscal discipline, it was on the fiscal front that most subsequent initiatives focused, starting with the main thrust of the “Six Pack” set of legislative measures in 2011<sup>2</sup>. It was followed in 2012 by the “Fiscal Compact”<sup>3</sup>, with provisions related to fiscal discipline (notably the preventive arm of the Stability and Growth Pact) and rules and procedures for coordination and governance, and in 2013 by the “Two Pack” directives<sup>4</sup>, aimed at reinforcing economic coordination and budgetary surveillance. Collectively, this series of policy and legislative initiatives, adopted as a direct response to the Euro area crisis, significantly strengthened the fiscal framework, while also attempting through macroprudential supervision and the Macroeconomic Imbalance Procedure to detect non-primarily fiscal imbalances potentially leading to a banking crisis or a collapse in competitiveness. The focus however was clearly on revamping fiscal rules; more attention was paid to debt dynamics, with more flexibility during a crisis as regards deficit limits. The new rules also increased the complexity and arguably the opacity of the surveillance process.

Most importantly, reforms of the crisis prevention framework were complemented by the creation of a permanent financial “backstop” to assist countries in danger of losing market access. The European Stability Mechanism replaced as of 2012 the idiosyncratic temporary support mechanisms created during the crisis. Its creation represented a significant addition, both to the European institutional landscape and to the policy toolbox. It has since become central to the current debate about the future of the euro area, with different views on its evolution, role and responsibilities.

Addressing the fragility of the banking system came next, in light of the “doom loop” transmitting the crisis from banks to sovereigns and back. Banking union was the forgotten element in the creation of a common currency, whose critical importance was demonstrated during the crisis. It was introduced in June 2012 with a Euro Summit statement whose first sentence read “we affirm that it is imperative to break the vicious circle between banks and sovereigns”<sup>5</sup>. In 2014, supervisory authority and the power to grant or withdraw banking licenses were transferred from national authorities to the Supervisory Board of the Single Supervisory Mechanism (SSM), a new structure within the European Central Bank (ECB). In 2015, the EU created the Single Resolution Board, a new Brussels-based entity which, together with national resolution authorities, constitutes the Single Resolution Mechanism. A Single Resolution Fund (SRF) financed by contributions from banks is being built up to support resolution procedures within the framework of the EU-wide Bank Recovery and Resolution Directive (BRRD). It was agreed at the Euro Summit in December 2018 that the SRF will be further backstopped by European Stability Mechanism (ESM) credit lines.<sup>6</sup> In addition to the European Council decisions, the European Central Bank has proved to be the most important actor in resolving the crisis. In response to the freeze of the interbank market, it quickly extended liquidity to the banking system and further provided it on increasingly flexible terms, effectively rewriting the rules to accommodate a fast-evolving situation. Its “Securities Markets Programme” of bond purchases from crisis countries since 2010 leveraged European Council decisions at a critical time, and was followed by the “Outright Monetary Transactions” programme of open-ended purchases in secondary sovereign debt markets, contingent on strict conditionality. The ECB was admittedly late in embarking on an unconventional monetary stimulus (which started in 2015 only), but its actions and words have been instrumental in defusing the crisis. They have also been the focus of intense criticism in a number of countries.

### 1.3. Out of the woods? Economic situation, prospects and risks today

Following a severe and comparatively protracted economic recession and a near-existentialist crisis, the euro area has seen a remarkable turnaround. By early 2013, the common currency no longer faced imminent danger, and the currency redenomination risk which haunted the currency union for about five years was tackled in 2015 when a Euro Summit decided against Greece leaving. By early 2019 the EU as a whole was in its seventh year of economic expansion, with no economy contracting in 2018. Unemployment is at the lowest rate in the last twenty years, and it has declined significantly (though still remaining high) even in the crisis-hit euro area countries. Nevertheless, the policy debate on what is necessary for a viable euro area is today taking place in an economic environment whose outlook is characterised by increasing risks.<sup>7</sup> The recovery has been long but also weak and is now petering out, with the slowdown in the second half of 2018 being more pronounced than expected. Economic activity is expected to slow down further

in the next few years, against a backdrop of increasing EU-specific as well as global economic and policy downside risks, not least from the Brexit process. Legacy crisis problems continue to weigh heavily. Despite its efforts, the ECB has not succeeded in bringing core inflation back to 2% and it is approaching self-imposed limits to the use of non-conventional policy instruments. Fiscal space is more limited than in 2008: for the euro area, debt levels are today almost 20 percentage points of GDP higher than at the beginning of the crisis, and are particularly high in a number of countries. This implies higher risks in a new downturn or in a sudden stop situation. Core-periphery divergences have narrowed down unevenly, feeding populist narratives and potentially prompting a backlash which could become a full-blown crisis. In short, it is questionable whether despite the efforts made, the EU as a whole and the euro area in particular are prepared today to handle the next crisis.

## 2. Outlining a reform agenda

### 2.1. From Mars or from Venus? The different starting points

The difficulty in pushing forwards with euro-area reform can be traced to two contrasting models for the EMU, which reflect national preferences that were openly expressed in decision-making during the crisis. In a stylized fashion, the first starts from the premise that crises mostly result from inadequate domestic policies. To correct them, it puts emphasis on stronger enforcement of EU fiscal rules to rein in debt and deficits, more market discipline, and an end to the risk-free status for sovereign debt. Regarding macro imbalances, its focus is on shoring up the competitiveness of lagging countries with high external deficits through structural reforms. This view is associated with reluctance to accept transfers, be they the result of an explicit budgetary mechanism or of risk-sharing mechanisms such as common deposit insurance for banks.

The contrasting view puts much more emphasis on systemic fault lines such as a lack of aggregate stabilisation and a vulnerability to destabilising capital flows. As far as solutions are concerned, it advocates the creation of a euro-wide fiscal capacity for stabilisation purposes, a distribution of fiscal efforts across countries to achieve an appropriate aggregate fiscal stance, and risk-sharing mechanisms. A corollary is the need for a euro-area Treasury. Fiscal difficulties during crises are perceived mainly as liquidity problems which could be solved through financial assistance. According to this view, macroeconomic adjustment should be symmetric in order to help weak countries and avoid the deflationary bias resulting from deficit ceilings. And as far as banking union is concerned, this view advocates common deposit insurance in order to ensure financial stability and private risk sharing. The fault line between these two policy views is a philosophical and academic one as well as a geographical one. In philosophical terms, it has been described as discipline vs. flexibility. In academic terms, it is the distinction often stylized as rules vs. discretion in economic policy-making. In geographical terms, it has been painted as a German/French or alternatively a north/

side divide. This divide is caricatured as the European north focusing on responsibility while the south on solidarity. More accurately, the first camp emphasizes risk-reduction while the latter risk-sharing.

The prospect of transforming the EU into a “transfer union” has haunted the European north and prompted fear of any risk-sharing. In practice however, both risk-reduction and risk-sharing are to be pursued simultaneously: risk sharing without effective risk reduction increases moral hazard and ultimately risk. Similarly, in the absence of appropriate risk-sharing arrangements, risk reduction in the financial area can result in market instability and higher effective risk. The debate will not be settled any time soon. Academics from France and Germany have emphasized that both approaches are more complement than substitute and have proposed a compromise to “reconcile risk-sharing with market discipline”.<sup>8</sup> Finding common ground in a practical way is therefore essential for both economic and political reasons, but discussions haven’t made much progress towards reaching this end.

## 2.2. About windows of opportunity: The politics of EMU reform

The handling of the euro area crisis has taught us that the solutions which prevail tend to be found at the intersection of what is economically desirable and politically feasible. Timing, sequencing, personalities all play a critical role; and policy choices on the table as well as decisions reached ultimately reflect the political constraints and realities in EU countries. Hence the vibrant academic debate on the most effective policy tools required to complete the EMU is necessary, but by no means sufficient. Catching the political momentum and forging alliances and agreements which can support reform is equally if not more important.

In this context, the last few years have been characterised by an attempt to fashion together a “grand bargain”; a compromise between the “risk-sharing” and “risk-reduction” approach which to become politically feasible would even extend beyond the policy parameters of EMU reform and include other EU policy areas such as security and defence. Political developments however in the main countries driving such a “grand bargain”, France and Germany, as well as the position of EU actors such as the so-called “New Hanseatic League” of fiscally conservative northern European states as well as populist positions in certain EU member states have complicated this outcome. The result and political balance emerging from the upcoming European Parliament elections will be critical for such a prospect.

## 2.3. Agenda setting: The proposals as set out by the institutions

A comprehensive policy agenda for EMU reform was laid out in the 2015 Five Presidents report<sup>9</sup> with its politically-driven two-stage approach for an economic, financial, fiscal, and political union, and the follow-up reflection paper and related communications by the Commission<sup>10</sup>. It is a comprehensive agenda which gives policy-makers different options; it represents a good starting point for the policy debate though it cannot represent the end-point.

This ensuing debate has crystallized around a limited number of specific but also difficult to resolve policy issues which are believed to represent the core in any attempt to reform the EMU. The main ones are:

- increasing the resilience and stability of the banking system through common deposit insurance (the discussion on the European Deposit Insurance Scheme - EDIS);
- creating appropriate common budgetary instruments such as a macroeconomic stabilisation function to better deal with country-specific shocks;
- creating a related central fiscal capacity that would equip the euro area with a proper fiscal policy;
- reducing risk at the level of the euro area with a joint financial instrument (the European Safe Asset);
- whether or how unsustainable sovereign debt in the Euro area should be restructured;
- reforming/streamlining fiscal rules beyond the changes already undertaken during the crisis years.

### 3. The critical policy elements of EMU reform

The individual policy issues above fall under the broad policy areas of banking union and fiscal union. Together with changes in Euro area governance, they represent the areas which will determine whether the crisis will have been used as an opportunity to repair the design faults of the common currency by overhauling policies and institutions.

#### 3.1. The state of Banking Union

Nearly seven years later since the 2012 Euro Summit statement on the need to break “the vicious circle between banks and sovereigns”, an impressive package of reforms has been implemented. There are, however, three reasons to be concerned that the “vicious circle” or “doom loop” at the core of the euro crisis of 2010-2012 has not been really broken.

1. The persistence of a strong home bias in the composition of bank assets in vulnerable countries. At end-2018, the share of sovereign bonds held by domestic banks exceeded pre-crisis levels in Greece, Ireland, Italy and Portugal (but not in Spain). Disproportionate holdings of bonds issued by the national sovereign result in an important channel of contagion from sovereign insolvency, or the threat thereof, to bank fragility, credit constraints and economic contraction<sup>11</sup>.

2. A resolution framework that is single in name only. Whereas supervisory authority and the effective supervision of the major banks largely rest with the ECB, the Single Resolution Board has a more confederal structure

that combines a “design” role of the SRB with the implementation role of the national resolution authorities. Early experience, especially in Italy, has shown that national governments and authorities often remain first in line to address banking troubles and provide financial support. Furthermore, regulators remain suspicious of possible cross-country transfers arising from the failure of a national entity within a cross-national group. For this reason, they tend to rely on ring-fencing to limit the potential mutualisation of resources.

3. Lingering disagreement on deposit insurance. The European Deposit Insurance Scheme (EDIS) proposed in 2015 by the European Commission was meant to ensure an equal protection of all deposits and a partial mutualisation of the corresponding risk. Despite proposals aiming at limiting potential transfers, it has been caught by the risk reduction/risk sharing debate and remains a remote perspective (it was not even mentioned by name in the December 2018 Euro summit statement). This is despite the fact that the Five Presidents report clarified that EDIS would be privately funded through ex-ante risk-based fees paid by participating banks<sup>12</sup>.

Because of the strength of indirect linkages between banks and sovereigns, even a full banking union that would have severed any direct link between them would not have eliminated the doom loop entirely. The persistence of direct channels further adds to the problem, whose significance was highlighted by the co-movements of sovereign and bank default risks on the occasion of the end-2018 dispute between the Italian government and the European Commission. The problem with the doom loop is that it may come back with full force as long as the national sovereign risks being perceived as the last-resort guarantor of bank liabilities and as long as the national banks risk being perceived as the last-resort purchaser of government securities. What matters is not whether the average risk is covered; it is instead who bears the marginal risk. Though significant, measures adopted so far have been insufficient to sever this link. Further reforms are needed to cut the doom loop for good. In ascending order of difficulty what is required is first, a more integrated structure that gives the SRB responsibility for the execution of bank resolution schemes; second, an integrated deposit insurance scheme that combines an incentive-compatible financing structure with the uniform protection of all depositors (this involves resolving the legacy of the large stock of non-performing loans in a number of countries); third, the gradual phasing-in of concentration charges which give incentives to bank asset diversification; fourth, introduction of a euro-area safe asset that provides banks with a channel for asset diversification (see also below on the safe asset)<sup>13</sup>. Ultimately, a stable currency area cannot rely on segmented credit markets. Banks are risk aggregators. As long as they aggregate risk along national lines, their fate tends to be correlated to that of their sovereign. The best way to eliminate this vulnerability would be to create integrated pan-European banks whose balance sheet structure provides an endogenous diversification of risk. This move, however, continues being resisted.

### 3.2. Fiscal union: core and peripheral issues

*“Fiscal union” is often regarded as an essential requirement of a well-functioning currency area. This concept however encompasses several distinct components that differ in nature, aim and ambition. Five key proposals can be distinguished:*

#### a. A macroeconomic stabilisation function

The idea of a euro-area counter-cyclical instrument improving the cushioning of large asymmetric macro shocks (and not meant as a crisis budgetary instrument) has been discussed since very first blueprints for Economic and Monetary Union. The essential rationale for it is that in a currency union where the exchange rate cannot anymore serve to cushion country-specific shocks, and where national fiscal policies have limited scope to provide such a cushion, there is a need for a stabilisation scheme that absorbs part of the larger shocks that cannot be coped with through national stabilisation. Policy tools discussed in this respect are: a European Investment Protection Scheme which would preserve priority investment from spending cuts in the event of a downturn; a “rainy day fund” through which participating countries could accumulate funds on a regular basis and disburse them to cushion a large shock; and a European unemployment insurance (EUI) or reinsurance scheme to help national economies better weather the crisis. A scheme that would add to the EMU system a cross-country insurance dimension and help cushion asymmetric shocks, while avoiding one-way fiscal transfers, involves careful design in order to minimize moral hazard and the distortion of incentives. Various variants have been explored, from direct pay-outs to reinsurance of national schemes, with the latter receiving most support. None fully avoid moral hazard, and while important, none can be expected to provide powerful stabilisation.<sup>14</sup>

The intellectual arguments underpinning the political objections raised to a stabilisation scheme do not dispute its potential stability benefits; instead they argue that these can be better achieved through stronger financial market risk sharing (once the banking union is complete) and a more effective use of fiscal stabilizers (building higher fiscal buffers).<sup>15</sup>

In recent policy discussions, attention has focused on an investment protection scheme or an unemployment insurance or reinsurance scheme. Both options were considered in the French-German proposal tabled on the occasion of the Meseberg meeting of June 2018.<sup>16</sup> However, the very principle of a macroeconomic stabilisation function has been opposed by the ‘New Hanseatic League’ led by The Netherlands and did not make its way to the Euro Summit decisions of December 2018.

#### b. A central fiscal capacity

Whereas stabilisation is generally considered in response to country-specific (or asymmetric) shocks, a separate issue is whether there is a need for an aggregate fiscal capacity that would make it possible to conduct a common

policy at euro-area level without having recourse to coordination among participating countries. The case for it stems from the reconsideration of the role of fiscal policy in a low interest rate environment that limits the scope for monetary action. However, a common euro-area budget would need to be rooted in a yet-inexistent legal and institutional framework. The proposal in the Five Presidents report on a euro-area Treasury is carefully worded and embedded in the cluster of suggestions aimed at enhancing democratic accountability and legitimacy, rather than under the purely fiscal measures where there are more political objections. Following a proposal initiated by France and agreed with Germany, the Euro summit took a first step in the direction of a Euro area budget in late 2018, without mentioning the stabilization function.<sup>17</sup> While an important step, it remains timid and tentative; it is furthermore unlikely that it would be scaled up to represent a significant addition to the Multiannual Financial framework. Furthermore blueprints for a fiscal capacity under discussion are a far cry from proposals in the direction of a federalist EMU involving joint revenue-generating mechanisms through a Europe-wide tax administration system.

### *c. A European Safe Asset*

The initial push for a common safe asset came in 2010 from the Delpa-Weizsäcker proposal for Eurobonds<sup>18</sup> and the ensuing flurry of variants – from Eurobills to ESBies and E-bonds. In its initial form, the common asset would have resulted from a joint and several guarantee on the ‘blue debt’ (below 60% of GDP), the counterpart of it would have been a juniorisation of the remainder or ‘red debt’ (above 60%). The differences between the various schemes which have since been proposed relate to critical features such as partial or common issuance, whether based on mutualisation of risks or entail no joint liabilities, involve pooling of sovereign bonds or “tranching” of national issuances.<sup>19</sup> The different proposals share a common goal: an asset which would be attractive to global and domestic investors as an alternative to national sovereign bonds, thereby allowing euro-area governments to finance themselves at reasonable cost, and in the process achieve the integration of European bond markets. To perform this role, such an asset would need a transparent structure with different maturity profiles, carrying comparatively the lowest possible credit and liquidity risk, while avoiding contagion. It would also need to be large enough to ensure it becomes a reference for collateral and liquidity both in the Euro area as well as for global demand. Through offering a vehicle for balance sheet diversification, a common safe asset could also complement concentration charges on oversized bank portfolios of (domestic) sovereign bonds and help address the “doom loop” between banks and sovereigns - a key destabilizing element in the euro area sovereign debt crisis.<sup>20</sup> Policy discussions have moved away from the initial proposal for Eurobonds, which has been rejected by Germany and would anyhow require a level of centralised control over national budgets that no country is willing to accept. The alternative of relying on sovereign bond-backed securities (SBBS – the creation of common assets through the tranching and pooling

of national issuances, but no mutualisation) is regarded with scepticism by policymakers and market participants. Though far from consensual, the only version that commands some support is the Eurobill – an asset issued by a common institution such as the ESM, including as a counterpart to direct loans to euro-area sovereigns.

#### *d. Restructuring unsustainable sovereign debt at national level*

The constitution of the euro was based on an ambiguity regarding the meaning of the “no bail-out clause”: whereas some, especially in Germany, regarded it as implying automatic restructuring of unsustainable public debt (and, in its strictest form, the prohibition of conditional financial assistance), the letter of the Treaty only ruled out taking responsibility for a member state’s debt. Therefore, the sovereign debt crisis that erupted in 2010 prompted wide-ranging soul-searching on the treatment of excessive public debt. Though repeatedly discussed, the issue has not yet been settled.

The euro area initially refused to address this issue at the beginning of the crisis, until the sudden turnaround with the ill-designed Deauville decision in late 2010 and eventually the 2012-3 Greek debt restructuring, the only instance to-date of an actual “write-down” of sovereign debt in a euro area country. However, the legacy of high and still rising debt levels is increasingly a matter of concern. In light especially of particularly high and unsustainable debt-to-GDP ratios in countries such as Greece and Italy, the discussion of whether debt restructuring should become a viable policy option in a more general sense, if all else fails, has taken on new significance.

The issue of a sovereign debt restructuring mechanism is a related one. In this area also, the argument for more market discipline and a return to the “no bailout rule” of the EU Treaty is pitted against fears of contagion that argue in favour of providing liquidity assistance, even in cases where solvency is not guaranteed. To euro area leaders, the Greek debt restructuring exercise was supposed to be a “one-off” event. But the pendulum seems to have decidedly swung: the idea of “orderly sovereign-debt restructuring” in cases where solvency cannot be restored through conditional crisis lending is gaining ground. In its most nuanced version, this does not imply automatic debt haircuts or maturity extensions when a country is forced into an ESM programme. It suggests debt restructuring as a last-resort option, with the ESM following IMF rules in this regard. In addition, it makes proposals for such restructuring to become less disruptive economically and financially; these include the concentration charges and the safe asset discussed earlier, as well as a euro area deposit insurance. It is an approach which tries to stay faithful to the “no bailout” clause in the Treaty while providing a framework to make it operational.<sup>21</sup>

#### *e. Simplification of fiscal rules*

The reforms during the crisis sought to amend and strengthen the SGP framework; yet their accumulation has made it too complex and ineffective. The criticism that the rules and their interpretation produced too little debt

reduction in the first decade of the euro and too much fiscal austerity during the crisis continues to resonate today. The SGP reforms were aimed at creating a more robust framework for assessing countries' fiscal positions and adjustment paths. But they rely on unobservable variables such as the structural deficit and forecasts of potential output growth; hence both the European Commission and Member States resort to creative interpretations in order to enforce a complex and error-prone set of rules avoid without unnecessarily sanctioning countries.<sup>22</sup>

The simplification of fiscal rules is probably the most mature reform area. Proposals vary, but the reform direction is shared both by proponents of a rules-based approach to fiscal monitoring as well as by those who put more focus on discretion. The core of most proposals is to replace the current system with a simpler rule focused on limiting the annual growth rate of expenditures. They differ on whether it would be “anchored” on a balanced budget rule or (as most suggest) on a medium-term debt target such as the 60% debt to GDP ratio in the SGP, or another to be defined in a discretionary way.<sup>23</sup>

## 4. Governance reform

The management of the sovereign debt crisis was clearly not the euro area's finest moment. While the decision-making process used may have worked for defusing the crisis, in the longer term it undermines the legitimacy of the European project. In this context, governance reform involves both reformulating the role of key European institutions in the common currency area, as well as addressing issues of democratic legitimacy. The core issue concerns the EU ambition and desire for a common destiny and initiatives to support it. There is a broader EU discussion of whether, given political realities and divergent national priorities, the Union will move ahead with “coalitions of the willing” emerging to work together in different policy areas, ranging from the economy to security and defence. Within this broader discussion, a number of practical proposals for institutional reforms in the euro area have been advanced.

### 4.1. The future role of the ESM

The one most advanced is the establishment of a European Monetary Fund within the EU's legal framework, built on the structure of the ESM. The ESM has indeed evolved since it was set up and is in the process of becoming, together with the ECB, central to the new EMU architecture. Once strictly limited to providing finance, it has equipped itself with the capabilities needed to be designing the financial aspects of support programmes, as well as monitoring former programme countries and undertaking debt sustainability analyses (for example the validation of the debt sustainability necessary for the ECB to use tools such as the OMT programme).<sup>24</sup> In these roles it has emerged as the backbone of a fully-fledged financial institution and an alternative to the European Commission.

There are two practical ways in which the ESM will evolve and come closer to resembling a European Monetary Fund. The first is to act as a financial backstop for the SRF in the form of a revolving credit line, so that the latter has adequate resources to restructure failing credit institutions and more generally withstand a financial crisis. The second relates to fiscal risk-sharing and providing a limited fiscal capacity for the euro area through shorter-term loans with lighter conditionality than under regular programmes.

The idea is to assist stabilisation and thereby avoid a situation where a full ESM programme is required. The main elements of this backstop were endorsed by the Council in December 2018 while the Council also made a move in the second direction by endorsing a “Term sheet on the European Stability Mechanism reform”.<sup>25</sup> This represents an improvement on existing rules; the stringent ex-ante eligibility conditions attached however may limit its usefulness in practice.<sup>26</sup>

An additional direction for ESM reform is in the context of debt restructuring. The ESM has effectively been given the mandate to manage an eventual sovereign debt restructuring framework and become a moderator between states and private creditors. The announced intention to change by 2022 the collective action clauses (CACs) framework and include this commitment in the ESM Treaty is a clear movement in the direction of making “orderly debt restructuring” part of the new EMU architecture.

The practical discussion on how the ESM will evolve and what additional tools it will be given takes place against the background of an institutional power struggle between the European Commission and the European Council. During the crisis, the initial creation of the EFSF and subsequently of the ESM showed that member states intended to keep financial support under their control. But as the ESM evolves into a future EMF, key euro-area member states might in fact use the necessary broadening of its scope to rebalance responsibilities. There are indeed three major differences between governance by the Commission and by the ESM: membership, as the former includes all EU members, and the latter only those taking part of the euro; balance as each country appoints one Commissioner whereas votes are weighted within the ESM; and distance, as the Commission is formally independent from the member states whereas the ESM is an intergovernmental institution.<sup>27</sup>

## 4.2. Institutional balance and accountability

The role of the Eurogroup in helping manage the crisis cannot be overemphasized. Because of this indisputably pivotal role in euro area decision-making, it has attracted widespread criticism about its lack of transparency and legitimacy.<sup>28</sup> The criticism has focused on its informal character and lack of democratic accountability, given the gravity and nature of its decisions. As we move beyond the crisis, this needs to be addressed.

Publishing the minutes of the meetings, more formal hearings of the Eurogroup President at the Parliament or electing a full-time President may help.

Fundamentally however, the issue is about resolving the conflict of interest expressed at the Eurogroup between creditor and debtor countries. The former

require “house cleaning” from debtors, with debts repaid through higher taxes and lower expenditures; the latter want a more balanced adjustment and more risk-sharing instruments. Reconciling the two goes beyond simple institutional changes at the Eurogroup.

The supranational European institution which played the most central role in keeping the single currency together is the European Central Bank. The “whatever it takes” stance taken by Mario Draghi in 2012 is widely credited as representing the watershed in overcoming the worst of the crisis. While the statement itself proved to have enormous impact, the ECB had from the start of the crisis regarded itself as endowed with the mission of preserving the integrity of the euro area – an implicit mandate as important perhaps as the stated mandate of preserving price stability.

Its gradually evolving initiatives since the beginning of the crisis involved secondary market sovereign debt purchases, long-term refinancing operations to provide liquidity to the European banking system, and targeted refinancing to unclog policy transmission channels. And following the 2012 statement, the introduction of the OMT scheme indicated that, in the name of tackling the redenomination risk, it could get closer to fulfilling a de facto function of lender of last resort. These moves were often met with considerable opposition from both within and outside the institution, and claims that it was operating beyond its mandate.

As Europe integrates further economically and socially, its institutions have not adapted sufficiently. Rather than following through with what should be a “quantum leap in institutional integration”,<sup>29</sup> Europe hesitates and dithers. This is because economic integration is accompanied by political divergence. And yet, the new geopolitics it is facing demand exactly the opposite.

## 5. Concluding remarks

Is the mission accomplished? Following the crisis, much has been done, but the euro area is still fragile. Financially, it is less so than in 2011, but the Italian episode has shown that the doom loop is still there, with the redenomination risk not fully eliminated. Economically, the current slowdown illustrates how quickly the outlook can deteriorate. There is not much monetary and fiscal ammunition left to ward off the next recession, and the asymmetry between successful and struggling countries remains blatant. Finally, while the political risk was second-order in mid-crisis, it now has center stage, with both northern and southern populism now developed - the one thing they have in common is a distaste for Europe. What is required at this juncture is an agreement on a minimal agenda that would not deliver an ideal EMU but would deliver a viable EMU. Its key ingredients could be to:

- Focus on structural reform and competitiveness. There seems to be agreement to use the EU budget to this end; combined with clever financial engineering (re: the Juncker plan) it can help in a much better way

- Finish the last mile in Banking union. Euro area countries have invested too much to backtrack. The priority agenda includes EDIS, concentration charges and a truly integrated resolution mechanism. Looking beyond, what is at stake is whether we agree on building an integrated banking market, as part of CMU.
- Harvest the low-hanging fruits in fiscal reform. These include a reform of the SGP that lengthens the leash for member states, and as a *quid pro quo* more individual responsibility in the case debt proves unsustainable (but no procedural or arithmetic automaticity). Stabilisation and a fiscal capacity are desirable, but not indispensable in the short term.
- Safeguard the institutions. Fully develop the new role of the ESM while avoiding a turf war between with the Commission. In this context, one solution could be that the Commissioner becomes the chair of the Eurogroup, but with fiscal surveillance delegated to a fiscal council.

**This minimal agenda should not stop us from pursuing all the elements discussed above for a fully functioning EMU. A safe asset, a stabilization tool and a central fiscal capacity for example continue to be necessary in this respect. But few of these reforms are technical; almost all incorporate a view on the general future EMU direction, on which there is no consensus. Further political integration represents both a limit and a prerequisite to full EMU reform. In the current political and economic environment, it is critical to at least proceed with what is absolutely necessary; for the rest, it is important to paint the bigger picture, lay out the political choices and the policy options that follow, and prepare the ground for decisions at a later stage.**

<sup>1</sup> “Strengthening Economic Governance in the EU – Report of the Task Force to the European Council” (<https://www.consilium.europa.eu/media/27405/117236.pdf>) and “Towards a Genuine Economic and Monetary Union” (<https://www.consilium.europa.eu/media/23818/134069.pdf>).

<sup>2</sup> See [https://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/119888.pdf](https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/119888.pdf)

<sup>3</sup> The text can be found in [http://europa.eu/rapid/press-release\\_DOC-12-2\\_en.htm](http://europa.eu/rapid/press-release_DOC-12-2_en.htm)

<sup>4</sup> See [http://ec.europa.eu/economy\\_finance/publications/occasional\\_paper/2013/pdf/ocp147\\_en.pdf](http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/pdf/ocp147_en.pdf)

<sup>5</sup> See <https://www.consilium.europa.eu/media/21400/20120629-euro-area-summit-statement-en.pdf>

<sup>6</sup> See [https://www.consilium.europa.eu/media/37268/tor-backstop\\_041218\\_final\\_clean.pdf](https://www.consilium.europa.eu/media/37268/tor-backstop_041218_final_clean.pdf).

<sup>7</sup> See [ec.europa.eu/info/sites/info/files/economy-finance/ip096\\_en.pdf](http://ec.europa.eu/info/sites/info/files/economy-finance/ip096_en.pdf)

<sup>8</sup> Bénassy-Quéré et al. (2018), “Reconciling risk sharing with market discipline: A constructive approach to euro area reform”, a report by French and German economists, CEPR Policy Insights No 91, January. The report can be found in [https://cepr.org/active/publications/policy\\_insights/viewpi.php?pino=91](https://cepr.org/active/publications/policy_insights/viewpi.php?pino=91)

<sup>9</sup> “Completing Europe’s Economic and Monetary Union” (the Five Presidents Report). The report can be found in [ec.europa.eu/commission/sites/beta-political/files/5-presidents-report\\_en.pdf](http://ec.europa.eu/commission/sites/beta-political/files/5-presidents-report_en.pdf)

<sup>10</sup> “Reflection paper on the Deepening of EMU” ([https://ec.europa.eu/commission/sites/beta-political/files/reflection-paper-emu\\_en.pdf](https://ec.europa.eu/commission/sites/beta-political/files/reflection-paper-emu_en.pdf)). The policy package proposed by the European Commission for completing EMU can be found in: [https://ec.europa.eu/info/publications/economy-finance/completing-europes-economic-and-monetary-union-policy-package\\_en](https://ec.europa.eu/info/publications/economy-finance/completing-europes-economic-and-monetary-union-policy-package_en)

<sup>11</sup> See <http://bruegel.org/publications/datasets/sovereign-bond-holdings/>.

<sup>12</sup> The European Commission produced in 2016 an “Effects Analysis” of the introduction of an European Deposit Insurance Scheme (EDIS). The non-paper can be found here: [https://ec.europa.eu/info/sites/info/files/161011-edis-effect-analysis\\_en.pdf](https://ec.europa.eu/info/sites/info/files/161011-edis-effect-analysis_en.pdf).

<sup>13</sup> These proposals are taken from Bénassy-Quéré et al. (2018), *ibid*.

<sup>14</sup> See for example Koester, G. and Sondermann, D. (2018), “A euro area macroeconomic stabilisation function: assessing options in view of their redistribution and stabilisation properties”, European Central Bank Occasional Paper series, No. 216; CEPS (2017), “Feasibility and Added Value of a European Unemployment Benefits Scheme”, Report commissioned by the European Commission.

<sup>15</sup> See Heijdra, M. et al. (2018), “A more stable EMU does not require a central fiscal capacity”. This article (by economists working for the Dutch government) can be found in: <https://voxeu.org/article/more-stable-emu-does-not-require-central-fiscal-capacity>.

<sup>16</sup> See <https://archiv.bundesregierung.de/archiv-de/meta/startseite/meseberg-declaration-1140806>

<sup>17</sup> The December 2018 Euro Summit statement mandates the Eurogroup to work on “a budgetary instrument for convergence and competitiveness for the euro area”. It is a watered-down version of the June 2018 “French German roadmap for the Euro Area”: [https://www.economie.gouv.fr/files/files/PDF/2018/Finances-Euro\\_Area\\_Roadmap-EN.pdf](https://www.economie.gouv.fr/files/files/PDF/2018/Finances-Euro_Area_Roadmap-EN.pdf).

<sup>18</sup> Delpla, J., and von Weizsäcker, J. (2010), “The Blue Bond Proposal”, Bruegel Policy Brief.

<sup>19</sup> Different schemes are discussed in Monti, M. (2010), “A new strategy for the single market”, Report to the European Commission, pp. 61- 65 (E-bonds); Philippon, T. and Hellwig, C. (2011), “Eurobills, not Eurobonds”, VoxEU.org.; Claessens, S. et al. (2012) “Making sense of Eurobond proposals”, VoxEU.org; Brunnermeier, M. et al. (2016), “ESBies: Safety in the Tranches”, ESRB Working Paper No. 21, September. European Commission (2011), “Green paper on the feasibility of introducing stability bonds”, COM(2011) 818, provides an overview: [http://www.europarl.europa.eu/meetdocs/2009\\_2014/documents/com/com\\_com\(2011\)0818\\_/com\\_com\(2011\)0818\\_en.pdf](http://www.europarl.europa.eu/meetdocs/2009_2014/documents/com/com_com(2011)0818_/com_com(2011)0818_en.pdf)

<sup>20</sup> The argument is made in Bénassy-Quéré et al. (2018), *ibid*.

<sup>21</sup> The “orderly debt restructuring” argument is made in Bénassy-Quéré, A. et al. (2018), “Reconciling risk sharing with market discipline: A constructive approach to euro area reform”, CEPR Policy Insight No 91. It has been endorsed in part by the France-German roadmap for Euro area reform. Two critical opinion pieces are De Grauwe, P. and Y. Ji (2018), “Financial engineering will not stabilise an unstable euro area”; and Tabellini, G. (2018), “Risk sharing and market discipline: Finding the right mix”, both in VoxEU.org.

<sup>22</sup> This argument is made *inter alia* in Wieser, T. (2018), “Fiscal rules and the role of the Commission”, VoxEU.org.

<sup>23</sup> Feld, L., et al. (2018), “Refocusing the European fiscal framework”, propose an expenditure rule within the “rules-based approach”. Other alternatives are in Darvas, Z., Martin, P. and Ragot, X., “The economic case for an expenditure rule in Europe”; and Beetsma, R. (2018), “Reforming the EU fiscal framework: A proposal by the European Fiscal Board”, all in VoxEU.org.

<sup>24</sup> This argument for the necessity that ESM and ECB work seamlessly in the EMU to defuse crisis is developed in Claey's, G. (2018), “Make euro-area sovereign bonds safe again”, VoxEU.org.

<sup>25</sup> See [https://www.consilium.europa.eu/media/37267/esm-term-sheet-041218\\_final\\_clean.pdf](https://www.consilium.europa.eu/media/37267/esm-term-sheet-041218_final_clean.pdf)

<sup>26</sup> See Claey's, G. and Collin, A. (2018) “Does the Eurogroup’s reform of the ESM toolkit represent real progress?”, VoxEU.org.

<sup>27</sup> For the ESM’s own view, see “A European Monetary Fund: for what purpose?”: <https://www.esm.europa.eu/speeches-and-presentations/european-monetary-fund-what-purpose-speech-klaus-regling>.

<sup>28</sup> See, *inter alia*, the case opened by the European Ombudsman in 2016 (Transparency of the Eurogroup - <https://www.ombudsman.europa.eu/en/case/en/48285>); the EP resolution on the review of the economic governance framework: stocktaking and challenges (2014/2145(INI)); and the Transparency International project on European Economic Governance (<https://transparency.eu/project/euro/>).

<sup>29</sup> Draghi, M. (2015), Speech at SZ Finance Day 2015, Frankfurt am Main, 16 March.

## EUROPE BEYOND BREXIT: SCENARIOS FOR THE FUTURE

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CONTRIBUTION TO THE PANEL

### *“The European Union after Brexit: centrifugal tensions and differentiated integration”*

Tradução para português disponível em [gulbenkian.pt](http://gulbenkian.pt)

## 1. Introduction

One of the most remarkable aspects of Brexit – the decision of the United Kingdom (UK)<sup>1</sup> to withdraw from the European Union (EU) – has been the degree to which the 27 other member states of the EU have been united in their dealing with the UK. Contrary to the expectations of some, the EU27 have never divided on issues connected to the UK withdrawal from the EU. In fact – with the marginal exception of Italy’s legal challenge against the EU Council decision relocating the European Medical Agency from London to Amsterdam, rather than Milan<sup>2</sup> – the EU member states have remained consistently united in negotiating with the UK, delegating all talks to the ad hoc European Commission Article 50 Task Force, and backing the work of the Brexit Chief Negotiator Michel Barnier.<sup>3</sup> Yet, one would be mistaken to believe that the unity of the 27 vis-à-vis the UK reflects a high level of harmony within the EU. In fact, in the midst of the Brexit process, tensions and divisions among the EU member states have actually increased in a number of policy areas. Beyond Brexit, the EU has recently weathered several other important crises – from the euro-crisis, to the migration-crisis and the rule of law crisis – which have increasingly tested the integrity of the Union, and thus raised pressing questions on the future of Europe.

The purpose of this paper is to reflect on the future of the EU27, discussing how a number of ongoing centripetal pressures besides Brexit impact on the project of European integration. As the paper claims, the recent multiple crises the EU has faced have produced deep wounds in the fabric of the Union. Most notably, the rise of populism – and the battle for the next European Parliament elections – has polarized the member states, shedding dark clouds on the future of the EU at 27. Certainly, as the paper points out, the impact of path dependency should not be underestimated, which means that a scenario where the EU carries on and resists all difficulties in its current format cannot be ruled out. Nevertheless, the paper suggests that growing differentiation among the member states – if not the outright creation to the side of the existing EU of a new, smaller union including only a minority of member states – are possible alternative scenarios for the future. As such, the paper is structured as follows. Section 2 maps three key centrifugal pressures challenging the EU27 and their consequences. Section 3 outlines three alternative scenarios for the future of Europe which can follow from the EU’s crises. And Section 4 briefly concludes.

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## 2. Centrifugal pressures

After the UK voted to leave the EU in June 2016, and notified its intention to withdraw from the EU in March 2017,<sup>4</sup> the EU has continued to face a number of other important crises which have tested the resolve of the other 27 member states. In fact, since Brexit tensions among the member states have possibly even increased on issues such as the response to the euro-crisis, the management of the migration crisis or the respect for the foundational values of the EU. Hence, the united face of the EU vis-à-vis the UK effectively concealed a house divided, with multiple centrifugal pressures challenging the integrity of the EU project.

### 2.1. Euro-crisis

By Brexit time, the peak of the euro-crisis had elapsed: while action by the European Central Bank (ECB) had fundamentally contributed to reboot the Eurozone economy, the architecture of European economic governance had been reformed to tighten budgetary constraints and increase financial stability.<sup>5</sup> Nevertheless, the Economic and Monetary Union (EMU) remained still incomplete<sup>6</sup> – and tensions between Northern creditor and Southern debtor countries persisted.<sup>7</sup> Indeed, the “crisis let the specter of a euro exit emerge – and we have not yet been able to fully make it disappear again.”<sup>8</sup> This was on show in summer 2018, when Greece ended with much fanfare its third bailout program but, as part of the post-program surveillance framework, was forced by the Eurogroup to commit to maintaining “a primary surplus of 2.2% of gdp on average in the period from 2023 to 2060”<sup>9</sup> – a target which most observers regarded as impossible to meet.<sup>10</sup> Moreover, the legacy of the euro-crisis with low growth and high level of unemployment continued to fuel acrimony among the member states. In fact, perceived unfairness in the architecture of EMU propelled forward political forces calling more explicitly for exiting the Eurozone – particularly in Italy, the third largest Eurozone economy. Following parliamentary elections in March 2018, the two parties which had emerged victorious – the League and the Five Star Movement – joined in a sovereigntist coalition, with an explicit plan to abandon the Eurozone.<sup>11</sup> Only the veto of the Italian President of the Republic forced the coalition parties to backtrack on this.<sup>12</sup> Yet, the new Italian government clearly embraced a confrontational stand against the EU: in presenting its draft budget bill to the Commission pursuant to the procedure foreseen by the European semester, the government openly admitted that it was violating the EU deficit rules set in the Stability and Growth Pact – which led the Commission to invoke for the first time ever its power to request a redrafting of the budget bill,<sup>13</sup> and to activate the excessive deficit procedure.<sup>14</sup> In the end, mostly under the pressure of the financial markets, the Italian Government compromised and agreed to revise its budget bill by postponing some expenditures, thus reducing the deficit.<sup>15</sup> Yet, it is clear that this is stopgap, and that the problem will remerge in analogous form in 2019 – as made evident also by the European Commission forecast for 2019,

which put Italy at the end of the queue in terms of growth, with a mere 0.2% projection for the year.<sup>16</sup>

Given this state of affairs it is unsurprising that major difficulties have been found in the discussions about completing EMU, including by setting up a fiscal capacity and the last pillar of banking union through a common deposit guarantee scheme.<sup>17</sup> In fact, while the efforts of French President Emmanuel Macron favored a convergence between France and Germany, which jointly proposed in November 2018 the establishment of a Eurozone budget with stabilization purposes,<sup>18</sup> a coalition of Northern countries generally known as the ‘Hanseatic League’, which includes both Eurozone and non-Eurozone states, came out to caution against the Franco-German proposals and rather pleaded for strengthening the European Stability Mechanism (ESM)<sup>19</sup> as a surveillance authority on the budget of the member states<sup>20</sup> – which, in fairness, had always been a German policy priority. In December 2018 the Eurogroup in an inclusive format eventually agreed on a compromise package, which included both a reform of the ESM and steps toward greater Eurozone convergence and competitiveness.<sup>21</sup> The Euro Summit endorsed the packaged, with the ambitious time-line to achieve it by June 2019,<sup>22</sup> but it remains to be seen how member states will be able to strike the balance between risk-reduction and risk-sharing in EMU.

## 2.2. Migration crisis

Like the euro-crisis, also the migration crisis had apexed by the time of Brexit. Although fears of uncontrolled migration into the UK were cynically exploited by the Brexiteers in the referendum campaign, by 2016 the EU had succeeded in reducing the inflow of people moving into the Schengen free-movement zone – not least at the cost of outsourcing to third countries (of dubious human rights record) the task of controlling the EU external border.<sup>23</sup> Nevertheless, the management of the migration crisis has remained a point of contention among the member states and, in fact, tensions have increased on the functioning of the European Common Asylum System (ECAS).<sup>24</sup> The EU migration policy had been developed in good time, but particularly the Dublin regulation,<sup>25</sup> which identified the member state responsible for processing asylum applications of third-country nationals, was ill designed to cope with a sudden surge of asylum applications. Yet, member states have dramatically divided on how to handle this crisis – with Central and Eastern European member states refusing any form of burden sharing vis-à-vis the coastline member states which had been the main points of entry for immigrants.

In September 2015, under the pressure of events, the Council adopted by majority a decision establishing a temporary relocation mechanism to the benefit of Greece and Italy, which foresaw the relocation of 160.000 asylum seekers to the other EU member states pro-quota, with the aim of reliving Greece and Italy of the increasing workload resulting from the sudden inflow of migrants from the Middle East and North Africa.<sup>26</sup> Although the number of asylum seekers to be relocated under the Council decision was a drop of

water in the ocean, considering that almost 4 million migrants had entered the EU in 2015, Hungary and Slovakia challenged the Council decision in the European Court of Justice (ECJ). And although in September 2017 the ECJ ruled that the Council had acted in a fully legitimated way in adopting the decision by majority,<sup>27</sup> the Visegrad countries bluntly refused to abide by the Council decision and the ECJ ruling – in the case of Hungary with the support of the state constitutional court, which declared the EU act in violation of the country’s constitutional identity, intended as enshrining an ethnically homogenous nation.<sup>28</sup> As the Commission had to acknowledge in June 2017 in its periodical report on the relocation system, progress in the implementation of the measure had been simply “insufficient.”<sup>29</sup>

In fact, disagreement among the member states in the Council paralyzed any efforts at reforming the ECAS, and despite the encouragement of the European Council,<sup>30</sup> the proposals by the Commission to overhaul the system<sup>31</sup> – including by introducing a permanent mechanism of relocation in order to increase its fairness – have gone nowhere. Furthermore, just like for EMU, the legacy of the crisis combined with the inequities of the system have fueled political movements which have more explicitly called for drastic responses, including fully suspending Schengen and reintroducing national borders.<sup>32</sup> Ironically this has not happened only in Northern member states such as Austria, or Denmark, but also in coastline countries such as Italy, or Spain, where xenophobic right-wing parties have gained momentum in national and regional elections. Yet the cleavage on the migration issue has mostly run along an East v West axis, and the political conflict among EU member states on how Europe should handle the migration crisis has gotten so intense that Luxembourg Minister of the Interior Jean Asselborn even suggested that Hungary should be expelled from the EU for the way it treats migrants.<sup>33</sup>

### 2.3. Rule of law crisis

Compared to euro-crisis and the migration crisis, another crisis got much worse in the midst of the Brexit process. Even if the first signs of backsliding on the respect for the rule of law in a number of EU member states of Central and Eastern Europe were evident since the early 2010s, in the years after the UK voted to leave the EU the phenomenon known as the rule of law crisis both deepened and widened.<sup>34</sup> Even though Article 2 TEU proclaims that the EU “is founded on the values of respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights, including the rights of persons belonging to minorities” several EU member states of the former Warsaw Pact have experienced legal and political developments that have challenged basic constitutional principles such as the independence of the judiciary, the separation of powers, or the fairness of the electoral process.<sup>35</sup> Such developments constitute a major threat to the integrity of the EU, as they undermine the mutual trust on the respect for the rule of law. Yet, Hungarian Prime Minister Viktor Orban proudly defended this path, explicitly arguing that his country was intent on establishing an authoritarian democracy.<sup>36</sup> And the Hungarian example increasingly served as a template in other countries of the region, notably Poland and Romania.

Although arguably with excessive delay, the EU institutions have started taking action against this phenomenon, with the support of several other member states and the main European political parties. In particular, as part of the preparatory work for the next multi annual EU budget, the Commission proposed to introduce a mechanism to freeze structural funds for EU member states which failed to respect the rule of law.<sup>37</sup> Moreover, in December 2017 the Commission activated Article 7 TEU against Poland calling on the Council to determine that the country faced a clear risk of a serious breach of the rule of law.<sup>38</sup> And in September 2018 the European Parliament approved a resolution starting the same process against Hungary.<sup>39</sup> Nevertheless, limited progress has been made by the Council in considering whether the situation in Poland and Hungary required an EU determination that corrective action was necessary. In fact, in the first semester of 2019, when the Presidency of the Council was held by Romania – a member state which had been strongly criticized for its rule of law record, and limited efforts to fight corruption by the European Parliament<sup>40</sup> – the application of the Article 7 procedure against Poland and Hungary was even removed by the agenda of General Affairs Council meeting.<sup>41</sup>

In this context also the ECJ was involved in the matter. Seized through a preliminary reference by the Irish High Court, the ECJ held that backsliding in respect for the rule of law – if this resulted in the reduction of the due process rights of a convicted person, to be assessed cases by case – could justify a judicial decision not to execute a European Arrest Warrant toward Poland.<sup>42</sup> And ruling in an infringement proceeding brought by the Commission, the ECJ enjoyed Poland from giving effect to a highly controversial law which altered the composition of the state Supreme Court.<sup>43</sup> Yet, while the ECJ has so far managed to command respect, its ability to halt the erosion of the rule of law based system at the national level is likely to face challenges in the long term – in the absence of EU coercive power, and given the growing rise of populism across Europe. In fact, with the formation of sovereigntist, Euro-skeptic government coalitions in an ever greater number of EU member states – including Austria and Italy – it is unlikely the EU intergovernmental institutions will mobilize to respond to domestic threats to the rule of law in forms analogous to what was done at the time of the Haider's affair.<sup>44</sup> As a result, the rule of law crisis has the potential to dramatically weaken the EU – de facto even imperiling the functioning of the internal market.

### 3. Scenarios

The centrifugal pressures identified in section 2 have significantly challenged the unity of the EU. As Dermot Hodson and Uwe Puetter have argued, the EU is currently in disequilibrium.<sup>45</sup> In this context, a debate on the future of Europe has been launched at the highest institutional level<sup>46</sup> – and growing attention is being dedicated to this critical question also by academics and civil society.<sup>47</sup> Many reflections on the future of Europe identify a path of increasing differentiation among, if not outright separation between, EU member states.

Yet, one should not under-estimate the dynamics of path dependency within the EU, which may allow things to continue as they have for at least another while. In what follows, therefore, I will try to outline three possible models of integrations that may compete in the next few years.

### 3.1. Resist and carry on

One cannot exclude that, despite all the challenges the EU is currently facing, things may simply continue as they have. After all, the EU is not new to weathering crises. In fact, crises have been a recurrent feature in the history of the EU – from De Gaulle’s Empty Chair,<sup>48</sup> to the failure of the European Constitution<sup>49</sup> and beyond. Hence the EU may simply be able to resist yet another set of crises and carry on as it stands. In fact, there are a number of policy areas where actually the EU is delivering – effectively – with its current governance and policy structures. In the field of international trade, for example, the EU has been able to achieve its objectives successfully. In the last five years, the EU has initialed a major free trade agreement with Japan,<sup>50</sup> and started negotiations for new economic partnerships with, among others, Australia.<sup>51</sup> Moreover, despite a challenge by the Belgian region of Wallonia,<sup>52</sup> the EU Council signed a comprehensive economic trade agreement with Canada,<sup>53</sup> and the European Commission received a mandate to start new trade negotiations with the US,<sup>54</sup> averting the threats of a tariff war with the Trump administration.<sup>55</sup>

The fact that the EU works – at least in some policy areas – is not irrelevant, as it strengthens the status quo and reduces the impetus for reform. In fact, as the economic scholarship has shown, institutional systems follow a logic of path dependency, and moreover reforms usually occur only when they are Pareto-optimal. Path dependency means that once an economic process or a governance arrangement is in place over-time, it becomes locked-in and it will be difficult to change it as institutional actors become accustomed to the status quo.<sup>56</sup> Pareto-optimality, instead, refers to a state of allocation of resources from which it is impossible to reallocate so as to make any one individual or preference criterion better off without making at least one individual or preference criterion worse off – meaning that improvements to a given equilibrium can only occur if no one loses out of the change. Applied to the EU, these economic insights suggests that reforming the EU at 27 will be a daunting task – if states and EU institutions are accustomed to existing governance practices, and if reform scenarios threaten to make some countries worse off, given the requirement that any amendment to the EU Treaties be made by unanimous consent.<sup>57</sup>

However, one cannot underestimate the novelty of the challenges the EU is facing today – compared to the past. Moreover, the ability of the EU to work in given areas, such as international trade, conceal the fact that this is a special domain, where the institutional structures of the EU actually support an effective governance. The Treaties, in fact, make the common commercial policy an exclusive competence of the EU,<sup>58</sup> vesting the powers to run international negotiations in the European Commission, subject to the

mandate of the Council, which operates under QMV, and the oversight of the European Parliament.<sup>59</sup> Yet, in most other areas of high politics, the EU does not follow the same supranational logic. On the contrary, intergovernmental modes of governance prevail, with the European Council mostly in charge of decision-making. As is well-known, this has led to paralysis, and increased inter-state tensions since intergovernmental institutions are unable to overcome the conflicting national interests of the member states and thus solve the problems at hand.<sup>60</sup> In this context, it is not clear that states will have an interest in maintaining the status quo, or that the system will be strong enough to withstand pressures for change.<sup>61</sup>

### 3.2. React and differentiate

It is for these reasons that an alternative scenario is one of reaction and increasing differentiation within the EU. Certainly, differentiation is not a new thing in the EU, as it finds its roots in the Treaties of Maastricht and Amsterdam, and the establishment of opt-outs (notably on euro-membership) and closer cooperation (including in the field of defense).<sup>62</sup> Nevertheless, in recent times differentiated integration has increasingly become a tool to deal with deadlock and diverging ideological preferences in highly salient policy areas.<sup>63</sup> For instance, the project of establishing a European Public Prosecutor Office (EPPO)<sup>64</sup> to investigate transnational crimes against the financial interests of the EU moved forward through enhanced cooperation with the support of only 20 states – Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Germany, Greece, Spain, Finland, France, Italy, Latvia, Lithuania, Luxembourg, Portugal, Romania, Slovenia and Slovakia. Not surprisingly, among the non-participating member states are Poland and Hungary – two countries subject to the Article 7 procedure.<sup>65</sup> In fact, the efforts by the Romanian government to oppose the appointment of a Romanian anti-corruption prosecutor to lead EPPO<sup>66</sup> signaled how differentiation in policy areas connected to the area of freedom, security and justice is somehow inevitable at a time when the rule of law is under threat in a number of member states.

The idea of embracing differentiation as a strategy to pursue integration at challenging time has been officially endorsed not just by the European Commission as one of its scenarios in the *Whitepaper on the Future of Europe*<sup>67</sup> – but also by several member states, including the four largest Eurozone countries – Germany, France, Italy and Spain – who expressed their wish “qu’il y ait de nouvelles formes de coopération pour de nouveaux projets – ce que l’on appelle les coopérations différenciées – qui fassent que quelques pays puissent aller plus vite, plus loin dans de domaines comme la défense, mais aussi la zone euro au travers l’approfondissement de l’Union économique et monétaire [...] sans que d’autres ne puissent s’y opposer.”<sup>68</sup> And even the European Parliament, albeit with some reluctance, referred to differentiated integration in an ad hoc resolution in January 2019.<sup>69</sup> As it pointed out, differentiated integration “has sometimes allowed for the deepening and widening of the EU to be pursued simultaneously.”<sup>70</sup> As a consequence,

the Parliament underlined that “one cannot oppose differentiation and integration, nor can one present differentiation as an innovative path for the future of the Union.”<sup>71</sup> Yet, it cautiously underlined how differentiation “is often perceived as a path towards the creation of first- and second-class Member States”<sup>72</sup> and thus concluded that “that differentiation should only be conceived of as a temporary step on the path towards more effective and integrated policymaking.”<sup>73</sup>

Whatever the benefits of differentiation, it is well known that this strategy suffers from a number of difficulties – not least actually the risk of being unable to effectively differentiate. The case of cooperation in the field of defense is telling from this point of view.<sup>74</sup> Following the decision of the UK to leave the EU, the European Council, in June 2017 agreed eventually on the need to launch for the first time an inclusive and ambitious Permanent Structured Cooperation (PESCO) in the field of defense pursuant to Article 42(6) TEU.<sup>75</sup> In December 2017 the Council formally approved the creation of PESCO on the understanding that member states participating to the military cooperation “shall make contributions which fulfill the more binding commitments which they have made to one another.”<sup>76</sup> And in March 2018 the Council gave its blessing to the first operational projects.<sup>77</sup> Nevertheless, the heterogeneity of the 25 participating member states – all except Denmark and Malta – quickly diluted the impact of the project, leading France – the EU member state with traditionally the greater strategic culture and military projection – to establish an alternative European Intervention Initiative.<sup>78</sup> This project, which involves only 10 countries (including the UK and Denmark) is designed to bring together EU states which share a common vision regarding security concerns – creating a framework of selective cooperation outside the structures of the EU. And this may be a model to be used elsewhere.

### 3.3. Downsize and restart

The idea that a number of member states could consolidate their cooperation through separated structures outside the EU has led some to think that the Eurozone could become the framework for the creation of a core Europe.<sup>79</sup> In response to the euro-crisis, Eurozone states have adopted inter se treaties outside the EU legal order to deepen their integration, including by establishing a Euro Summit as an ad hoc body grouping the leaders of the Eurozone countries,<sup>80</sup> an ESM to assist failing states,<sup>81</sup> and a Single Resolution Fund to support failing banks.<sup>82</sup> But monetary union requires even greater federalization, particularly in order to establish a fiscal capacity, with the connected problems of taxation and representation.<sup>83</sup> In the future, if efforts at deepening and completing EMU were to succeed, therefore, this may lead to the consolidation – de facto to the side of the EU – of a new organization, with its own institutions and governance rules for member states of the Eurozone. In such a scenario, the EU27 would not disappear but it would be increasingly shadowed by a separate union, for a smaller subset of member states – those which have decided 20 years ago to share a single currency, aka a hallmark of sovereignty. However, the ability of the Eurozone to operate as a core alliance of EU

member states suffers from two limitations. On the one hand, not least because Eurozone member states decided in 2014 to appoint as President of the Euro-Summit Donald Tusk, who comes from a non-Eurozone state (Poland), ongoing debates on EMU reform have been enlarged to non-Eurozone countries, and are thus now undertaken in an inclusive format.<sup>84</sup> While this catered the interest of the more Euroskeptic countries such as those of the Hanseatic League – which by involving non-Eurozone countries can tame the leadership of France and Germany on Eurozone matters and their shared ambition to complete EMU – it is clear that this weakens the ability of the Eurozone to operate as a platform to promote further integration. On the other hand, the attacks that the new populist Italian government is staging against the EMU institutional architecture and fiscal rules suggest that this framework may be actually too inclusive to be the springboard for a restart of the EU project. As such, a scenario where the Eurozone would serve as the breeding ground for greater integration among a sub-set of member states cannot be taken for certain at least short term. If this were the case, then, the restart of the project of integration may occur on an even smaller scale. In this regard, the recent conclusion by France and Germany of the Treaty of Aachen in January 2019 signals a possible roadmap.<sup>85</sup> In this bilateral agreement the two core EU/Eurozone member states committed to deepen their integration at all levels, including with the aim of achieving a “zone économique franco-allemand dotée de règles communes.”<sup>86</sup> In fact, the Treaty also creates a new organizational structure for Franco-German cooperation,<sup>87</sup> and a commitment to advance joint proposals on all major European issues.<sup>88</sup> While the Preamble of the Treaty affirms that the two countries are interested “à approfondir leur coopération en matière de politique européenne afin de favoriser l’unité, l’efficacité et la cohésion de l’Europe, tout en maintenant cette coopération ouverte à tous les États membres de l’Union européenne”<sup>89</sup> it is clear that it could represent the nucleus of a new kern Europa, to which only a few other like-minded EU member states could be associated. While this scenario has raised concerns as it would lead other member states behind,<sup>90</sup> it could be a welcome development to address the challenges that Europe is facing and to overcome the paralysis of the EU institutional system.

#### 4. Conclusion

This paper has analyzed the scenarios for the future of Europe beyond Brexit. As it pointed out, while the EU 27 have been remarkably united in negotiating with the UK, they are heavily divided between themselves on crucial political issues. In fact, the legacies of the euro-crisis and migration crisis and the growing rule of law backsliding in a number of EU member states are leaving deep scars in the fabric of the EU. While political efforts have been made at the highest EU institutional level to chart a united way forward, the forthcoming European elections and the rise of populism do not bode well for the unity of Europe. In this context the paper has outlined alternative scenarios for the future. As it has been suggested, while the influence of path-dependency

in the functioning of the EU cannot be minimized, greater differentiation could become an inevitable response to Europe's current challenges. In fact, one cannot even exclude that step by step a new, separate organization of integration may emerge to the side of the EU – either around the Eurozone, or a smaller alliance of states championed by France and Germany. In the end, as Irish poet Oscar Wilde famously put it, “prediction is very difficult, especially if it's about the future.” So the future of Europe remains to be seen. Yet, there is little doubt that Brexit will not be the last disruptive developments in the life of the EU and, important adjustments are to be expected among the EU 27.

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<sup>2</sup> See generally Federico Fabbrini (ed.), *The Law & Politics of Brexit* (OUP 2017).

<sup>3</sup> See Regulation (EU) 2018/1718 of the European Parliament and of the Council of 14 November 2018 amending Regulation (EC) No 726/2004 as regards the location of the seat of the European Medicines OJ [2018] L291/3.

<sup>4</sup> See European Council (Article 50) Conclusions, EUCO XT 20015/18, 25 November 2018, §3 (thanking “Michel Barnier for his tireless efforts as the Union's chief negotiator and for maintaining the unity among EU27 Member States throughout the [Brexit] negotiations”).

<sup>5</sup> Letter of Prime Minister Theresa May to European Council President Donald Tusk, 29 March 2017.

<sup>6</sup> See further Federico Fabbrini, *Economic Governance in Europe* (OUP 2016).

<sup>7</sup> See ECB President Mario Draghi, speech at the session of the plenary of the European Parliament to mark the 20th anniversary of the euro in Strasbourg, 15 January 2019 (stating that “EMU remains incomplete”). See also French President Emmanuel Macron, speech, Athens, 7 September 2017 (defining the euro-crisis as “une forme de guerre civile interne”).

<sup>8</sup> Kerstin Bernoth et al., “Happy Birthday? The euro at 20”, study commissioned by the European Parliament Economic Affairs Committee, January 2019, 6

<sup>9</sup> Eurogroup statement on Greece, 22 June 2018

<sup>10</sup> See Jeromin Zettelmeyer et al., “How to Solve the Greek Debt Problem” Peterson Institute for International Economics Policy Brief 10/2018.

<sup>11</sup> See Alessandro Trocino, “M5S-Lega, il contratto di governo: uscita dall'euro e cancellazione del debito”, *Il Corriere della Sera*, 15 May 2018 (reporting a leaked draft of the coalition agreement between the League and the Movimento 5 Stelle including a plan to exit the Eurozone).

<sup>12</sup> See Italian President Sergio Mattarella, speech, Rome, 27 May 2018 (opposing the appointment as Minister of the Economy of a person “che potrebbe provocare, probabilmente, o, addirittura, inevitabilmente, la fuoruscita dell'Italia dall'euro”).

<sup>13</sup> European Commission opinion of 23 October 2018 on the draft budgetary plan of Italy and requesting Italy to submit a revised budgetary plan, 23 October 2018, C(2018) 7510 final.

<sup>14</sup> European Commission report on Italy prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union, 21 November 2018, COM(2018) 809 final.

<sup>15</sup> European Commission letter to the Government of Italy, 19 December 2018, Ares(2018) 7351969 (welcoming amendments to the Italian draft budget law to assuage the Commission's fiscal concerns).

<sup>16</sup> European Commission, Winter 2019 Economic Forecast – Italy, 6 February 2019, available at [https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-performance-country/italy/economic-forecast-italy\\_en](https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-performance-country/italy/economic-forecast-italy_en) (last visited 16 February 2019)

<sup>17</sup> See further Federico Fabbrini & Marco Venturuzzo (eds.), *Research Handbook on European Economic Law* (Elgar 2019).

<sup>18</sup> See Franco-German Proposal on the architecture of a Eurozone Budget within the Framework of the European Union, 16 November 2018.

<sup>19</sup> See Treaty Establishing the European Stability Mechanism, 25 March 2011.

<sup>20</sup> Shared views from the Finance Minister of Denmark, Estonia, Finland, Ireland, Latvia, Lithuania, the Netherlands and Sweden, 6 March 2018.

<sup>21</sup> Eurogroup report to Leaders on EMU Deepening, 4 December 2018, PRESS 738/18.

<sup>22</sup> Euro Summit statement, 14 December 2018, PRESS 790/18.

<sup>23</sup> See EU-Turkey statement, 18 March 2016, Press release 144/16.

<sup>24</sup> See generally Cathryn Costello, *The Human Rights of Migrants and Refugees in European Law* (OUP 2015).

<sup>25</sup> See Regulation (EU) No 604/2013 of the European Parliament and of the Council of 26 June 2013 establishing the criteria and mechanisms for determining the Member State responsible for examining an application for international protection lodged in one of the Member States by a third-country national or a stateless person, OJ [2013] L180/31.

<sup>26</sup> See Council Decision (EU) 2015/1523 of 14 September 2015 establishing provisional measures in the area of international protection for the benefit of Italy and of Greece, OJ [2015] L239/146 and Council Decision (EU) 2015/1601 of 22 September 2015 establishing provisional measures in the area of international protection for the benefit of Italy and Greece OJ [2015] L248/80.

<sup>27</sup> See Case C-643/15 and C-647/15 *Slovakia & Hungary v. Council of the EU*, ECLI:EU:C:2017:631

<sup>28</sup> Hungarian Constitutional Court Decision 22/2016. (XII. 5.) AB

<sup>29</sup> See European Commission Thirteenth report on relocation and resettlement, 13 June 2017, COM(2017) 330 final.

<sup>30</sup> See European Council conclusions 28 June 2018, EUCO 9/18, §12 (calling for a “speedy solution to the whole package” of reforms).

<sup>31</sup> See European Commission communication, *A European Agenda on Migration*, 13 May 2015, COM(2015) 240 final.

<sup>32</sup> See European Commission communication on preserving and strengthening Schengen, 27 September 2017, COM(2017) 570 final.

<sup>33</sup> Madeline Chambers & Marton Dukai, “EU should expel Hungary for mistreating migrants, Luxembourg minister says”, Reuters, 13 September 2016

<sup>34</sup> See generally Andras Jakab & Dimity Kochenov (eds.), *The Enforcement of EU Law and Values* (OUP 2017).

<sup>35</sup> See Laurent Pech & Kim Lane Scheppele, “Illiberalism Within: Rule of Law Backsliding in the EU” (2017) 19 *Cambridge Yearbook of European Legal Studies* 3.

<sup>36</sup> Hungarian Prime Minister Viktor Orban, speech at the XXV. Bálványos Free Summer University and Youth Camp, 26 July 2014 (stating that “the new state that we are building is an illiberal state, a non-liberal state”).

<sup>37</sup> European Commission proposal for a regulation of the European Parliament and the Council on the protection of the Union’s budget in case of generalised deficiencies as regards the rule of law in the Member States, 2 May 2018, COM(2018) 324 final.

<sup>38</sup> European Commission reasoned proposal in accordance with Article 7(1) Treaty on European Union for a Council Decision on the determination of a clear risk of a serious breach by the Republic of Poland of the rule of law, 20 December 2017, COM(2017) 835 final.

<sup>39</sup> European Parliament resolution of 12 September 2018 on a proposal calling on the Council to determine, pursuant to Article 7(1) of the Treaty on European Union, the existence of a clear risk of a serious breach by Hungary of the values on which the Union is founded, P8\_TA(2018)0340.

<sup>40</sup> European Parliament resolution of 13 November 2018 on the rule of law in Romania, P8\_TA(2018)0446.

<sup>41</sup> See General Affairs Council, Outcome of meeting, 8 January 2019, Doc 5039/19.

<sup>42</sup> See Case C 216/18 PPU, LM, ECLI:EU:C:2018:586

<sup>43</sup> Order of the Vice-President of the Court in Case C-619/18 R, *Commission v. Poland*, 19 October 2018 (ordering the immediate suspension of the application of the provisions of national legislation relating to the lowering of the retirement age for Polish Supreme Court judges).

<sup>44</sup> Wojciech Sadurski, “Adding Bite to Bark: The Story of Article 7, E.U. Enlargement, and Jörg Haider” (2010) 16 *Columbia Journal of European Law* 385.

<sup>45</sup> Dermot Hodson & Uwe Puetter, “The European Union in Disequilibrium”, (2019) *Journal of European Public Policy* 3.

<sup>46</sup> See in particular European Commission Whitepaper on the Future of Europe, 1 March 2017.

<sup>47</sup> See e.g. Sergio Fabbrini, *Europe’s Future* (CUP 2019).

<sup>48</sup> See Piers Ludlow, “Challenging French Leadership in Europe: Germany, Italy, the Netherlands and the Outbreak of the Empty Chair Crisis of 1965-1966”, (1999) 8 *Contemporary European History* 231.

<sup>49</sup> See Nick Barber et al (eds.), *The Rise and Fall of the European Constitution* (Hart 2019).

<sup>50</sup> See EU-Japan Economic Partnership Agreement

<sup>51</sup> See European Commission press release, “EU and Australia launch talks for a broad trade agreement”, 18 June 2018, IP/18/4164

<sup>52</sup> Opinion 1/17 on CETA, Opinion of AG Bot, 29 January 2019 (fining CETA’s mechanism for the settlement of disputes between investors and states as compatible with EU law).

<sup>53</sup> See EU-Canada Comprehensive Economic Trade Agreement OJ [2017] L11/23.

- <sup>54</sup> See European Commission press release, “EU-US Trade Talks: European Commission presents draft negotiating mandates”, 18 January 2019, IP/19/502
- <sup>55</sup> Joint EU-US Statement, 25 July 2018, STATEMENT/18/4687
- <sup>56</sup> See Kurt Dopfer, “Toward a Theory of Economic Institutions: Synergies and Path Dependency” (1991) 25 *Journal of Economic Issues* 535.
- <sup>57</sup> See Art. 48 TEU.
- <sup>58</sup> Art. 3 TFEU.
- <sup>59</sup> Art. 207 TFEU.
- <sup>60</sup> See Federico Fabbrini, “Constitutional Crisis and Institutional Reform: The European Union at the Crossroad” (2017) 32 *Connecticut Journal of International Law* 285.
- <sup>61</sup> See also Ronan McCrea, “Forward or Back: The Future of European Integration and the Impossibility of the Status Quo” (2017) 23 *European Law Journal* 66.
- <sup>62</sup> See Bruno De Witte et al (eds.), *Between Flexibility and Disintegration* (Elgar 2017).
- <sup>63</sup> See also Maria Demertzis et al., “One size does not fit all: European Integration by Differentiation”, Bruegel Policy Brief 3/2018.
- <sup>64</sup> See Council Regulation (EU) 2017/1939 of 12 October 2017 implementing enhanced cooperation on the establishment of the European Public Prosecutor’s Office OJ [2017] L283/1.
- <sup>65</sup> See n \_\_
- <sup>66</sup> See Kit Gillet, “Ex Corruption Fighter in Romania, Shortlisted for Top E.U. Job, Faces Foes at Home”, *The New York Times*, 10 February 2019.
- <sup>67</sup> European Commission whitepaper on The Future of Europe, 1 March 2017, COM(2017) 2025 final.
- <sup>68</sup> See Déclaration au Sommet informel Allemagne, Espagne, France, Italie à Versailles, 6 March 2017.
- <sup>69</sup> European Parliament resolution of 17 January 2019 on differentiated integration, P8\_TA-PROV(2019)0044
- <sup>70</sup> *Ibid.*, §E.
- <sup>71</sup> *Ibid.*
- <sup>72</sup> *Ibid.*, §C.
- <sup>73</sup> *Ibid.*, §3.
- <sup>74</sup> See Federico Fabbrini, “Do NATO Obligations Trump European Budgetary Constraints?” (2018) 9 *Harvard National Security Journal* 121.
- <sup>75</sup> See European Council conclusions, 22-23 June 2017, EUCO §8.
- <sup>76</sup> Council Decision (CFSP) 2017/2315 of 11 December 2017 Establishing Permanent Structured Cooperation (PESCO) and Determining the List of Participating Member States, OJ [2017] L 331/57, Art 3(1).
- <sup>77</sup> Council Decision (CFSP) 2018/340 of 6 March 2018 establishing the list of projects to be developed under PESCO, OJ [2018] L65/24.
- <sup>78</sup> French Minister of Defence Florence Parly, speech at the European Council on Foreign Relations, Paris, 28 May 2018.
- <sup>79</sup> See also Federico Fabbrini et al (eds), *What Form of Government for the EU and the Eurozone?* (Hart 2015).
- <sup>80</sup> See Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, 2 March 2012, Art. 12
- <sup>81</sup> See n \_\_
- <sup>82</sup> See Agreement on the transfer and mutualisation of contributions to the Single Resolution Fund, 21 May 2014
- <sup>83</sup> See further Federico Fabbrini, “A Fiscal Capacity for the Eurozone: Constitutional Perspectives”, study commissioned by the European Parliament Constitutional Affairs Committee, February 2019.
- <sup>84</sup> Euro Summit, Leaders’ Agenda, 23 March 2018.
- <sup>85</sup> See n \_\_
- <sup>86</sup> Treaty of Aachen, Art. 20.
- <sup>87</sup> *Ibid.* Art.s 23-26.
- <sup>88</sup> *Ibid.* Art. 2.
- <sup>89</sup> *Ibid.* Preamble.
- <sup>90</sup> See Declaration of the Visegrad Group and the Federal Republic of Germany, 7 February 2019 (stating that “There is no place for East–West, North–South, Old–New divides in the current European Union. [...] Unity is the key”).

## REBUILDING THE HOUSE OF EUROPEAN DEMOCRACY

Carlos Jalali \*

CONTRIBUTION TO THE PANEL

### *“Populism and the elections to the European Parliament”*

*Populism (...) accompanies democracy like a shadow.*

Canovan (1999)

Tradução para português disponível em [gulbenkian.pt](http://gulbenkian.pt)

### 1. Introduction

Populism is not a new phenomenon. In the late 19th century, a nascent populist party provided a powerful challenge to the dominant two-party system of the United States. However, its decline was such that, a few decades later, an American journal concluded that: “Populism as a political and economic philosophy is as anachronistic as an ox-cart”.

This reading of populism as an anachronism largely prevailed in post-war 20th century. Populism was mostly seen as an excrescence of democracy in countries with weak democratic traditions, fragile institutions and unequal societies, prone to the appeal of charismatic leaders – or, more pithily, of democracy in Latin America.

During this period, the European continent appeared to have vanquished the populist threat. Democratic values were firmly entrenched in the post-war democracies of Western Europe. Democracy then further expanded in the 1970s and in the 1990s, first as authoritarian regimes in the continent’s south embraced democracy, then as former Soviet satellites in Central and Eastern Europe followed suit. This widening reach of democracy was also mirrored in the successive enlargements of the European Union, with this “democratic club” more than quadrupling its original membership by the early 2010s.

In the 21<sup>st</sup> century, it appears that political ox-carts are back in fashion, not least in Europe. Populism has arguably become the defining political term, with one author describing the current period as “the age of populism”; and another speaking of the “Populist Zeitgeist”. It is an increasing focus of interest amongst academics and decision-makers, citizens and the media. Democrats in polities in the grip of populism ponder the reasons for its ascent. Their counterparts in polities not facing populist electoral uprisings reflect on their apparent exceptionality – and contemplate the possibility that they may be next. The elections to the European Parliament (EP) provide a unique setting in which to consider this rising populist tide. On the one hand, these elections provide a distinctive vantage point from which to assess the ascent of populism, providing a snapshot of voters’ support for populism across the European Union at a single point in time. On the other hand, the European Parliament becomes a relevant context in which to observe the effect of

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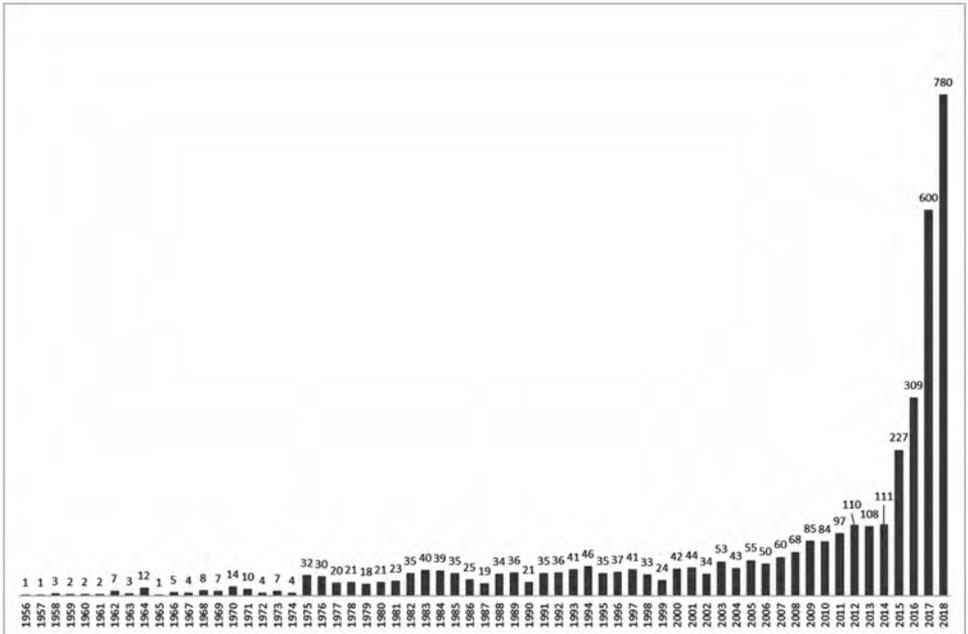
populism in democratic institutions. By congregating various populist parties under a single roof, it allows us to observe how they impact the way the European Parliament functions. This is all the more relevant given that much the animus of these parties is directed at the European Union itself. This paper seeks to reflect on this populist challenge, presenting policy proposals that can bolster European democracy. To do so, it first provides an overview and working definition of the concept of populism. It then examines populism in the European Union in general and more particularly in the European Parliament, before outlining four proposals for the strengthening of European democracy.

*Now we must address ourselves to the biting of the sour apple, a difficult part of our proceedings, which is the attempt to formulate some kind of model or definition or formula into which we can fit all the various types and nuances of populism.*

Isaiah Berlin (1967)

## 2. Defining populism

The growing usage of the term populism in public discourse has done little to simplify its definition. Nailing it down is akin to nailing down the proverbial jelly. One can find considerable scholarly debate regarding what constitutes contemporary populism. Indeed, its very categorization is contested, let alone its definition. Is it an ideology; a strategy; a rhetoric; a stance; a political style; a communication style; a doctrine; or a discursive frame? The debate is ample and enduring. As the most influential scholarly proponent of populism himself put it, ‘We know intuitively to what we are referring when we call a movement or an ideology populist, but we have the greatest difficulty in translating the intuition into concepts’. Unsurprisingly, this academic debate percolates through to public discourse, where the populist label remains uncertain. While it is most frequently used as negative political epithet, often conflated with demagoguery, irresponsible policies and political opportunism, that view is not necessarily universal. A good example of this are the remarks of President Obama at the 2016 North American Leaders’ Summit, when he proposed that a populist is someone who “has been on the frontlines working on behalf of working people” and “carrying the laboring oar to open up opportunity for more people”, concluding that “I suppose that makes me a populist”.<sup>1</sup> Populism thus emerges not only as an instance of potential conceptual *confusion* (in the sense that the term ‘populism’ is used with distinct meanings) but also of conceptual *contestation*. This debate concerning the definition of populism is potentially accentuated by the almost exponential rise in academic publications on the topic, highlighted in figure 1. By the close of 2018, there were almost 4,000 scientific articles with populism as the topic indexed in the Web of Science database. Out of this total,



two-thirds (over 2,500) were published in the most recent ten-year period (2009-2018); and almost half in the years 2016-2018 (1,689 articles). It is beyond the scope of this paper to resolve the debate surrounding the concept of populism, or to present its myriad forms. Rather, our goal is a more pragmatic and modest one: to present a working definition of populism that encapsulates the concept in a sufficiently satisfactory and intelligible manner to permit policy proposals. In this sense, our goal is to replicate for populism the test that Justice Potter Stewart established for identifying obscenity: “I shall not today attempt further to define the kinds of material I understand to be [obscenity]; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it”.

In other words, this paper does not provide the definitive conceptualization of populism; but rather aims at providing the elements that broadly allow us “to know it when we see it”. This also allows us to adhere to Isaiah Berlin’s admonition to avoid the “Cinderella complex” in defining populism; i.e., we should not assume “that there exists a shoe – the word ‘populism’ – for which somewhere there must exist a foot”, and wander like the prince in search of the foot that is “true, perfect populism” and fits this shoe. In order to help generate this working definition of populism, table 1 provides an overview of how the concept is characterised in the most frequently cited recent political science scholarship on populism<sup>2</sup>.

FIGURE 1 —  
*Number of articles  
 on populism  
 until 2018,  
 Web of Science*



|  |  |
|--|--|
| <p>Jan-Werner Müller (2016), <i>What is Populism</i>. Philadelphia: University of Pennsylvania Press, pp. 19-20, 35</p>                        | <p><i>Populism is a particular moralistic imagination of politics, a way of perceiving the political world that sets a morally pure and fully unified—but, I shall argue, ultimately fictional—people against elites who are deemed corrupt or in some other way morally inferior.</i></p> <p><i>In addition to being antielitist, populists are always antipluralist: populists claim that they, and only they, represent the people.</i></p> <p><i>They can accurately be described as “enemies of institutions”—although not of institutions in general. They are merely the enemies of mechanisms of representation that fail to vindicate their claim to exclusive moral representation.</i></p>  |
| <p>Margaret Canovan (1999). “Trust the people! Populism and the two faces of democracy”. <i>Political Studies</i>, vol. 47, no. 1, pp. 3-6</p> | <p><i>Populism in modern democratic societies is best seen as an appeal to ‘the people’ against both the established structure of power and the dominant ideas and values of the society.</i></p> <p><i>They involve some kind of revolt against the established structure of power in the name of the people. Within democratic systems that often means an attack on the established parties.</i></p> <p><i>[P]opulism challenges not only established power-holders but also elite values.</i></p> <p><i>Populists claim legitimacy on the grounds that they speak for the people: that is to say, they claim to represent the democratic sovereign.</i></p> <p><i>Populist appeals to the people are characteristically couched in a style that is ‘democratic’ in the sense of being aimed at ordinary people. Capitalizing on popular distrust of politicians’ evasiveness and bureaucratic jargon, they pride themselves on simplicity and directness.</i></p> <p><i>But simple, direct language is not enough to mark a politician as populist unless he or she is prepared also to offer political analyses and proposed solutions that are also simple and direct.</i></p> <p><i>Populism’s fundamental structural characteristic, popular mobilization against the political and intellectual elites, implies not only a direct, simple, style but also a characteristic mood. Populist politics is not ordinary, routine politics. It has the revivalist flavour of a movement, powered by the enthusiasm that draws normally unpolitical people into the political arena.</i></p> |
| <p>Cas Mudde and Cristóbal Rovira Kaltwasser (2017). <i>Populism: A very short introduction</i>. Oxford: Oxford University Press, pp. 6-8.</p> | <p><i>We define populism as a thin-centered ideology that considers society to be ultimately separated into two homogeneous and antagonistic camps, “the pure people” versus “the corrupt elite,” and which argues that politics should be an expression of the <i>volonté générale</i> (general will) of the people.</i></p> <p><i>Unlike “thick-centered” or “full” ideologies (e.g., fascism, liberalism, socialism), thin-centered ideologies such as populism have a restricted morphology, which necessarily appears attached to—and sometimes is even assimilated into—other ideologies. In fact, populism almost always appears attached to other ideological elements, which are crucial for the promotion of political projects that are appealing to a broader public.</i></p>  |

TABLE 1 — Definitions of populism in frequently cited academic publications

So how can we boil down these various ideas into a more succinct, working definition of populism? Leaning on the above ideas and the broader academic debate, we posit five central and interrelated aspects in populism<sup>3</sup>:

1. Antielitism, with a moral division of society into two homogenous camps: a romanticized community of virtuous “people” that has been left out, versus a corrupt and wicked “elite” that is the “enemy”. This antagonism encompasses not only the composition of the elite but also its prevailing values and norms.
2. Antipluralism, with populists seeing themselves as the sole true and genuine representatives of the “people”.
3. An overriding emphasis on popular sovereignty and a disapproval of the conventional institutions of representative democracy, seen as a means for the “elite” to control and exclude the “people”. This is often accompanied by proposals for different forms of democracy, which include – but are by no means restricted to – direct democracy.
4. A thin ideology, with populism thus often attached to other ideological elements (e.g., nationalism).
5. A political discourse that is Manichean, simple and blunt in terms of proposals and speech.

*European Union politics is a sitting duck [for populist attack].*

Canovan (1999)

## **Populism in the European Union and the European Parliament**

As noted in the previous section, the definition of populism as a thin ideology means that it is often attached to other ideological positions. We can thus speak of various subtypes of populism. Moreover, these different forms of populism are usually context-specific in nature. As Margaret Canovan aptly puts it, populists “take on the colour of their surroundings.” Thus, populism in North America differs from that in Latin America or Europe; and even within each of these broad continental cases there is substantial national (and even subnational) variation. Indeed, even if we take a single country, we find that populism mutates over time, adapting to its changing environment, as the case of France exemplifies, from post-war *poujadisme* to 21<sup>st</sup> century “*front nationalisme*”.

These local specificities make it virtually impossible to inventory all the various guises by which populism exists in the European Union’s political space. However, we can note three broad dimensions based on the existing literature. The first is that a particularly common form of populist parties in Europe are populist radical right parties. As Mudde and Kaltwasser explain, these combine populism with authoritarianism (“the belief in a strictly ordered

society”, with an emphasis on “law and order” issues); and with nativism (thus generating “an ethnic and chauvinistic definition of the people”). The second is that radical right populism coexists with other subtypes of populism in the EU. While much of the focus on populist parties has been on this radical right subtype – indeed, so much so that in recent times “populist” has frequently become short-hand for “populist radical right” – they are not the sole purveyors of populism in Europe. Inter alia, we can identify at least three other subtypes:

- i) Left-wing populism (or, as some authors dub it, populist radical left populism), associating redistributive policies with anti-elite and anti-institutional stance, as exemplified by Podemos in Spain, with its anti-elite stance against the “caste”.
- ii) Neoliberal populist parties, such as UKIP or Forza Italia, which, according to Mudde and Kaltwasser, combined “neoliberal policies of lower taxes and free trade with strong populist critiques of the political system and elites”.
- iii) Post-communist populism in Eastern Europe, which tends to be conservative, nativist and often with an explicit religious hue, as exemplified by PiS in Poland and Jobbik (even more so that Fidesz) in Hungary.

The third is that the populist space is a very fluid one. Thus, populist parties can shift from one subtype to another over time. For instance, we would be hard-pressed to keep UKIP in the neoliberal subtype in 2019, as it metamorphoses towards a populist radical right party. Equally, non-populist parties can become populist over time, as exemplified by Fidesz’s evolution from a liberal, centrist pro-European party to a national conservative populist party. Still others may drift out of populism. Arguably, that may be the gradual case for Syriza in Greece, with its populism tempered by office (though one should note that office does not necessarily subdue all populists). Overall, then, the configuration of populism at one point in time is by no means applicable at later (or earlier) ones.

While populism comes in different flavours, there is one important common element to virtually all European populists: their anti-EU stance. The underlying logic for this commonality is not hard to fathom. As Margaret Canovan notes, populists decry “backroom deals, shady compromises, complicated procedures, secret treaties, and technicalities that only experts can understand”. It is hardly surprising that she concludes that European Union politics are a “sitting duck” for populism.

As noted earlier, populism has been on the rise across Europe in recent years. The 2014 European Parliament elections brought a record number of populist MEPs to Strasbourg and Brussels. While exact estimates vary depending on different classifications of populism, it is broadly accepted that some 20 to 25 percent of MEPs in 2014 hailed from various populist parties. This 2014 result continued a pattern of steady increase in populist presence in the European Parliament since the 1999 EP elections.

The implications of this for the European Parliament's political process are considerable. As a recent study by Simon Hix, Abdul Noury and Gérard Roland shows, the post-2014 legislature marks a significant change in the way political competition is organised in the European Parliament. Whereas previously the main dimension of competition was the traditional left-right divide, in the current EP this was replaced by a pro/anti-EU divide. The outcome of the 2019 EP elections is naturally uncertain. However, it seems unlikely that we will see a radical reversal in populist fortunes. Rather, given current opinion polls, it seems fair to estimate that populist MEPs will represent some 20 to 30% of the 2019-24 European Parliament. A further shift towards pro/anti-EU as the main dividing line within the EP thus appears possible.

As the study by Hix and his colleagues concludes, this is not good news for European integration. As they point out, this could signify a shift away from the hitherto functioning left-right coalitional structure of European politics to one dominated by "intractable conflicts over the nature of European integration, for example over whether there should be deeper integration in the euro area or whether there should be common EU refugee policies to resolve the migration crisis". At the limit, they note, "we could see steps to undo parts of European integration".

The actual impact of populism in the post-2019 European Parliament will naturally hinge on the support that populists generate in the May elections. Moreover, the variety of populisms in the European Union weakens their capacity to unravel the European project, as ideological differences make some populists improbable bedfellows.

At the same time, pinning one's hopes for the future of the European Union on the inability of populists to coalesce seems to be the very definition of ill advised. Rather, dealing with the populist challenge requires bolstering democratic performance, and thus weakening the demand for populism in European electorates. In the next section we make four policy proposals towards this end.

*"Populism (...) is a mirror in which democracy may contemplate itself, warts and all, in a discovery of itself and what it lacks."*

Panizza (2005)

## **Rebuilding European democracy: what can be done?**

The debate on how to stem the populist tide is considerable. Studies have noted the role of combatting economic inequalities to curb populism. Likewise, several authors highlight the need to give value to different cultural conceptions, as well as generating social integration and recognition for recently marginalised groups, particularly those that lost not only jobs but also status as a result of globalisation and technological change<sup>4</sup>. A burgeoning field of work has examined how education can reinforce democratic values and inoculate citizens against misinformation. Still

others have noted the role that corruption scandals have played in propelling populist parties, thus calling for a strengthening of transparency and the control of corruption in contemporary democracies.

Our goal in this paper is not to review or debate existing proposals. Rather, we seek to build on the existing discussion. More specifically, we make four proposals, briefly outlined next. These are: mandating impartiality at delivery for online media; introducing constituency or district pooling in EP elections; establishing a European Citizens Parliament; and promoting community building. We are fully cognisant that these proposals are not necessarily easy to implement. However, it seems fair to say that that is only by reflecting – and, at some point, innovating – on the nature of democracy that we can contribute to its future.

### **a) Mandate due impartiality at delivery for online media**

It is hard to understate the contemporary ubiquity of online media.

The Internet in general, and its media platforms – be these of the social persuasion, such Facebook or Instagram; video-sharing platforms such as YouTube; or media and advertising conglomerates such as Google – now consume a large proportion of citizens' time and attention.

While the purview of these online media platforms goes well beyond politics, their political impact cannot be underestimated, not least as they become increasingly important sources of political information for individuals.

The problems that these online media can generate for democracy are well-documented: they facilitate the propagation of misinformation; they allow for targeted and manipulative political advertising based on psychographic profiles of individuals; and, more prosaically, they provide a platform for anti-democratic discourse and mobilization. Indeed, while correlation is not causation, one cannot help but note the close proximity between the growth of these online media platforms and of populism.

One particular problem that has been highlighted with regard to online media pertains to the “filter bubble” and “echo chamber” effect that they generate. To a far greater extent than traditional media, online media platforms typically reinforce the users' existing values, by exposing them to what they already believed in.

How does this happen? The algorithms of online media such as Facebook or YouTube are calibrated to retain attention. To do so, they keep feeding the content that the user has already shown interest in. Once the platform determines that you have an interest on a particular content, it systematically feeds you more of that content; in some cases, this takes the form of gradually showing increasingly radical material pertaining to that content. It thus places the user inside a “filter bubble”, from which other points of view are excluded. Even something as seemingly harmless as an internet search is not immune to this filter effect. With the profile it already has on the user, a search engine will show results (and advertising) that most closely match this profile, thus

reinforcing pre-existing interests. In political terms, this generates a dangerous echo chamber that feeds populism and extremism. This echo chamber also becomes a fertile propagating ground for the spread of misinformation and ‘fake news’ as online media systematically confirm and reinforce pre-existing biases. The echo chamber also increases political polarisation, with a consequent decline in reasoned public debate. Yet, can online media be blamed for this? After all, these online media platforms do, quite reasonably, claim to be impartial. They do not generate content. Rather, it is individuals who can quite freely upload content to YouTube, or Facebook, or create webpages that are then indexed by Google. If this includes polarising or populist appeals, it is a reflection of the political diversity in a society. To quote YouTube’s mission statement, “We believe that everyone deserves to have a voice”; and their claim to impartiality derives from letting everyone generate content (and thus “have a voice”). However, we would argue that this impartiality of online media platforms is embedded at an inadequate level. It is impartiality in the way content is generated: what we term *here content production impartiality*. However, this does not ensure that these platforms are impartial in the way they deliver content to consumers. In other words, impartiality in the production of content does not generate impartiality in the delivery of content. Indeed, as we noted above, it is very much the opposite that is happening. While content production is free and impartial, the content delivery is made partial by the nature of the platforms’ algorithms.

In other words, online news media are not effectively impartial. To use an analogy, the existing system of impartiality for online media would be akin to a traditional media outlet that has an impartiality mandate, such as the BBC, claiming that it achieves impartiality by having journalists of all ideological persuasions producing news-stories, even though the news that it actually publishes veer solely to only one ideological position. The first (and arguably most forceful) proposal is then a very simple one. Online media platforms that claim to be impartial, as is the case with Facebook or YouTube, must provide for impartiality at the point of delivery of content, at least with regard to political content. In other words, online media platforms should be treated as traditional media when it comes to due impartiality, rather than having the free-pass they currently enjoy. In practical terms, this would require that the automatically recommended content these platforms feed to users be balanced and respect a due impartiality mandate.

This proposal has at least three expected benefits. First, it provides users with counterpoints to their positions. Second, and related, it hinders the spread of misinformation. Third, it facilitates bridging across political divides. All three are welcome outcomes for democratic debate, and potentially make simplistic and manipulative populist appeals online less effective.

## **b) Reform the electoral system for EP elections**

The second proposal is an ambitious one – and, we also recognise, arguably more debatable and certainly harder to implement. It envisages a radical change in the electoral system for EP elections. This faces two challenges. The first is the general difficulty in changing electoral systems, for both principled and partisan reasons. The second is the reluctance across a number of national parties to create a more ‘Europeanised’ EP election. While this proposal cannot eliminate either challenge, it can potentially mitigate the latter. As for the former, the proposal’s potential capacity to reduce populist support could well help overcome some of the more partisan reasons for avoiding electoral system change.

This proposal derives from the literature on electoral systems in heterogeneous contexts, which the EU can reasonably be seen as an instance of. In particular, it seeks to implement what one author describes as an *incentives approach* to generate moderation in such contexts. The overall logic of the proposal is simple one: the adoption of constituency or district pooling across EU member states in EP elections. Thus, each of the electoral districts of a member state (the “national” district) would be twinned with a relatively small number of districts from other member states (the “twin” districts). Only parties from the country of the “national” district could contest these elections, so there would be no risk of parties from different EU member states competing against each other. The difference with regard to existing elections is that parties’ vote totals would be determined by the sum of the national and twin districts. In order to obviate fears of excessive Europeanisation, this proposal is sufficiently flexible to allow each member state to graft its own specificities to this district pooling structure, be it in terms of “core” electoral system elements such as the number of national districts; the electoral formula; or electoral thresholds; or broader electoral rules, such as who can run, gender parity laws, campaigning rules and so on. Indeed, each member state could even be free to delineate its various potential “twin” districts.<sup>5</sup>

As mentioned, we are fully aware that this proposal would face considerable barriers. Nevertheless, it should be noted that it would have a positive impact in terms of curbing populist parties. By necessitating parties to obtain votes not only in their own national district but also from the “twin districts”, in other member states, it would significantly curtail populist appeals. Populism is largely a national product, and the “people” rarely encompasses those from other member states. Populist parties would thus be faced with a difficult choice: maintain their discourse unaltered, but lose seats in the EP; or keep EP seats by shifting their discourse away from populism. Moreover, by increasing the influence that each voter had – as she can not only vote for her national district but also in others where she is a “twin” voter, this proposal could contribute to a somewhat greater citizen interest and participation in EP elections.

### c) European Citizens Parliament

This proposal borrows heavily from the Green Paper on the Future of Democracy in Europe for the Council of Europe. Published in 2005, and now somewhat neglected, this document contains a number of relevant proposals that merit revisiting. The European Citizens Parliament is an adaptation of the Citizen Assembly outlined in that Green Paper. The European Citizens Parliament (ECP) would consist of a randomly selected sample of European citizens. This sample would be drawn so as to ensure a similar proportion of citizens and MEPs from each member state.<sup>6</sup> It would meet once a year and its purpose would be to review and vote on a limited number of bills<sup>7</sup> approved by the EP and the European Union during the previous year, for which a certain minimum threshold of MEPs<sup>8</sup> have requested an overview by the ECP. In this sense, the ECP would resemble a deliberative voting platform. Each Member of the ECP (MECP) would be compensated for the period of civic duty<sup>9</sup>.

They would equally be assigned with legislative assistants to ensure receipt of relevant documentation, following up on requests for further information and assistance in dealing with the public. MECPs would initially be provided with the necessary documentation and information to analyse the bills. Likewise, the names of the MECPs would be made public and citizens would be encouraged to contact their office. After this, the actual MECPs would meet, so as to deliberate and vote on the bills referred to it. Bills rejected by the European Citizens Parliament would not be implemented.

The creation of the ECP could help reduce the gap between citizens and EU institutions, and thus erode a key element of populist appeal: that the EU is too removed from the common citizen. By randomly selecting MECPs, it creates a sentiment in citizens as a whole that they too can oversee European institutions, which again weakens populism. Moreover, the fact that it can block legislation means it is less likely to be perceived as mere “deliberative window-dressing”, and can generate broader media and citizen interest.

Again, we are fully aware that the adoption of this proposal is far from easy. It implies an almost unprecedented degree of change in the nature of our political institutions. In addition, giving effective powers to an unelected body, chosen at random, runs counter to classical notions of representative democracy. Nevertheless, it is a proposal that merits consideration. It would be a potent symbol against populism, bringing the citizen closer to the EU’s complex political process. While it does entail giving power to an unelected body, the random selection of its members does have roots in democratic history. Last but not least, it is worth noting that the existing institutions of democracy were themselves innovations when first adopted. As one influential academic study notes, “there is lots of room for institutional creativity” in contemporary democracies.

#### d) Community building

The previous three proposals imply fairly precise and specific actions, even if they are adjustable in a number of parameters prior to implementation. This fourth proposal, on the other hand, is more diffuse in nature. We can perhaps best conceive it as a policy goal that can be achieved through a variety of particular measures. The departure point for this final proposal is the fact that democracy presupposes a sense of community. As Pierre Rosanvallon notes, democratic citizenship is not merely an individual trait; rather, the citizen “is also defined by his relation to others, his fellow citizens”, engaging with the latter in a common society. As Rosanvallon also points out – echoing older literature on the decline of social capital – this sense of community has waned in recent decades. This decline of a sense of community is in itself a spur for populist appeals. Populism does not merely posit a people against an elite: it posits a *community of people* against the elite. The populist “people” is not an aggregation of individuals. Rather, it is an idealized and imagined community, whose virtuous character is as much (if not more so) a collective one as it is an individual one. As scholarly research shows, the support for populism is tied to a need for common belonging, not least in the face rapid social, technological and economic change.

This proposal echoes, and seeks to translate into reality, the conclusion of Rosanvallon that “democracy needs (...) a more active, creative concept [of community], a more complex understanding of what elements of life and experience can and should be held and lived in common.”

How might this be achieved? Our proposal is for the EU to actively engage and support community-building efforts. This can take a number of different forms. It could involve establishing and supporting neighbourhood festivities – European “block parties” or “street parties” – that would regularly bring together a local community. These “block parties” could even take a leaf from the ‘soft power’ initiatives of Chinese Confucius Institutes and offer food, games and activities from around EU member states.<sup>10</sup> Another possibility would be to offer vouchers (or even initial inducements, to promote participation) that motivate citizens to get involved in social activities, be it pottery lessons, cooking courses or karate classes. It would also involve the EU consulting and learning from the experience of civil society organisations already engaged in community building efforts.<sup>11</sup> In all of these measures, the underlying principle is the same: creating spaces where people can interact and engage with others, gradually generating a sense of community that embraces both commonality and diversity. By building actual communities, we can reduce the need for the imagined ones offered by populism.

## Conclusion

A central feature of democracy is its ability to adapt and reinvent itself, **safeguarding principles, but renewing processes.** The substantial increase in the number of democracies throughout the 20<sup>th</sup> century led to it to be dubbed the “democratic century”. However, it is important to note that the nature of democracy evolved over this period, as the extension of the suffrage to women, or the abolition of racial or class distinctions in accessing political rights amply illustrates. Likewise, the emergence of this “democratic century” was not a linear process. Rather, democracy faced significant setbacks over the 20<sup>th</sup> century, and its expansion required considerable effort and imagination. **Much the same is true of the European Union, which has reshaped and reinvented itself considerably over its 60-odd years of existence.** As in the past, tackling the current populist challenge requires innovation, experimentation and effort. Such experimentation and innovation is not, one should add, without cost. As Fisher Ames put it in his celebrated (even if potentially apocryphal) comparison of democracies and non-democracies, the latter like a great merchantman vessel that sails well “but will sometimes strike on a rock, and go to the bottom”; whereas democracy is like “a raft, which would never sink, but then your feet are always in water.” **The proposals in this paper involve, in one way or another, wet feet. But unless we are willing to get our feet wet, the shadow of populism will continue to loom large.**

<sup>1</sup> And interestingly then adding that Bernie Sanders “genuinely deserved the title [of populist]”.

<sup>2</sup> These cover some of the most cited political science books and authors on the topic of populism, as cited in Google Scholar and Web of Knowledge.

<sup>3</sup> Given the nature of this paper, we do not indicate references to these ideas, though the origin of several can easily be identified from table 1.

<sup>4</sup> As Timothy Garton-Ash memorably puts it, “in the pathology of contemporary populisms, the inequality of attention and respect is at least as important as any economic inequality”.

<sup>5</sup> For practical reasons, we would suggest two “twins” per national district, though this number could be higher (or lower). The number of voters in the twin districts can also vary, though a plausible size would be a ratio of approximately 1:1 between the “national district” and the “twin districts”. At specified intervals, the “twins” for each national district would change, in order to foster broader moderation and consensus. In order to maintain for accountability and responsiveness despite this rotation, one possibility would for it to occur in a staggered and randomized manner.

<sup>6</sup> The Green Paper suggests an initial selection of two potential members of the citizen assembly, to reduce risks of capture.

<sup>7</sup> The Green Paper suggests one or at most two.

<sup>8</sup> The Green Paper suggests one-third, though a more effective form could be to have a variable threshold: the one or two bills that gained the largest support for CEP review, as long as they are supported by e.g. more than 15% or 20% of MEPs.

<sup>9</sup> In addition, employers should also be compensated if an employee is selected, so as not to discourage participation.

<sup>10</sup> Though it should be noted that the goal of this ‘soft power’ angle would not be to make an explicit link to the EU.

<sup>11</sup> Including religious and faith-based organisations, as exemplified by the work of the Bahá’í community in several European countries.