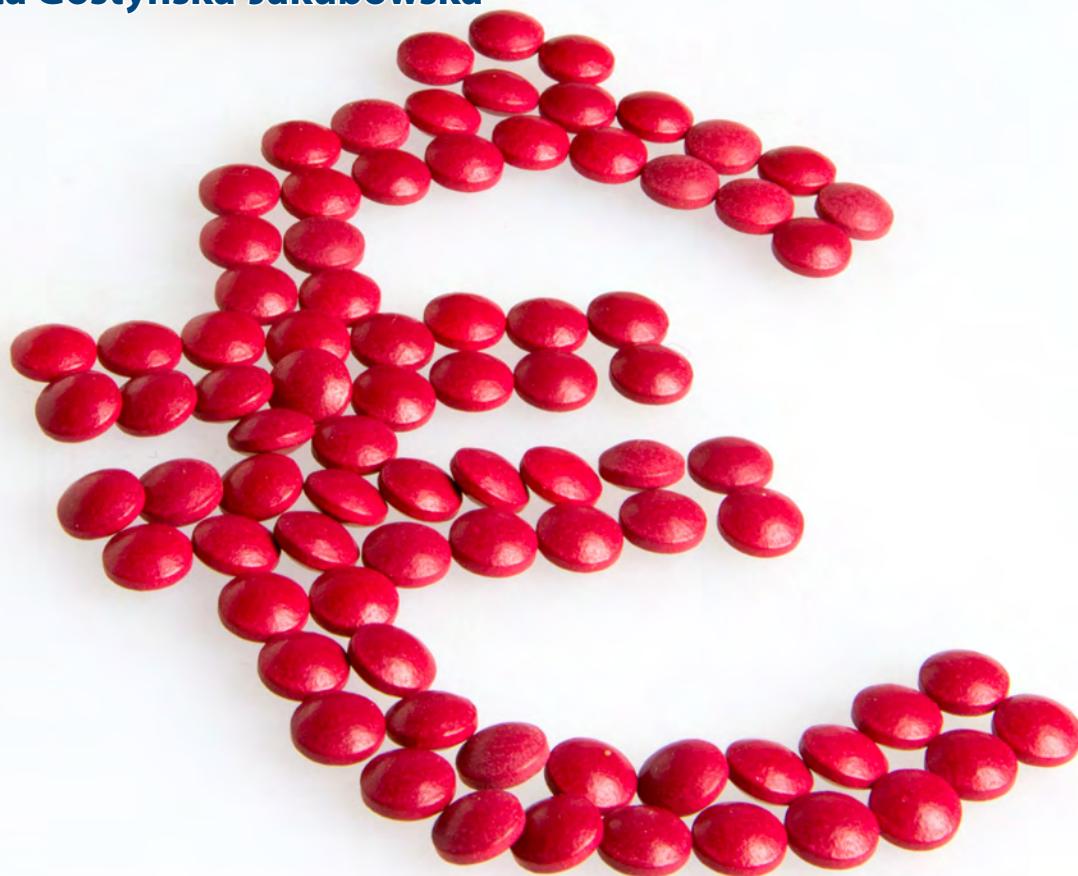


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A new deal for the eurozone Remedy or placebo?

By Agata Gostyńska-Jakubowska



A new deal for the eurozone: Remedy or placebo?

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- ★ The eurozone is out of intensive care and its economic recovery has gathered pace. But the commitments involved in adopting the single currency remain a source of political tensions. Painful and unpopular austerity policies have bred resentment and feelings of disenfranchisement. And the eurozone needs further reform so that it becomes more resilient to the ups and downs of the business cycle.
- ★ France's energetic new President, Emmanuel Macron, has fuelled hopes with his call for a "new deal for the eurozone". He is pushing for a more flexible EU, and a dedicated eurozone finance minister, accountable to members of the European Parliament from eurozone countries. He also wants the eurozone to have its own budget to facilitate structural reforms, boost investment and address future economic shocks.
- ★ Macron faces headwinds: substantial eurozone reform is likely to need treaty change, which would require the unanimous support of all EU member-states. Most northern eurozone countries oppose risk-sharing mechanisms such as a eurozone budget, while the euro 'outs' are concerned that they will be marginalised if the eurozone integrates further and creates a separate institutional framework.
- ★ The European Commission does not agree that the 19-country eurozone should have its own budget and government. Instead, President Jean-Claude Juncker has proposed the creation of a minister of economy and finance for the EU as a whole, and suggested the EU budget could have a dedicated line for the eurozone within it.
- ★ Once the new German government is up and running, Berlin might engage more forcefully in the debate about the eurozone's future. But Germany will not help Macron as much as he hopes and it will probably not throw its weight behind treaty change.
- ★ A substantial eurozone budget, with its own dedicated tax revenue, could improve the single currency area's ability to withstand economic shocks. But there is a risk that Macron's proposals will be watered down by Germany and other creditor countries to the point where they become insignificant.
- ★ EU leaders need to find ways to reconnect with their citizens before they start the process of eurozone reform. The EU's member-states and institutions should hold a series of joint democratic conventions to understand their populations' perspectives on the EU. These conventions would test the appetite for reform.
- ★ EU leaders will do more harm than good if they rush to create new institutions and structures which turn out to be toothless. Ultimately, EU citizens want the EU to foster greater prosperity and security, and a new minister with a grand title and no power will deliver neither.

The eurozone is out of intensive care; unemployment is falling and economic output per capita has finally recovered to levels seen before the 2008 crisis.¹ But the crisis and the painful remedies prescribed have left many voters disillusioned with the EU and with their domestic institutions. In the countries that were hardest hit by the crisis, citizens felt disenfranchised, as creditors demanded austerity in exchange for financial assistance. This provided fertile ground for eurosceptics and populists, who promised to resist the alleged diktats from Brussels and Frankfurt. If EU member-states fail to win back the support of disaffected voters, the bloc could end up facing a more serious existential threat as populists and eurosceptics look to win more seats in their domestic legislatures and the European Parliament.

Emmanuel Macron's election victory has generated some optimism that France and Germany can agree a plan that will put the euro area on a more stable footing and boost public enthusiasm for the EU as a whole. Macron has called for a "new deal for the eurozone" that would facilitate investment and make the euro area less vulnerable to future economic shocks. He believes that the eurozone would be strengthened by having its own finance minister and budget, which would help stimulate demand during a downturn. Paris and its southern allies have long argued that eurozone countries do not have the firepower to tackle economic shocks on their own: monetary policy is set at the eurozone level, and they are unable to resort to currency devaluation.

“Preference for national responsibility for debt has put the North on the other side of the debate from the South.”

Macron believes that a more flexible EU in which the eurozone integrates more deeply – without forcing non-euro area countries to follow suit – would undermine the populist narrative about 'Brussels diktat' and boost the eurozone's legitimacy. But member-states that are legally obliged to adopt the euro in future (most of them in Central Europe) or that have an opt-out from the common currency (Denmark) are worried that further eurozone integration would marginalise them from EU decision-making. Post-Brexit, the eurozone will account for 85 per cent of the EU's total economic output and 76 per cent of the bloc's population.² Eurozone countries can already outvote non-members in the Council of Ministers if they choose to. Countries that do not use the euro fear that they would find it even harder to influence policies if deeper eurozone integration entailed new institutions exclusively for eurozone countries.

Eurozone countries are less concerned about a multi-track EU than the euro-outs. Leaders of Germany, Italy, Spain, and France met in Versailles in March 2017 and endorsed the idea of a more flexible EU. Berlin, Rome, Madrid and Paris have argued that a flexible EU could help reconcile member-states' differences, which could in turn improve the EU's image in the eyes of the public. But Berlin and its northern allies also insist that the eurozone's problems are rooted in countries' domestic wrongdoings rather than in the eurozone's architecture. The northern bloc has pushed for tighter budgetary discipline in the eurozone while opposing risk-sharing mechanisms like a eurozone budget. This preference for central control of spending combined with strict national responsibility for debt has put the fiscal hawks on the other side of the debate from France and the debtor countries, creating a serious obstacle to eurozone reform.³

This policy brief begins by examining the eurozone's democratic legitimacy. The tension between the economic orthodoxy imposed by technocrats and creditor countries, and the desire of elected governments to adopt their own economic policies, is central to the eurozone's democratic flaws. By joining the euro, members ceded their power to set monetary policy and agreed to fiscal rules that after 2008 mandated austerity in an economic slump. Countries that received financial assistance, such as Greece, Portugal and Ireland, had to implement painful structural reforms in return for emergency lending.

Second, the paper examines EU governments' views on how to improve the eurozone's democratic legitimacy and assesses the prospects for securing political consensus on the its future.

Third, the brief assesses the legal options for eurozone reform. In his Sorbonne speech on the future of the EU, Macron complained that the bloc had paid too

1: Eurostat, 'Unemployment statistics, data up to September 2017', October 31st 2017.

2: Guntram Wolf, 'Eurozone or EU budget? Confronting a complex political question', Bruegel, June 29th 2017.

3: There is an excellent overview of the dividing lines in the eurozone between the supporters of the 'stability union' and 'fiscal union' in: Björn Hacker, Cédric M. Koch, 'The divided Eurozone: mapping conflicting interests on the reform of the Monetary Union', Friedrich Ebert Stiftung, 2017.

much attention to instruments rather than policies.⁴ He urged eurozone members to focus on which reforms the eurozone needs rather than on whether or not they would be legally feasible. But whether Macron likes it or not, some eurozone reforms would require treaty change.

Fourth, the paper analyses the role of Germany. Chancellor Angela Merkel hinted during the French presidential campaign that she was open to the idea of eurozone reform. Germany is not against treaty revision per se. But Berlin thinks that member-states need to make sure they are on the same page before they open up the EU treaties.

Finally, the brief assesses Macron's chances of pushing through his new deal for the eurozone. Donald Tusk, the European Council President, prepared the 'Leaders'

Agenda', which provides a list of priorities for the EU leaders to focus on during the next two years. Tusk – who also presides over eurozone-only summits – wants member-states to take concrete decisions on how to reform the currency union before the European Parliament elections in 2019.

The paper concludes that member-states should engage their citizens in a discussion about the eurozone's future before they embark on its reform. EU leaders should refrain from creating new institutions and offices if they have no intention of giving them a significant role. Such a fudge would do more harm than good to the eurozone's democratic legitimacy. EU citizens want the EU to boost prosperity and security; a new 'minister' with a grand title but no power would not deliver either.

The eurozone's democratic flaws

From its inception, the euro was both a political and an economic project. It was designed to support the creation of the European single market by making it easier to trade across borders and facilitate capital flows, and to encourage closer alignment of macroeconomic policies.⁵ But this dual nature led to the eurozone's lack of democratic legitimacy. As long as countries had their own currencies, floating exchange rates and the ability to pursue independent fiscal policies, voters could vote for different parties with some confidence that they would enact different policy mixes. Governments could opt for tighter or looser monetary policies, different approaches to fiscal surpluses and deficits – and a government that got the mixture 'wrong' could be replaced at the next election by a government offering a different set of policies. With the introduction of the single currency, however, national governments lost some of their traditional economic policy tools, and this powerlessness was brought into sharp relief when the 2008 financial crisis struck. Voters in Greece found that even electing a left-wing populist government committed to ending austerity did not end austerity: the eurozone could override it.

“Citizens resent the EU for interfering in their lives, and their domestic governments for not standing up to Brussels.”

The eurozone needs two types of legitimacy if it is to be sustainable in the long term: 'output' and 'input'. Output legitimacy depends on the euro area's ability to provide prosperity to people who use the single

currency. Input legitimacy, on the other hand, derives from elections through which EU decisions are subject to direct democratic control (in the European Parliament) and indirect democratic control (through ministers from democratically elected governments meeting in the Council of Ministers). The eurozone crisis has undermined both sources of legitimacy.

The harsh conditions attached to financial assistance programmes undermined living standards in debtor countries. For example, the International Monetary Fund (IMF), the European Central Bank (ECB) and the eurozone creditor countries imposed severe cuts on Greece's public spending, hoping that it would reduce the country's ballooning public debt. But creditors underestimated the impact of fiscal austerity on demand, and hence on Greek living standards. The number of employees working in the public sector in Greece dropped by nearly 50 per cent between 2010 and 2015; the Greek economy contracted by 25 per cent between 2008 and 2016; unemployment shot up to 28 per cent; and one in three Greeks were at risk of poverty or social exclusion in 2015.⁶

The eurozone's 'input' legitimacy has also suffered from the way decisions have been taken since the crisis began. Although elected governments have taken decisions at euro summits or in the Eurogroup – the informal meetings of eurozone finance ministers – the European Commission and the European Parliament have effectively been side-lined. The fiscal compact, which tightened EU rules on fiscal discipline and the European Stability Mechanism (ESM), which offers financial assistance to euro members in need, were established outside the EU's legal framework. This made it difficult for the European Parliament to scrutinise the

4: Emmanuel Macron, 'Initiative for Europe', Sorbonne University, September 26th 2017.

5: Committee for the study of Economic and Monetary Union, Jacques Delors (Chairman) 'Report on Economic and Monetary Union in the European Community', April 17th 1989.

6: European Parliament, 'Unemployment and poverty: Greece and other (post) programme countries', briefing, May 31st 2017.

terms of financial assistance programmes. The European Parliament can invite the managing director of the ESM or the president of the Eurogroup to exchange views with MEPs. But this economic dialogue usually takes place after finance ministers have already decided whether to grant financial assistance to a country.

Many eurozone countries have argued that since the ESM's paid-in capital comes from member-states rather than the EU budget, it should be up to national parliaments to hold their finance ministers to account for decisions they take in the Board of Governors, the decision-making body of the ESM. And some do: German MPs need to give their consent to any decision of the German government to provide EU financial assistance to another member-state, including the exact amount of funding. But other parliaments do not take their job as seriously as the Bundestag. In 2015, ten eurozone parliaments did not vote at all on the third rescue package for Greece.⁷

“It is wrong to assume that the high rates of support for the euro translate into public satisfaction with the eurozone project.”

The eurozone's inadequate output and input legitimacy has translated into citizens' disillusionment with the EU and also with their domestic institutions. Some people have been left with the impression that it does not matter which parties are voted into power at national level because it will be the EU that ultimately takes the key decisions on countries' economic policies. Citizens resent the EU for interfering in their lives, and their domestic governments for not standing up to Brussels. The majority of Greeks (76 per cent), Cypriots

(57 per cent) and Spaniards (51 per cent) do not trust the EU. But they are even more distrustful of their own institutions: 88 per cent of Greeks, 80 per cent of Spaniards and 61 per cent of Cypriots do not trust their own governments.⁸

There is a greater level of trust in the EU across creditor countries, but they are not immune to the eurosceptic narrative either. They might have escaped the worst of the economic crisis, but there remains an undercurrent of resentment that their governments are funding less fiscally prudent countries like Greece or Spain, or are bailing out investors in Italian sovereign bonds through the ECB. The Slovak government collapsed in October 2011, after the opposition criticised it for contributing to the rescue package for Greece. Political opponents of the then Prime Minister Iveta Radičová argued that poorer Slovaks should not sponsor richer Greeks.⁹ The 'Finns Party' (formerly the 'True Finns'), which opposed financial assistance programmes, did well in the Finnish parliamentary elections in 2015 and were in government from 2015 until June 2017. The elections in Germany on September 24th also boosted the eurosceptic *Alternative für Deutschland* (AfD), which has called for a referendum on German membership of the eurozone. AfD entered the Bundestag for the first time.

The European Commission tends to interpret public support for the euro as an indicator that the eurozone has started to recover politically from the crisis. The single currency is now backed by 74 per cent of eurozone citizens, the highest level since 2004. But it would be wrong to assume that the high rates of support for the euro translate into public satisfaction with the eurozone project. Instead, the public may simply believe that there is no alternative to the euro, as leaving the currency union would plunge their countries into chaos.

Remedies for tackling eurozone democratic deficiencies

The eurozone may be out of intensive care, but there is much work to be done before it makes a full recovery - and Macron thinks he has just the tonic. The French president seems to believe that the EU's existing crisis toolkit is insufficient when it comes to tackling the eurozone's democratic deficiencies and restoring trust in the EU, especially in the states that have suffered the most. The EU has introduced tighter fiscal and budgetary discipline across euro area countries, hoping that it will help prevent future crises. The European Commission can now recommend changes to the draft budgets of eurozone

members before they go to their national parliaments for approval.¹⁰ But the eurozone's crisis measures do not currently offer much that would support reform efforts in euro area countries or stimulate demand to help overcome a recession; the ESM is for severe crises only, while the fiscal rules focus too much on deficit control.

France argues the eurozone needs a finance minister with command over a dedicated budget that could boost investment, soothe the pain of structural reforms in individual euro area countries, and help mitigate crises

7: Valentin Kreilinger, Morgan Lohr, 'Does the Eurozone need a parliament?', Jacques Delors Institute Berlin, November 14th 2016.

8: European Commission, 'Public opinion in the EU', Standard Eurobarometer, May 2017.

9: Jakub Groszkowski, 'Slovakia: the Eurogroup's enfant terrible', OSW Commentary, October 18th 2017.

10: Agata Gostyńska, Marta Stormowska, 'The European Commission in EU economic governance: In search of political capital', PISM bulletin, July 23rd 2013.

in the future. Democratic oversight of decision-making would shift to EU level from the member-states, with MEPs from the euro area countries holding the eurozone finance minister accountable.

But only a substantial budget would make a difference. Macron would like this budget to be “worth several per cent of eurozone GDP”.¹¹ When he was French minister for economy Macron suggested that it should be funded by new eurozone taxes, perhaps a financial transaction tax or harmonised corporate tax. However, the EU’s effort to establish a common consolidated corporate tax base (CCCTB) has moved at a snail’s pace, despite the fact that a CCCTB would neither harmonise tax rates nor transfer corporate tax revenues to a eurozone budget. Macron may believe that a new eurozone tax under common eurozone control would increase citizens’ support for the EU; and that member-states should, therefore, speed up discussions about it. There is growing concern that some multinational companies – and in particular, those that derive their revenue from the internet – benefit unduly from Europe’s fragmented national tax systems by paying minimal tax in the countries they operate in. If the eurozone forced multinationals to pay their fair share and then used this money to reduce social inequalities throughout the euro area, citizens might have a higher opinion of the EU.¹²

“The French ideas will face strong resistance because they challenge the economic orthodoxy in northern member-states.”

If the eurozone budget were financed through a new eurozone tax rather than member-states’ contributions then – according to Macron – MEPs from eurozone countries should have some control over how the budget is spent. He argued in Berlin in January 2017 that a eurozone budget “will have to be placed under the scrutiny of MEPs from the concerned countries”.¹³ This suggests that the French president believes in the slogan of the American colonists rebelling against Britain’s King George III: “no taxation without representation”. But the inverse may also be true: no representation without taxation. The logic of Macron’s thinking is that MEPs from non-euro area countries would not have any influence over how the pot of revenue from eurozone countries would be distributed, even though spending decisions might affect their interests – particularly in the case of

MEPs from countries that are committed to adopting the euro but have not yet done so.

Macron seems to believe that a more flexible EU in which eurozone countries could progress towards greater political co-operation without forcing others to keep up might weaken eurosceptic arguments. Populists across the EU have long claimed that Berlin and Paris, aided by European Commission president Jean-Claude Juncker, are seeking to impose a one-size-fits-all EU superstate on all member-states.

Southern eurozone countries broadly share France’s economic views and it is likely that they would support Macron’s reform proposals. Italy and Spain agree that the eurozone needs a budget that would provide a cushion in future economic crises. Indeed, Madrid and Rome’s visions for the eurozone’s future go beyond Macron’s most recent proposals. After he became president, Macron sought compromise with Germany on debt mutualisation. In a move to appease Berlin, where these issues are taboo, Macron said in his Sorbonne speech that he did not intend to “pool our past debts, nor to solve public financing problems in one state or another”.¹⁴ But Spain and Italy believe that debt mutualisation should be on the table in the long run.¹⁵

The southern bloc might also look favourably upon Macron’s plans to develop separate eurozone institutions. Paolo Gentiloni, Italy’s prime minister, supports the idea of more flexible integration. In December 2015, when he was foreign minister, he wrote an opinion piece with Philip Hammond (then the UK’s Foreign Secretary) in Britain’s *Daily Telegraph*, in which he argued that the eurozone should be allowed to integrate more deeply, so long as it respected the rights of non euro-area countries. Rome thinks it is time to recognise that there is more than one currency in the EU, and that euro-ins and euro-outs should coexist peacefully rather than trying to constrain each other.

The French ideas will, however, face strong resistance from fiscal hawks in the eurozone, because they challenge the economic orthodoxy in northern member-states. Berlin and its allies believe that southern eurozone states would have been better able to weather and recover from the global economic crisis if they had conducted more responsible fiscal policies.¹⁷ The northern member-states want to maximise oversight of countries’ fiscal policies and minimise transfers from richer to poorer countries and debt pooling. The Dutch coalition agreement provides an example: the government considers joint

11: Le Point, ‘Exclusiv. Emmanuel Macron: Le Grand entretien’, August 30th 2017.

12: Charles Grant et al, ‘Relaunching the EU’, CER report, November 2017.

13: Transcript of the speech of Emmanuel Macron at the Humboldt University, January 10th 2017, www.en-marche.fr.

14: Emmanuel Macron, ‘Initiative for Europe’, Sorbonne University, September 26th 2017.

15: Tobias Buck, ‘Spain urges sweeping reforms on eurozone to correct flaws’, *Financial Times*, June 14th 2017.

16: Philip Hammond, Paulo Gentiloni, ‘Britain and Italy stand together on EU reform’, *Daily Telegraph*, December 14th 2015.

17: Björn Hacker, Cédric M. Koch, ‘The divided Eurozone: mapping conflicting interests on the reform of the Economic Union’, Friedrich Ebert Stiftung, 2017.

financing of the debt in the EU as undesirable and will not support any steps towards a transfer union.¹⁸ EU creditors, like the Netherlands and Finland, have also objected to Macron's idea of giving the EU institutions more powers in economic governance. The Finnish government has argued that "since responsibility for economic policy is with the member-states, political legitimacy and accountability of economic policy-making is best secured at the national level through national parliaments".¹⁹ The Dutch government has also championed a greater role for national parliaments rather than the European Parliament in eurozone decision-making.

“Juncker has shown little enthusiasm for Macron's ideas about separate eurozone institutions and a eurozone budget.”

The French president is unlikely to find a great deal of support for his reform plans in most of the Baltic states either. They were badly hit by the financial crisis but introduced draconian structural reforms, spending cuts and tax rises. Lithuania and Estonia have little sympathy for the idea of giving financial rewards to member-states for reforming their economies. That, according to Vilnius, should be a national responsibility.²⁰

Member-states outside the eurozone have different views on how to stabilise the eurozone and improve its democratic legitimacy. Some – like Denmark – support German economic orthodoxy, while others – like Croatia – tilt towards the southern economic philosophy.²¹ But they have all been sceptical about the idea of separate eurozone governance. Those euro-outs committed to adopting the single currency worry that Macron's proposals would significantly alter the balance of power in the EU. They fear that if Macron's eurozone governance ideas were implemented, these countries would not have a vote in the new institutions and would struggle to influence policies that would affect them once they had adopted the euro. These euro-outs are also worried that if a fully-fledged fiscal union or debt mutualisation were put in place before their eurozone accession, they would be liable for the debt that was accumulated before their membership started.

The EU institutions have some sympathy for the southern states but they also share the concerns of the easterners. Donald Tusk has argued that the EU should focus on

practical solutions for providing citizens with security and increasing prosperity rather than getting bogged down in institutional debates.²² He made this one of the guiding principles of his Leaders' Agenda and wants euro area leaders to stick to this principle when they meet to discuss eurozone reform in December 2017.

Like Tusk, Jean-Claude Juncker, the President of the European Commission, has shown little enthusiasm for Macron's ideas about separate eurozone institutions and a eurozone budget. Juncker hopes that in the longer term most member-states will join the single currency. In his view, the EU should develop instruments to encourage the outs to join, rather than pushing them away by creating a multi-track EU. In his State of the Union address on September 13th, which laid out the Commission's priorities for the next 12 months, Juncker proposed a new euro accession fund which would facilitate the euro-outs' preparation to join the single currency.²³ The Commission president also suggested that the EU create a dedicated line for the eurozone in the EU budget.

But whereas Tusk has expressed reservations about creating new institutions, Juncker seems to believe that the EU as a whole would benefit from having an economy and finance minister in the longer term. Juncker wants to integrate this function with the Commissioner for economic and financial affairs, and make him or her Vice President of the Commission. This person would also chair Eurogroup meetings, oversee budgetary discipline, support structural reforms in euro area countries and manage the euro area budget line within the overall EU budget, as well as other financial assistance programmes. This new minister would answer to the European Parliament.

The European Commission also wants to turn the ESM into a European Monetary Fund and integrate it over time into the EU's legal framework. Germany's finance ministry has hinted in the past that it would like to take away the Commission's power to oversee budgetary discipline across the euro area countries and transfer it to the ESM. The European Commission might look to preempt the German plan, which would make it harder for Berlin to have its way.

The European Commission will put forward legislative proposals to that end on December 6th 2017. It will then also become clear whether the Commission wants such a monetary fund to perform the role of backstop for

18: People's Party for Freedom and Democracy, Christian Democratic Alliance, Democrats '66, Christian Union, 'Confidence in the future', 2017-2021 coalition agreement, October 10th 2017.

19: The European Commission, 'Contributions from the Sherpas of the member-states to the Five Presidents' Report: Finland', May 15th 2015.

20: The European Commission, 'Contributions from the Sherpas of the member-states to the Five Presidents' Report: Lithuania', June 22nd 2015.

21: Björn Hacker, Cédric M. Koch, 'The divided Eurozone: mapping conflicting interests on the reform of the Monetary Union', Friedrich Ebert Stiftung, 2017.

22: Donald Tusk, Invitation letter to the European Council meeting, October 17th 2017.

23: Jean-Claude Juncker, State of the Union Address, September 13th 2017.

the banking union or not. The EU created the Single Resolution Mechanism, which is composed of the Single Resolution Board and Single Resolution Fund (SRF) – bodies designed to ensure that insolvent banks can be wound up in an orderly fashion without the help of taxpayers. But in a severe crisis, the SRF may not have enough firepower to be able to wind up several failing banks simultaneously. If national governments were then called upon to help, their budgets could themselves come under pressure. The eurozone banking union, therefore, needs a common fiscal backstop for the Fund and a future European deposit insurance scheme (EDIS).²⁴

Treaty change: A thorn in reformists' side?

Paris would like to form a 'group for the re-foundation of Europe', which would include representatives of member-states and EU institutions. One of the tasks of the group would be to sketch out the legal options available to EU countries, if they decide to push for a 'new deal' for the eurozone.

“Macron has claimed the EU has shied away from ambitious policy proposals because it worried it would trigger treaty change.”

But one does not need a group of experts to know that meaningful eurozone reform is likely to require treaty change. Many member-states shudder when they recall the last time they revised the EU treaties. It took them almost ten years to conclude and ratify what is today known as the Lisbon Treaty. The public in France and the Netherlands voted against the Constitutional treaty in referendums, forcing member-states to eliminate any suggestion of EU federal ambition, and to rebrand it as the Lisbon treaty. If member-states wanted to repeat this exercise, they would first have to hold a European convention composed of the heads of state or government, representatives of national parliaments, MEPs and the Commission, which would draft a new treaty.²⁵ All member-states would then have to approve the final text of the treaty and ratify it, and several would need to hold referendums.

The European Commission has suggested the EU could avoid going through the cumbersome process of treaty change. The Commission has argued that it can use

The Commission's idea of putting all the measures for dealing with financial crisis in the hands of an EU economy and finance minister who would be accountable to the European Parliament is music to MEPs' ears. The European Parliament, together with the Council of Ministers, adopts the EU's annual budgets and approves the Council regulation setting out the seven-year-budget but it has no formal influence over the ESM. Juncker's proposal would give MEPs an opportunity to increase their power over eurozone economic governance.

Article 352 of the treaty on the functioning of the EU (TFEU) to reform eurozone governance. The article provides that "if action by the Union should prove necessary, within the framework of the policies defined in the treaties, to attain one of the objectives set out in the treaties, and the treaties have not provided the necessary powers, the Council, acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament, shall adopt the appropriate measures".²⁶ But the existing divisions between the North and South and between euro-ins and euro-outs strongly suggest it will be difficult to reach unanimity on a comprehensive eurozone reform package this way.

Juncker believes that his reforms are worth pursuing despite the political difficulties. The Greek authorities have to deal with, for example, 'the Quadriga', composed of representatives of the IMF, ESM, ECB and Eurogroup, when they negotiate the terms and conditions of their rescue package. To many Greeks, the Quadriga has become a symbol of a dysfunctional and inefficient EU. Juncker thinks that creation of an EU economy and finance minister would improve the bloc's efficiency.

Pierre Moscovici, the commissioner in charge of economic and financial affairs, has argued that putting a commissioner at the helm of the Eurogroup will also help make eurozone decision-making more transparent.²⁷ The Eurogroup's gatherings are not open to the public, even though it is charged with discussing a range of things that have a profound effect on the public, including reform programmes attached to financial assistance for debtor countries. Furthermore, the Eurogroup only publishes its agenda and other documents from its meetings if they do

24: Valdis Dombrovskis, Pierre Moscovici, 'Reflection paper on the deepening of the Economic and Monetary Union', The European Commission, May 31st 2017.

25: The European Parliament could give its consent to skipping the European Convention in the process of treaty change. It is unlikely, however, that it would agree to do this. The European convention includes representatives of the European Parliament (among others), and allows MEPs to exert influence on the direction of the talks.

26: Article 325 of the treaty on the functioning of the EU, OJC 326, October 26th 2012.

27: Politico, 'EU Confidential podcast with Pierre Moscovici', June 13th 2017.

not contain market-sensitive information.²⁸ In contrast, the Commission has to answer to the European Parliament: designating a commissioner as the Eurogroup chair would provide greater democratic accountability for the Eurogroup decision-making process.

While some of the Commission's reform ideas could be implemented without treaty change, others could not. For example, giving an EU economy and finance minister some discretionary powers on economic governance would amount to a transfer of competences from the national to the EU level, and hence would require treaty revision. Accommodating Macron's vision would be equally difficult. Article 311 TFEU provides that a decision to establish a new category of EU revenue, such as a tax to fund the eurozone budget, requires unanimous agreement and ratification by all member-states. Giving eurozone MEPs the power to adopt and oversee the eurozone budget while excluding other MEPs from the decision would also require treaty revision. The EU treaties state that MEPs represent the Union's citizens rather

than member-states, and prohibit discrimination on the grounds of nationality.²⁹

But treaty change is no longer taboo for France. Macron has claimed that for too long the EU has shied away from pursuing ambitious policy proposals because it worried that they would trigger treaty change. He might think that the EU could win national referendums if it engaged in an honest discussion with its citizens about how they would benefit from the reform process. He has encouraged EU leaders to launch 'democratic conventions' in their respective countries between now and summer 2018. Macron hopes that such conventions would end the era of referendum campaigns based on myths rather than facts, and facilitate eurozone reform. If EU citizens knew more about the Union and how they were benefitting from their country's membership, they might be more supportive of the European project. Leo Varadkar, the Irish prime minister, recently announced that his government would hold such a convention with Irish citizens, to better understand their feelings about further European integration.

Will Merkel come to Macron's rescue?

The French president will need Berlin's help in bridging any differences between member-states and EU institutions on the eurozone reforms. Indeed, the German Chancellor cautiously backed the idea of a multi-track Europe during the French presidential campaign. She also said she could envisage a eurozone budget, albeit on a small scale, as well as a finance and economy minister. Merkel hoped that by showing that she was willing to work with Macron to reform the eurozone, she might weaken his election rival, Marine Le Pen, who had called for a referendum on France's membership of the single currency.

“Officials in Berlin have suggested that if the eurozone wants to reform, it should revise the inter-governmental treaty on the ESM.”

But one should not read too much into Merkel's pre-election comments. Berlin might agree with Paris on labels but it disagrees on substance. Whereas France would probably like to give the new finance minister some discretion over how to stimulate investment in the eurozone and mitigate economic shocks, Berlin would like the official's primary focus to be on enforcing budgetary discipline. Berlin also believes the EU would be better off using the existing budgetary framework to encourage

member-states to conduct structural reforms, rather than creating a separate eurozone budget. In its reflection paper on the future of the EU's finances, the Commission said that the EU could use the Cohesion Fund, which aims to reduce economic and social disparities between member-states, to reward member-states for reforming their economies.³⁰

German officials have argued that – like Macron – Berlin is not against treaty change per se. But they rightly point out that there is little political appetite for treaty revision in other member-states. Berlin wants to avoid a situation where EU member-states embark on the tortuous path of treaty revision, only to discover that there is more that divides the 27 countries than unites them. Officials in Berlin have suggested that if the eurozone wants to reform, it should do so by revising the inter-governmental treaty on the ESM, rather than by opening up the EU treaties. An internal memo prepared by the German finance ministry, leaked to the press in October 2017, argued that the ESM is best placed to monitor the application of both the Stability and Growth Pact and the fiscal compact – which seek to ensure that countries maintain sound public finances. German officials complain that the European Commission has become too political in enforcing budgetary discipline across the member-states, and want to weaken its powers. Juncker's Commission decided in July 2016 not to recommend sanctions on Spain and Portugal even though they continued to run excessive deficits, for example. Berlin, even though it supported these decisions in the

28: Emily O'Reilly, 'Recent initiative to improve Eurogroup transparency', letter to Jeroen Dijsselbloem, President of the Eurogroup, March 14th 2016.

29: Article 14.2 of the Treaty on the European Union provides that "the European Parliament shall be composed of representatives of the Union's citizens".

30: Günther H. Oettinger, Corina Crețu, 'Reflection paper on the future of EU finances', The European Commission, June 28th 2017.

Council, believes that there should be no room for such political judgments in enforcing budgetary discipline in the future, and has argued that a technocratic ESM would perform this role better.

Concentrating more powers in the hands of the ESM would mainly benefit Germany. The Board of Governors of the ESM, which takes decisions on financial assistance, is a consensus-oriented body. The Board can agree to disburse money if the Commission and the ECB think that a failure to grant assistance to a country in need could threaten the financial stability of the eurozone, and if 85 per cent of shareholder votes are in favour. This means that Germany, which holds more than 26 per cent of the shares in the ESM, can veto financial assistance on its own.³¹

But even the prospect of maximising German influence on eurozone decision-making might not be enough to convince Merkel to back reforms any time soon. Federal elections on September 24th 2017 significantly weakened Merkel and her party; the Christian Democrats (CDU)

topped the polls but lost vote share and seats in the Bundestag, and it remains unclear which parties will form a new government or whether snap elections will have to be called. The Free Democrats (FDP) have just decided not to enter into a coalition with Merkel's CDU/CSU and the Greens. Chancellor Merkel might try to lure the Social Democrats into another grand coalition, form a minority government or opt for snap elections. The Social Democrats have ruled out reviving their alliance with the Christian Democrats, believing that they stand better chance of improving their public standing in opposition. But there is a mounting pressure from inside the party to reconsider this decision. However, if the SPD leadership refuses to enter into the coalition talks with Angela Merkel she will have only two options left. She has suggested that she would prefer early elections to a minority government. But this would mean any debate about the eurozone's future being put on hold at least for several months. At the time of writing, the outcome of discussions in Berlin remains unknown.

Eurozone reform: Conclusions and recommendations

The EU is often seen as a technocratic project. In practice, the idea that member states across the bloc can all follow the same set of policies regardless of citizens' political persuasions has played into populists' hands; they have rejected technocratic expertise and offered radical answers to the eurozone's problems. EU leaders need to find new ways to reconnect with citizens and to give them the sense that the eurozone is responsive to their views. If the eurozone does not show that it exists for the benefit of its citizens, it will drive them into the arms of eurosceptics ahead of the European Parliament elections in 2019 and further undermine trust in the EU.

“If the eurozone does not show that it exists for the benefit of its citizens, it will drive them into the arms of eurosceptics.”

The idea of holding democratic conventions across member-states would, if implemented, could be a good way of showing citizens that their voice matters in debates about the eurozone's future. But member-states that have agreed to hold them should also bear in mind that the European Commission has launched its own debates on the future of Europe.³² Member-states and the Commission should co-host these conventions rather than organising competing events. EU leaders

and commissioners should make an effort to reach out to stakeholders from all walks of life, rather than only preaching to the converted.³³ If they succeed in attracting participation from across society, the conventions could serve as a real test of the appetite for reform across the bloc. EU leaders should also be open to the possibility that citizens might not want some of their reforms. There is no point in holding conventions if the EU then sweeps citizens' feedback under the carpet.

France and other EU countries that are enthusiastic about developing a multi-track EU need to recognise that some member-states with fewer resources and capabilities see it as a threat. Central European countries have long felt uneasy about the Franco-German axis; they are worried that a more flexible EU would essentially serve as a mechanism for marginalising member-states that do not share the Franco-German vision. The French president should invite both supporters and opponents of a more flexible EU to his 'group for the re-foundation of Europe'. By seeking common ground over the future of the eurozone, Macron would show that he wants the single currency area to thrive while preserving EU unity.

Macron should not expect Angela Merkel to help hammer out a compromise any time soon. After the collapse of the coalition talks Merkel's leadership has been put to the test. Merkel will not invest political capital in mediating between the north and the south, or between euro-ins

31: France and Italy are other veto holders, but it is unlikely they would veto financial assistance to any of their allies in the South; see article 4.5 of the Treaty on the European Stability Mechanism, February 2nd 2012.

32: The European Commission, 'White paper on the future of Europe: reflections and scenarios for the EU-27 by 2025', March 1st 2017.

33: Richard Youngs, 'Can Macron's big gamble to save the EU really pay off?', *The Conversation*, August 4th 2017.

and euro-outs. She will focus instead on forming a new government or on electoral campaign.

If Merkel somehow emerges unscathed from the current political crisis and remains Germany's chancellor she might be prepared to engage in the debate about the eurozone's future. After all, her legacy is intimately bound up with it. She may not want to be remembered as the chancellor who quashed hopes for reform when the time was ripe. But Paris should not expect Berlin to throw its weight behind treaty change or a fully-fledged fiscal union. Traditionally, Germany had been more *communaux* than the French, and supported a strong role for the institutions in EU decision-making. But when the economic crisis struck the eurozone, the Commission was too weak to corral the member-states, so Germany filled the gap, and then found that it could live without reverting to the old way of doing things. If anything, Berlin is likely to opt for revising the treaty on the ESM as a way of achieving eurozone reforms. In the ESM, Berlin has veto power and can call the shots.

“EU leaders should not push for new institutions ahead of the European Parliament elections in 2019.”

There are limits to what eurozone members can do outside the EU's legal framework. The European Court of Justice ruled in 2012 that any international agreement among a smaller group of member-states must not violate the EU treaties or undermine the rights of non-participating members.³⁴ The ECJ could strike down a new ESM treaty, if it discriminated against non-participating members or undermined the EU principle that institutions must act in accordance with competences conferred on them by the EU treaties. The European Commission might want to challenge any revision of the ESM treaty if, say, euro-area countries sought to weaken the Commission and shift powers of economic governance to the mechanism.

The limited appetite among member-states for revising the EU's treaties, and the prospect of the ECJ striking down an inter-governmental treaty, might force Macron to moderate his ambitions. Bruno Le Maire, French finance minister, suggested in Berlin in November that Paris was ready to take a step-by-step approach to reforming the eurozone; euro members would first focus on completing the banking union and bolstering the ESM, and would leave the creation of the eurozone budget and finance minister for later. Macron may begin to look more favourably on the European Commission's proposals and

34: Judgment of the Court (Full Court), *Thomas Pringle v Government of Ireland and Others*, November 27th 2012.

35: The European Parliament has, for example, launched an inquiry into the Volkswagen emission scandal and has forced the European Commission to take action against the German carmaker.

decide the best way forward is to push for reforms within the current EU framework. The European Commission thinks the current EU treaties can accommodate most of the necessary eurozone reforms. According to the Commission, merging the Commissioner responsible for the euro with the chair of the Eurogroup would not require treaty revision. A protocol to the EU treaties provides that ministers from member-states whose currency is the euro should elect the Eurogroup president for two and a half years by a simple majority. But the protocol does not specify that the president should be an incumbent finance minister (as it has been up to now) or rule out the election of a European Commissioner as the Eurogroup president.

It is no secret that the Commission and Macron's visions for the future of the Economic and Monetary Union differ. But there is one thing that unites them: both the Elysée and the Berlaymont are wary of the German finance ministry's idea of giving the technocratic ESM the right to enforce budgetary discipline across euro members. Using the ESM to get tough with debtor nations would do little to improve trust in the EU among citizens of the south. Opposition to these ideas could drive closer co-operation between Paris and Brussels over eurozone reform.

But it would be a mistake to concentrate budgetary and fiscal powers in the hands of the European Commission and the European Parliament without properly involving national parliaments. The right to determine fiscal and budgetary policy is an important attribute of sovereign countries. MEPs are supposed to represent EU citizens, but in many member-states they are elected on a very low turnout and are not regarded as having much democratic legitimacy. Many citizens think that the European Parliament is obsessed with increasing its power and does little to tackle their everyday problems. This is usually not the case: MEPs have a track record of fighting for improved consumer rights across the EU, for example.³⁵ But the European Parliament would benefit from greater co-operation with national parliamentarians, who may have a better understanding of the impact of economic policies on ordinary citizens.³⁶

Without full-blown treaty change, however, the eurozone will struggle to introduce meaningful reforms to address its deficiencies. A substantial budget, with its own revenues and mutualisation of debt issuance, would help the eurozone boost investment and cushion economic shocks in the future; but there is no political appetite in northern euro countries at the moment to create a fully-fledged fiscal union with a finance minister who would answer exclusively to eurozone MEPs. EU member-states outside the euro area and the European Commission will also lobby against this idea. The risk is that ambitious

36: Agata Gostyńska-Jakubowska, 'The role of national parliaments in the EU: Building or stumbling blocks', CER policy brief, June 2017.

eurozone reform proposals are watered down to the point that they are politically acceptable to all but become macroeconomically insignificant.

EU leaders should not push for new institutions ahead of the European Parliament elections in 2019 if this will result in bodies that have a merely symbolic role. The eurozone has survived almost two decades without its own government, but it might not survive the cynicism of its citizens if they feel they are being palmed off with placebos, rather than being prescribed a bona fide remedy for the single currency area's problems.

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