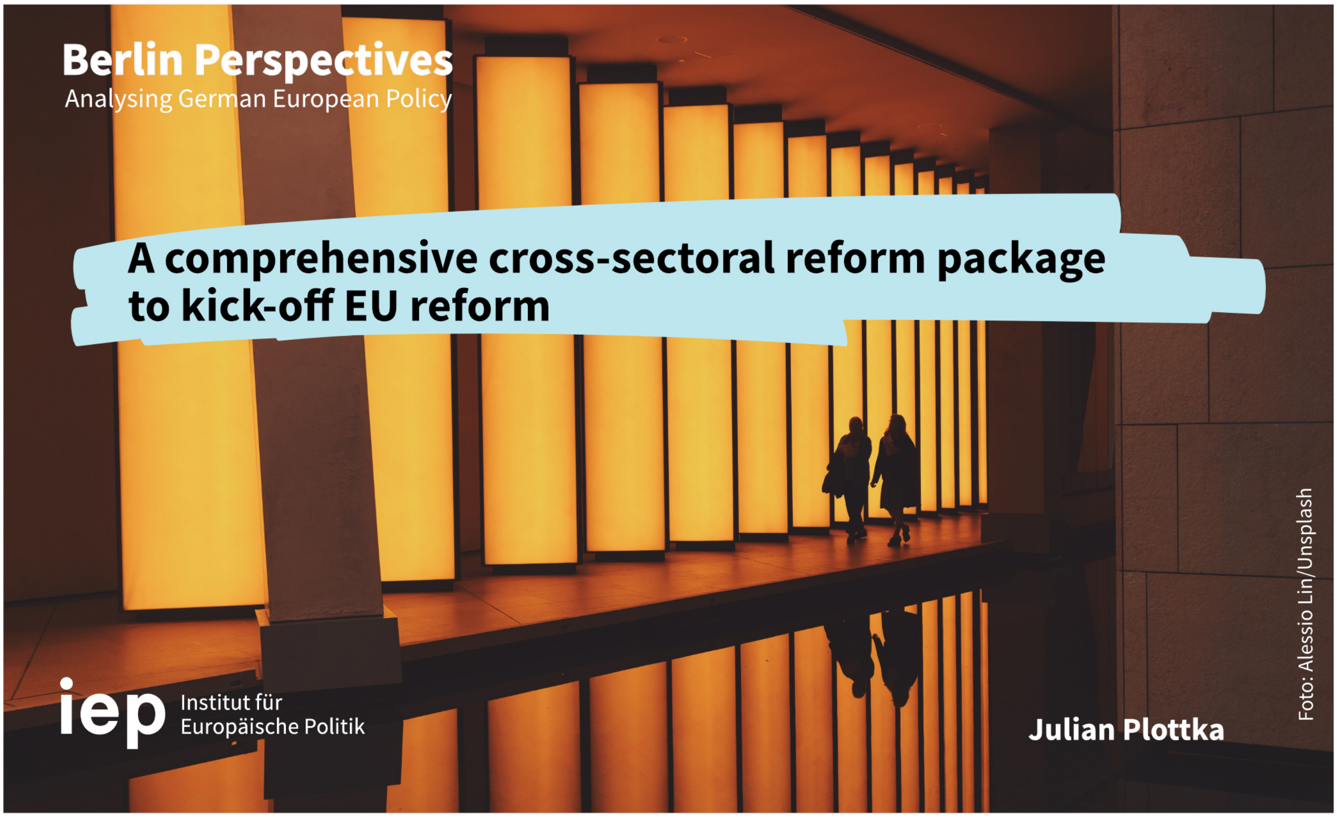

A comprehensive cross-sectoral reform package to kick-off EU reform

Julian Plottka

The proposals to implement separately the recommendations of the Conference on the Future of Europe risk getting stuck in the European Union's (EU) internal divides. The German government should propose a comprehensive reform package with the European Economic and Monetary Union (EMU) at its centre that allows for bridging internal conflicts.

What is the issue?

The conclusions of the Conference on the Future of Europe (CoFoE) have provided the latest wake-up call for the EU about the need for fundamental reform. Major parts of the Lisbon Treaty were drafted during the European Convention of 2002/2003. Thus, the EU treaties have been hardly adapted to current challenges for nearly 20 years. In this time, in policy areas where reforms have been adopted, they have been incremental, have added to the EU's complexity and were never completed, resulting in numerous leftovers. Muddling through during the crisis in the euro area – from the delayed decisions in its early stages to the Fiscal Treaty adopted outside the EU primary law – was a prime example of inefficient reform. Therefore, treaty reform is not an end in itself, as reluctant governments tend to argue, but is needed to strengthen the EU's capacities to act and to make its decision-making efficient.

While the European Parliament is pushing for a European Convention and the European Commission has published its plans for implementing some of the CoFoE's recommendations, the European Council only took note of the conference conclusions without any further discussion. In a moment when strong advocacy from a group of member states would be needed to kick off a reform process, the recent non-paper by the founding members and Spain offers lukewarm support for treaty change. Thirteen Northern, Central and Eastern European countries are afraid of the complexity of a new European Convention at a time when Europe is under attack from Russia. "Everything but treaty change" seems to be the widely preferred option for reform.

However, assuming that incremental reforms are easier to negotiate and that muddling through is less resource-consuming than a Convention will very likely turnout to be a severe miscalculation in an ever diverse EU. First, previous Heads of State or Government learned 20 years ago with the Nice Treaty the lesson that the intergovernmental method results in insufficient outcomes. Second, single-issue reform processes such as the use of the "passerelle clause" do not offer room for comprehensive package deals, which have always been crucial for facilitating compromises.

For five reasons, a comprehensive cross-sectoral reform package needs to have a reform of the EMU at its heart:

First, the Next Generation EU (NGEU) instrument for post-pandemic recovery shows that a common economic policy is in the interest of the Union and not a trade-off between so-called net-payers and net-recipients. Given the current economic outlook, the EU should prepare for more common action early. Neither separate, uncoordinated initiatives in every member state nor waiting until economic crises have reached their peak were successful strategies in the past.

Second, in defence and energy policy, the required investments in European infrastructure are immense. In both areas, there is considerable potential for synergies and European added value of common projects. Taking unilateral decisions without consulting other EU members, like Germany did with the Nord Stream 2 pipeline, will cost each country much more than pooling investments. In a worst-case scenario, the bad handling of unilateral investments could result in a new sovereign debt crisis.

Third, the decision about the refinancing of NGEU will be up for negotiation anyway. Finding a compromise on the EU's new own resources will be much harder without linkages to future spending priorities and structural reforms. Talking exclusively about payments risks becoming a destructive zero-sum game while compromises on beneficial investments are easier to reach. In the Council, the unfair distribution of costs from the European Emissions Trading System (ETS) and the Carbon Boarder Adjustment Mechanism (CBAM) between the member states was lamented even before the European Commission provided sufficient impact assessments.

Fourth, in economic policy, there are crosscutting lines of conflict between members of the euro area and outsiders, between frugal and Keynesian governments, and between supporters of sound fiscal management and governments benefitting of corruption.

Fifth, the institutional complexity of the EU's governance structure and the many leftovers of the crisis in the euro area need to be addressed before the next crisis arrives. The ongoing initiatives for completing the banking union and the capital-market union can only be first steps, which need to be followed by a fundamental reform.

Concerning EMU reform, a comprehensive package should balance four lines of conflict between member states. First, it should save taxpayers' money by making EU-level investments that focus on creating European added value. Second, it should end the series of nearly permanent exceptions by making fiscal rules more flexible to ensure that financial markets trust in these rules. Third, it should establish new EU own resources, which help to overcome the conflict between so called net-winners and net-losers. Fourth, it should make the governance structure more inclusive to narrow the gap between those in and out of the euro area.

What is Germany's position?

More than half a year since the coalition government consisting of the Social Democratic Party, the Greens and the Free Democratic Party took office, its European policy is still unclear. While the call for a "federal Europe" in the coalition agreement was mostly symbolic, it was also understood as a signal that the government intended to take the initiative on EU reforms.

Expectations were high that Chancellor Olaf Scholz would be ready to formulate a sufficient answer to the reform proposals that France's President Emmanuel Macron had made some years earlier and had not been considered by the previous grand coalition.

Procedural questions of how to implement the CoFoE proposals are at the core of the debate. The coalition agreement commits the government to the holding of a European Convention. While Chancellor Scholz supports reforms in a short- or medium-term perspective, he does not consider treaty change necessary. Foreign Minister Annalena Baerbock also revised the government's position concerning a European Convention. If treaty change is required, the use of the "passerelle clauses" or of the simplified revision procedure seem to be the preferred procedures in the Federal Foreign Office. But it remains unclear for which priorities the government intends to use these instruments.

When it comes to the EMU reforms, differences between the three coalition partners could further complicate the formulation of a comprehensive reform package. While the Free Democrats, including Minister of Finance Christian Lindner, have a hawkish position on sovereign debt, the Greens and the Social Democrats are more open to finding compromises with those governments calling for a reform of the Stability and Growth Pact (SGP). If the three governing parties in Germany can agree on a common reform proposal, it is likely that this could find support from several member states with different views on European economic policy.

In their coalition agreement, the "traffic light coalition" committed to strengthening and deepening the EMU and to developing fiscal rules further. The reform objectives are transparency, debt sustainability, economic growth, and sustainable and climate friendly investments. This leaves considerable room for defining a government position on reforming the SGP.

The Bundestag's decision in response to the Russian war in Ukraine to establish a special fund of 100 billion euros for the German military could be a model for finding a compromise on reforming the SGP. This fund does not touch the debt break that is enshrined in Germany's Basic Law but allows for spending additional money. Lindner's statements following his first Council meeting in January 2022 were interpreted in a similar way: treaty provisions on the SGP are the red line, that cannot be crossed, but a reform of the implementing provisions can be reached.

This is in line with the European Commission's idea to focus on individual debt-reduction paths for every member state, while treaty provisions on the SGP are considered the third rail of EMU. The tides in European economic policy continue to change, following the pandemic and against the backdrop of the economic fallout of Russia's war in Ukraine but, due to a lack of initiative, Germany's government seems to leave the driving seat of EU reforms to other governments. A recent Dutch-Spanish proposal on the EU's economic and financial policy cuts across the fault line between frugal and Southern European member states by proposing a balance between the need for swift, coordinated

European responses in economic policy and reinforcing fiscal sustainability.

The view of Germany's government on the refinancing of NGEU is not much different from its view on NGEU. The coalition agreement stipulates that repayments of NGEU related loans may not be financed by cutting EU spending instruments. In it, NGEU is described as a temporary instrument and limited in size. While the Greens consider this to be only a factual statement on NGEU itself, the Free Democrats interpret it as excluding any new similar EU fund.

However, the three coalition partners are also committed to the interinstitutional agreement of 16 December 2020 between the European Parliament, the Council and the European Commission on budgetary issues and own resources. Its annex II on new own resources entails a roadmap to a carbon border adjustment tax and digital levy. The Greens like to emphasise that the Free Democrats sitting in the European Parliament supported the interinstitutional agreement, while the Free Democrats in Germany are strictly against new taxes. In the Council, negotiations about the ETS and the CBAM, Germany's government focuses on financing NGEU-related debts and the need to remain a reliable creditor. The design of both instruments shall be discussed in close relation with the climate policy objec-tives of the Fit-for-55 package, instead of decoupling both debates.

What should Germany do?

To avoid the negotiations about the EU's new own resources following the traditional destructive logic of net-payers versus net-recipients, Germany should with France and a minimum of five other likeminded countries propose a comprehensive cross-sectoral reform package. Such an initiative by an inclusive avantgarde that is open to other member states to join but bears the potential of adopting the reforms alone and leaving others behind, has an additional lever to get more hesitant governments on board.

The comprehensive cross-sectoral reform package should combine currently separate negotiations on different reform strands to overcome the destructive logic of zero-sum games and make the reform discussions more efficient. The assumption that negotiations can be facilitated by keeping dossiers apart will most likely backfire, as shown by the experience of multiple initiatives that got stuck for ever in the Council in recent years, especially the urgently needed reform of the Common European Asylum System. A European Convention would consume fewer resources than negotiating dozens of dossiers in parallel. Muddling through is more prone to leading to deadlock as it does not allow for finding compromises across policy areas.

The comprehensive cross-sectoral reform package should have at its heart a common response to the looming economic crisis, caused by Russia's war against Ukraine and address the considerable need for investment in European infrastructure. The pandemic taught even Germany's business sector that a common economic policy is at the core of the country's self-interest, and this has not changed in recent months. The package should focus on investments in defence capabilities, energy infrastructure and – if additional projects not yet covered by NGEU are ready for implementation – green transition. There is considerable potential for synergies and European added value, making EU-level investments more efficient than national-level spending sprees, which will waste much taxpayers' money.

As the European Commission has already prolonged the suspension of EU fiscal rules until 2024, Germany should support a reform of the SGP to avoid a permanent status of exemption. Increasing the flexibility of the European fiscal rules in cases of external shocks, such as the global financial crisis, the pandemic or Russia's war against Ukraine, is necessary. If flexibility is always agreed on an ad-hoc basis, the EU's fiscal rules will lose credibility in a medium-term perspective.

Finally, Germany should not repeat past mistakes of doing it alone and not consulting its European partners but demanding their solidarity afterwards. Depending on Russia's gas policy, Germany will most likely need such solidarity next autumn and winter. The comprehensive cross-sectoral reform package should send a clear signal that for Germany's current government solidarity is a two-way street and crises are managed together. A commitment by the government to considerable investments in European defence and energy infrastructure has the potential to prevent the isolation of Germany. Otherwise, the costs the country will need to bear next winter and in the long-term will be much higher.

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