THE EU'S EXISTENTIAL THREAT:
DEMANDS FOR FLEXIBILITY IN AN EU BASED ON RULES

Adriaan Schout

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Abstract: Deeper integration is on the agenda to complete the monetary union, to get growth back on track, and to rebuild trust in the EU. It will involve a political union with a fiscal capacity, and it will probably turn EU institutions into state-like bodies. Such centralization might put the integrity of the EU at stake by creating public resistance and a disparity between Euro-ins and Euro-outs. It is also doubtful whether it ensures the long-term competitiveness of the Eurozone. This paper starts from the assumption that the need for a political union results from the inabilities of some national governments to reform and to respect agreed upon rules. It is apparently easier to discuss reforming the Eurozone than to reform a country’s own institutions (“integration by default”). If the root-cause of the Euro crisis lies at the level of member states, then that is where reforms should start. This paper argues that countries unwilling or unable to reform should not demand flexibility on EU-rules, but should instead leave the Union altogether.

Keywords: EU integration | Eurozone crisis | Economic governance | Public opinion

Introduction: 60 years of integration

It seems like history is repeating itself. In the 1950s, the Netherlands was reluctant about European integration.¹ The founding fathers wanted each

¹ Adriaan Schout, "The Netherlands: The 100% Union that Never Was and Never Will Be", in Hussein Kassim and Adriaan Schout (eds.), National EU Narratives in Europe’s Multilevel Context, forthcoming.

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other’s markets\(^2\) and the Netherlands was afraid it could be side-lined if Germany, France, and Belgium concluded free trade agreements. Yet, the Netherlands was also afraid of an ambitious, protectionist, and “Catholic” (Southern dominated) integration project. From the beginning, it had been opposed to the idea of a political union of some sort. According to Dutch preferences, integration had been, and again is, a project of market integration. To underline equality and the centrality of member states, the Netherlands had pressed for a rotating presidency of the Council instead of agreeing to a permanent president that could be more inclined towards listening to the larger member states. With the success of the internal market in the 1970s and 1980s, the Netherlands adopted a strongly integrationalist and even federalist approach, until the Maastricht Treaty created the Euro and the reform of the Common Agricultural Policy (CAP) made the Netherlands a major net-payer. “Maastricht” resulted in the first serious political discussions about whether integration was going too far and whether countries such as Greece and Italy should be allowed into the monetary union. European integration started to move from permissive consensus to constraining dissensus. “Maastricht” laid the foundations for the veto in the referendum to the Constitutional Treaty in 2005. Sixty years after 1957, the Dutch are again reluctant to pursue deeper integration.

Many of the integration steps that the Dutch had hoped to avoid are now being taken. Due to the Euro, integration is now much more than a project of market integration and the UK, which the Dutch hoped would block Franco-German ambitions, has opted for Brexit. Moreover, ambitious integration steps are on the agenda that have forced the Netherlands into an accommodating mode that is painful for the government to explain to voters. For example, the third rescue package for Greece was defended in public on the grounds that it could not be stopped, Juncker’s investment plan got lukewarm acceptance at best, and Draghi’s expansionary policy is publicly criticized by the president of the Dutch Central Bank. The move towards deeper integration in the Eurozone also threatens the integrity of the EU by creating tensions between the Euro-ins and the Euro-outs. The question is whether deeper integration and political union are indeed necessary to get out of the current crisis in the Eurozone and hence the crisis in European integration. There may be another option for integration – and it could keep the Dutch motivated.

The focus in this paper is on the Euro crisis and its consequences for integration. According to Juncker in his State of the Union speech of 2015,

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growth and jobs have to be created to end the Euro crisis so that the public will regain confidence in European integration. Unemployment, Brexit, the success of Trump and the rise of populism have imposed the need to address unemployment, inequality and perceived short-term needs of citizens. According to this Commission, the people have to get back “the feeling for Europe.” Current proposals imply major steps towards a political union and are bound to have major consequences for the relation between national governments and EU institutions. The European Commission may start to resemble a European government and thus the European Parliament may tend towards a real parliament, potentially with a sizeable budget and powers related to economic supervision. The next section briefly discusses current trends and proposals related to completing the Economic and Monetary Union. The third section introduces Juncker’s central message that the EU – and especially the Eurozone - must regain trust and therefore that deeper integration is needed. Is it that evident that citizens lack trust in the EU? Effective steps towards a sustainable Eurozone first require a proper diagnosis of the weaknesses (section four). The paper posits that “More Europe” is on the agenda because member states are failing. This is termed here “integration by default”: deeper integration is pursued because failing member states in the Eurozone have to be accommodated by European policies. Countries that stand on their own two feet hardly need a political union. The question to address is therefore whether Commission president Juncker and others are right to demand solidarity and to claim that deeper integration along the lines of the Four and Five Presidents reports must be pursued.

1. Deeper integration?

There are good arguments for discussing deeper integration. The reports of the European presidents have explored the road towards a “genuine” monetary union including a stronger role for the European Parliament in legitimizing economic policies, a fiscal capacity, and a European minister of finance (e.g. van Rompuy Report). The underlying assumption is that the “economic” and “monetary” dimensions of the Economic and Monetary Union (EMU) have been incomplete and that these alleged “design flaws” contribute to the persistence of the Euro crisis. Economic coordination has remained problematic because member states cherish their sovereignty in

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3 Frans Timmermans in Dutch Parliament, 8 December 2016.
economic policies and do not accept risk-sharing mechanisms. As a result, according to the presidents reports, the Eurozone remains vulnerable to external economic shocks. European strategies have been consistent in terms of redressing the alleged gaps in the Euro-system: the internal market has to be completed to create jobs, member states have to make their economies resilient, and European economic governance has to be reinforced.

Deeper integration is also on the agenda in relation to functions and the size of the EU budgets. Mario Monti produced a report on the EU's own resources and Juncker created a large-scale European Fund for Strategic Investments (EFSI). In addition, the work programme of the Commission for 2017 lists a White Paper on A strong Union built on a strong EMU including the option of Treaty change. In the meantime, France, Greece and Italy have been pressing for more solidarity and for a flexible treatment of the Stability and Growth Pact (SGP) rules. Such developments will imply a more political Eurozone. This will make the Commission a sort of European government and the European Parliament will progress towards becoming a true parliament with economic and budgetary powers.

To avoid this type of European integration, the Netherlands and Germany had wanted to stall monetary integration and to first start with economic convergence. However, Andreotti and Mitterrand side-stepped the discussion on economic convergence by including the deadline of 1999 for the single currency in the negotiations in Maastricht in December 1991. The Euro began with countries unfit to join and that now force a political union that was not agreed to. Monetary union has thus become a major example of “integration by stealth.” Given that current proposals and options tend towards some sort of political union, Juncker’s insistence that the EU is not moving towards a United States of Europe may be an example of his political pragmatism.

The Netherlands, given its limited size and political weight, had little alternative than to trust that the Maastricht criteria and the SGP rules would

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7 “We decide on something, leave it lying around […]. If no one kicks up a fuss, because most people don’t understand what has been decided, we continue step by step until there is no turning back.” Jean-Claude Juncker quoted by Dirk Koch, “Die Brüsseler Republik”, in Der Spiegel, No. 52/1999, p. 136, http://www.spiegel.de/spiegel/print/d-15317086.html.
discipline member states. It did not. Yet, the current debates on deeper integration need not be an immediate threat to Dutch support for European integration. The Netherlands is among the most pro-European countries in the Eurobarometer. This support needs some qualification. Geert Wilders’ anti-EU “Freedom Party” has been leading in the polls in recent months prior to the elections which will take place in March 2017. Moreover, support does not mean affection. For example, the Dutch score lowest when it comes to “feeling affiliation” to other Europeans (5 percent, compared to 29 percent of the Germans who feel affiliation to other Europeans) and test panels show that opinions of the EU can easily switch under the influence of negative opinions, making support for the EU rather volatile. It is therefore important that plans to regain trust address the real threats to the Eurozone and that they lead to lasting support. Proper diagnoses of the weaknesses of the Euro are therefore essential.

2. Regaining trust, but at what level?

The persistence of the Euro crisis, of high unemployment and of failing banks – along with the migration crisis – have strengthened the impression of an incapacitated EU. Yet, is it correct to focus on trust in the EU? Figure 1 shows that people trust the EU (a lot) more than their own governments. Trust in the EU is not the biggest problem. People in almost all Eastern and Southern European countries lack trust in their own institutions. Therefore, claiming that the EU has to regain trust is a misleading starting point for any discussion on the state of the Union. Trust is inevitably linked to economic performance and citizens seem to have ample reason for being unhappy about their governments (see Figure 1).

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8 For a review see Adriaan Schout, “The Netherlands: The 100% Union that Never Was and Never Will Be”, cit.
**Figure 1 |** Trust people have in the EU and in their own government (% of the population)

![Graph showing trust in EU and own government](Image)


To ensure trust in the EU’s multilevel organization, effectiveness at both national and EU levels is required. Yet, discussions about economic governance are mostly about the EU. Theories of federal systems however suggest focusing on the level of the elements of the network (in the case

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Nobel Prize winner Herbert Simon discussed the relations between sub-systems and the overall system using the parable of the two watchmakers Hora and Tempus. They both made excellent watches and new customers frequently rang their shops. Yet, Hora prospered while Tempus failed. The difference was: Hora made watches using subsystems of ten components each whereas Tempus had designed his watches as one system. When Hora had to pick up the phone, he lost only a small part of his work. Tempus had a complex interconnected system that fell apart every time he was disturbed. Simon’s parable is important in complex system theory and therefore federalism. His theory on federalism is closely linked to concepts of “equipotentiality” (subsystems have to have the required strengths to deal with the pressures in their sub-environments) and “nearly decomposable systems” (a macro system is effective if it is based on effective/resilient micro systems). Complex system theory warns against reliance on centralization and points to the importance of the strengths of the individual components.

3. European integration by default

The narrative behind deeper integration assumes an incomplete EMU. Yet, theory of complex organizations stresses the need to diagnose weaknesses at lower levels of governance and the dangers of centralization. Applied to the Eurozone, table 1 shows the development of competitiveness of the individual countries between 2006 and 2016. It fits the pattern also underlined by the ECB that, instead of convergence, economies in the Eurozone have diverged. France, for example, as a leading European economy dropped out of the top-20 (down from 18th in 2006 to 21st in 2016) whereas other countries managed to climb, even within the top-10. The most competitive countries in the global ranking are the Netherlands (4th, climbing from 9th a decade ago), Germany (5th, up from 8th), and Finland (which however dropped from 6th to 10th). Even though we have to be careful with complex competitiveness rankings, the table also suggests that the gap between top-performers and underperformers has widened and this puts major strain on the Eurozone. Further research is needed in to the competitiveness of the Eurozone: the member states).

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12 Adriaan Schout, Internal Management of External Relations. The Europeanization of an Economic Affairs Ministry, Maastricht, European Institute of Public Administration (EIPA), 1999.
rankings of the Eurozone but there seems to be ground to hypothesize that the Eurozone countries have also dropped on the competitiveness ranking compared to other trading blocks.

Table 1 | Competitiveness index in the Eurozone (2006-2017)

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Note: * Countries joined after 2006.

European Central Bank (ECB) president Draghi, as well as Commission president Juncker, among others, have emphasized that this calls for efforts at two levels: “we need now to press ahead with […] convergence through [national] structural reforms. And second, we need to move from rules to institutions through governance reforms.” The problem, however, is that the first is not happening. This forces EU institutions to step in. This mechanism can be called “integration by default.”

The basic problem with the Eurozone is not, as Juncker presented in the State of the Union address in 2016, that the Union does not have “enough

union.” As the graphs below show, there are strong correlations between competitiveness and indicators of the quality of national institutions such as control of corruption, regulatory quality, rule of law and the quality of national government. The graphs show broadly the same groups of countries performing well. Overtime, this analysis also shows that the groups of performing and non-performing countries are relatively stable. Countries that had dubious reputations at the start of the EMU are still underperforming. Hence, the “genuine monetary union” should start by reforming institutions related to economic competitiveness and rule of law in weak member states.

**Figure 2** Correlations between competitiveness and control of corruption, quality of regulation, rule of law and government effectiveness (2014)

Divergence can also be seen in national public debt figures. Some countries such as Italy and France have debt levels well beyond the target figures set by the Maastricht criteria and by the SGP. Instead of 60 percent state debt to GDP ratio, France is approaching the 100 percent state debt level and Italy is above 130 percent. As a corollary, these countries have no buffers to deal on

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16 The non-eEurozone countries are also incorporated to make a statistical analysis possible.
with “unexpected” or “external” shocks and they have to depend on the EU to act as buffer. Germany and the Netherlands are bringing their state debts down to 60 percent or less and hence ensure their own stabilization buffers (as before the economic crisis of 2008).

Similarly, the government’s share in the economies of France and Belgium is 57 percent and 54 percent whereas Germany and the Netherlands have brought the public shares in their economies down to approximately 45 percent. This share in the economy indicates the size of the market economy and it indicates that some countries have rather oversized welfare states. Current plans to increase the EU budget using “own resources” (EU taxes of some sort) would imply that the combined demands of the national and the European public sectors on the national economies would increase. An EU budget of 5 percent of the EU’s GDP would imply that the French public sector burden would rise to 62 percent. Some even go so far as to plea for an EU budget of 30 percent (comparable to the US federal budget). This would, for France, imply a public demand on the national economy of 87 percent and bring it close to a fully planned economy. Any increase in the EU budget therefore has to be complemented with comparable cuts in national budgets. Given the past track records of reforms and cutbacks, this is going be difficult if not unlikely.

Conclusions and way forward

Decisions are needed to save the Euro. As it is now, the Eurozone is trapped in the process of “integration by default”: without reform, weak states force other member states into accepting a political union that will probably not work and that was never agreed on. It is too easy to assume that the economic and monetary union is incomplete, and that a fiscal capacity is needed, etc. The basic problem, as also underlined by e.g. Draghi,\textsuperscript{17} is member states failing to reform. The much-discussed “design flaws” of EMU distract the attention from where priority reforms are needed. The competitiveness of some Eurozone countries is decreasing and, 25 years after the Maastricht treaty, convergence is still not taking place. Moreover, European institutional solutions have been ineffective and are bound to remain so. The powers of the Commission to supervise reforms have been enhanced but the Commission is unable or unwilling to use them, for example “because it is France.”\textsuperscript{18} The

\textsuperscript{17} Mario Draghi, \textit{Speech by the President at SZ Finance Day}, cit.
The dilemma of the Eurozone is that some countries agreed to the rules to get in, subsequently have failed to adhere to the rules, and now ask for a different kind of EMU based on flexibility.

Yet, continuing down the path of deeper integration seems to be economically and politically dangerous. Further centralization of the Eurozone even amounts to gambling with history. With or without deeper integration, the Eurozone seems to tend towards an economically inferior Eurozone and possibly an implosion if countries do not reform. It is time to consider what the position should be of those member states that were too weak to join and that are still threatening the success of the Euro and, hence, of European integration. Lagging countries cannot and should not demand reforms of the Eurozone. If reforms continue to be mere promises, then those countries should leave the Eurozone – probably also for their own good. This should not lead to a split between a northern and a southern Eurozone. More likely, a limited number of countries that have relatively little economic overlap may have to consider going back to their own national currencies instead of trying to establish a separate monetary union.

It can be argued that it is currently the determination of the ECB that allows failing countries to stay in by keeping interest rates low and propping up fragile banks. Now that the ECB is cutting back the quantitative easing (QE), questions reappear regarding whether and how weak countries can be supported. Of course, (high) costs will be involved if a country leaves. However, these costs are sunk costs as debts will probably have to be written off in any case and, as argued by Stiglitz, continuation down the current track will be much more disruptive and expensive in the longer run. One lesson that could have been drawn from the predecessor of the Euro, the Exchange Rate Mechanism (ERM), is that the longer the delays in exchange rate adaptations, the higher the costs.

A Eurozone based on responsible countries may also help to prevent further division between the Euro-ins and the Euro-outs. If deeper integration is not needed because Euro-countries can stand on their own feet, then institutional differences between the EU and the Eurozone will remain modest. This may also help to quiet EU-critical voices in the Netherlands, given that its allies include Euro-outs in northern Europe. Allowing weak member states to leave seems to benefit the integrity of the EU at large. Paraphrasing J.F. Kennedy, countries that have taken the obligations of convergence too lightly should

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not ask what the EU can do for them; they should ask what they need to do to save the Euro and the EU. A strong Union can only be built on strong member states. If time is used wisely than it is still possible that the Eurozone has a bright future.

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2017 is set to be a crucial year for the European Union (EU) and its Member States. Multiple crises, key electoral appointments and the celebrations of the 60th anniversary of the signing of the Treaties of Rome are among the most important events in the EU agenda. Against this backdrop, the Istituto Affari Internazionali (IAI) and the Italian Ministry of Foreign Affairs and International Cooperation (MAECI), in cooperation with the Centro Studi sul Federalismo (CSF) and in the framework of IAI’s strategic partnership with the Compagnia di San Paolo, have launched a new research project: EU60: Re-founding Europe. The Responsibility to Propose. The initiative seeks to re-launch the EU’s integration process, and will involve researchers from leading European think tanks who will contribute policy papers analysing specific political or institutional dimensions of the EU.