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European Integration and the Future Institutions of Europe

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Abstract: This article summarizes a talk, given at the conference *From Bretton Woods to Berlaymont: Globalisation, Integration and the Future of Europe*, organized by KOF Swiss Economic Institute and ETH Zurich from 22-23 March 2018. It highlights the complexity and multidimensional nature of the question about the future development of the European Union. It argues that there is a need for rebalancing subsidiarity and supranationality, but that the assignment of tasks and the ‘optimal’ degree of centralization has to be judged on a case-by-case basis, differentiated by policy area. Moreover, it emphasizes the need to draw a line between what is desirable from a scientific perspective and can be judged by objective standards and what is desirable from a political perspective, which will vary a lot with political preferences. Finally, it argues that, at least in the short- to medium-run, economic integration should be given priority over political integration.

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European Integration and the Future Institutions of Europe

The Future of Europe: This is a colossal topic, which clearly transcends the borders of the discipline of economics. It has also a political science dimension: How should the EU institutions be designed to ensure not only efficiency, but also democratic legitimacy? It has a legal dimension: Which is the proper legal framework to ensure the desired political outcome, how can the tension between supranationality and subsidiarity be resolved? How does it relate to the assertion of national self-determination, proclaimed as the superior war aim by US president Wilson some 100 years ago? Today, this is still a burning issue as reflected in internal secession crises like that in Catalonia. It has a sociological dimension: How does the EU shape and how is it shaped by socio-economic patterns and developments of its populations? It has a foreign, security, and defence policy dimension, which is closely related to a geo-political dimension: What is the role of the EU in the world (economy)? Which relation does the EU want to have with Russia, with China, what about Africa, after all? And through which institutional setup can the EU best fulfil the role it has assigned to itself?

While these questions are influenced by the economic development of Europe and by economic mechanisms, they cannot be fully analysed by economic methods alone and would actually require a (more than book-length) interdisciplinary treatment. Moreover, there's no precise, well defined research question that is limited in scope, can be addressed with the proper state-of-the-art methods to yield strong conclusions, which can be defended by scientific standards. Hence, this article has a much more modest goal, namely to share some observations and assessments from the author's predominantly (but not solely) economic point of view.

When talking about the future of Europe, we can address this topic from a positive perspective: What will the EU look like in the future? Alternatively, we can take a normative perspective: How should the EU look like in the future?

Regarding the positive perspective, Niels Bohr's famous quote comes to mind: "Prediction is very difficult, especially if it's about the future." Let's travel back in time to the early 1950s. Probably only a very small minority at that time had envisaged the spectacular progress that European integration would be making over the next six decades: the setup of a customs union, the establishment of the Single Market, the expansion of the EU from originally 6 to 28 member states, the formation of European institutions (Commission, Council, Parliament, Court of Justice, etc.), the deepening of integration in several policy areas, the introduction of a common European currency at the end of the 20th century, to mention just the most significant achievements.

On the other hand: Let's look back into the more recent past, say the year 2005. Up to then, European integration was characterised by some ups and downs, but in fact there was steady progress; the Eurosclerosis in the 1970s was overcome by the Single European Act and the launch of the Single Market Programme, then things went remarkably smooth. Euroscepticism was basically a minority programme, the EU Project in its substance was undisputed, success was taken for granted, a failure and a break-up of EU was not even conceivable. Who at that time, in 2005, had thought or predicted that – over the next decade – the EU would be sliding into a severe economic and institutional crisis, that there would be serious concern about a breakup of the Eurozone, that all these developments would ultimately culminate in the most severe backlash in European integration, namely the British vote on leaving the EU.

Hence, I will not attempt to make a prediction how the EU will look like two or three decades from now. If I had to make a guess, my guess would be that there will be no new convention designing of a consolidated, consistent constitution of Europe, no big new deal. I would rather say that there will be a series of incremental steps shaping the development of the EU, though it is not clear whether these steps will all be steps of further integration or whether there will also be steps of disintegration. Brexit reminds us that the evolution and development of the EU is not a one-way road, retrogression is as well possible. I do not regard this as a pessimistic outlook – in my view a (small) step-by-step policy, conducted by policymakers taking legitimate EU criticism seriously, is the only way forward to avoid a further strengthening of centrifugal forces and to gain, or better, to regain a broad and stable support by European voters that is immune against unsubstantiated anti-EU rhetoric.

Let's turn to the normative view, which is actually the more interesting one. Which recommendations can we give to policy makers? There are many questions, many economic questions, where scientists can give rather precise, clear-cut recommendations that are shared by the vast majority of the community (even in the social sciences). However, for the broad topic at hand – European Integration and the Future Institutions of Europe – this appears to be a hopeless task and I am very reluctant to spell out clear-cut recommendations and conclusions. Addressing this normative question does not only transcend the borders of the discipline of economics, its answers inevitably depend on one's political preferences, and so it does also transcend the borders of scientific analysis. While there is basically nothing wrong with politics, a clear line has to be drawn between what is desirable from a scientific perspective and can be judged by objective standards and what is desirable from a political perspective and will vary a lot with political preferences.

Other economists would probably be less modest or careful in this respect. I was actually very stunned and sometimes speechless that some economists have repeatedly presumed to claim that there would be one way, only one way without alternatives, that has to be taken by the EU if it is to survive the next decades. Unsurprisingly, these claims by different economists were quite different from and inconsistent with each other; this means that all but one or all these views are wrongheaded. I will therefore continue to leave making dogmatic claims to others.

Let me emphasize this once more: One should not confuse the term “normative” with political opinion. It is pretentious to equate one’s subjective view on “what should be” with an objective perspective, defined by precise criteria. It is a straightforward consequence of believing in democracy to admit that there are different, equally valid views on how the EU should look like in 2050. This is a matter of course but appears to get lost sometimes in public debates, even among scientists.

Actually this narrowing down of alternatives has always bothered me, and I am happy to see that even the European Commission (2017) – in its recent White Paper on the Future of Europe – has spelled out this thought clearly by, first, enumerating and describing five scenarios for the future of the EU and their pros and cons, and second, in its chapter on the way forward, stating that “regardless of which of the scenarios presented here ends up closest to reality, these values and aspirations will continue to bind Europeans and are worth fighting for.” (European Commission, 2017, p. 26). I happily realize that in Brussels the view has arrived that there are alternatives to “enlargement and deepening at any price”, that there is more than one way for the EU to survive and that there is more than one attitude towards the future of the EU which is consistent with being a good European.

Which alternatives does the EU Commission enumerate?

Scenario 1: Carrying on, i.e., maintaining the status quo implementing agreed upon reforms.

Scenario 2: Nothing but the Single Market and limited cooperation within Eurozone.

Scenario 3: Those who want to do more, in other words: a two- or multi-speed Europe.

Scenario 4: Doing less more efficiently

Scenario 5: Doing much more together (Economic, financial and fiscal Union is achieved as envisioned in the report of the Five Presidents of June 2015)

In my view, two scenarios should be ruled out:

Scenario 1: Carrying on. This is no way forward. Speaking in a positive sense, Europe very much looks like a half built house? This is no stable solution. In a negative sense, one could say, quoting John Cochrane (2010), when commenting on the Euro crisis and pointing out

the inconsistencies and indecisiveness of European economic policies: *“The Europeans have found the worst of all combinations.”*

Scenario 3, the two- or multi-speed Europe should also be ruled out: In my view this path would lead to an insider-outsider constellation and is ultimately bound to result in a break-up of the European Union. Possibly, such a scenario might work, but at the very least the concept of forming integration blocs within an integration bloc appears to be an odd concept, like a reversal of the original idea of economic integration, a contradiction with the principles of non-discrimination and most favoured nation treatment.

This leaves three scenarios. Given their unclear distinction, I would consolidate Scenarios 2 (nothing but the SM) and 4 (doing less more efficiently) into a single one, such that ultimately only two scenarios remain. Scenario A: Doing less more efficiently, and scenario B: Doing much more together.

Taking a closer look, these two options are only inconsistent with each other at a general, aggregate level. Different policy areas require different solutions. Economic theory, public choice theory, the theory of fiscal federalism all lead to the conclusion that for different policy fields, there will be different optimal levels of centralization or integration. This holds true for the relation between Member States and EU institutions as it does for the relation among regions in the nation state. Hence, when judged on a case-by-case basis, it is likely the case that there are policy fields where integration/centralization should be cut back, and that there are other policy fields, where integration should be deepened, where more supranationality is warranted.

Hence, after all, it boils down to only one feasible basic scenario: Doing less in some areas, doing more in other areas. The obvious question: where to do what? Or to put it differently: where do we need more supranationality, where do we need more subsidiarity? Theory, economic theory, tells us there are trade-offs revolving around economies of scale, heterogeneous local preferences, transaction and coordination costs, spillover effects, the provision of local public goods and so on.

But there is one issue that is often neglected when comparing centralized and decentralized solutions, namely the possibility that policy failures may become more likely under more complex governance structures of large-scale institutions such as the EU. By policy failures I mean – among others – the lack of ability to respond to shocks in a timely manner, the choice of solutions that are biased towards the preferences or interests of (a subset of) single member states, or the lack of coordination and absence of a coherent policy.

Unfortunately, when we look at the EU experience, there have been at least two severe policy failures in the recent past. Even worse, this has occurred in the cases of most need, where supranationality or at least coordinated national policies have been most called for.

First, I am absolutely convinced that the handling of the economic crisis, the lack of courage to stick with the no-bail out rule and the introduction of risk sharing instruments through the back door has not only caused (and will continue to cause) excessive costs (while benefiting only a few member states that were the drivers of this policy). Apart from the direct economic damages, the handling of the crisis has also severely damaged the credibility of the EU policy making and has left deep scars in the confidence into the European rule of law.²

The second grave mistake was made during the surge of the refugee crisis. As many commentators put it more generally: The EU migration policy is characterized by a lack of migration policy. This may be due to a lack of competences at the EU level, but it was certainly also due to the lack of willingness of individual member states to coordinate with others before making strong assertions and joint commitments, creating an accomplished fact and waking up afterwards, when their assertions turn out unsustainable and create strong political tensions within the Union. Hence, this is not necessarily a failure of EU institutions but a weakness of leadership in EU institutions, combined with a misbehaviour of individual member states, forging ahead without coordinating.

In my view, there is a direct road from these two policy failures to the decision of Great Britain to leave the EU. And regarding Brexit: Not for a single second I considered this as a positive event, a chance to move on with European integration (which has been hindered by the UK), as some commentators put it. To me, Brexit is a disaster, the exit of the EU's second largest economy implies a substantial loss in the EU's economic weight, it also implies a weakening of member states' voice in favour of a liberal market economy approach, and last but not least, it implies a loss of a defining element of Europe's identity.

What did the EU do to prevent the exit vote of Great Britain? Not very much. And how did the EU respond to this most severe backlash for European integration? It went over to business as usual, nominated some negotiators, end of the story. To me, this does not look like a Union that is inspired by a vision of Europe as it has been shared by its founders. History will tell, whether the politicians, both at the EU and member states level, who are responsible for the recent developments will turn out as the acclaimed great Europeans

² Some lawyers (and politicians) argue that the handling of the crisis was adequate from a legal perspective and no deviation from the letters of the Maastricht treaty. If that were true, the corresponding stipulations in the Maastricht treaty would be one of the worst laws ever been written – of course, these stipulations were designed and introduced to prevent precisely what has happened in 2008 and 2009.

or as coward bureaucrats without vision, who have done irreversible damage to the European project.

Anyway, let's ignore Brexit for the moment, let's ignore the pitfalls in the governance of large-scale institutions, and let's consider the trade-offs between supranationality and subsidiarity from a purely theoretical perspective. Such an analysis suggests that there are several policy areas, where the benefits of centralization clearly outweigh its disadvantages: Migration, security, defence, competition, environment are examples that come to one's mind immediately. "Doing much more together" would be the right approach in these fields.

But for the vast majority of policy areas, (economic) theory gives us much less clear guidance about the optimal degree of centralisation. Yet, as Danthine (2017) points out, subsidiarity is still the key to Europe's institutional problems, he even refers to it as a forgotten concept at the core of Europe's existential crisis.

I do not want to delve into an enumeration of the pros and cons of alternative governance models, this is well documented in the literature. If there is a general conclusion to be drawn, it is that even in narrow policy areas, at least in many of them, there is no optimal governance model, but rather a range, a continuum of possible alternatives, all of which might be optimal under specific internal and external circumstances and constraints. Since no one can reasonably predict how these internal and external circumstances and constraints will evolve over time, each choice within a certain range appears equally justified.

In the end, for many if not most policy areas, it boils down to one question: How much risk sharing is desired and how severe is the problem of moral hazard? Obviously there are different assessments, and again I wish to emphasize: different legitimate assessments, regarding the number of and the weights assigned to criteria of a social objective function, which includes more than purely economic variables.

In light of the fact that for several policy areas, there is a range of possible, workable setups, which provide a way forward, their ultimate choice should also be guided and influenced by political preferences, i.e., the democratic will of the populations. This process of political clarification – the dissemination and open debate of planned changes in institutions or policies – is of utmost importance, and should be given the same priority and importance as the scientific, economic analysis.

One side remark: The European Economy Advisory Group (EEAG), in its report from 2017 concludes in its recommendation chapter on populism: "*Democratic political processes*

must leave room for fruitful disagreements and debates. While mechanisms for compromise are needed, too much consensus can backfire.” (EEAG, 2017, p. 6). And they continue: *“EU institutions should act strictly within their mandate and EU policies should adhere to the principle of subsidiarity. The EU Commission should focus on its role as a guardian of EU treaties.”* (EEAG, 2017, p. 6).

These recommendations sound obvious, almost trivial, not even worth mentioning. In my view, the fact that a group of very smart economists feels that there is a need to emphasize and formulate as recommendations these basic elements of democracy and adherence to the rule of law is a serious warning signal.

Let me turn to my conclusions, which I will draw around two quotes. *“Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements which first create a de facto solidarity.”* (Monnet, 1950). His vision has always been: Economic integration comes first, political integration follows, and it follows in small steps and at a moderate pace. Over the last years, there may have been a disturbing mismatch in the speed of these two interrelated processes.

„The Single Market and active competition policy remain the cornerstone of efforts at EU level to improve European growth performance. They represent a foundation without which other efforts would be wasted.“ (Sapir et al. 2004, p. 158). Several shortcomings highlighted in the (15-years old) Sapir report do still exist, many recommendations are still valid. This is a serious problem, since no institutional setup can overcome shortcomings in the design of the European Market (Alesina and Giavazzi, 2007).

Putting these arguments together results in the following conclusion: Focus on and speed up economic integration, carefully pursue political integration at a modest pace, but not without listening to the electorate. With an improved performance as a result of economic reforms and a better economic outlook, political integration will also be easier to implement.

The alternative, forcing political integration first to be able to implement the required reforms, bypassing or evading the constituent, would be wrongheaded in my view. The approach to go for economic integration first and pursue a policy of small steps with respect to political integration is certainly the more tedious, cumbersome one, it will have to take some detours, it will be difficult to stay on track, it will be the lengthier, the more painstaking way. But, this is the democratic way, it is the sustainable way, it is the only way that is likely to be successful.

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