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EUROPE GOES TO THE POLLS

TEN PRIORITIES FOR REFORMING THE EU AND THE EUROZONE

1. THE EU AND THE EURO HAVE FAILED TO FULFIL MANY OF THEIR PROMISES

The forthcoming elections to the European Parliament will set the course for the future of the European Union and the Eurozone at a critical stage in the integration process. The European integration project, which once enjoyed widespread support, has lost considerable popularity over the years of multiple crises. The problem is not just that one of the largest and economically strongest Member States – the United Kingdom – is in the process of leaving the Union. It is also that the internal cohesion within the remaining countries is increasingly being threatened by new conflicts and fault lines dividing Northern and Southern Europe as well as Eastern and Western Europe. It would, however, be inaccurate to interpret the declining level of support for the EU purely as a problem of poor communication and misleading populist rhetoric. The fact remains that the EU and the euro have over the years conspicuously failed to fulfil many of their promises. Their economic performance is falling behind that of other industrialised nations, while individual euro area countries have over the past decade totally failed to benefit from the growth of the European Single Market. The institutional framework of the currency area remains inadequate, and it is far from clear how the current institutions could cope with any new economic, financial or debt crises. The sharing of responsibilities between the EU and its Member States remains problematic, and the EU budget continues to allocate most of its resources to agricultural and cohesion policies while on the other hand neglecting policy areas that would provide much more clearly discernible benefits for Europe.

Researchers at the Leibniz Centre for European Economic Research (ZEW) have in recent years conducted a number of studies in which they analyse these challenges and draw various conclusions about the prospects for reforming the EU and the euro area. These findings have been summarised in the form of ten priorities below.

2. TEN PRIORITIES

2.1. RECONFIGURE THE EU BUDGET SO THAT IT ADDS VALUE FOR EUROPE

The newly elected European Parliament will have the right to veto the next Multiannual Financial Framework (MFF), which will stipulate the parameters of the EU budget for the period 2021 to 2027. It is high time that the Parliament became a strong advocate of fundamentally reconfiguring the budget. The EU should primarily finance policies that genuinely produce a 'European added value'. Far from simply being empty rhetoric, this phrase can be operationalised and quantified (Weiss 2013, Weiss et al. 2017). European policy adds value whenever the EU can perform a task at a lower cost or, in the widest sense, is able to achieve something that would otherwise exceed the capabilities of the individual Member States. Policy areas where considerable European added value could potentially be created are migration, defence, the environment, climate change and international development. Poorly coordinated national responsibilities in all of these areas produce unsatisfactory policy outcomes and, moreover, incur unnecessarily high costs. The challenge is therefore to expand these policy areas at European level (Wambach 2017).

2.2. START TO PHASE OUT DIRECT PAYMENTS TO FARMERS

Given the aforementioned new priorities for the EU and the potential loss of a key net contributor as a result of Brexit, it is essential to rein in costly policy areas that lack European justification in Brussels' budget. The direct payments made to farmers under the Common Agricultural Policy (CAP) are a prime candidate for such cuts (Wambach 2018). This expenditure continues to consume roughly 30 per cent of the entire EU budget. However, it does not perform any useful social policy function because the recipients are not means-tested and the subsidies – which are based on the size of farmland – mainly benefit wealthy landowners. Moreover, at present this expenditure does not create any meaningful incentives to achieve higher environmental, climate-change or animal-welfare standards that go much beyond what is required by law anyway (Heinemann 2018c, Heinemann and Weiss 2018). During this debate thus far the European Parliament has shown itself overly willing to defend agricultural vested interests and should correct this approach during the next legislative period in order to free up EU budget funds for compelling European projects. Direct payments should only continue to be made to farmers if, in return, they make a measurable contribution to environmental, climate-change and animal-welfare standards that go well beyond what is required by law anyway.

2.3. IMPROVE THE PRECONDITIONS FOR SUCCESSFUL COHESION POLICIES

In addition to the CAP, cohesion policy is another costly item in the European budget. The basic idea of encouraging successful convergence within the Single Market by providing effective support for underdeveloped Member States and regions is correct. However, the track record in this respect is disappointing, as illustrated by the poor economic performance of Southern European Member States despite decades of support in the form of substantial payments from the EU structural funds. What's more, this policy lacks focus because large sums are paid to very wealthy countries and regions. In order to ensure that cohesion policy is successfully reconfigured and accurately targeted, the next Parliament should pursue three objectives. First, cohesion policy should refocus on its original purpose, which is to support poor regions (Heinemann 2013). This would enable significant amounts to be saved and used for new policy areas that added value for Europe. Second, any payments must be made clearly conditional on the political independence of the courts in the beneficiary countries. The European Commission's demands that cohesion payments be linked to the rule of law in the beneficiary country are justified because without an independent judiciary it is impossible to fight corruption and the squandering of funds effectively (Heinemann 2018b). And third, it is essential that the cohesion programmes be independently evaluated. The existing evaluation culture at European level still fails to meet the minimum requirements in terms of methodical standards and independence (Heinemann 2016).

2.4. INCREASE THE VALUE OF GNI-BASED OWN RESOURCES AND EXPAND NATIONAL CO-FINANCING

The European Parliament should abandon its longstanding goal of tapping a dedicated source of taxation for the EU budget. A new tax for Brussels' budget would create more problems than it solved (Osterloh et al. 2008). At present the budget is reliably and sustainably financed by resources that the Member States contribute in proportion to their gross national income ('GNI-based own resources'). These GNI-based own resources provide a transparent form of funding that is seen as fair. Any new tax would trigger renewed debates about fairness and distribution because it would affect Member States in very different ways depending on the chosen tax base. Moreover, any tax-based funding would not solve the problem that Member States focus excessively on how much of the EU budget flows back to their own countries. What's more, many of the types of tax being discussed (e.g. taxes on plastic, financial transactions, or corporations) would be extremely non-transparent in terms of the actual burden they would impose. Larger contributions by individual countries ('co-financing') to agricultural and cohesion policies could therefore be much more accurately targeted than a tax for the EU budget. Especially in these areas, where the European benefit of such policies is highly dubious, the Member States should have to contribute much more of their own money. In order to ensure that European spending is transparently and fairly funded, the EU should, if anything, further increase the value of GNI-based own resources by phasing out VAT-based own resources, which are useless and impose unnecessary bureaucracy costs.

2.5. RETAIN EXISTING UNANIMITY RULES ON TAXATION AND BUDGETARY POLICY

It is already the case that decisions on EU laws in most areas are taken by qualified majority. In areas with important financial implications, however, unanimity on the Council remains mandatory. This applies, for example, to all decisions on tax policy and to resolutions concerning the MFF. These unanimity rules have come under criticism – also in the European Parliament. This critical view is one-sided and exaggerated. Unanimous decisions offer huge advantages, especially in the context of fiscal policy. The obligation to reach a consensus protects an individual Member State from being exploited by the majority. Unanimity guarantees that, in its budgetary and tax policies, the EU only implements projects that benefit all of its Member States. Majority decisions on taxation and finances can be highly detrimental to the integration process if they impose substantial costs on the countries that have been outvoted. The prominent role played by the United Kingdom's net payments to the EU budget during the Brexit referendum campaign shows that a country can turn its back on the EU even as a result of relatively minor fiscal burdens. Unanimity ensures that in future a country does not have to leave the EU in order to avert EU budgetary or tax policy burdens that it considers to be unacceptable.

2.6. CUT THE NEXUS BETWEEN NATIONAL BANKING SYSTEMS AND MEMBER STATES

The next EU Commission and European Parliament will have to continue working to reform the eurozone. Much has been achieved in recent years to make the common currency more resilient to crises. One serious failure is that it has so far proved virtually impossible to sever the close connection between national banking systems and member states (the 'bank-sovereign nexus'). Current developments in Italy illustrate the considerable dangers: Italian banks have such large loan exposures to their own government that the Italian banking system would collapse if the state were to become insolvent. The Eurozone can therefore be blackmailed by populist governments (Fuest and Heinemann 2017, Heinemann 2018a). Governments can ultimately expect the eurozone to bail out Member States by providing them with transfers even if they get into a self-inflicted debt crisis. This undermines the credibility of debt rules and the incentives to pursue responsible national policies. The way to sever this bank-sovereign nexus has been known for some time and should at last be implemented: rules on large loan exposures as well as the requirement to back them with sufficient equity must now also apply to banks' loan exposures to their own national governments. This would force banks to diversify their risks. A single country's debt crisis would then become an isolated problem, and EU support could be made credibly conditional on whether the crisis-hit country cooperated or not.

2.7. ESTABLISH AN INSOLVENCY PROCECURE FOR EUROZONE COUNTRIES

A further measure needed to make the eurozone resilient to crises is the introduction of an insolvency procedure for eurozone countries. Only an orderly insolvency procedure can ultimately guarantee that an overindebted Eurozone country will not have to be bailed out by unavoidable transfers at the expense of taxpayers in other eurozone countries (Destais et al. 2019). The advantage of insolvency procedures is that private creditors are forced to bear some of the losses that they themselves have helped to cause as a result of their lending. This improves the incentives for potential creditors to lend cautiously and for eurozone countries to pursue sound fiscal policies. Establishing an insolvency code for the euro area will be difficult, time-consuming and not without risk. It is therefore essential that preparations get under way during the next legislative period. Blueprints for a functioning system and how to achieve it are available and assign a key role to the European Stability Mechanism (Fuest et al. 2014, Fuest et al. 2016).

2.8. INTRODUCE INSURANCE AGAINST SEVERE RECESSIONS AS PART OF A COMPREHENSIVE PACKAGE

In addition to the question of how to deal with a sovereign debt overhang, protecting eurozone states against macroeconomic shocks that are not self-inflicted remains a further challenge. Better macroeconomic stabilisation is a concern for France in particular, as evidenced by French president Emmanuel Macron's proposals on the establishment of a eurozone budget. But the Baltic states, for example, which have been exposed to very strong economic volatility in recent years, also believe that such insurance schemes are important to protect against severe recessions. Crucial to the political acceptance of such schemes are guarantees that they could not be misused to finance long-term transfers or to communitise national debts. Consequently, new institutions such as a eurozone budget should always form part of a comprehensive reform package (Dolls et al. 2016). This package must also contain the two aforementioned elements (an end to the bank-state nexus, and an insolvency code for overindebted countries). Only such a package deal can ensure that the problem of excessive national debts is resolved by carefully targeted debt restructuring rather than a transfer solution.

2.9. DEPOLITICISE THE STABILITY PACT BY EXPANDING THE ROLE OF THE EUROPEAN FISCAL BOARD

During the legislative period currently drawing to a close the European Commission has increasingly come to see itself as a 'political institution'. This development is not per se to be criticised.

Nonetheless, this does make it necessary to reallocate certain responsibilities. Politicians are no good referees. In interpreting the Stability and Growth Pact, the Commission under Jean-Claude Juncker has used a huge amount of political discretion and often, out of purely political considerations (election cycles, fear of vote-winning populist parties, support for preferred governments), has stretched to its limits the discretion available for interpreting the Pact. Relevant examples from recent years include France and Italy. This has meant that the rules redefined and tightened in the wake of the euro crisis have so far failed to achieve the desired effect and that the debt situation of some countries has not improved. Future rules will only be credible if the role of guardian is performed apolitically and impartially. The European Fiscal Board (EFB) should play a key part here (Heinemann 2018d). The EFB was set up to impartially monitor how the Commission applies the Stability Pact (Asatryan and Heinemann 2018). The independence of the EFB should be strengthened and its remit broadened: it should be given responsibility for deciding on the existence of excessive deficits and for evaluating the Pact's many exemption clauses.

2.10. ALLOW MORE SCOPE FOR A EUROPEAN IDENTITY TO EMERGE

Improving economic performance alone cannot guarantee the progress of the integration process. 'Soft' factors are also important in addition to 'hard' ones such as economic and social issues. These soft factors include the creation of a 'European identity', which sits alongside people's national and regional identities. Only if Germans, Poles, Italians and French people feel that they also possess a common European identity will they ultimately be prepared to pursue joint policies and constantly search for successful compromises even when their national interests diverge. Previous efforts to foster a European perspective – such as the Erasmus programmes for university students – have primarily been designed for target groups that already have a fairly strong European identity. Future EU programmes should focus more on groups who lack any international connections and have therefore had very little opportunity to experience Europe in their own lives. Here it would be recommendable to adopt innovative ideas such as a form of 'Erasmus for pensioners' or a kind of 'European internship', through which people in professions without any international contacts are given the opportunity to work abroad (Ciaglia et al. 2018).

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