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**POLICY  
BRIEF**

# THE EU'S SILENT REVOLUTION

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## SUMMARY

The voices advocating a substantial overhaul of the European Union's institutions have become weaker in the last 12 months. Comprehensive treaty reform is no longer on the wish list of the leading EU member states and is now the least likely option for solving the current crisis. Nevertheless, a silent revolution of the EU is underway. The supranational dream of a European federation is giving way to a pragmatic approach based on a new intergovernmentalism. It is not a new grand design of European integration but a default mechanism necessitated by the impossibility of treaty change and by the interests of the major players.

Similarly, a new type of differentiation by default rather than by political purpose is taking place within the EU. Despite efforts to keep the EU together, the rift between the eurozone and the rest of the member states is becoming deeper. In particular, the UK is unlikely to realign with the EU and Poland is unlikely to accede to the euro any time soon. Both the British and Polish questions will have a major impact on the future shape of the EU. Between the German elections in September 2013 and the European election in May 2014, Europeans will be reminded that the issues thrown up by the EU's silent revolution are still on the table.

The worst of the euro crisis seems to be behind us. The declaration by European Central Bank (ECB) President Mario Draghi in June 2012 that he would do "whatever it takes" to save the euro was followed by the Outright Monetary Transactions (OMT) programme to buy sovereign debt in the secondary markets, the second bailout of Greece, and the announcement that a banking union would be put in place to stabilise the European banking sector. These steps have calmed the markets, albeit perhaps only temporarily, and restored some of the eurozone's credibility. However, one of the consequences of this partial stabilisation of the eurozone has been to weaken those voices in the European debate which argued that a new major step in European integration was necessary and that, without a substantial overhaul of its institutional structure, the eurozone would break up.

In the autumn of 2012, a number of ideas for further development of the eurozone towards a genuine economic and monetary union were put forward by the so-called Westerwelle Group, European Council President Herman Van Rompuy, and European Commission President José Manuel Barroso, as well as other politicians and think tanks. In the run-up to the European summit in December 2012, the "four presidents" (that is, of the European Council, European Commission, European Parliament, and Eurogroup) endorsed a roadmap to complete the European Monetary Union (EMU) with a banking, fiscal, monetary, and economic union, and strengthened democratic legitimacy.<sup>1</sup> But the summit showed that their sense of urgency was not shared by member states. Since then, momentum has been lost and the debate has stalled.

<sup>1</sup> "Towards a Genuine Economic and Monetary Union", 5 December 2012, available at [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/134069.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/134069.pdf).

However, the lack of a strategic vision in some capitals and the decreasing interest in a great leap forward in European integration does not mean that profound changes are no longer needed. Europeans are in a Catch 22 situation: they know they need to overhaul the system but are not sure whether the European Union would survive the process of overhauling the system. There is little doubt that long-term stabilisation of the eurozone requires stronger co-ordination of the member states' economic policies, a full-fledged banking union, and a solution to the problem of democratic legitimacy. But major treaty change based upon article 48 of the Treaty on European Union not only requires unanimity for the treaty negotiations but also ratification in 28 countries and, in some cases, a referendum that may be unwinnable. Under the current political conditions, therefore, major treaty change is extremely unlikely to happen.

This brief argues that, despite the widely held view that the EU has done "too little, too late", a "silent revolution" in the EU's political system is already taking place and will paradoxically be accelerated by the impossibility of major treaty change and other factors. This revolution is not based on any grand design and has not been agreed in the way that previous steps in integration were agreed – that is, through an Intergovernmental Conference followed by treaty change. Rather, incremental reforms taken on an ad hoc basis are creating a hybrid system of supranational technocracy combined with an increasingly intergovernmental mode of integration, deepening the separation between the eurozone and the rest of the EU. This revolution will affect both the institutional construction of the EU and the relationship between the eurozone and the rest of the EU.

## The EU's new intergovernmentalism

In theory, there are three ways to reform the EU: full-blown treaty reform; incremental progress within the treaty through enhanced co-operation; and integration outside the EU treaty through intergovernmental treaties with no role or a limited role for the EU institutions (as in the fiscal compact). For a number of reasons, treaty change is the least likely option for the foreseeable future. Given the growing distrust of the EU institutions, there is no political support for strengthening their supranational grip on the EU member states.<sup>2</sup> Since all 28 member states would need to agree on a new treaty (and some would need to hold a referendum), it seems unlikely to succeed. In particular, there is now little appetite for treaty change in Germany. Last summer, both the government and the opposition Social Democratic Party and Greens flirted with the idea of political union. But these days, when German government representatives such as Finance Minister Wolfgang Schäuble talk about treaty change, it is in order to postpone a project such as banking union.

German politicians are avoiding treaty change not only because of the forthcoming election but also because of the positions adopted by France and the UK. Berlin and Paris do not have sufficient shared purpose with regard to the future shape of

Europe to make major progress likely to happen under the treaty. The recent Franco-German proposal before the June 2012 European Council did not live up to expectations and skilfully omitted the issue of treaty change.<sup>3</sup> Preoccupied with its domestic economic malaise and with the failure of the 2005 referendum in mind, the government of President François Hollande has little interest in an experiment with treaty change.

British Prime Minister David Cameron's promise to hold a referendum on the UK's membership of the EU before 2017 and to attempt to renegotiate his country's relationship with the EU was another cold shower for the enthusiasts of a constitutional big leap in integration. As any substantial renegotiation would require treaty change, opening this Pandora's box would give the UK leverage on institutional reform of the EU that most other EU member states would like to avoid. Polish officials say that embarking on the path of treaty reform would boil down to "sabotage of the integration process". Van Rompuy also backed away from the idea of treaty change after Cameron's announcement. In London in March, he said there was "no impending need to open the EU treaties".<sup>4</sup>

The enhanced co-operation clause does not offer a promising solution either.<sup>5</sup> While it gives a group of countries a way to move forward in integration in a selected area within the institutional and legal framework of the EU, it is difficult in practice to do so. Eleven member states recently used the provision to introduce a financial transaction tax (FTT). But the UK claimed that the step violated EU rules and launched a legal challenge against the plans.<sup>6</sup> Regardless of its legality, the lesson of the FTT is that enhanced co-operation is not a "quick fix" for the EU's problems but a rather messy and risky way of moving ahead with integration. Although the EU patent is a successful example of enhanced co-operation, this mechanism is suited to completing existing policies rather than to overhauling the whole system.<sup>7</sup>

The reforms undertaken by the eurozone in response to the crisis have introduced new supranational mechanisms and led to an unprecedented shift of power to Brussels. In particular, the "European Semester", "Six Pack", fiscal compact, and "Two Pack" have given the European Commission the power to scrutinise national budgets, give member states guidance on budgetary and economic policy (so-called country-specific recommendations) and, most importantly, impose penalties on those member states which are part of the Excessive Debt Procedure (that is, those that are in breach of either the deficit or the debt criteria). The ECB has also been able to overcome opposition from the most powerful national central

3 "France and Germany – Together for a stronger Europe of Stability and Growth", Pressemitteilung, Nummer 187/13 vom 30. Mai 2013, Presse- und Informationsamt der Bundesregierung, available at [http://www.bundesregierung.de/Content/DE/\\_Anlagen/2013/05/2013-05-30-dt-fiz-erklaerung-englisch.pdf?\\_\\_blob=publicationFile&v=3](http://www.bundesregierung.de/Content/DE/_Anlagen/2013/05/2013-05-30-dt-fiz-erklaerung-englisch.pdf?__blob=publicationFile&v=3).

4 "Van Rompuy to Cameron: 'We have an exit clause'", *EurActiv*, 1 March 2013, available at <http://www.euractiv.com/uk-europe/van-rompuy-cameron-exit-clause-news-518163>.

5 Article 20 enables participating EU member states to organise greater co-operation than that initially provided for by the treaties under the policy concerned. Enhanced co-operation is carried out under the auspices of the European Union, through the European institutions and procedures. To be enacted, the mechanism needs support of one third of the member states and the agreement of the European Commission. It cannot be vetoed by other member states except for the area of foreign policy.

6 "Financial transactions tax: UK launches legal challenge", *BBC News*, 19 April 2013, available at <http://www.bbc.co.uk/news/business-22227019>.

7 See Sebastian Kurpas, Julia De Klerk-Sachsse, José I. Torreblanca, and Gaëtane Ricard-Nihoul, "From Threat to Opportunity – Making Flexible Integration Work", EPIN Working Paper, no. 16, 2006, available at <http://www.ceps.eu/files/book/1380.pdf>.

2 José Ignacio Torreblanca and Mark Leonard, "The continent-wide rise of Euroscepticism", European Council on Foreign Relations, 16 May 2013, available at [http://www.ecfr.eu/publications/summary/the\\_continent\\_wide\\_rise\\_of\\_euroscepticism207](http://www.ecfr.eu/publications/summary/the_continent_wide_rise_of_euroscepticism207).

banks, including the Bundesbank, to take controversial steps such as OMT.

However, this shift does not mean that a European federation or an EU with strong supranational institutions, a democratically elected president, and an empowered European Parliament is in sight – at least not in the form advocated by many European intellectuals and politicians. The incremental reforms undertaken in response to the crisis have little to do with the idea of a genuine political union, which would require a democratically legitimised transfer of power to the EU level. The European Parliament is marginal in eurozone governance. Instead, the shift is on the basis of what Jürgen Habermas has called “technocratic federalism”.<sup>8</sup> In fact, this is one of the main reasons why the idea of transferring even more power to Brussels is discredited among citizens and increasingly contested by national capitals. Not surprisingly, the lack of trust in a “technocratic Brussels” is a strong argument against even such reforms that could make the eurozone structures more democratic and transparent.

Rather than supranationalism, what is emerging in response to the crisis is a new intergovernmentalism. Intergovernmental co-operation has already led to important institutional innovations since the crisis began. The European Stability Mechanism (ESM), fiscal compact, and Euro Plus Pact – all central elements of the new eurozone governance – are based upon agreements initiated by and concluded between (some) member states that do not involve EU institutions or involve them only on a secondary level.<sup>9</sup> Their establishment did not use the enhanced co-operation principle or Article 136 of the EU treaty, which allows the adoption of measures specific to EMU countries to ensure the proper functioning of the EMU (and which would then constitute part of the *acquis*). Instead, it was the Schengen Agreement that provided the legal template for these reforms: intergovernmental treaty by a group of member states to co-operate in areas of EU integration in which other countries do not want to engage or which they would not accept.

The ESM’s relation to the existing treaties is unclear: it is an international organisation formally independent of the EU. Thus, the European institutions can participate in the decision-making process of the ESM due to provisions of the ESM treaty rather than the EU treaty. The non-eurozone member states have the right to ad hoc participation in the financial aid activities of the ESM but are not part of the decision-making structures. The Euro Plus Pact is a political agreement by eurozone member states designed to strengthen their competitiveness and structural reforms, which goes deep into the matters previously restricted to the competences of the nation states.

The fiscal compact, which de facto strengthens the provisions of the Stability and Growth Pact, is another example of this new institutional conundrum. Established outside the treaty framework, it is open to all EU member states but its signatories have committed to incorporate it into the existing treaties at

some point. At the same time, accession to the fiscal compact is necessary for those countries that need assistance from the ESM. The “fiscal compact model” – that is, intergovernmental agreement outside the treaty framework – is often referred to as a blueprint for overcoming the reform deadlock in the future.<sup>10</sup>

However, the new intergovernmentalism is not only a default mechanism to solve problems in an ad hoc way in the emergency situation in which the eurozone has found itself in recent years. There is also growing scepticism about the “community method” as the main modus operandi of the EU. Most revealing and relevant in this respect is the shift in thinking of German Chancellor Angela Merkel. In her speech in Bruges in November 2010, she advocated an active role for member states in advancing stronger co-operation in areas in which they have competence. She said that the aim of the “community method” was not to transfer more power to the European level but to carry out those powers which have been already attributed to the EU. In the areas where there was no EU competence, she said, integration can be advanced only by the member states.<sup>11</sup>

The “union method” advocated by Merkel was in part a recognition of the need for quick and decisive steps to tackle the crisis. But it was also an expression of increasing scepticism about the European Commission, which has, as one German official says, “lost its centrality in the German debate”.<sup>12</sup> In the past, Germany exerted its power in the EU through the EU institutions, which, even if they were not always efficient, gave Berlin the legitimacy it needed. However, there is little support left in Germany for the Commission. Merkel recently said in an interview that she saw “no need to transfer even more rights to the Commission in Brussels in the coming years” and that strengthening economic co-ordination was “not the same thing as giving more authority to Brussels”.<sup>13</sup>

Thus Merkel is against a further transfer of power to the EU institutions in key policy areas such as economic policy, fiscal policy, social policy, and tax policy. Instead of “communitarising” them and thus empowering Brussels, she advocates an intergovernmental approach. If Merkel has an original vision of Europe, it is not of a revamped, more powerful Commission and European Parliament but of a parallel structure that would be suited to better co-ordinate the policies of those member states who are willing and able to join.

According to a German journalist who is close to Merkel, it could be a “union next to the EU, a new conglomerate of nation states [...] The countries conclude agreements among themselves and decide how they solve the problems”.<sup>14</sup>

<sup>8</sup> On “technocratic federalism”, see Jürgen Habermas, *Die Verfassung Europas* (Berlin: Suhrkamp Verlag, 2012).

<sup>9</sup> With the exception of the fiscal compact (the role of the European Commission).

<sup>10</sup> The treaty entered into force with the acceptance of only a majority of the member states. It leaves the door open to be included into the EU treaty in the future. For more details, see Nicolai von Ondarza, “Zwischen Integrationskern und Zerfaserung. Folgen und Chancen einer Strategie differenzierter Integration”, SWP-Studie, Berlin, September 2012, available at [http://www.swp-berlin.org/fileadmin/contents/products/studien/2012\\_S20\\_orz.pdf](http://www.swp-berlin.org/fileadmin/contents/products/studien/2012_S20_orz.pdf).

<sup>11</sup> Angela Merkel, speech at the College of Europe in Bruges, 2 November 2010, available at <http://www.bundesregierung.de/Content/DE/Rede/2010/11/2010-11-02-merkel-bruegge.html>.

<sup>12</sup> Unless stated otherwise, quotations are from interviews with the authors.

<sup>13</sup> “Angela Merkel on Europe: We Are All in the Same Boat”, Spiegel Online, 3 June 2013, available at <http://www.spiegel.de/international/europe/spiegel-interview-with-angela-merkel-on-euro-crisis-and-arms-exports-a-903401-2.html>.

<sup>14</sup> Stefan Kornelius, *Angela Merkel. Die Kanzlerin und ihre Welt* (Hamburg: Hoffmann und Campe, 2013), pp. 262–263.

There has also been criticism of the European Commission elsewhere in Europe – and not only in traditionally eurosceptic countries. Hollande recently said it should not “dictate” how France should run its economy.<sup>15</sup> A few weeks later, the Dutch government published a “subsidiarity review” in which it said that “the time of an ‘ever closer union’ in every possible policy area is behind us”.<sup>16</sup> More specifically, “if the Treaties do not give the EU competence in a specific policy area and the Commission thus cannot propose legislation, it should in principle also refrain from issuing non-binding communications or recommendations or taking an activist approach to that policy area in some other way”.<sup>17</sup> The European Commission should refrain from certain initiatives if there “are widely shared objections to EU legislation in the Council” – a demand which, when taken up, would put in question the majority decision-making system in the Council.<sup>18</sup>

In May, in another sign of the lack of sympathy for an empowerment of the European Commission, the European Council decided to uphold the current principle of one commissioner per member state – in other words, to not make use of the possibility of reducing their number and thus streamlining the structure of this institution. As Josef Janning rightly argues, this is a clear sign that the EU member states do not want the Commission to become the EU executive and that the European Council’s agreement “means another, albeit small, step toward a more intergovernmental and less supranational EU”.<sup>19</sup>

This growing scepticism about the EU’s existing institutions and in particular the European Commission will not stop European integration as such. But together with the impossibility of treaty reform, it will necessitate a different form of integration than in the past. It may still lead to “more Europe”, but it will be a different Europe than that imagined by advocates of “ever closer union”. In particular, it may lead to the creation of new eurozone institutions that shadow the European Commission and the European Parliament, and more horizontal, intergovernmental co-operation among the member states. In the last three years since the crisis began, there has been much discussion about the perceived emergence of a “German Europe”. But, at least in institutional terms, the eurozone may more and more resemble the French vision of Europe and its *gouvernement économique*.

The Franco-German paper of 30 May reflects this tendency very well. It shows what a compromise à la “Merkollande” could look like: a fusion of the German insistence on increasing member-state competitiveness (through jointly agreed and co-ordinated structural reforms) and the French sympathy

for intergovernmental structures. The paper envisages stronger co-ordination of economic policies based on common indicators and a “commonly accepted diagnosis” of the current deficiencies. These reforms will “increase competitiveness, growth and employment” and may affect a whole range of new policy areas that have so far not been part of the integration process (labour market, retirement policies, general taxation, unemployment, and social inclusion etc.). Strikingly, this major leap in the economic co-ordination of the member states is not supposed to be paralleled by an increase of the competences of the European Commission (which in the ten-page document is mentioned only three times in rather irrelevant contexts).

Instead, the French and German governments propose “to strengthen the governance of the Euro area after the next European elections” by appointing a full-time president of the Eurogroup (the group of eurozone finance ministers) who can task other eurozone ministers as well by convening more regular eurozone summits. In the past, both Merkel and Schäuble voiced their support for the idea of a super-empowered currency commissioner as a solution to strengthen the European level in eurozone economic governance. Now, they invest more expectations in intergovernmental co-operation. The Eurogroup is emerging as the real economic government and, according to the document, should acquire “wider resources” – new structures, perhaps?

The German idea of “contractual arrangements” – agreements in which EU member states commit to structural reform in exchange for financial support from a new “fiscal capacity” (that is, a eurozone budget) – offers scope for even more intergovernmentalism. Since the system of contractual arrangements will be the core of future eurozone economic governance, the way they are designed is crucial for the functioning of the whole of the EU. In a communication in March 2013 that outlined the concept of contractual arrangements, the European Commission gave itself the central role in the new system.<sup>20</sup> But the Franco-German paper gives the European Commission no such role and says that “Member States and the European level will enter into contractual arrangements. Both sides will be committed to implement the undertakings under these contractual arrangements.”

Given the scepticism about the Commission in Berlin and Paris, it is not inconceivable that “the European level” could mean other institutions – most notably the ESM. As some Berlin officials admit, the ESM, which already administers €700 billion, could easily become the eurozone’s “fiscal capacity” and its emerging organisational structures could help co-ordinate the contractual arrangements. The ESM – an intergovernmental institution not based on the EU treaty – is clearly evolving beyond its role as an institution that bails out struggling eurozone economies. According to the Franco-German paper, the “ESM should play the role of an additional public backstop both through lending facilities to Member States or direct recapitalization” and could be “brought together” with the Single Resolution Mechanism. Thus the ESM would

<sup>15</sup> Bruno Waterfield, “Francois Hollande tells European Commission it can’t ‘dictate’ to France”, the *Daily Telegraph*, 29 May 2013, available at <http://www.telegraph.co.uk/finance/financialcrisis/10088005/Francois-Hollande-tells-European-Commission-it-cant-dictate-to-France.html>.

<sup>16</sup> “NL ‘subsidiarity review’ – explanatory note”, 21 June 2013, available at <http://www.government.nl/documents-and-publications/notes/2013/06/21/nl-subsidiarity-review-explanatory-note.html>.

<sup>17</sup> “Testing European legislation for subsidiarity and proportionality – Dutch list of points for action”, 21 June 2013, available at <http://www.government.nl/documents-and-publications/notes/2013/06/21/testing-european-legislation-for-subsidiarity-and-proportionality-dutch-list-of-points-for-action.html>.

<sup>18</sup> Nikolas Busse, “Europa nur wenn nötig”, *Frankfurter Allgemeine Zeitung*, 4 July 2013.

<sup>19</sup> Josef Janning, “The Making of EU Government”, German Council on Foreign Relations, 17 June 2013, available at <https://ip-journal.dgap.org/en/ip-journal/topics/making-eu-government>.

<sup>20</sup> “Towards a Deep and Genuine Economic and Monetary Union. The introduction of a Convergence and Competitiveness Instrument, Communication from the Commission to the European Parliament and the Council”, Brussels, 20 March 2013, COM(2013) 165 final, available at [http://ec.europa.eu/economy\\_finance/articles/governance/pdf/2039\\_165\\_final\\_en.pdf](http://ec.europa.eu/economy_finance/articles/governance/pdf/2039_165_final_en.pdf).

play a crucial role in both economic union and banking union and become a kind of new European Commission. It would symbolise not only the EU's intergovernmentalism but also its increasing differentiation as the eurozone becomes the centre of the EU.

## Differentiation by default

The question of the relationship of the reformed eurozone with the rest of the EU is the second dimension of the EU's silent revolution. Last year, Europe was haunted by the spectre of the disintegration or splitting of the EU with the eurozone forming an exclusive club. But this fear has not become a reality – in part because, even as they sought to improve the institutional and economic performance of the EMU, most eurozone countries tried to keep other EU member states as involved in the new institutions as possible. There is very little appetite for a durable split between the eurozone and the rest of the EU. The negotiations around the fiscal compact and the Single Supervisory Mechanism (SSM) clearly showed that any attempts, whether intended or by default, to exclude a part of the EU from common new initiatives could lead to political tensions.

To be sure, new forms of co-operation and new institutions have emerged and integration has become more flexible since the crisis began. In particular, there are now various groups and circles based on different legal bases such as intergovernmentalism in the case of the fiscal compact and the Euro Plus Pact and enhanced co-operation in the case of the FTT. However, no exclusive core has been established and the principle of openness has been generally preserved – not least on the insistence of some EU member states such as Poland which are worried about the likely emergence of a multi-tier Europe as a permanent model.

However, one lesson of the crisis is that it is not only big political projects but also incremental changes that can have long-lasting effects both on institutional dynamics within the EU and national debates in EU member states. A prolonged differentiation or fragmentation of the EU is still possible. In fact differentiated integration has already divided the EU into at least three groups (eurozone, “pre-ins”, and “outs”) and will most probably be deepened – even though most national capitals are opposed to the idea. In other words, what is emerging is differentiation by default rather than by political purpose.

With Latvia and possibly Lithuania joining the eurozone in the coming years, the principle of openness and inclusivity of monetary union seems so far to have been preserved. However, as important as it is for those countries to join the single currency, their accession will not have a major impact on the political and institutional dynamics of the EU. These dynamics are largely determined by the tendency towards a stronger institutionalisation of the eurozone, which is becoming the real centre of power in the EU, as well as by the positions and interests of two major political players outside the EMU

– Poland and the UK. The question for the EU is to what extent the eurozone is able and willing to accommodate the interests and expectations of London and Warsaw. In other words, the eurozone will face two “tests” in the near future.

The “Polish test” is to how to enable a “pre-in” to join a more integrated eurozone as soon as possible. Poland wants above all to be at the heart of EU decision-making and has the potential to shape the EU agenda more than any other of the “outs” or “pre-ins”. If Poland – and also Bulgaria, the Czech Republic, Croatia, Hungary, and Romania – remained outside the single currency for a long time, the fault line that existed in Europe before the enlargement of 2004 would in effect re-emerge.

The “British test” is different: how to keep the country in the EU without risking opening a Pandora's box while renegotiating the terms of British membership. Clearly, British expectations run in exactly the opposite direction to those expressed by Warsaw: while Poland does not question the need for the eurozone to be more integrated but wants to “keep the foot in the door” to join the EMU at a later stage, the UK wants to withdraw from part of the integration process, block some steps undertaken by the eurozone such as the FTT, and use other steps as leverage of its renegotiation position. Most probably it will be extremely difficult to meet the demands of both Poland and the UK.

Of course, whether and how the EU passes the Polish and British “tests” will be decided not only by the eurozone but also by the choices of the two countries themselves. Those choices will in turn be influenced by developments within the eurozone. All in all, the differentiation in EU integration – not only in the strictly legalistic sense but also in the broader political one – will be largely dependent on the three factors mentioned above: the transformation of the eurozone itself; Poland's euro accession; and the prospects of “Brexit”. The developments of recent months suggest that, in at least the medium term, there is likely to be a deepening of differentiation rather than a levelling down of divisions.

The recent Franco-German compromise suggests a stronger institutionalisation of the eurozone than might have been expected in recent months. Germany signalled many times that it was not interested in leaving the “pre-ins” (especially Poland) behind by creating new, exclusive eurozone institutions. The Hollande administration is also perceived to be much more sympathetic to the desire of the “pre-ins” to preserve a seat at the table despite remaining outside the eurozone. However, with Germany's position shifting towards intergovernmentalism and pragmatism in strengthening the eurozone, a multi-tier Europe is becoming more and more likely. The Franco-German paper includes provisions that have been long opposed by countries such as Poland: regular euro area summits, a eurozone president, and structures within the European Parliament dedicated specifically to the euro area.

Moreover, a eurozone with a “political dimension”, as Hollande has put it, that loosens its ties with the institutions of the whole EU, could be equipped with a separate budget that would support the co-ordination of member states' economic policies

and structural reforms. Such a “fiscal capacity” is supposed to be an integral part of the proposed system of “contractual arrangements”. Although the Franco-German paper states that “non euro area member states are invited to participate [in contractual arrangements] on a voluntary basis”, it is much less clear on their access to the new financial resources. In fact, it envisages the “creation of a specific fund for the Euro area” and leaves open the question of whether and how euro “outs” willing to sign the contracts could take advantage of this “specific fund”. In sum, the pragmatic, step-by-step, and largely intergovernmental institutional upgrade of the eurozone could result in new fault lines that separate the eurozone from even those countries willing to join it in the future.

In fact, the hurdles for the accession to the eurozone have already risen. There is now a widely held opinion that, in future, fulfilling the Maastricht criteria will no longer be sufficient to join the euro. “The fulfilment of the parameters enclosed into the Euro Plus Pact will certainly be an important measure of the eurozone candidate countries’ economic performance on which the accession to the EMU will depend”, says a leading Polish expert. The Euro Plus Pact, which was designed to increase the competitiveness of the EU member states’ economies, aims to strengthen the “sustainability of pensions, health care and social benefits” as well as implementing “national fiscal rules”. It introduces quantitative measures of long-term and youth unemployment rates and labour participation rates. It makes recommendations to member states about how they should achieve these goals, for example by “limiting early retirement” or implementing “schemes and using targeted incentives to employ older workers”. Even more importantly, it expects the countries to pass “national legislation” on “private debt for banks, households and non-financial firms” if they exceed certain benchmark levels. Although this co-ordination of the economic policies of the EU member states is not part of the *acquis*, there is little doubt that economic performance, as defined by these measures, will be taken into consideration while considering applications to join the eurozone.

This is why the ongoing debate on the contractual arrangements is so important for the “pre-ins”. As the main pillar of the new economic union that is being created, they could be either an instrument of de facto exclusion or a tool that would enable the “pre-ins” to better prepare for accession to the eurozone. How they are designed will therefore be crucial. They could equal an “associated membership” by helping (through financial and non-financial incentives) the candidate countries carry out structural reform which could prevent them from experiencing the disastrous “Spanish scenario” of rising wages and insufficient competitiveness following accession to the eurozone. On the other hand, an exclusion of the “pre-ins” from this instrument could further open the gap between the euro area and the rest of the EU, which would accelerate differentiation by default. “Pre-ins” will also have to join the ESM, which will involve considerable costs. In short, there is a growing perception that the euro is becoming a “moving target”.

The emerging banking union also adds to this picture. It could lead to what Polish MEP Danuta Hübner has called a “radical division” in Europe as member states within it have greater credibility with financial markets.<sup>21</sup> Moreover, the decisions taken within a banking union would necessarily impact upon the banking systems of the non-euro states. The SSM will result in the centralisation of the management of liquidity and capital at the level of big financial groups. It could have negative consequences for those countries such as Poland that have a large share of banks that are owned by foreign capital.<sup>22</sup> This is why the relationship between host and home country in the new banking union is crucial for the stability of the financial sector of those member states.

The proposals of the European Commission for a banking resolution do not live up to Polish expectations as they do not grant the “host” countries equal voting rights in the process of winding up banks in “home” countries.<sup>23</sup> On the other hand, accession to the banking union for non-euro member states is a risky undertaking as well. Poland has a very good bank supervision system at the national level and in the case of accession would need to replace it with less efficient mechanisms. Besides, banking union will also involve financial transfers, and countries such as Poland that have sound banking systems could be asked to make a disproportionate contribution to the system. Thus, despite its European ambitions, the Polish government is very cautious while making commitments to join the banking union and the national-conservative opposition rejects the idea.

Given the importance of the banking union for the future shape of the EU – it has the potential to both stabilise the European economic and financial structures and create new fault lines – Poland’s dilemmas illustrate the possible “differentiation by default” that is emerging. Poland is widely expected to join the eurozone soon and its accession would increase the viability and credibility of the monetary union. For example, Alexander Stubb, Finnish Minister for European Affairs, said he was encouraged by Latvian and Lithuanian plans to join the eurozone and had no doubt that Poland would also join soon.<sup>24</sup> In fact, this is too optimistic. Even those in the Polish administration who advocate accession as soon as possible expect it to be a much longer and bumpier ride than many in Europe imagine. It is the distance between Poland and the eurozone – not the prospect of immediate accession – that determines Poland’s current interests and choices.

The changes in eurozone governance since the crisis began and the emergence of a multi-tier Europe strengthen those in the “pre-ins” who oppose euro accession and deeper integration. Poland’s Law and Justice party (PiS) refers to Cameron and Britain’s strategy as a blueprint for a sovereign European policy. The party proposes a renegotiation of the relationship – not

<sup>21</sup> Josef Janning, “The Making of EU Government”, German Council on Foreign Relations, 17 June 2013, available at <https://ip-journal.dgap.org/en/ip-journal/topics/making-eu-government>.

<sup>22</sup> Zofia Szpringer, Unia bankowa, *Infos*, nr 8 (145), Biuro Analiz Sejmowych, 18 April 2013, available at [http://orka.sejm.gov.pl/WydBAS.nsf/o/5990455F3B1C85A6C1257B4F00495720/\\$file/Infos\\_145.pdf](http://orka.sejm.gov.pl/WydBAS.nsf/o/5990455F3B1C85A6C1257B4F00495720/$file/Infos_145.pdf).

<sup>23</sup> “Hiszpania i Polska zgodne ws. unii bankowej, ale nie ws. klimatu”, *Forbes*, 15 July 2013, available at <http://www.forbes.pl/hiszpania-i-polska-zgodne-ws-unii-bankowej-ale-nie-ws-klimatu,artykuly,158137,1,1.html>.

<sup>24</sup> Alexander Stubb, “Upstairs, Downstairs and the European Union”, speech at the College of Europe, Natolin, Poland, 5 February 2013, available at <http://valtioneuvosto.fi/ajankohtaista/puheet/puhe/fi.jsp?oid=376909>.

between Poland and the EU but between the eurozone and the rest of the EU – to prevent any further reforms in the eurozone that will weaken the position of the “pre-ins” and “outs”.<sup>25</sup> Even more importantly, PiS argues that the commitment Poland made in the accession treaty to adopt the common currency is not valid anymore because the eurozone has changed so much.

PiS argues that, instead of pursuing the goal of accession, the Polish government should call a referendum on the euro to give citizens an opportunity of revising or confirming a choice they made under different circumstances. Given the strength of the party, which is currently leading in the polls, these positions are politically highly relevant. A further obstacle is that Poland would also have to change its constitution to join the euro. Because of the public mood – only one in four Poles supports the adoption of the euro – and the rising power of the eurosceptics, it will be difficult to achieve the necessary two-thirds majority. These developments – increasing euroscepticism at the national level and the way that the eurozone is pragmatically “going its own way” – could mutually reinforce each other and postpone Polish eurozone membership until an undefined future.<sup>26</sup>

Finally, the strategy of avoiding treaty change will probably further alienate the UK. Treaty reform would give the UK leverage to renegotiate the terms of its membership of the EU – which is partly why the appetite for such an exercise is decreasing among other EU member states. But without treaty change, it is unclear how British expectations of a renegotiation could be met so that pro-Europeans could campaign in an in/out referendum for the UK to remain in the EU.<sup>27</sup> Even if the “European debate is moving in favour of the British argument for competitiveness over solidarity, the free market over intervention, at least in some countries in the EU”, it may not be enough to convince British citizens to vote to stay in the EU.<sup>28</sup>

## Conclusion

The current steps in European integration are following a different pattern and have a different quality than developments in the past. The deepening of integration is taking place in the core area of EU co-operation – that is, in the realm of economic and monetary policy and among those countries that have already adopted the euro and/or are willing and able to do it in the near future. It will therefore strongly impact on the whole integration process, the functioning of the single market, and on all those countries staying outside. Thus, this is not a new phase of “differentiated integration” but an entirely new phenomenon that requires institutional and political adjustments from all actors of EU politics. It is clearly necessary to strengthen the eurozone and the fate of the EU may depend on how quickly it can be achieved. But it may lead to a two- or three-tier Europe – albeit by default rather than by political purpose.

The danger is that, by relying primarily upon intergovernmentalism, member states may weaken the

EU institutions. If the new European Parliament is more eurosceptic, as many expect, and the newly elected European Commission is incompatible with the expectations of the larger member states, it could further strengthen the tendency towards intergovernmentalism. Both aspects of the EU’s silent revolution – the intergovernmental turn and the further differentiation – influence each other. The UK’s strategy of renegotiation of the terms of the relationship reduces the appetite elsewhere for treaty change. But the deepening of integration outside the treaty framework makes the creation of new executive and parliamentary institutions shadowing the existing ones much more likely. Such a reinvention of the EU, or the formation of a “union within the union”, would broaden the gap between the core and the outer tier(s).

Intergovernmentalism and differentiation also raise questions about democratic legitimacy in the EU. For example, if member states are required to commit through contractual arrangements to undertake structural reforms in exchange for financial support, who decides on the reforms? The imposition of reforms by Brussels would strengthen “technocratic federalism”. If, on the other hand, they were designed by national governments but a new government would be bound by them, it would limit the space for political discretion and thus violate democratic rules even more than in the current system. The deeper integration of the eurozone also raises questions about how to secure democratic accountability and public scrutiny of policies there by using institutions designed for the whole EU. Should the whole European Parliament perform tasks also in the areas which do not affect all EU member states? Building new parliamentary structures for the eurozone may be the only solution – with far-reaching consequences for the whole institutional structure of the EU.<sup>29</sup>

Given the lack of public support for further transfers of power to Brussels and in the face of institutional deadlock, the EU’s silent revolution may be the only way forward for Europe at the moment. However, while the new intergovernmentalism and differentiation by default solve some problems, they also create new ones and exacerbate old ones – most notably the democratic deficit and the crumbling unity of the EU. Compared to the two years before, there has been little debate during the last 12 months about Europe’s institutional reinvention. But this quiet period is about to come to an end. Between the German elections in September 2013 and the European Parliament election in May 2014, Europeans will be reminded that the issues thrown up by the euro crisis are still on the table.

<sup>26</sup> Polish Finance Minister Jacek Rostowski said in July 2013 that Poland “may join the Eurozone in 10 years or maybe a bit earlier”. See “Euro w Polsce za niecałe 10 lat?”, *EurActiv*, 22 July 2013, available at <http://www.euractiv.pl/gospodarka/artykul/euro-w-polsce-za-niecale-10-lat-004883>.

<sup>27</sup> For possible options, see Nicolai von Ondarza, “Rote Linien und eine ausgestreckte Hand”, SWP-Aktuell, February 2013, available at <http://www.swp-berlin.org/de/publikationen/swp-aktuell-de/swp-aktuell-detail/article/eu-doppelstrategie-fuer-den-umgang-mit-grossbritannien.html>.

<sup>28</sup> Nicholas Walton, “The local politics of #letbritaindecide”, *Whose World Order?* blog, European Council on Foreign Relations, 5 July 2013, available at [http://www.ecfr.eu/blog/entry/the\\_local\\_politics\\_of\\_letbritaindecide](http://www.ecfr.eu/blog/entry/the_local_politics_of_letbritaindecide).

<sup>29</sup> For more on this issue, see Josef Janning, “European Democracy and Variable Geometry. How multi-speed Europe complicates the Union’s democratic legitimacy”, German Council on Foreign Relations, 3 June 2013, available at <https://ip-journal.dgap.org/en/ip-journal/topics/european-democracy-and-variable-geometry>.

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## Acknowledgements

This paper benefitted from exchanges with a number of colleagues. In particular, I would like to thank Ulrike Guérot, who helped set up the structure of the paper and was an invaluable partner while discussing its core arguments. The same is true for José Ignacio Torreblanca, who carefully read and commented on the earlier drafts. Discussions with Josef Janning, Kai-Olaf Lang, Nicolai von Ondarza, Aleksander Smolar, Jan Barcz, and Sebastian Dullien, as well as with diplomats in Berlin and Warsaw, were extremely inspiring and helpful for shaping the arguments. Mark Leonard and Hans Kundnani genuinely supported the work on the paper, and Hans made it sound like proper English. I appreciate their contribution very much. However, as ever, the responsibility for arguments and conclusions rests solely with the author.

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ISBN: 978-1-906538-87-3

Published by the European Council on Foreign Relations (ECFR),  
35 Old Queen Street, London,  
SW1H 9JA, United Kingdom

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