

EUROPE AT A CROSSROADS: MOVING BEYOND CONSTRUCTIVE AMBIGUITY

The text that follows is an English adaptation of the working paper on the future of the European project and France's role in it. You can read the original on the "2017/2027" French-language website [here](#).

That the EU is at a crucial moment in its history there is little doubt. Not only is its single currency shaken, it is confronted with growing instability at its periphery. What's more, its economic and social integration is at a standstill, and it faces a crisis of legitimacy.

All of these difficulties run deep and cast doubt on the viability of the European project and its common policies and institutions, built up successively over seven decades.

While they have been brought to the fore by an economic crisis of global reach, their roots lie in the uncertainty and disagreement as to how to move the European project forward.

Like their fellow Europeans, the majority of French people seem decided against the EU moving towards more integration. At the same time, they are equally opposed to rolling back progress made or accepting the unsatisfactory status quo.

Given this apparent paradox, a new balance has to be struck between integration when the collective interest calls for it, respecting national sovereignty where it should prevail and ensuring more effective institutions where they are deficient.

France's partners are currently outlining their way forward in the EU. So too must France, looking beyond its ambiguities to put forth a coherent project.

The 2017 presidential election provides French citizens the occasion to collectively choose the future they want for their country in Europe. What they decide will have a significant impact on the future of the European project itself.

1 NATIONAL ATTITUDES TOWARDS THE EUROPEAN UNION

	EU does not understand the needs of its citizens	EU is intrusive	EU is inefficient	EU promotes peace	EU is a world power	EU promotes prosperity
<i>Greece</i>	85%	86%	67%	70%	59%	30%
<i>Italy</i>	77%	63%	57%	64%	41%	31%
<i>France</i>	69%	54%	50%	70%	59%	42%
<i>Spain</i>	65%	68%	63%	65%	57%	53%
<i>United Kingdom</i>	64%	60%	64%	67%	43%	53%
<i>Germany</i>	53%	64%	43%	84%	39%	47%
<i>Poland</i>	49%	58%	30%	76%	51%	66%
Median	65%	63%	57%	70%	51%	47%

SOURCE: PEW Research Center, 2014

MAY 2016

FRANCE WILL FACE IMPORTANT CHALLENGES WHEN IT GOES TO THE POLLS IN 2017 TO ELECT ITS NEXT PRESIDENT. TO BOTH FOSTER AND INFORM DEBATE AMONG CITIZENS IN THE MONTHS LEADING UP TO THE ELECTIONS, FRANCE STRATÉGIE HAS LAUNCHED ITS "2017/2027" PROJECT. IT AIMS TO ZERO IN ON WHAT IS LIKELY TO SHAPE POLICY OVER THE NEXT DECADE BY PUBLISHING A SERIES OF WORKING PAPERS ON TWELVE ISSUES VITAL TO THE FUTURE OF THE COUNTRY. MEMBERS OF THE PUBLIC WILL BE ABLE TO SUBMIT WRITTEN REACTIONS ONLINE. A DEBATE WITH THE AUTHOR(S) AND OTHER EXPERTS WILL THEN BE ORGANIZED FOR EACH ISSUE ON THE BASIS OF THE WORKING PAPER AND THE SUBMISSIONS.

FOUR FUNDAMENTAL ISSUES

Europe today faces four pressing issues: the future of the eurozone, stalled economic and social integration, instability at its periphery and a crisis of legitimacy.

THE FUTURE OF THE EURO

The French and the citizens of 18 other European countries have shared a single currency for 15 years. It was designed to foster economic integration, ensure monetary stability, enable Europe to project its economic influence and create a shared prosperity by generating growth, purchasing power and jobs.

But since 2009 the euro has been unable to achieve these goals. Per capita income in the area as a whole has still not made it back to 2008 levels, while differences in unemployment rates have reverted to what they were prior to the euro (Graph 1), and per capita income disparities have grown (Graph 2). To be sure, the global financial crisis has played a role in this. But in the end, the euro's scorecard 15 years after its introduction is disappointing to say the least.

This predicament is as much a result of old economic policies as it is recent ones – all a reflection of the unfinished nature of the European monetary project and the degree to which the different members diverge from its guiding principles.

The euro was built on a narrow foundation: a comprehensive monetary union buttressed by fiscal discipline but without a banking and financial union, a crisis management regime, a governance and coordination mechanism and specific political institutions. What's more, it was built against the backdrop of diminishing returns to further economic integration in the EU.

Such an inchoate project could only succeed if it were conceived as a base to be built on progressively. But the political appetite, the awareness of the hazards and the decision-making capability were all lacking following the euro's launch in 1999. As opposed to what the architects of the currency believed, it didn't lead to a convergence in social, fiscal and political realms, but rather member states were set on preventing the EU from encroaching on what policy prerogatives they hadn't relinquished.

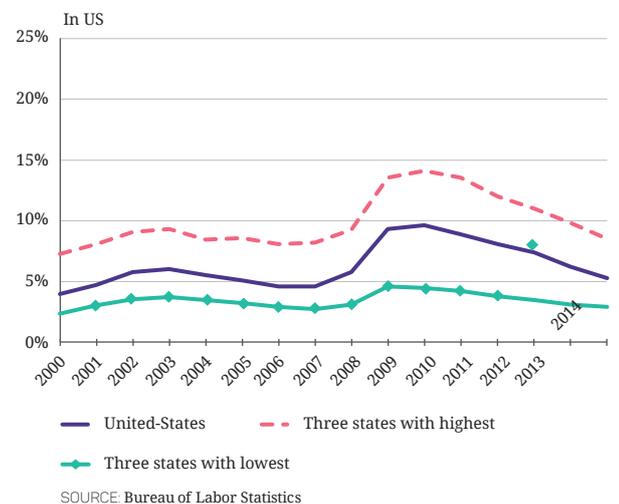
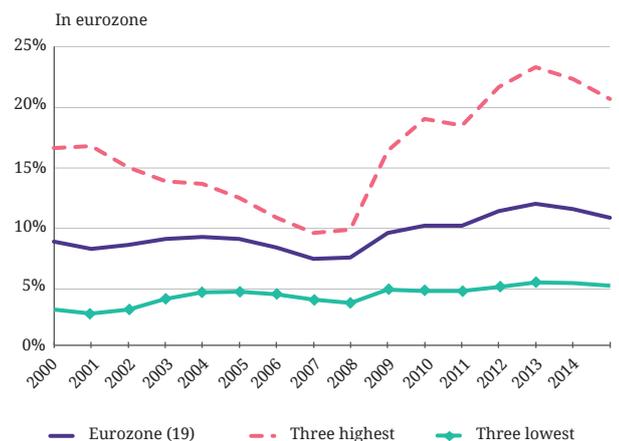
This resulted in several failings, whose cost began to become apparent by 2010:

- Prior to the crisis, financial supervision failed to react to the sharp drop in interest rates triggered by the introduction of the euro, which led to excessive growth of credit and a real-estate bubble in several countries.
- Economic integration came to a standstill, and national policies carried out over the first decade were not in line with the requirements of belonging to a monetary union. Moreover, no mechanism was put in place to forestall divergence in cost competitiveness or encourage member states to institute policies to favour long-term growth.

A lack of foresight and outright disagreement led to a series of costly errors in managing the financial crisis and the 2010-2012 eurozone crisis:

- Brussels and member states took too long to clean up banks' balance sheets.
- Policy responses to tension in bond markets have often been characterized by too little, too late. Though the liquidity policy of the European Central Bank (ECB) was reactive, member states more often than not played for time when faced with the choice of helping a country attacked by speculation and shoring up the systemic weaknesses of the monetary edifice.
- Authorities tightened fiscal policy too early and too indiscriminately between 2011 and 2013, pushing the eurozone into a second recession^[1], while monetary policy was slow to react to bolster the weakened economy^[2].
- The systemic character of the euro crisis was only acknowledged in 2012.

1 UNEMPLOYMENT RATES



1. Aviat A. et al. (2016), "Vers un meilleur pilotage de l'orientation budgétaire de la zone euro ?" (Towards Better Management of Fiscal Policy in the eurozone?), *Trésor Eco*.

2. Mody A. et al. (2015), "The European Central Bank: Building a Shelter in a Storm".

It took the 2010-2012 crisis for eurozone member states to take urgent collective action. They established the European Stability Mechanism (ESM) to assist eurozone countries in financial difficulty.

The EU also created a banking union, which essentially grants the ECB the role of supervising the largest eurozone banks and reinforces resolution mechanisms in the event of difficulty.

Eurozone countries also reformed in 2011 the Stability and Growth Pact (SGP), which ensures fiscal monitoring of EU members. They did so with six regulations – known as the Six-Pack – aimed at strengthening the procedures to reduce public deficits and redress macroeconomic imbalances such as high current account deficits and housing bubbles.

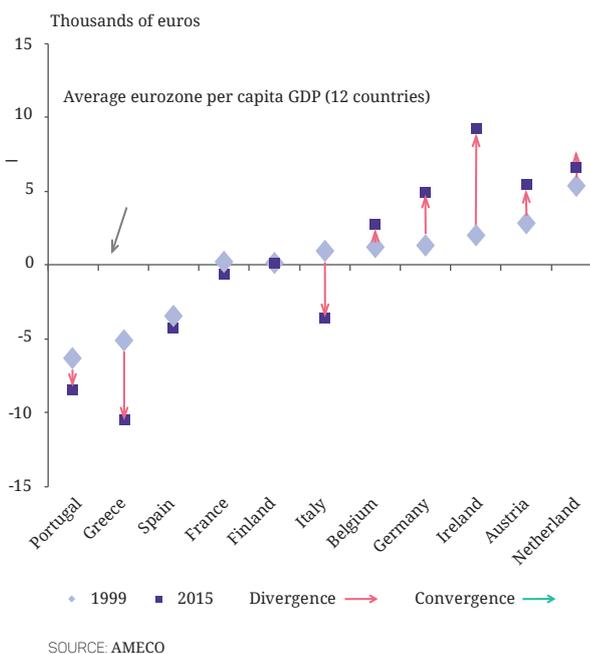
The EU added to this in 2012 with the Treaty on Stability, Coordination and Governance. Its central requirement is that member states transpose a “balanced budget rule” into domestic law, preferably at a constitutional level.

Lastly, it adopted two further regulations in 2013 – the Two-Pack – to complement the Six-Pack. They require eurozone members to submit their draft budgets to the European Commission prior to adoption by national parliaments. Moreover, it obliges members to ensure independent bodies are in place to monitor compliance with national fiscal rules.

If the eurozone had been equipped with these mechanisms and institutions when the euro was introduced, the crisis would not have been as harsh. That said, it has yet to resolve certain difficulties that are still a hindrance:

- The growth potential and resilience of member states’ economies remain insufficient.
- In the short-term, despite the ECB’s loose monetary policy of low – and even negative – interest rates and its asset purchase programme, demand and hence inflation remain low. The zone finds itself in a situation where it would have limited room to manoeuvre if it were exposed to a substantial new shock.
- From a structural point of view, the euro area still hasn’t managed to create a framework conducive to the orderly unwinding of macroeconomic imbalances (e.g. current account deficits and surpluses) and the convergence of living standards. On the contrary, imbalances have simply shifted: countries with trade deficits, for example, have seen them disappear, while those with surpluses like Germany have seen them continue to grow. This has increased the risk of deflation and held back the recovery.
- From an institutional point of view, the euro area’s ability to provide a collective and timely solution to problems is hampered by its weak executive governance. Moreover, there is a lack of an institution perceived as having sufficient democratic legitimacy and able to ensure the common good prevails over national interests.

2 DIVERGENCE OF EUROZONE PER CAPITA INCOME



STALLED ECONOMIC AND SOCIAL INTEGRATION

While integration grew in leaps and bounds from the 1980s till the turn of the century, over the past fifteen years Europe has struggled to define a project capable of meeting the challenges its economies and societies face.

The single market in search of a second wind

As the European project’s main achievement, the aim of the single market was to continue the dismantling of trade obstacles and enable companies to obtain economies of scale.

Combined with competition policy, a monetary union, a set of fundamental social rights and regional development policies, the single market was intended to ensure efficiency, growth and fairness.

The elimination of most commercial barriers and the relative harmonization of products’ standards has led to strong growth in intra-European trade and substantial economic gains.

However, the EU has failed to set forth a model of integration for 21st century industries. In many service sectors, member states have preferred for their markets to be organized on a national basis (e.g. telecoms and IT), whereas in others, such as energy, liberalization has not been implemented fully and has not lived up to expectations.

Eliminating barriers to trade is no longer enough. The challenge for many sectors lies in developing a model based on uniform legislation and regulation, as has been the case in the banking sector. But this implies agreeing on key parameters, such as how personal data is protected and the conditions in which data are exchanged in the digital economy.

Improving the quality and intensity of financing is an essential factor in fostering the development of an integrated capital market in Europe, in particular for capital investments.

Lastly, the tools for regional development must be re-considered in light of the flaws and misuse of the EU's structural funds and the role of urban areas as drivers of growth.

Rudderless social and fiscal integration

The EU set itself the goal of a high level of social protection, mostly leaving it up to member states to define their policies and the tools to implement them at the national level. This balance has been called into question for the following reasons:

- National social systems have been weakened by economic conditions and scarce budget resources.
- The diversity of social models and the common desire to protect it means that apart from the Youth Employment Initiative and the move to create a so-called pillar of social rights, there has been a lack of collective action in recent years to further social progress.
- Against the backdrop of increasing inequality, doctrinal differences and fiscal competition strategies among member states have made the EU a laggard in eliminating tax-evasion practices and the use of offshore havens.

In several member states the EU is seen as bent on deregulation, whereas paradoxically the opposite perception prevails in the UK (witness the Brexit debate).

The lack of coordination of tax policies is costly, as the Luxembourg leaks financial scandal demonstrated in 2014. A race to the bottom when it comes to personal income taxation, wages and the regulatory environment is a real risk over the next decade.

AN UNSTABLE PERIPHERY

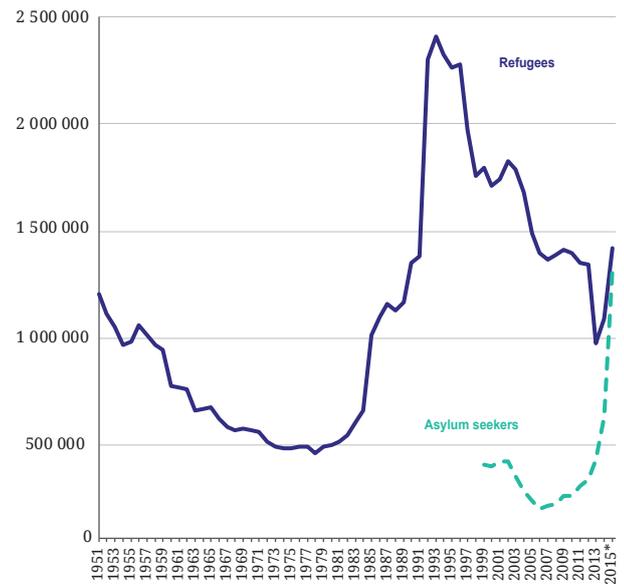
The refugee crisis is the greatest human tragedy the EU has faced in its history. At the same time, it has been struck at its very core by terrorists operating with external support. The common denominator is a highly unstable European periphery.

A disorganized and insufficient response to the refugee crisis

The second large wave of refugees to reach Europe's shores in the past 30 years has highlighted the lack of a coordinated European policy for migrants and border control.

The resulting humanitarian crisis represents both a failure in terms of human rights and in terms of border control. It has also exposed fault lines with the Union and within member states themselves. Moreover, it has led citizens to turn to the nation state, seen as the ultimate protector of people and their territory. But individual countries are caught short-handed, and their border policies have an immediate and significant effect on their neighbours.

4 REFUGEES AND ASYLUM SEEKERS IN THE EU FROM 1951-2015*



NOTE: Number of people residing in the EU having official refugee status in a given year. Asylum seeker represents the number of people recently arrived in the EU whose request for refugee status is pending.

SOURCE: The UN Refugee Agency (*the 2015 figures are a France Strategie estimate).

The necessity of a coordinated response is even more pressing given the US' strategic "pivot to Asia" doctrine and the likelihood of its gradual disengagement from Europe and its periphery over the next decade.

Europe, however, appears ill-prepared to deal with instability in neighbouring countries for the simple reason that the European project was conceived to guarantee peace within its borders – not without.

Since the fall of the Berlin Wall, the only policy regarding neighbouring countries the EU has been able to carry out with any success has been with respect to its own enlargement. The promise of joining the EU played a key role in the transition of countries in eastern and central Europe, but this model has mostly run its course.

This reflects the lack of an alternative to enlargement in the form of a sufficiently robust policy to stabilize the EU's periphery and anchor it in a partnership based on trust. Indeed, European member states are still unable to effectively accompany countries having gone through military interventions or democratic uprisings towards their economic and political reconstruction.

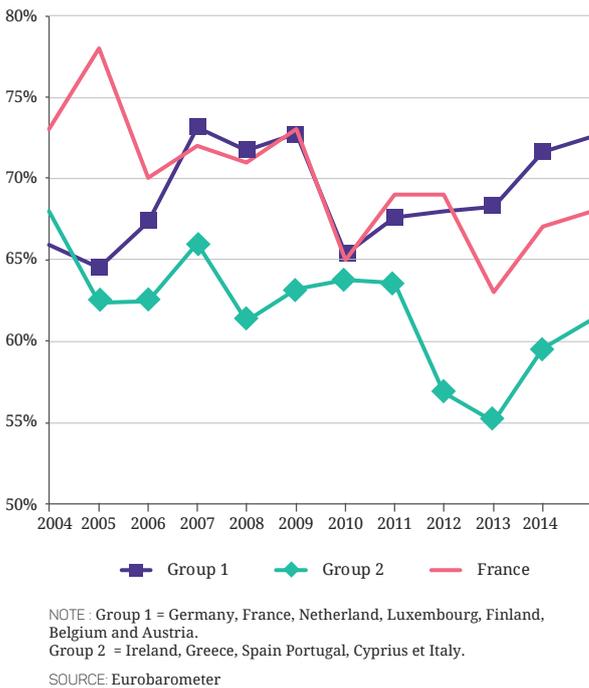
Despite the fact that a majority of European citizens are in favour of them, common defence and security policies remain remarkably absent, and Europe is weaker than ever in these areas. Defence spending relative to GDP has been decreasing continually in almost all member states over the past 30 years, with a minority of countries – such as France – contributing the lion's share. In 23 out of 28 member states, spending is less than the goal of 2% of GDP set by NATO as a minimum. If all EU countries were to abide by it, total defence spending would increase from €187 billion to €265 billion

A CRISIS OF LEGITIMACY

Against moving forward, backward or accepting the status quo

Despite the serious difficulties with which they are confronted, a majority of citizens across Europe continue to express support for the European Union (Graph 4a). Following a dip in the wake of the economic crisis, this sentiment has been on the rise since 2011. What's more, a majority of the population in eurozone countries back the single currency – even in countries that have borne the brunt of the crisis (Graph 4b).

4a RATE OF SUPPORT FOR THE EURO



4b SENSE OF BELONGING TO THE EU



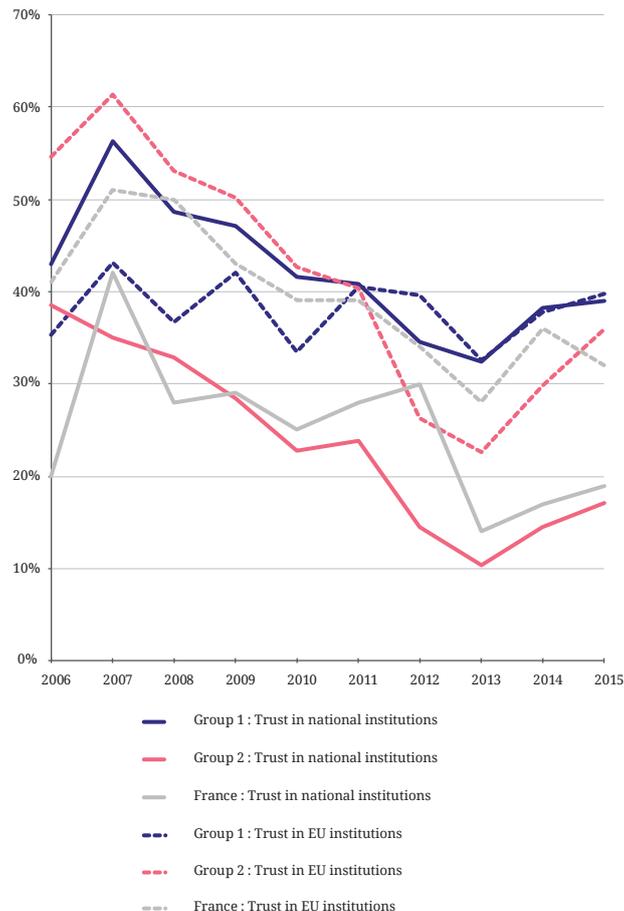
Nevertheless, trust in EU institutions has been seriously dented in many countries (Graph 5). Not surprisingly, it is lowest where the economic crisis has been the harshest. It should be noted, however, that citizens' distrust in their own national institutions is even higher, again, especially in countries hit hardest by the crisis. But as the US presidential primaries have shown, Europe is far from alone in this.

The refugee crisis has compounded this, exposing fault lines between member states and the difficulty of acting in solidarity in the face of adversity, the very principles on which Europe was rebuilt. Europe today is split by rifts both within and between member countries.

The paradox is that while a majority of Europeans are both against handing more power to Brussels and their country leaving the EU, they are also unsatisfied with the status quo. This foretells the end of the strategy championed by Jean Monnet, that of integration by "small steps", each one building on the previous one.

Two conclusions can be drawn: one, Europe is at a strategic impasse, at least temporarily; or two, EU leaders must change their approach and present citizens with coherent and comprehensive alternatives to choose from.

5 TRUST IN NATIONAL AND EU INSTITUTIONS



Inefficient and faltering institutions

EU citizens feel their institutions have not lived up to their promises of prosperity and have not been able to address the gravest problems they have been confronted with (Table 1). Moreover, they don't understand the democratic decision-making process and are in the dark as to who is ultimately responsible for the decisions made. The exclusion of the European Parliament from decisions regarding the eurozone – and in particular the most consequential ones during the Greek debt crisis – has only added to this perceived lack of legitimacy. Certain member states also contest the legitimacy of EU institutions proposing solutions to problems not covered by common policy, as is the case with the refugee crisis. The entire European institutional system has been called into question.

Yet many of the decisions on matters such as tax and social policy that have been heavily criticized are made either under the unanimity rule or using the intergovernmental method, with both the Parliament and the Commission playing no role at all or only a minor one.

All of which is to say there is a high probability today of one of the major founding members voting in an anti-European government over the next decade. In such an event, the European institutional system would quickly be exposed to a shutdown.

In short, the status quo cannot be an option for a way forward.

WHAT PROPOSALS COULD FRANCE PUT FORTH ON THE FUTURE OF EUROPE?

As mentioned, the 2017 presidential election presents the French electorate with the opportunity to choose the direction they wish their country to take with regard to Europe. That said, positions on the EU within the country run the gamut from clawing back sovereignty to moving further towards federalism.

The ruling parties tend to avoid delving into the issues in depth and making hard choices – even during presidential campaigns – given that rifts exist within their own ranks. This time, however, the stakes are too high. Due attention must be accorded to the future of Europe in order to prepare the choices and proposals France will have to make.

WHAT ARE SOME POSSIBLE PATHS FOR THE EUROZONE?

Should the monetary union be disbanded?

Is it worth keeping the single currency? With the UK vote on Brexit looming and the controversies in several countries surrounding the management of the euro, this question can no longer be brushed aside. Three points need to be kept in mind when answering it.

First, nothing guarantees irreversibility. A return to fixed but adjustable exchange rates would not be compatible with the free movement of capital, but reverting to floating exchange rates could be a possibility.

Second, the price of dissolving the union would be without question high. In addition to the direct costs of financial disruption, uncertainty and the inevitable acrimonious splintering of Europe would deal a blow to member countries' economies.

Third, as all countries that have experienced balance of payments crises know, monetary sovereignty also comes with weighty obligations and financial constraints.

No fixed cost justifies perpetuating a sub-par system. For this reason, the answer to the question of the EU's future cannot be the status quo. The main parties must find common ground in a positive project that can drive collective prosperity.

Today, there are three hurdles to realizing this: tenacious disagreement regarding the origins of the crisis and the responsibility of each member state in the union's poor performance; striking a balance between individual responsibility and collective solidarity; and defining an efficient and legitimate system of economic governance.

HOW CAN NATIONAL SUPPLY-SIDE POLICIES AND JOINT MANAGEMENT OF DEMAND BE RECONCILED?

The eurozone's recent history shows the extent to which events and member's responsibilities can be read and interpreted radically differently from one country to the next. Some see inappropriate national policies as hindering the eurozone. For others, the absence of common policy tools and a lack of coordination are the problem.

It is true that an efficient monetary union requires dynamic and resilient economies. It is also true that monetary policy alone cannot be relied on to manage demand – all the more so when inflation is low.

Moreover, although an economy's competitiveness constitutes a sign of robustness, in a monetary union the external effects of national policies must be monitored, especially when adjustments are costly.

All member states – including France – must be able to commit in order to reconcile these imperatives. There must also be effective coordination tools: should competitiveness committees be created to close price and wage gaps? Should there be a more binding budgetary coordination for the eurozone? Should member states go further and create joint institutions and mechanisms?

How can a balance between individual responsibility and collective solidarity be struck?

The tension between member states' responsibility for their indebtedness and the necessity of risk sharing with fellow members is inherent in a monetary union such as the Eurozone.

Some in Germany defend the idea that market discipline should be the rule for public debts – in particular by allowing sovereign debt restructuring – while overall macroeconomic stabilization should be left to the member states themselves.

In France, traditionally, the position is more in favour of creating joint fiscal instruments, fostering solidarity between member states, coupled with rules for coordination. The question is whether a creative compromise can be struck between the two options.

How can the EU's executive governance be reinforced?

Several ideas have been put forth to solve the euro area's executive deficit and strengthen its governance. The current model is one of rules-based coordination, which depends on the ability of countries to reach common goals with national instruments.

The question, now, is whether or not and to what extent this model should evolve. The EU can either create an executive body, capable of defending the common good and overseeing collective action or it can move towards a model of devolution, delegating defined powers in specific areas to the euro area, along the lines of what was done in the banking union.

It is time for France to put forth a set of specific propositions on the economic policies likely to kick-start European growth, basing them on unambiguous courses of action in these three areas.

HOW CAN PRIORITIES FOR INTEGRATION BE REASSESSED?

Citizens and businesses stand to gain from more French involvement at the EU level when it comes to the economy, whether it's IT, fighting climate change, energy, services or capital markets. The question is what are the priorities and what shape should integration take. Should there be uniform law and a sole regulator in certain sectors?

At the same time, certain areas that have traditionally been within the remit of Brussels could be reconsidered simply because the costs of applying the same set of rules to different situations and national preferences outweigh the benefits of integration.

Should, for example, the common agricultural policy be readdressed, moving towards more diverse national policies within the framework of common competition rules?

More generally, the level and structure of EU spending has been rigid for a long time and is no longer in tune with current priorities. Should this be called into question?

What are some social and fiscal initiatives?

France has always supported ambitious positions for European integration in social and fiscal matters. It has tried to make the Union more equitable by proposing a minimum wage and harmonization of corporate tax rates. But despite some openness on the

part of European institutions, other member states have nipped the proposals in the bud.

The question then is what the best strategy to realize these ambitions is. If there is no consensus within the Union on these issues, France could get the ball rolling by proposing further integration to several of its closest partners.

EU social policy must be thoroughly overhauled to take into account the challenges of the coming decade if member states wish to breathe new life into it. This could entail multiplying efforts to work towards a standard for a minimum wage, adapting social protection to the jobs in the on-demand, or gig, economy or supporting the development of workers' skills and mobility.

Lastly, are member states willing to address fiscal competition?

WHAT IS A POSSIBLE MODEL FOR THE EU'S RELATIONS WITH ITS PERIPHERY?

Aside from the short-term necessity of addressing the refugee crisis, the EU has to consider possible paths of action to stabilize its periphery. Because stability and security are a public good, collective action in these areas is warranted.

Specifically, is the EU – or a group of its member states – capable of putting forth a common policy for development, foreign affairs, defence, security and migration? What institutional, fiscal and human resources should be allocated to this end?

Should this be taken further through a formal, institutionalized regional partnership with certain neighbouring countries? Or should a bilateral approach on a case-by-case basis be undertaken?

If European action is not possible, what should France's position be? Should it increase its action beyond its borders and commit additional financial resources outside of any EU framework? Or should it roll back its foreign engagements?

WHAT ARE SOME POSSIBLE CONTOURS FOR THE UNION?

Running through all these questions is the one of the limits of the European project. There are three possibilities:

- Maintain a union of countries who wish to pursue integration and adopt the euro (with legally justified exceptions). This union would share common goals and would enter into a partnership with a second group of countries outside the EU.
- An inner circle of countries who pursue a federal project; a second group with common policies akin to those of the EU today; and a third group, outside the EU, which participates in certain aspects of the single market by adopting the necessary legislation and participating in the EU budget.
- A set of common policies that countries would choose to take part in on a case-by-case and individually tailored basis.

Adapted by
Richard Venturi,
based on
“*Europe : sortir
de l’ambiguïté
constructive ?*” by
Vincent Aussilloux
and Arthur Sode

Could or should current member states be asked to confirm their continued participation in a collective project redefined along the lines of one of these options?

HOW CAN THE EXPECTATIONS OF AN UNSATISFIED CITIZENRY BE MET?

Given citizens’ dissatisfaction with the EU, either its democratic accountability has to be re-established or member countries can pin their hopes on better results bolstering the Union’s legitimacy.

Should there be a new founding movement for Europe? If so, should the way forward be cooperation among nation states? Or should it be more integration for more efficiency, legitimacy and a better understanding of policies on the part of citizens?

Or should the EU concentrate on concrete initiatives to restore its legitimacy through renewed prosperity?



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