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The Europe we need



EXECUTIVE SUMMARY MARCH 2017

*There is no desire more natural
than the desire of knowledge*

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EXECUTIVE SUMMARY

Overall and in the light of history, the European Union (EU) has been a great success. That is still the case, for most of its members. However, Europe is facing a major crisis. The European Union can continue to succeed, if its leaders are ambitious and pragmatic. The Montaigne Institute, a leading French think-tank, offers analyses and concrete suggestions for reinvigorating the great European project in a new report, *The Europe we need*.

The EU's successes – peace, prosperity and solidarity – are significant, but the people of Europe have lost their enthusiasm for the project, as the Brexit vote in 2016 made frighteningly clear. What is to be done? The answer is not simply more of the same – **more centralisation and more opaque arrangements**. Rather, concrete problems must be addressed in a transparent and increasingly democratic way.

First and foremost, the Eurozone project must be completed. The single currency has accomplished some of its goals – inflation is down, lower financing costs have improved investment and capital allocation, and the euro has become a global reserve currency. **However, Member States have not risen to the challenges which come with the single currency.** They sometimes have been irresponsible in their policies and lacked solidarity in crisis.

A new attitude is necessary, and new Eurozone institutions to reinforce it. The Montaigne Institute proposals include a formalisation of the Eurogroup with a permanent president and an explicit res-

possibility to the European Parliament, better budget planning **for all the Member States of the euro area**, increased funding to stabilise the zone in times of stress and, eventually, a Eurozone budget. The budget can be effective even if it is small, only 2% of Eurozone GDP. It can also benefit to all members.

At the same time, the European economy needs to be revitalised.

The Montaigne Institute proposes to increase European integration in the following sectors: finance, energy and digital technology. For these sectors, the EU can help with more unified regulation, a proper anti-trust framework and carefully targeted financial and institutional support. European rather than national champions are needed to face global competition. The report also calls for a more citizen-oriented European trade policy.

In the globalised world, Europe faces other challenges which are best met as a union rather than as individual states. Now is the time to **increase cooperation on security**, with a more European approach to procurement, strategy, anti-terrorism, anti-organised crime – and the establishment a permanent European military command centre. **Migration issues should be addressed with more solidarity**, both by a more uniform willingness to take in refugees and a stronger Frontex (European border police). **Europe must also come together in its foreign policy**, both to deal more effectively with large and powerful trading partners and to fill the global gap created by the changes in the United States.

The Institute recognises that the European Union will eventually need new treaties. For now, though, it is better to rely on what is already available, and a lot can be done within current treaties. No formal treaties are required to make the Commission smaller and

more efficient or for national governments to take a more responsible and collaborative approach to their budgets.

The Europe we need is not an impossible dream, but it cannot be reached without significant changes in the Europe that we have now. Hard work on specific issues is required. More than that, the EU needs a renewal of the spirit which animated the founders of this project 60 years ago.

The European Union was founded on the principle that nations are stronger when they work together. Looked at over the decades, the principle has proved itself well. The EU has made significant contributions to the region's peace and prosperity. It has created open borders and freed trade. It has supported the rights of workers and promoted social justice.

But in recent years the EU has lost the support of many of its citizens. Fewer than half of the eligible voters have participated in European Parliamentary elections since 1999, and national elections and referendums have shown a steady increase in Euroscepticism in most countries. Unfortunately, governments have mostly ignored this discontent. They have pushed ahead with unpopular expansions of EU-wide regulations and done little to address the serious complaints about economic shortcomings and the lack of popular democracy.

For the European project, **2016 was an *annus horribilis***: Brexit, the vote to leave the Union, showed the need for internal changes. The election of Donald Trump, the least EU-supportive American President ever, showed the importance of taking a strong and unified position in the world. After these setbacks, much has to be done if the EU is to thrive.

At the most basic level, the most urgent need is to revive the spirit which inspired European cooperation in the 1950s. At the time, European countries were dedicated to finding pragmatic but ambitious solutions to the common challenges of the people of Europe. Today, people doubt that the Union strengthens its Member States. If the EU is to stay united, its leaders must rediscover some of the initial enthusiasm. Change is needed, starting from the top. It could begin with a strong threefold commitment from the heads of state of all EU members.

First, they should reaffirm their shared core European values. This would present a much needed challenge for Poland and Hungary, which have introduced illiberal laws without facing much protest from the EU.

Second, they should identify the current challenges which the EU, as a single entity, is better able to address than the individual members: climate change, the digital revolution, the rise of Asia, the change in U.S. strategy and the protection of citizens from terrorism and from economic insecurity.

Third, they should clarify how the EU will divide and exercise its responsibilities. They should remember the EU's principle of subsidiarity, which assigns as many matters as possible to the national governments. They should also remember that extensive shared regulatory regimes are not always necessary to bind European countries together.

The Montaigne Institute's analysis leads to concrete proposals, under six headings.

1. First and foremost, make the Eurozone work

The single currency was the EU's most ambitious project. Never before had nation-states shared monetary sovereignty without a substantial unified budget. The euro was to rely only on political solidarity and the shared acceptance of fiscal limits. The currency's promise of deepening European unity is compelling, so much that the three Baltic states joined right in the midst of a crisis.

The euro project has had some clear success – inflation rates have fallen in countries where they were stubbornly high and the euro is now the second reserve currency in the world, after the U.S. dollar. However, the euro remains a work in progress, with substantial weaknesses.

Bad behaviour has been an issue from the beginning. Many Member States have not taken up the responsibilities which come with a shared currency. On the contrary, some nations used cheap and readily available credit to take on unsustainable quantities of private and sovereign debt. Their willingness to live beyond their means was the prime cause of the 2010 crisis of sovereign debts and insolvent banks. However, these nations' Eurozone creditors were also irresponsible. They courted trouble assuming that the Eurozone's "no bailout" rule would not be obeyed.

Some progress has been made since the crisis. The European Central Bank lived up to its European responsibilities. Governments and

investors now believe that it will do whatever is needed to support the monetary union. There has been a new effort to enforce fiscal discipline and prevent sustained unbalanced current accounts. There has also been significant progress towards the unification of the banking system under Eurozone control. There is now a single regulator and a common rescue fund under the Banking Union project.

However, the situation remains fragile. The capitalisation of many banks is still not robust, sovereign debts remain far higher than before the financial crisis and the room for extraordinary monetary policy is almost exhausted. While economic growth is strengthening, the damage to the worst hit countries remains severe, and the domestic politics reflects the economic troubles. The Member States still have no coherent unified economic policy. They do not sufficiently work together to reduce imbalances of trade and fiscal policies. Further, the adjustment mechanisms for shocks to part of the single currency zone remain feeble.

The break-up of the single currency should not even be considered as an option. Europe needs a currency bloc to be a strong player in international financial and economic debates. Besides, the reintroduction of variable exchange rates would cause significant economic damage. More importantly the disruption created would cause huge damage to all economies involved.

But there is also no need to move toward a full fiscal union of the Member States. **The Eurozone does not need to make a drastic “federalist leap” to avoid a recurrence of the destructive pro-cyclicality which it showed in 2010.** The currency area can thrive with more moderate measures, but the Member States must accept

the principle that some national sovereignty has to be shared for the sake of a stronger collective sovereignty. The Eurozone must be given the tools it needs, neither more nor less.

In detail, the Montaigne Institute recommends:

- A. More Franco-German cooperation. France needs to deal with the longstanding structural problems which have restrained GDP growth and restricted job creation. Germany must finally admit that its trade surpluses cause problems elsewhere in the euro area. Both sides must change, but France should make the first move.
- B. Each and every member nation must make a serious commitment to responsibility and solidarity. The current system of rigid budget rules and supposedly automatic punishments cannot work. Willing cooperation to strive for jointly agreed policy goals can.
- C. The Eurozone needs stronger governance. There should be regular summits for Eurozone government leaders, an annual Eurogroup budget review, three-year plans for righting structural imbalances, direct supervision of the Eurozone by the European Parliament, and a parliament-appointed “chief executive” for the Eurogroup.

To give the Eurozone more formal administrative structures with democratic supervision from the European Parliament is to recognise the need for a multi-speed Europe. That division can actually support unity, because a formal organisation of Eurozone members, which will create a clear and clearly supervised monetary structure, will help improve public trust in the whole European project.

- D. Imbalances in trade, debt and economic development should be addressed by the Eurogroup, working together. Specific goals, for example adjustments of national pay levels or control of property prices, are best set jointly, leaving the individual governments free to decide to how to reach them.
- E. Each member government should have its own clear process for keeping the fiscal position in line with agreed medium-term objectives. Such positive and domestic efforts will be both more effective and more democratic than the current negative and external disciplinary system.
- F. The supply of money readily available to help deal with shocks has to be increased. The European Globalisation Adjustment Fund should be doubled. Europe also needs a European Monetary Fund, based on the ESM. This would provide the same sort of aid and expertise as the International Monetary Fund, but the EMF would be supervised by the European Parliament.
- G. The Eurozone needs its own unified budget. The idea has been resisted by the Member States' governments, but some fiscal sharing is required to keep the euro crisis from recurring. Conceptually, the change would be significant, but in practice the sums involved could be quite modest. In comparison, the central Swiss budget is 9% of GDP. The Institute believes that 2-3% of the Eurozone GDP would be enough to stabilise Member States which fall into sudden difficulties.
- H. This budget would not be a politically unacceptable continual North-South aid fund. Rather, it would be a cyclical adjustment fund. One plausible suggestion – the Eurozone administration

receives a portion of national VAT and corporate tax receipts and pays out some portion of unemployment benefits. A mix of this sort would be helpfully counter-cyclical.

2. Improve the EU economy

An “ever closer union” in Europe used to be interpreted as ever more centralisation and regulation. The new political mood has mostly blocked that path, but there are several ways for EU authorities to help improve the region’s somewhat sluggish economy. To start, some important sectors of the economy will be healthier and growing faster if they are organised on a European rather than on a national scale.

Finance is one. The deepening of truly European, rather than merely national, financial regulation and markets should be encouraged, working towards the implementation of a capital market union. The goal of a truly European approach to the raising and allocation of capital should be pursued. One example of a helpful change – bank liquidity should be considered across the Eurozone, rather than country by country. A more European approach to finance will help in global business, and also help support the Eurozone.

In the *energy sector*, divergent national policies create unnecessary costs and conflicts. Electricity should be more European in the choice of sources, the organisation of transmission and the scale of companies. In addition, the EU should eliminate carbon subsidies, support low carbon transport and create effective emissions trading, while staying neutral on climate change technologies. The energy transition should become a much higher European priority, moving ahead of agriculture and big transport projects.

The challenge in *digital technology* is different. None of the world's leading companies are European. Digital technology should be a European priority, supported by the tax system, regional and national economic planning and regulators. The region's global position can be helped with more government money for research, more coherent regulation and careful supervision of foreign monopolists, including enhanced protection of privacy. A coordinated fiscal policy across the EU would ensure that the incumbent leaders are not given unfair tax advantages.

European education needs a boost, but the current effort to standardise years of schooling across the Member States is too rigid. A flexible approach would work better.

Flexibility should also be the guiding principle for some fragmented industries. It is usually better to work on mutual acceptance of national standards than to increase EU-level regulation. Conversely, in the single market, European-scale companies should not be discouraged by the imposition of narrowly national anti-trust standards. On the contrary, a stronger bias in favour of a European standard for competition policy will serve customers better and create stronger global competitors.

Trade policy is naturally an EU, rather than a member-state, responsibility. But the current system is too opaque. What is needed is a more citizen-oriented and transparent European trade policy. The EU also needs to pay more attention to the costs which come along with the gains from more open trade. Up to now, the European commitment to opening markets has been greater than the effort to help workers and communities which have lost out in the transition.

Negotiators and enforcers should be determined in their pursuit of European goals. One goal is the non-discrimination of European companies in public sector contracts. Another is the imposition of anti-dumping and anti-subsidy tariffs against unfair foreign competitors. Governments should make use of rules approved in late 2016, which make fast responses easier. Also, governments should be committed to protecting economically and strategically significant European companies from takeovers by non-European firms or governments if those very countries do not enable Europeans to enter their markets in the same way. Indeed, the notion of reciprocity should drive our commercial approach.

3. Strengthen European security

The security challenges faced by Europe have multiplied in the last few years, and with the election of Donald Trump as U.S. President, the confidence of American support in times of need has diminished. European nations should rise to this challenge together by creating a Security Union to fight on a EU-scale against terrorism, organised crime and cyber-crime. In the long term, this could lead to a “European FBI”. In a more immediate time frame, agreements between neighbouring countries can help control borders without damaging the Schengen agreement on free travel.

The European military needs to be strengthened as well as unified. Military spending has been falling in recent years. It should increase to the long-established target of 2% of GDP. Better strategic planning is also a necessity. There should be more regional coordination of research and a more regional approach to procurement. Multinational programmes are essential, but they should be delegated to a single

agency to prevent national conflicts. A central and permanent European military command headquarters would have practical and symbolic meaning, as would a less nationalistic approach to the organisation of defence companies. A Buy European Act for military procurement is worthy of consideration. Also, it is important to avoid one potential weakening of security. Brexit should not lead to a reduction of cooperation with the UK.

4. Strengthen European foreign policy

EU members states must learn to think about the world from a more unified European perspective. The search for national advantage, rather than for strong common position, inevitably weakens Europe's global standing and aggravates the problems on the EU's various borders.

Relations with non-member neighbours are at the centre of the European diplomatic agenda. Besides negotiating an appropriate Brexit, the EU has to establish sustainable relationships with the Balkan countries which are stable and supportive but do not promise membership in the near future. A strong relationship with Turkey is also among the EU's top diplomatic priorities, although the perspective of the country entering the Union is clearly not on the agenda.

Change in the United States constitutes a challenge for Europe, but it is also an opportunity, as Europe can now take on its moral leadership of the West. Russia presents a significant challenge, on security issues, but remains an important economic and cultural partner. In dealing with Russia, European unity is crucial. For China, the EU is the largest trading partner, and the Europeans must encou-

rage the rising power to take up its global responsibilities, while limiting the Chinese state's influence on European companies. Finally, the EU can do more for Africa, with investments, aid and help in governance.

5. Try to come to grips with migration

Migration, both of asylum-seekers and for economic reasons is a great challenge for Europe, which is caught between the political reality of growing anti-migration feelings across Member States and the Union's foundational liberal values. The Montaigne Institute recommends a new European centre for the study of migration and a reworking of the international law definition of refugees. It also calls for a stronger and more unified European border police and more European political solidarity in the response to asylum-seekers. A new European asylum agency might be helpful. Over the long term, the EU needs to integrate migration issues more fully into its foreign policy. One goal should be to reduce the desire for permanent settlement in Europe. That can be helped by offering stronger institutional support for post-conflict reconstruction and by experimenting with permits for extended but temporary stays in the EU.

6. Make the existing EU system work better

The EU must be more unified, stronger and more flexible. **It must be, and be perceived as, more democratic.** Unfortunately, today's European institutions are widely considered as dysfunctional and dangerously distant from the national democratic debates. The founding members are often the worst offenders. What is needed

now is not negotiations for a new treaty with its rules and organisations – that was tried in Lisbon in 2009 with only modest effect. What is urgently required is a renewed *élan*, a recovery of the pragmatic idealism which built unity and prosperity after the devastation of the Second World War.

The effort has to be more bottom-up than top-down, more flexible and less rigid. The desire to put national traditions before the common good has to be resisted and the recourse to power blocs has to be reduced. The European responsibility is to agree on clear and realistic agendas. Member States should now focus on finding the most appropriate ways to reach the goals they have fixed for the Union. One simple reform, already in the treaties, is to reduce the number of Commissioners and to reinforce national parliaments' implication in European affairs. That would provide a constant reminder that Europe can only be strong when its countries trust each other and work together.

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THERE IS NO DESIRE MORE NATURAL THAN THE DESIRE OF KNOWLEDGE

The Europe we need

In the year of its sixtieth birthday, the European project has never seemed so threatened. In the face of external and internal contestations, only a pragmatic and efficient response, based on the European Union's (EU) solid achievements, may engage a new dynamic.

This report identifies three priorities. First and foremost, the euro area, Europe's political core, must be reinforced. National economies should be given a new input by strengthening and expanding the single market, better coordinating antitrust, commercial and industrial policies, as well as accompanying the energy and digital transitions. Finally, the EU must ensure its citizens' security, give form to a common foreign policy and meet the challenge of migration.

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