

COUNCIL *on*
FOREIGN
RELATIONS

*International Institutions and
Global Governance Program*

WORKING PAPER

A New Reality for the European Union

Katinka Barysch
September 2010

This publication is a part of CFR's International Institutions and Global Governance program and has been made possible by the generous support of the Robina Foundation.

The Council on Foreign Relations (CFR) is an independent, nonpartisan membership organization, think tank, and publisher dedicated to being a resource for its members, government officials, business executives, journalists, educators and students, civic and religious leaders, and other interested citizens in order to help them better understand the world and the foreign policy choices facing the United States and other countries. Founded in 1921, CFR carries out its mission by maintaining a diverse membership, with special programs to promote interest and develop expertise in the next generation of foreign policy leaders; convening meetings at its headquarters in New York and in Washington, DC, and other cities where senior government officials, members of Congress, global leaders, and prominent thinkers come together with CFR members to discuss and debate major international issues; supporting a Studies Program that fosters independent research, enabling CFR scholars to produce articles, reports, and books and hold roundtables that analyze foreign policy issues and make concrete policy recommendations; publishing *Foreign Affairs*, the preeminent journal on international affairs and U.S. foreign policy; sponsoring Independent Task Forces that produce reports with both findings and policy prescriptions on the most important foreign policy topics; and providing up-to-date information and analysis about world events and American foreign policy on its website, CFR.org.

The Council on Foreign Relations takes no institutional positions on policy issues and has no affiliation with the U.S. government. All statements of fact and expressions of opinion contained in its publications are the sole responsibility of the author or authors.

For further information about CFR or this paper, please write to the Council on Foreign Relations, 58 East 68th Street, New York, NY 10065, or call the Director of Communications at 212.434.9400. Visit CFR's website, www.cfr.org.

Copyright © 2010 by the Council on Foreign Relations®, Inc.

All rights reserved.

Printed in the United States of America.

This paper may not be reproduced in whole or in part, in any form beyond the reproduction permitted by Sections 107 and 108 of the U.S. Copyright Law Act (17 U.S.C. Sections 107 and 108) and excerpts by reviewers for the public press, without express written permission from the Council on Foreign Relations. For information, write to the Publications Office, Council on Foreign Relations, 58 East 68th Street, New York, NY 10065.

Introduction

With a rescue package for Greece and a financial safety net for other eurozone economies squared away, the European Union (EU) finally has a moment to reflect on the political consequences of the eurozone crisis. In the aftermath of the crisis, a new EU reality has emerged; the dynamics that pushed the European project forward over the past sixty years can no longer be relied on to drive future integration. The crisis has brought to light, and accelerated, a number of trends already visible in recent years: decision-making power is shifting from Brussels to the national capitals of EU member countries, two-speed Europe is becoming a reality, the ideal of an egalitarian Europe is giving way to the reality of political dominance by larger countries, and the alliance between France and Germany—long the motor of European integration—is weakening.

Underlying and exaggerating these changes is Germany's growing euro-skepticism. Long the engine of European integration, Germany is now starting to act like a "normal" country—understandably so, perhaps: no one would expect Britain, France, or Poland to put European interests ahead of national interests. However, it was exactly because Germany did not always behave like the United Kingdom and France that European integration moved forward and European solutions were possible. Even if the euro crisis can be contained, it is difficult to see how the EU could make progress on anything—whether it is services market liberalization or a common energy policy—with a reluctant, grumpy and inward-looking Germany at its heart.

Without renewed Germany leadership and commitment from member states to revive and strengthen the EU, the result could be a Europe where the realpolitik of power and money counts more than visions of integration and solidarity.

Governments Rule

In the past ten years, the EU has seen a gradual shift of decision-making power from the EU's federal institutions back to the national governments of member states. Great Britain has always been suspicious of "unelected Brussels bureaucrats," while France's enthusiasm for the European Commission diminished after the overly (for French tastes) free-market Jose Manuel Barroso took over as president in 2004. But it is Germany—traditionally a strong supporter of the European Commission and the European Parliament—that is now at the forefront of this move toward more "intergovernmentalism." German support for the European Commission has progressively weakened since the days when the mercurial Jacques Delors ran the EU's Brussels-based executive. Nevertheless, the way Berlin has recently sidelined the commission is unprecedented. When Merkel is looking for a European solution to a problem, she phones other EU capitals directly rather than communicating directly with Brussels. German politicians and officials have few good things to say about Barroso, whom they

accuse of grabbing more and more power from member states without having a plan for using them. Indeed, it was Merkel who insisted that Herman van Rompuy, president of the Council of EU leaders, and not Barroso, be put in charge of the EU's new working group on fixing the eurozone.

The commission has tried to regain the initiative, for example by putting forward its own proposals for economic governance and introducing "EU taxes" to finance the union's central budget rather than relying on transfers from cash-strapped national governments. However, as long as Europe remains in crisis mode and EU governments are putting large sums of taxpayer money at risk to save the euro, decision-making power will remain firmly in the national capitals. Berlin, Paris, and the other EU capitals should remember that a strong European Commission is needed to defend the union's achievements. For example, the commission has traditionally acted as the guardian of the EU's internal markets; it has fought for ambitious EU climate change targets; it has resisted EU governments' lobbying for more trade protectionism; and it has pushed for more integration in areas from banking to rail transport.

Two-Speed Europe

Flexible integration, or "variable geometry" in EU-speak, became a reality long before the current crisis. Only sixteen out of twenty-seven EU countries participate in the single currency; the "Schengen" area of passport-free travel is not universal; and Britain and Denmark have opted out of most EU initiatives on internal security. Further, important EU foreign policy initiatives—such as trying to dissuade Iran from building nuclear bombs—have been run by a small group of big member states.

The EU and its governments have traditionally upheld the idea that any such flexible arrangements were temporary; however, the euro crisis could lead to a semipermanent schism between the euro ins and outs. The eurozone countries—not the EU-27—negotiated and underwrote the rescue packages for Greece and other southern European countries. Of the non-euro countries, only Poland and Sweden made notional contributions to the bailout in the name of European solidarity. UK participation was conspicuously absent. Although Britain's new coalition government—which is led by the traditionally euro-skeptic Conservative party—has been on a charm offensive around Europe, it has argued that the euro crisis is simply not its problem. In the past, London would try to prevent smaller groups of EU countries from going forward with initiatives for fear of having to join later on terms that did not suit Britain. Now the UK seems fairly happy with a Europe à la carte. This attitude may cause resentment should other troubled eurozone countries be forced to borrow money from the new European stability facility (a €440 billion fund to help eurozone countries that can no longer borrow in the markets). With UK-based banks highly exposed to Irish and Spanish debt, Britain would be a major beneficiary of a Spanish or Irish bailout without having contributed.

Germany still insists that a move toward stronger economic governance should take place at the level of the EU-27. It has resisted French calls for a permanent Euro Council—a meeting of the leaders of the sixteen eurozone countries independent of the regular EU-27 summits. Even so, Germans have conceded that such meetings could take place on an ad hoc basis—as happened several times during the euro crisis. For the non-euro countries, a Euro Council raises the specter of being permanently pushed to the sidelines. The so-called Euro Group—the meeting of the finance ministers of

the sixteen euro countries—already pre-cooks decisions on a wide array of economic issues. Similarly, regular Euro Councils would probably take on an expansive agenda beyond fiscal rules and economic monitoring, thereby weakening the voices of non-euro countries on issues ranging from financial market regulation to competition policy. Since many of the EU's most pro-market countries are outside the euro, such a two-tier Europe could move toward less liberal economic policies.

Size Matters

In a more intergovernmental union, bigger countries would have greater influence than smaller ones, which is why the EU's smaller member states are staunch supporters of the “community method” of decision-making, which gives a big role to the European Commission and parliament. However, in recent years, the idea that all EU countries are equal has lost credibility. With twenty-seven member countries, it is increasingly difficult to achieve consensus, and leaders from the big countries often talk to each other first to shape a preliminary agreement.

Angela Merkel initially promised to pay more attention to the smalls, but the euro crisis ruptured any illusions about where the real power lies in Europe. The momentous decisions about the bailout were made by the big euro countries and presented to the others as a *fait accompli*. This may have suited some EU governments at the height of the crisis: Austria, Finland, and the Netherlands, for example, wanted tough conditions for Greece just as much as Germany and they were happy to let Merkel do their bidding. The Mediterranean countries relied on France as their mouthpiece. Others, like Slovakia, felt plainly and painfully ignored. A newly elected Slovak government decided in August that it did not want to hand money over to the much richer Greeks. Since the smaller countries are finding it harder to make their voices heard—let alone to set the agenda—they could become more prone to drastic action, such as vetoing agreed EU policies or simply opting out unilaterally. Notions such as equality and solidarity—which underpin the very idea of European integration—could unravel.

Franco-German Leadership

Although Merkel consults Paris more often than Brussels or any other EU capital, the Franco-German alliance is anything but strong. French and German positions often fall on opposite ends of the policy spectrum, especially when it comes to European economic management. A clash in political style further accentuates the rift between the two countries. Merkel tends to approach issues with cautious, cold analysis. The chancellor starts from the final objective and focuses on feasible solutions; she likes to under-promise and over-deliver. At home in Germany, this approach made her consistently popular with voters, at least until recently. At the EU level, however, Merkel's cautious

approach contrasts with the impulsive style of French president Nicolas Sarkozy, who likes to announce ambitious objectives without quite figuring out how to get there.

Merkel and Sarkozy have learned from bitter experience that they can achieve little if they work against each other. Consequently, they think that the first and indispensable step toward an EU-wide consensus is a French-German rapprochement. However, close consultation and collaboration between Berlin and Paris at the height of the crisis neither resolved their differences nor forged mutual trust.

In the past, Merkel would get upset about Sarkozy's unilateral initiatives, such as the Mediterranean Union or the idea of a European bank bailout fund. Now Germany is itself becoming unilateralist: after Berlin announced its national ban on the naked short-selling of German bank stocks and eurozone bonds in May, France protested that it had not been consulted and initially said that it would not follow suit.

For much of the history of the European Union, the alliance between Germany and France was the main motor for integration. As the number of EU countries has continued to grow, the influence of the two-country alliance has weakened. But agreement between Berlin and Paris remains a condition for accomplishing anything in the union today. The euro crisis will make it harder to paper over Germany and France's differing interests and ideas about the future of the EU.

German Euro-skepticism

The eurozone crisis is bringing a latent sense of German frustration and disillusionment with the EU to a boil. With the German media in a frenzy and Merkel's government weakened by coalition squabbles and losses in regional elections, German euro-skepticism may now take hold. While Germany's belated and ill-tempered reaction to the eurozone crisis surprised many, the country's attitude toward the European Union has been cooling for over a decade. Underlying this shift are a number of structural and historical factors.

First, Germany is now run by a group of leaders with no living memory of the horrors of World War II. For the first four decades after the war, the Germans' main aim was to merge into the European Union and the North Atlantic Treaty Organization (NATO). Postwar Germany could have a foreign policy only as part of a European club or a western alliance. Within the EU, the Germans saw their role as a facilitator of compromise and they were happy to foot the bill if necessary, as with Helmut Kohl's famous checkbook diplomacy. Today, many Germans think they have paid their historical dues. Already with Gerhard Schröder, Germany had a chancellor who was much less emotionally attached to—and much less idealistic about—the European idea. Merkel has continued along this trajectory. For the generation of Helmut Kohl, Europe was a matter of war and peace; for Chancellor Merkel and most of her contemporaries, it is a question of costs and benefits.

Second, during the Cold War, Germany was a frontline state. Membership in NATO and the EU seemed a matter of survival. Following the accession of ten former Warsaw Pact countries to the EU in 2004 and 2007, Germany is now surrounded by friends. In such a safe environment, Germany can define its national interests differently. Eastward enlargement has also changed the political dynam-

ics of the EU—in a union with twenty-seven member states, Germany can no longer equate its national interest with that of the EU, even if it wants to. The EU is simply too big and too diverse.

Third, Germany's traditionally pro-EU elites appear increasingly detached from the European cause. Even the few remaining federalists rarely make the case for deeper and faster European integration. Instead, they grumble that whenever they tried to move European integration forward, their fellow members wanted nothing of it. Today, the once rock-solid cross-party consensus in favor of more integration is crumbling. The German constitutional court—traditionally the most highly respected political institution in the land—has set the national tone by ruling that the EU's latest treaty (the Treaty of Lisbon) took the union as far as it should go for now.

Germany's elites are fully aware how much their country has benefited from the EU: it has gained markets for its exports, a common currency that is stable but not too strong, friendly neighbors, and the ability to act on the world stage. Puzzlingly, successive German governments—as well as Germany's business leaders and newspaper editors—have been rather reticent when explaining these benefits to the German people. Many ordinary Germans think that EU integration was a sacrifice they made for the benefit of other European countries. A majority now feel that giving up the Deutschmark for the euro was a grave mistake. During the euro crisis, this growing sense of euro-skepticism has been whipped up by a vitriolic campaign in the German mass media—something that would have been unthinkable even a few years back.

The Way Forward

If the EU is to continue to function, some damage limitation is needed. The German government must show constructive leadership in the euro crisis. Leadership should include greater willingness to discuss Germany's own contribution to strengthening European demand, as well as presentation of a vigorous case to the German people that saving the euro, and the achievements of European integration, lie at the heart of German national interest. Germany's European partners, in turn, should be more sympathetic to Merkel's domestic constraints. If they want Berlin to engage in an open debate about how to reduce the damaging imbalances in the eurozone, they must accept the German mantra that solidarity only works alongside responsibility (in the shape of rigorous national plans for long-term budgetary consolidation). They should also remember to highlight some of the strengths of the German economic model. Further, EU countries outside the eurozone should acknowledge that the fate of the single currency is of pivotal importance for them too—and act accordingly. Without such an attitudinal shift, a permanent split between eurozone countries and those outside the single currency is inevitable.

Finally and crucially, both Berlin and Paris must do their best to overcome current frictions and turn the Franco-German alliance once again into a positive force in EU integration. The EU can only function with twenty-seven well-meaning governments and strong central institutions. If the big countries ignore the voices of the smaller ones and try to sideline the European Commission, achieving consensus in the EU will become impossible and many of the union's remarkable achievements may unravel.

About the Author

Katinka Barysch is deputy director of the Centre for European Reform, an independent, London-based think tank.