The mixed blessing of the 'multi-speed' EU

Marek Dąbrowski examines the rationale behind a multi-speed European Union and the potential risks that could encourage anti-EU sentiments

The UK decision to leave the EU kicked off the debate of how the remaining 27 member states want to repair and further advance a European integration project. The 60th anniversary of the Rome Treaty celebrated in March 2017 provided an additional impulse to this discussion. In particular, the European Commission (2017) published the White Paper on the *Future of Europe* followed by the Rome Declaration of the EU27 leaders issued on March 25, 2017 (European Council, 2017).

While their language concentrates on declaring EU unity, setting vision of prosperous Europe and willingness to resolve today policy problems it remains less concrete in respect to reform measures required to achieve those goals. However, the process of preparing both documents and, partly, their content triggered a new round of debate on the 'multi-speed' EU[1].

Potential rationale of the 'multi-speed' EU

The deep political and institutional roots of the 'multi speed' EU[2] lie in the voluntary and consensual character of the European integration process. That is, delegation of any new portion of national sovereignty to the EU governing bodies via changes in the EU Treaties must be approved by national parliaments or referenda in all EU member states. This makes the EU very different to other federations and confederations, including the US, which have been created, at least partly, as result of wars, conquests, colonization or other means of coercion.

As result, those new integration steps that did not enjoy unanimous support of all member states required granting concessions to the sceptical governments. Quite often, they took the form of waivers to those who opposed, allowing them for non-participation in a given project. Technically, various legal routes were used such as permanent opt-outs, temporary derogations, mechanism of enhanced cooperation and separate intergovernmental treaties.

The examples of permanent opt-outs include the Treaty's provisions, which allowed the UK and Denmark remaining outside the Economic and Monetary Union (EMU) and the UK and Ireland – outside the Schengen free-travel zone.

Temporary derogations have been applied to the new EU entrants in respect to various pieces of *acquis communautaire*, for example, free movement of capital and labour as well as to their EMU and Schengen membership (which required meeting various technical criteria to become a member).

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The Article 20 of the Treaty on European Union (TEU) and Articles 326-334 of the Treaty on the Functioning of European Union (TFEU have introduced the institution of enhanced cooperation. It concerns areas of non-exclusive EU competences, requires participation of at least nine EU member states and shall remain open to others at any time. So far, this mechanism has been used only in respect to minor initiatives such as a divorce law.

Another possibility to initiate new integration areas between the interested EU member states is to conclude separate inter-governmental treaties, formally outside the TEU and TFEU but often resulting in setting new mandates and tasks for the EU governing bodies, in particular the European Commission.

The recent examples of such initiatives include the Treaty on the European Stability Mechanism (ESM, operational since October 2012), and the Treaty on Stability, Coordination and Governance in the EMU (the so-called Fiscal Compact, in force since January 1, 2013).

The variable geometry allows moving forward with integration process despite objections of some member states. If the particular initiative proves successful, it can create positive demonstration effect and encourage originally sceptical countries to join later (Moeller and Pardijs, 2017). The good example is the Schengen area, which originally (1985) started as the intergovernmental agreement of five member states to become eventually part of the Amsterdam Treaty in 1997.

In the post-Brexit environment, with the euroscepticism on the rise, some analysts believe flexibility might be the best approach to new integration initiatives (Adebahr, 2016; Grabbe and Lehne, 2016; Moeller and Pardijs, 2017). Such an approach was also proposed as one of the five scenarios in the European Commission's (2017) White Paper: this was the Scenario 3 called *"Those who want more do more"*.

Indeed, if a new integration initiative is limited to those who are interested and ready to join, perhaps this can help soften opposition of other member states and counteract the populist anti-EU backlash.

And its risks

However, further development of the 'multi-speed' EU, beyond we have now already, may also involve serious risks to the consistence and transparency of the EU institutional architecture and eventually encourage rather than discourage anti-EU sentiments.

First, selected membership in important integration projects can create durable divisions within the EU. This exactly has happened in the case of the EMU and Schengen. Formal and informal opt-outs do not serve solidarity within the EU to address common challenges (as demonstrated by the European financial crisis and refugee crisis) and often lead to self-isolation and alienation of opt-out holders in respect to common policies (the example of the UK, which eventually led to Brexit).

In an extreme-case scenario, a 'multi-speed' integration may lead to an 'integration à la carte', with strong incentives for individual member states to focus on short-term political interests rather than long-term integration benefits, and the weakening and even partial institutional disintegration of the EU governing bodies, as various narrower integration circles will require their own management and coordination mechanisms.

Finally, potential political benefits of 'flexible' integration can be overestimated as the biggest opposition to the idea of the 'multi-speed' EU has come so far from the non-euro area member states who are afraid to become marginalized by a deeper integration within the common currency area.

How to avoid marginalization?

Looking from the perspective of EU members who have not adopted a common currency yet their opposition to the closer integration in the euro area (to the extent, which such an integration is justified by institutional and policy complementarities – see Dabrowski, 2015) is not necessarily an optimal long-term strategy.

Instead of opposing completion of the euro area integration architecture to make it more resilient to future shocks, they should think about joining the EMU over the next, let say, five to ten years. There is a number of arguments in favour of going in such a direction.

Politically, remaining outside the EMU means accepting the political status of a second-category member state with limited impact on several EU policy decisions taken within the so-called Eurogroup. If one assumes further deepening of EU economic and political integration within the euro area is unavoidable the degree of marginalization will increase (see above). Furthermore, after the Brexit the bargaining power of euro 'outs' in the Council will substantially decrease.

Legally, all EU member states except the UK and Denmark are obliged to join the EMU. Their membership is only subject of temporary derogation, until they meet accession criteria. Although accession timetable is not legally determined, they should not postpone euro area accession indefinitely.

Economically, a common currency is an integral part of the single market architecture even if, for political reasons, it is considered as a separate integration project, subject to different membership criteria. The limited membership in the euro area is an important source of cross-border transaction costs within the EU, often more serious than typical trade protectionism instruments.

As long as national currencies continue to exist within the single market, one cannot rule out intended or unintended competitive devaluation with the harm to other member states (currency depreciation in individual member states is a zero-sum game for the entire block). Furthermore, instability of national currencies can lead to financial crises in euro 'outs' (as it happened in 2008-2009) with negative implications for the entire EU.

Looking from the perspective of potential entrant, flexible exchange rates impose additional transaction costs what means less trade and investment creation and less participation in the common market for financial services and capital market, other things being equal.

Even if according to the theory of an optimum currency area exchange rate flexibility can serve as an adjustment tool in case of macroeconomic imbalances or idiosyncratic shocks, in the contemporary environment of financial globalization exchange rate movements are not always driven by changes in trade and current account balance; more frequently they respond to changes in global capital flows.

That is, in case of a small open economy exchange rate flexibility will not necessarily deliver the desired direction of exchange rate adjustment in a given period. In a long run, exchange-rate flexibility cannot replace microeconomic flexibility, ie. substitute structural reforms.

Furthermore, a larger-scale currency depreciation can easily damage financial sector stability and balance sheets of non-financial corporations and households.

EMU enlargement as a tool to reduce 'multi-speed' integration

Historically, EMU membership proved the most powerful factor of a 'multi-speed' integration, leading to an increasing degree of internal differentiation between euro 'ins' and 'outs'. Thus, adopting a credible strategy of EMU enlargement on both the national and EU level could reduce the demand for a 'multi-speed' integration and associated dilemmas of how optimally manage this process.

Working out such a strategy will not be an easy task in those non-euro area member states where local politicians invested a lot of effort in building up irrational fears and prejudices, for example, that the euro project will eventually collapse (it will not) or that introducing euro leads to across-the-board price increase (it does not).

Of course, the new EMU entrants must meet all the criteria required to adopt the euro. The EU institutions and incumbent EMU members should encourage them going in this direction rather than discourage (as it happened on few occasions in the past). ■

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Endnotes

1. This commentary partly draws from Dabrowski (2016)

2. It is often referred to as a 'multi-speed' Europe (see http://eur-lex.europa.eu/summary/glossary/multispeed_europe.html), 'flexible' integration (Warleigh, 2002) or 'variable geometry' (Dabrowski, 2016).

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