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Economic Intelligence

Up-to-the-Minute Analysis from
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'To Persist in Error Is Diabolical'
How Intergovernmentalism Could Torpedo the Next Generation European Union Plan

On the eve of the first "in-person" European Council since the outbreak of the Covid-19 pandemic, there remain continued divisions on the key issues concerning the main item on the leaders' agenda: the launch of a pandemic recovery fund known more formally as the Next Generation European Union Plan.[1] Agreement does not appear beyond reach on its size (around €750 billion); the related envelope of the multiannual financial framework (reduced to €1.07 trillion); the breakdown between grants and loans (respectively, €500 billion and €250 billion); and lump-sum rebates for some countries.[2] Deep divisions persist however on the degree of any conditionality and, most acutely and importantly, on the recovery fund's governance arrangements.

Compromises appear possible on several of these issues. While far from perfect, as is in the nature of compromises, they may turn out to be broadly acceptable, especially when set against the ground-breaking innovation embodied in the design of the fund: common borrowings for redistribution. There is however one area where a lowest-common-denominator solution could fundamentally subvert the whole project, sowing the seeds of

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[1] **Economic Intelligence** is a series of up-to-the-minute policy briefs from Alessandro Leipold, chief economist of the Lisbon Council and former acting director of the International Monetary Fund's European Department and later executive director for Italy, Greece, Portugal, Malta, Albania and San Marino. Special thanks to Paul Hofheinz, Chrysoula Mitta and David Osimo.

[2] European Commission, "The Pillars of Next Generation European Union," 10 May 2020. https://ec.europa.eu/info/sites/info/files/3pillars_factsheet_0.pdf
The basis of possible agreement was set out by President of the European Council Charles Michel's new "negotiating box" on 10 July 2020. See President of the European Council, "Press Conference by President Michel on his Proposal for the European Union's Long-Term Budget and the Recovery Plan," Brussels, 10 July 2020.
https://video.consilium.europa.eu/en/webcast/d608bdfb-2ebe-4494-806a-f379af8ed594

future discord and rancour rather than solidarity. This area is that of the recovery fund's governance arrangements. Here, compromise risks perverting the very nature of the fund, transforming a mechanism of mutual support into one of divisive mistrust, eroding the European ideal itself.

What is in dispute? In essence, it is the question of who makes the final decision about the release of grants or loans to individual member states. Should it be the European Commission in a *super partes* role, or the other member states individually? The latter approach would in effect give veto power to any one country, leading to a toxic politicisation of the process.

Lucius Annaeus Seneca, the Roman philosopher and statesman, once said that "to err is human, but to persist in error is diabolical." Opting for an intergovernmental decision-making process would mean persisting in the original sin committed at the outset of the euro area crisis – which was ultimately a crisis of governance. The original sin in question was the failure to seize the occasion to create a community institution fully integrated in the European Union framework, as indeed had been proposed and advocated by the European Parliament and the European Central Bank (ECB). Instead, the European Stability Mechanism (ESM) was saddled with a narrow intergovernmental governance structure, which has hobbled its effectiveness ever since.

The ECB itself has emerged as a polite but persistent critic of this way of running things, noting with careful understatement in a 2011 opinion that the ESM was being created as "an intergovernmental mechanism instead of a union mechanism" and stressing that "the ECB supports recourse to the union method and would welcome that, with the benefit of the experience gained, the ESM would become a union mechanism at an appropriate point in time."[3] Nine years have lapsed since that opinion. Not only has the ESM's governance remained unchanged but the same flawed governance structure is now being suggested by some for the new recovery fund.[4]

Why is an intergovernmental structure so deleterious, especially for an instrument intended to demonstrate solidarity? The reasons are evident from the evolution of the euro area crisis: it is a structure that leads to the prevalence of narrow national interests and the institutionalisation of political interference. Nothing could be more antithetical to the rationale of a mutually shared recovery from the common economic shock of a pandemic.

It is incumbent on this European Council to avert such an outcome. While agreement on leaving decisions solely to the European Commission is unlikely, there are intermediate ways forward. For example, the European Commission's decisions could be automatically

[3] European Central Bank, *Opinion of the European Central Bank on a Draft European Council Decision Amending Article 136 of the Treaty on the Functioning of the European Union* (Frankfurt: ECB, 2011). https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52011AB0024&from=HR

[4] The ESM's subjugation to national capitals has indeed stymied its response to the Covid crisis; see Alessandro Leipold, "The European Stability Mechanism: Missing in Action," *Economic Intelligence: A Lisbon Council Policy Brief*, 19 March 2020. https://lisboncouncil.net//index.php?option=com_downloads&id=1507

approved unless they are overturned by a qualified majority of countries. Alternatively, member states could approve decisions through a weighted majority voting system. Neither of these are ideal, but they are immeasurably superior to the alternative of national veto power.

In essence, it is crucial that this extreme solution, and the related pernicious politicisation of the process, be avoided. Surely this much can be asked for a mechanism that is in any event intended to be one-off and temporary. An intergovernmental governance setup would doom the recovery fund to be a source of European tensions with potentially dire consequences. This seems to have been understood by the majority of member states, including Germany. With this upcoming European Council meeting being the first of the Germany-led Presidency of the Council of the European Union, it provides a unique opportunity for Chancellor Angela Merkel to display her considerable leadership skills. It is not hyperbolic to state that Europe's future depends on demonstrating true solidarity at such a difficult juncture via unanimous agreement on a harmoniously functioning fund to exit the pandemic's economic crisis jointly, with mutual benefits for all.

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