The new frontier of European integration after Next Generation-EU: Looking back, looking forward

Marco Buti
Marcello Messori
Table of contents

Executive summary 3

1. Introduction 4

2. At the roots of the new EU 4

3. In search of a new compass 6

4. Future avenues 9

Endnotes 10

ABOUT THE AUTHORS

Marco Buti holds the Tommaso Padoa-Schioppa Chair in European Economic and Monetary Integration at the European University Institute.

Marcello Messori is a Part-time Professor at Schuman Centre, European University Institute.

ACKNOWLEDGEMENTS / DISCLAIMER

This Paper is part of a research developed at the EMU-Lab. We thank, without implicating, Fabian Zuleeg for helpful comments. The support the European Policy Centre receives for its ongoing operations, or specifically for its publications, does not constitute an endorsement of their contents, which reflect the views of the authors only. Supporters and partners cannot be held responsible for any use that may be made of the information contained therein.
Executive summary

To tackle the domestic and geopolitical challenges that the European Union is facing in the short and long-term, we need to rediscover the spirit of Jacques Delors approach. The latter sought a balance between government intervention and the market, competition and solidarity, interventions on the supply side and support of the aggregate demand. To build on Delors’ contributions, one has to appeal to different and, in certain cases, conflicting theoretical strands that underpin European integration. This further elaboration specifically applies to the current problems of the European Union. A new compass will be needed to redefine the macroeconomic policy mix, complement the new fiscal rule book, strengthen economic governance, and revamp the European Union’s growth model. As recently proposed by a “Manifesto for Europe”, leaders and policymakers should engage in the construction of a “gradual and pragmatic federalism”.
1. Introduction

Jacques Delors passed away on December 22, 2023. He is rightly considered the last of the European Union (EU) fathers. As president of the European Commission from 1985 to 1995, Delors provided decisive contributions to the creation of the Single Market and the reform of the European budget, thanks especially to the strengthening of cohesion policies in connection with the enlargement of the EU to the Iberian Peninsula (the so-called Delors Package I). He then played a fundamental role in the agreements relating to the creation of the euro area, which were included in the Maastricht Treaty. In his last year as President of the Commission, Delors finally produced the White Paper focused on supporting EU growth, competitiveness and employment thanks to cross-border infrastructure investments financed by the issuance of common debt (European Commission, 1994).

Delors' view of Europe was based on a dynamic conception of subsidiarity that left no room for ideological conditioning, such as the dispute between supranationalism and intergovernmentalism. Delors intended to progress constructing the EU through gradual steps and using a wide range of economic and social policy tools. From this perspective, he sought a difficult balance between government intervention and the functioning of the market, between competition and solidarity, between interventions on the supply side and support of aggregate demand.

In many commemorations it has been said that the EU's change of pace after the Euro-sclerosis phase of the 1970s should be ascribed to the climate of cooperation that Delors was able to establish with German Chancellor, Helmut Kohl, and with French President François Mitterrand. There is no doubt that such a political climate allowed the EU to respond effectively to the "call of history" triggered by the fall of the Berlin Wall in 1989. However, the "alignment of political stars" in the second half of the 1980s and the first half of the 1990s found their roots in economic theory, institutional analysis, and political science that – directly or indirectly – have inspired the construction of the EU since the origins of the European Economic Community.

Examined in this Discussion Paper are aspects of some of the fundamental and institutional contributions, which led to both the Maastricht Treaty and the creation of the European Economic and Monetary Union (see Section 2). Also analysed are contributions that provide an understanding of the problems that emerged in the post-pandemic period, which allow us to identify the main areas of intervention that, after the European elections in June 2024, the new EU institutions will have to address (see Section 3).

2. At the roots of the new EU

Figure 1 (below) attempts to capture Delors' vision of the EU's institutional and policy equilibrium. The complementarities between rules and market discipline, national and EU levels, efficiency and equity, find their operational translation into the Single Market, the cohesion policy, the Broad Economic Policy Guidelines (that are the embryo of economic policy coordination and the precursor of today's European Semester), and eventually the Single Currency as the highest incarnation of shared economic sovereignty.

The prominent personalities underpinning Delors' idea of Europe differ in terms of national origin and ideological orientation. The same applies to the academics and policymakers who took up the baton together with Delors. To create the European institutional foundations, the thoughts and initiatives of Jean Monnet, Robert Schuman, Altiero Spinelli, and Pierre Werner were crucial. On a political level, the inspiration and vision of Simone Veil, Willy Brandt, Olof Palme and – in the enlargement to post-communist countries – Ralf Dahrendorf and Bronislaw Geremek were decisive.

Any attempt to go into detail about the contributions to the construction of Europe provided by these and other figures is beyond the scope of this paper. Even at the cost of some simplification, it is possible to identify issues considered at the core of their elaborations at the time of Delors and that remain essential to address the economic and institutional dilemmas currently facing the EU. In essence, as sketched out in Figure 1, three cornerstones can be identified:
a. The search for a balance between respect for common rules and market functioning should ensure economic stability.

b. The overcoming of the tensions between efficiency and equity, that is between long-term growth and social cohesion, and between responsibility and solidarity, or, in modern parlance, between risk reduction and risk sharing.

c. The new definition of subsidiarity, which is based on the ‘vertical’ coordination between the policies of the European institutions and those of the national authorities, with a new centrality to public decisions at European level.

These cornerstones are not only the fruit of the intellectual legacy of the fathers of Europe and the political institutional contributions of their successors. Points (a) – (c) can also be traced back to the analytical elaborations - not always compatible with each other – offered by economists and social scientists early in the last century, in “the years of high theory” and during the Fifties.

A first interpretation of point (a) was offered by ordo-liberalism, which thanks to the contributions of authors such as Eucken (1950) and - more generally - the ‘Freiburg school’ and the intellectual and political elaboration of Ludwig Erhard, produced the vision of the ‘social market economy’. According to this approach, the market plays a fundamental role but cannot be conceived as the only ordering principle of an economic-social system. It requires the complement of an architecture which, by combining institutions and rules, guarantees its efficient functioning through the specification of the different areas of competence. According to ordo-liberalism, the overriding goal should be economic and social stability, which must be guaranteed by individual responsibility.

The influence exerted by the social market economy emerges in the contents of the Maastricht Treaty (1992) and – above all – in the construction of a monetary union based on a fiercely independent central bank. The objective of centralised monetary policy is price stability, and to satisfy this objective, the European Central Bank (ECB) must take its decisions in full independence of national fiscal policies which, in turn, are bound to the rules of the Maastricht Treaty and, subsequently, to those of the ‘Stability and Growth Pact’. However, by imposing severe constraints at national level policies and denying any space for centralised tools of economic and social stabilisation, ordo-liberalism introduces strict limits in pursuing the objectives of growth, social equity, and solidarity. To safeguard the cornerstones defined by points (b) and (c), it is therefore necessary to have a broader view of the foundations of European architecture by referring to other analytical theories.

The influence exerted by the macroeconomic approach of Keynes (1936) and the welfare state proposals of Beveridge (1942) is clear: monetary and fiscal policies should pursue economic stabilisation via the support for aggregate demand and sharing of risks. Perhaps less obvious, but equally relevant, are the contributions offered by the strand of public economics and fiscal federalism and by the Schumpeterian economic development. Musgrave (1959) identifies three functions of government: namely allocation, redistribution, and stabilisation. Hence, he lays the foundations of the theory of fiscal federalism, where

* We will adopt the current ‘social market economy’ label here, even if it can be misleading. The social role of the market is recognised by many authors who take opposite views on the working of the capitalist society. It refers to Marx (1857-58), who maintains that the market creates a social nexus between individuals “mutually indifferent”, and Friedman (1962), who advocates free market economics. As specified in the following, ordo-liberalism was instead characterised by the thesis that a social economy must complement the market. In this perspective, it would be more appropriate to use the label “market social economy” (see Messori, 2021).
cyclical stabilisation must be pursued at a central level (Oates, 1972). Moreover, in examining the sequence of the stationary states and the phases of expansion and recessions, Schumpeter (1912 and 1939) identifies close links between positive innovative breaks, waves of imitation, sharing mechanisms for risks reduction, and redistribution of the net proceeds of innovations and imitations among the different groups of agents.

To apply these general approaches elaborated by great economists of the past to the case of European integration, it is necessary to focus on theoretical contributions that are sufficiently confined to specific issues to be empirically verifiable, that is, to the so-called “middle-range” theories as defined by Merton (1949). In the economic field, the “middle-range” identifies the perimeter for the theory of economic policy.

In the combination of macroeconomic stability and efficient allocation of resources, a notable example of “middle-range” theory is provided by the “inconsistent quartet” of Padoa-Schioppa (1987), which extends to the single market Mundell’s trilemma (1960 and 1965) on the incompatibility between independent monetary policies, fixed exchange rates, and perfect capital mobility. In the absence of a single currency and a centralised monetary policy, competitive devaluations of the exchange rate would result in distortions in the functioning of the single market. What was not fully understood at the time was that the lack of centralised instruments to respond to shock, could give rise to national ‘industrial policies’, which would also hamper the functioning of the single market. Another example of the “middle-range” theory, which is relevant for the European integration and the related policies, is offered by the analysis of Atkinson (1975 and 1991) on the EU’s role in the evolution of the welfare state. The latter would be crucial in reducing European inequalities and incentivising investment in social capital.

This focused reflection emphasises the importance of supranational public decisions for European construction. In this respect, the above-mentioned theory of fiscal federalism shows that the supply of public goods with high externalities must be placed at the central level. However, as Olson (1965) underlines, this centralisation raises a complex decision-making problem because there is a tension between the minimum level of aggregation in the provision of public goods, which is required to exploit economies of scale and scope, and the heterogeneity of preferences, which reduces the lowest common denominator. This finding opens the way to the formation of “clubs” in case of specific policies. However, even clubs must overcome the test of the ‘Arrow paradox’, which proves the impossibility of specifying any efficient function of collective choice based on individual preferences (Arrow, 1950).

3. In search of a new compass

The considerations carried out so far show that the analytical foundations developed in the last several decades and their economic policy applications pursued in the 1980s and 1990s are still of great importance for addressing the EU’s current problems. A challenging problem in this regard is offered by the trade-offs characterising supranational and national public decisions. After the June 2024 elections, European policymakers will have to identify and manage the issues arising from the forthcoming EU ‘radical’ enlargement that will lead to a further increase in the heterogeneity of national preferences. In the new European setting, it will become even more essential but, at the same time, more difficult to pursue collective goals.

To select effective policy tools to handle this new situation, the recourse to “middle-range” theories may be useful. These theories allow us to apprehend how the economic governance and institutional architecture of the EU have changed, due to the sequence of major crises that happened from 2008 to 2023 and risk resurfing in the near future. To effectively react to these incoming crises, the European institutions should draw the lessons from the international financial crisis, the European ‘doom-loop’ between the sovereign debt and the banking sector, the economic collapse caused by the lockdown during the pandemic, and the post-pandemic bottlenecks and geo-political conflicts.

Today, there is a broad consensus on the limits of the European economic policy response to the shock of 2008-2009 and the related sovereign debt crisis of 2009-2013. This response came too late. In some cases, it imposed such severe budget adjustments on member states in difficulty to aggravate their economic and social imbalances, at least in the short to medium term. The reaction to the shocks highlighted the unsustainability of the institutional framework of the European economic and monetary union, characterised by lack of centralised tools for crisis management and by excessive reliance on monetary policy for cyclical stabilisation.
The dual legacy of the ordo-liberal approach was eventually overcome by creating European central crisis management tools (first temporary mechanisms and then a permanent one, the European Stability Mechanism: ESM). The unfolding of the crisis showed that economic stabilisation requires centralised instruments in the event of large shocks.

To summarise, the impact of the international financial crisis highlighted that national stabilisation policies tend to be effective in responding to normal cyclical fluctuations but are inadequate in the face of significant exogenous shocks. At that juncture (2008-2013), however, it was believed that the adoption of central mechanisms for crisis management, the imposition of binding constraints on fiscal policies of the member states in difficulty, and the reliance on the centralised monetary policy as an anti-cyclical tool were sufficient to absorb the exogenous shock without the need of a central fiscal capacity. Instead, the outcome was a pro-cyclical fiscal stance and an overburdening of the monetary policy that lasted for several years (until the end of 2018). As we stress below, this overburdening led to market distortions.

**The impact of the international financial crisis highlighted that national stabilisation policies tend to be effective in responding to normal cyclical fluctuations but are inadequate in the face of significant exogenous shocks.**

Only the economic impact of the pandemic led to the awareness that monetary policy cannot be separated from fiscal policy. The EU’s institutional response led to a balanced combination between monetary policy and fiscal policies (i.e., a congruent ‘policy mix’) and to the building of a substantial, albeit temporary, central fiscal capacity with the adoption of the SURE program and, especially, Next Generation–EU. The latter aimed at achieving a sustainable and long-term economic growth through ‘green’ and digital transitions.

Whilst this policy mix was effective in dealing with the economic impact of the pandemic, it was not adapted to handle the aftermath of the shock. The post-pandemic was characterised by bottlenecks in aggregate supply that triggered a rapid rise in inflation since the beginning of 2021. Inflation exceeded the 2% target since July 2021 and was dramatically aggravated by the energy crisis that followed Russia’s war of aggression on Ukraine. Together with the new tragedy in the Middle East, these events opened a new dramatic phase in the EU also from an economic point of view.

The ruptures in international value chains, the unavailability of critical raw materials for the digital transition, the need to accelerate the energy transition have revealed the obsolescence of an EU production model characterised by an excessive dependence on foreign demand and low-cost imports, an abnormal weight of small firms, the use of solid but mature technologies, and backward and fragmented services. These elements make the need to build a permanent or recurrent central fiscal capacity at the European level even more pressing. The strengthening of the European budget should be used for the (centralised) production of European Public Goods (EPGs) that have a crucial role in the implementation of a European industrial policy.19

This evolution of the EU architecture should make it possible to connect the three cornerstones, introduced in the previous section (the balance between common rules and market functioning; the overcoming of the tensions between efficiency and equity, and ‘vertical’ policy coordination), with three new topics linked to EU’s response to the pandemic and post-pandemic shocks: (i) the coordination between monetary policy, national fiscal policies and new centralised fiscal policies; (ii) the complementarity between risk reduction and risk sharing; and (iii) the establishment of an EU industrial policy based on EPGs’ production.

Regarding the policy mix, the “loneliness” of the ECB during the sovereign debt crisis and the subsequent years produced many distortions that amounted to new forms of “fiscal dominance and financial dominance”.20 Lacking the support of other policies, the ECB was forced to undertake systematic non-conventional programs for the purchase of euro area public debt securities, and to squeeze the policy interest rates onto its “effective lower bound” (even in negative territory).

As such, monetary policy became a substitute for explicit risk-sharing mechanisms and indirect support of national fiscal policies.21 The policy mix designed and implemented during the pandemic proves that a successful coordination of EU economic policies is possible. Yet, when European inflation exceeded the 2% target (from July 2021), monetary policy was once again left alone. Instead, recourse to a centralised and selectively expansionary fiscal policy on the supply side would have helped the monetary policy in contrast to inflation. A supply counter-shock would have been more suitable to tackle the inflationary pressures at the source.22

A supply counter-shock would have been more suitable to tackle the inflationary pressures at the source.
The complementarity between risk sharing and risk reduction builds on the reflections of Habermas (2008) and Tirole (2015), who argue in favour of solidarity as insurance, and Rawls’ “veil of ignorance” according to which reforms should be designed without knowing in advance which specific group of individuals would benefit from (Rawls, 1999). In situations of radical uncertainty or “permacrisis”, such as the current one, this insurance solidarity prevents transfers between member states from being systematically in favour of an invariant set of countries. Therefore, it reduces the probability that the EU is transformed in a ‘Transfers Union’, a concern often stigmatised by Germany to justify the need that national risk reduction precedes centralised risk sharing.

Regarding a centralised industrial policy, the need to progress towards objectives of climate neutrality and to reduce the EU’s growing technological gap compared to the United States and China has highlighted the need for European transnational projects with positive and strong externalities. These projects should support the creation or the strengthening of truly European markets. The latter would positively interact with one of the main components of the new centralised industrial policy: the production of EPGs.

From a political standpoint, the supply of EPGs implies a quantum leap in the sharing of sovereignty. However, this does not necessarily imply a loss in terms of national interest. Figure 2 illustrates this statement in a stylised fashion. The Single Market and the euro, by allowing to exploit untapped economic benefits, brought the EU onto the integration frontier (from A to B, and from B to C, respectively): in both cases, stronger EU sovereignty and national interest went hand in hand. However, any further sharing of sovereignty along the current frontier would imply a loss of national interest (from C to D). It is necessary to shift the integration frontier outward to find complementarity between EU sovereignty and national interest. The supply of EPGs pursues this aim (from C to E).

---

**From a political standpoint, the supply of EPGs implies a quantum leap in the sharing of sovereignty.**

---

**SHARING SOVEREIGNTY**

![Diagram](source: Authors’ elaboration)
4. Future avenues

At the international level there is a growing fragmentation of institutional and economic governance and a lack of shared global leadership. In this situation, described by Bremmer (2012) as a G-0, which has now replaced the unthinkable G-2 and the “classic” but outdated G-7 and G-20, the European dimension represents the minimum critical mass to play a significant role at the international level. In other words, none of the EU countries would be able to pass what we have called the “Jean Monnet compatibility test”: the ability to make decisions that ensure economic, institutional, and political coherence. Today, it is necessary to start a new season of integration. From this perspective, we need to return to the fundamentals. This is about asking ourselves the why, the what, the when, the how and – finally – the who of our being together as Europeans.

As to the “why”, European citizens and institutions need to become fully aware of the medium-term unsustainability of our current production model and its domestic and international ramifications. Without revamping Europe’s growth potential, it will be increasingly difficult to collect sufficient resources to sustain our social model that, despite its limits, has ensured the highest standards of social inclusion in the world. In an international setting that is moving away from the principles of liberal democracy, the gradual dismantling of the European social model would have dire domestic consequences and reduce the attractiveness of the EU on the world stage.

The European challenges are to reach the technological frontier, overcome the export-led model, and reduce the dependence of its innovative activities on foreign inputs. At the same time, the EU should acquire sufficient autonomy in terms of security and defence. If it were not able to meet these objectives, the EU would become increasingly vulnerable from an economic, social, and institutional point of view, regardless of whoever becomes President of the United States in November 2024. These objectives are unachievable without shifting part of the sovereignty from the national to the European level. In the face of international markets and geopolitical relations that favour conflicts resulting in zero-sum or even negative-sum games, the inadequate size of the EU’s individual member states has become glaring. Only through the sharing of sovereignty will the EU have a chance to oppose the current destructive trend and to preserve its “soft power”, as defined by Tommaso Padoa-Schioppa).

The “what” concerns the policy agenda looking forward. As a recent Manifesto points out, it is necessary to construct a “gradual and pragmatic federalism” to revamp the fading EU business model and strengthen the international role of Europe. Such federalism should entail significant progress towards the centralisation of different fields that are essential for a well-functioning Union. In this respect, crucial steps are building a deep European financial market, implementing horizontal and vertical fiscal cooperation, setting up a common energy policy, designing an industrial policy based on the supply of EPGs, and pursuing a unified defence strategy. These advances entail centralised financing and production of economic and non-economic public goods, which require a substantial reform of the EU budget. Credible compliance with the incoming new EU fiscal rules is of the essence to create the political conditions for such reform.

As to the “when”, the experience of the global financial crisis points to the costs of postponing difficult but unavoidable decisions. Moreover, actions taken under emergency conditions rarely lead to the best choices. Therefore, given the recurrence of crises and the current risk of serious disruptions, a discussion on the strengthening of production and supply of EPGs is a matter of priority.

On the “how”, we need a new narrative capable of restoring trust between national governments, between the latter and European institutions, and ultimately between European citizens and the EU. Rebuilding trust will require a “dense” society with effective intermediate bodies which support and legitimise conflicting interests within an accepted general framework. In so doing, they contribute to the building of balanced social equilibria that are essential for extending the time horizon of decisions and favouring their implementation. At the European level, this would strengthen participatory democracy and would help decrease the “discount rate” applied to European public choices.

Rebuilding trust will require a “dense” society with effective intermediate bodies which support and legitimise conflicting interests within an accepted general framework.

The “who” once again calls into question national and European political leaders. The latter must demonstrate that they are up to the enormous challenges that the EU has ahead of it. Jacques Delors, Helmut Kohl, and François Mitterrand faced dramatic choices after the fall of the Berlin Wall. In equally difficult circumstances, Ursula von der Leyen, Angela Merkel, and Emmanuel Macron were able to cross ‘red lines’ in the response to the pandemic. Who are the champions of European sovereignty today? We are comforted by the fact that Mario Draghi, in recent interventions and contributions, has provided similar indications, which will be translated into concrete proposals in his report on European competitiveness. The challenge will be to find the political willingness to implement such an ambitious agenda.
The European Policy Centre is an independent, not-for-profit think tank dedicated to fostering European integration through analysis and debate, supporting and challenging European decision-makers at all levels to make informed decisions based on sound evidence and analysis, and providing a platform for engaging partners, stakeholders and citizens in EU policymaking and in the debate about the future of Europe.

The European Politics and Institutions programme covers the EU’s institutional architecture, governance and policymaking to ensure that it can move forward and respond to the challenges of the 21st century democratically and effectively. It also monitors and analyses political developments at the EU level and in the member states, discussing the key questions of how to involve European citizens in the discussions over the Union’s future and how to win their support for European integration. The programme has a special focus on enlargement policy towards the Western Balkans, questions of EU institutional reform and illiberal trends in European democracies.