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Policy Brief

Check yourself before you wreck yourself

On the gap between political ambitions and institutional realities in EU economic policymaking

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Strengthening the EU's capacity to act in economic policy making has become a fashionable talking point on the European policy agenda. At the same time, there is little debate about the institutional preconditions to be able to live up to these ambitions. In this policy brief, Nils Redeker and Thu Nguyen argue that the combination of grand policy ambition and institutional neglect constitutes a dangerous mix. Without new financial tools and decision-making procedures, the agenda is bound to disappoint. The authors argue that the debate on EU economic sovereignty needs to start talking about real reforms or else stop raising false expectations.

1 Introduction

Strengthening the EU's capacity to act has become a fashionable talking point on the European policy agenda. The idea comes in different names and nuances: from more European sovereignty to larger autonomy, to greater resilience. This applies to policy areas where sovereignty has always been the foreign policy of first resort, such as sanctions, security or defence. But the debate is also increasingly shifting to an area that has so far mostly been debated as an intra-European issue: economic policy. Here, the argument often goes as follows: Given the changing geopolitical landscape, the rising demands of the digital and green transition and the recent experience with the pandemic, the EU needs to become a more powerful regulator, a more strategic long-term investor and a more effective crisis manager to be able to fend off competition from the US and China. **This agenda often implies more European economic policymaking. But there is little debate about the institutional preconditions to be able live up to these ambitions.**

This combination of grand policy ambition and institutional neglect is a dangerous mix. Recent episodes – from the problems surrounding the European vaccination procurement process, to the debates on the ambitions and potential of the Conference of the Future of the Europe to decide on meaningful EU reforms – have shown that ignoring the institutional side of European policymaking comes with serious side effects: talking policy without sketching out how to get there often means that plans fizzle out with no tangible consequences. Worse, the habit of announcing that the EU is going to solve problems without putting it in the position to actually deliver on the task gives member states the chance to hide behind Brussel's back when things go south and undermines citizens' trust in joint policymaking. Designing the right financial tools and decision-making procedures thus needs to be part and parcel of any agenda for strengthening the EU's capacity to act on economics – otherwise the current debate sets the Union up for failure.

Therefore, calls for stronger EU action in formulating and promoting economic policies need to consider the institutional preconditions for joint policymaking. This entails two main requirements. First, a lot of the envisioned new tasks are costly. If the EU is to take on new roles, it will need new financing instruments. Second, joint policymaking means giving up a certain degree of national control over decisions. When member states want issues to be solved at the European level, they need to cede control at the national level to EU institutions. Where the European Union is taking on new roles but is not given the appropriate institutional backing, both the Commission and member states need to clearly communicate the limits of what the EU can achieve in the relevant area. Otherwise, they risk undermining trust in European problem-solving.

2 What a greater role in economic policymaking means

Recent months have given rise to fundamental discussions about the EU's economic role. As policymakers grapple with the question of how the EU should respond to a changing geopolitical landscape, to the ongoing technological and climate challenges and to the lessons learned from the pandemic, new terms have entered the economic policy debate that originated from the foreign policy world, from European sovereignty to (open) strategic autonomy, to European economic resilience. Debates about the semantics of these new terms have been fierce and often point to important conceptual differences. In their wake, however, a policy consensus has been forming that boils down to three broad political ambitions.

First, proponents of the new agenda want the EU to become a more powerful regulator. On the one hand, this means that the EU should develop new instruments to curb what is perceived as unfair competition from abroad. For example, the Commission is supposed to reign in the distortive effects of foreign subsidies in the single market and take measures to prevent big foreign tech firms from abusing their market power.[1] On the other hand, it implies setting more ambitious standards for the green and the digital age. By introducing European rules that have the potential to become global standards, the EU is supposed to get ahead of the regulatory curve. By shaping nascent markets and technologies like AI while it still can, the EU aims to protect European values such as privacy, while at the same time providing European firms – which ideally already comply with these standards – with a competitive edge on world markets.

Second, there are calls for the EU to become a more important strategic long-term investor. To safeguard European jobs and cohesion, secure competitiveness in high value-added areas and reduce supply-chain dependencies in strategically important sectors, the EU should be able to steer large amounts of resources towards common economic priorities. In practice, this often implies more active industrial and innovation policies, the pursuit of the investment goals of the European Green Deal and calls for the EU to subsidise and support the development of key technologies on the continent.

Finally, and especially since the outbreak of the pandemic, there are calls for the EU to become a more effective crisis manager. The second major economic crisis hitting the continent in little more than a decade has brought home the message that joint capacity to act not only implies long-term strategising but also the ability to quickly respond to changing economic circumstances. From setting up and managing the Recovery Instrument (RI) to organising large-scale vaccination procurement or supporting the regionalisation of strategically important supply chains, the last year has confronted the EU with a wide range of (largely unanticipated) new tasks.

What all these calls have in common is that they imply more joint economic policymaking. Independent of whether policymakers call for strengthening sovereignty, autonomy or resilience, in practice, their proposals usually require a substantial expansion of the *EU's capacity to act* in

1 Concrete examples here include the proposals on counteracting the distortive effects of foreign subsidies or measures that limit the ability of foreign tech giants to exploit their dominant market position.

economic policymaking. This has important institutional implications. In many of the areas the EU is now supposed to become more active in, its role traditionally has had clear limits set by the treaties and by member states' reluctance to cede control.

When considering new economic policy tasks for the EU, proponents should therefore be ready to put in place the conditions for successful European policymaking in the relevant policy area.

3 What changes are needed

Updating EU tools and decision-making procedures thus needs to become an integral part of the debate on how to strengthen the EU's capacity to act in the economic realm. Specifically, the agenda needs to cope with two fundamental questions: first, are member states ready to equip the EU with the necessary financial resources to become more active in economic policymaking? And second, are member states willing to give up control in joint economic decision-making where necessary? If there is no willingness on the side of the member states to do either, the European Commission must consider this in its communication and start seriously reigning in expectations as to what it can reasonably achieve in the economic realm.

3.1 The EU must be given new financial instruments

First of all, if the EU is to take on new economic roles, it needs new financial resources. To take one example: Investment-centered industrial policy – especially if it goes beyond supporting research and development – is costly. Turning the EU into an economic actor that can match the investment capacities of other economic powerhouses such as China or the US would require enabling the EU to channel large amounts of resources into sectors and economic activities of strategic long-term importance. Similarly, if proponents of a stronger capacity to act want the EU to become a more effective crisis manager, they need to think about new ways to provide the EU with the financial resources to quickly react to changing economic circumstances and events. Under the current budget, both the EU's ability to invest money in joint long-term priorities and its capacity to become an effective crisis manager are severely limited.

The EU's spending power rests solely in the long-term budget and has narrow limits. First, there is very little joint spending at the EU level. The Multiannual Financial Framework (MFF) of the EU is comparably small and for decades has plateaued at about 1% of the EU's annual economic output. The lion's share (about 70% in the 2021-27 budget, see Figure 1) does not flow towards joint expenditures but is dedicated to agriculture subsidies and regional aid. It is thus pre-allocated to specific regions and implemented by member states. De facto, this means that the EU has very little money and discretion in spending on new joint priorities. Second, EU spending is famously inflexible. The general structure of the budget is agreed upon seven years in advance and hinges on support from all member states. After that, it is very difficult to transfer money from one title or heading to another, and any change in the ceiling of overall spending again requires unanimous support in the Council and a majority in the European Parliament. From an investment perspective, this is problematic. Even for long-term projects, financing needs to be flexible enough to change course if undertakings do not plan out. Moreover, it is hard to plan all investment needs seven years in advance. If priorities change or unexpected crises emerge, the EU has no regular procedure to adapt its financial instruments.

Importantly, the regular budget framework has proven to be enormously difficult to reform. While the current debate puts a new spotlight on the deficiencies of the MFF, the insight that the EU lacks common spending and is much too inflexible is by no means new. Every seven years, a new round of ideas is introduced on how the structure of the budget could be changed. And every seven years, a lot of smart plans get lost in the political economy of unanimous budget negotiations in which all member states are keen to secure pre-allocated parts of the budget and chop the joint expenditures. This playbook is easy to bemoan, but very hard to change.

To realise the financial underpinnings of Europe's capacity to act, new financial instruments are needed. The Recovery Instrument (RI) has settled the question as to whether the EU is allowed to take on debts for the purpose of macroeconomic stabilisation. Moreover, the requirements for the national recovery and resilience plans explicitly link the goal of macroeconomic stabilisation with a focus on public spending on areas that have clear European spillovers such as the green transition and digitalisation. In practice, the RI will therefore not just be the first debt-based

crisis instrument; it also shows that a more expansive European investment policy is possible. And by introducing the possibility of financing via new own resources, it points to new European income sources.
A key question for those who want to strengthen the EU's capacity to act should therefore be how to turn the lessons learned from the RI into new permanent financial tools. At the moment, the instrument is limited in time and clearly restricted to the consequences of the pandemic. For the tasks envisioned in the new agenda, the EU would, however, need new instruments to raise additional common funds for additional common expenditures either in the form of debt or new own resources. Of course, this raises difficult questions, including in what kind of circumstances debt-based spending should be an option, how to determine what kind of joint expenditures to prioritise, and what form of own resources could be leveraged. But it is clear that without new financing instruments, the EU will hardly be able to take on new tasks that require financial resources.

3.2 Member states must be prepared to cede control to the European level

If member states are serious about expanding the EU's capacity to act, they must be prepared to cede national control over decision-making to the European level. More joint European capacity to act means giving up some individual national capacity to act in return. This can mean removing unanimity requirements in the Council in areas in which the EU is expected to seriously push forward the agenda. Member states cannot expect the EU to accomplish wide-ranging actions and at the same time insist on retaining their right to always be able to block any such actions. But it can also mean transferring national decision-making powers to the European level without further interference in the first place. What may sound like a truism is not always fully appreciated by the proponents of more European capacity to act, but it is all the more important in times of crisis. A lack of willingness of member states to cede control can make decision-making procedures both too murky and too slow.

The risk of rendering decision-making procedures too murky can be well-illustrated by the European vaccine strategy as the largest and most important public procurement activity on the European level in recent times. The Commission was tasked by the member states with procuring vaccine doses for the entire EU. But instead of giving it free reign in the negotiations, member states decided to retain control over the process as part of a negotiation team and through a Steering Board, composed of officials from all 27 member states, and did not give the Commission the financial resources to go all-in. Instead, all purchasing decisions remained with member states. The lack of demarcation of competences in this setup rendered the vaccine procurement decision-making process murky and intransparent to the European public. Alas, once it became clear that the EU potentially committed a number of strategic mistakes, e.g. regarding the early build-up of production capacity or the overreliance on strict liability clauses and low prices – likely also an effect of said murky decision-making process – the Commission took all the blame as it was the most visible actor while member states hid behind the Commission's back. This contributed to a feeling that the EU was not up to the task it was given and undermined public trust in joint problem-solving in the EU.

The tendency to combine a call for strong European solutions with an unwillingness to relinquish national powers can also be seen in other areas in which the EU currently attempts to redefine its economic role. Last year, a new foreign direct investment (FDI) screening mechanism came into force as a central instrument to strengthen the EU's "open strategic autonomy". The goal is to better protect firms and technologies that are deemed to be of strategic European interest from foreign takeovers. However, for all the European ambition, member states remain fully in charge of checking and potentially blocking takeovers. In essence, they now only have to take the non-binding positions of other member states and the Commission into account when calling the shots. As a result, national regulations on FDI screening remain a patchwork, and it is unclear what real weight Brussels will have in future decision-making. This was especially evident from the French government's recent decision to block the takeover of its flagship supermarket chain Carrefour by a Canadian company even before starting the official screening procedure. What looks like European policymaking from the outside thus often comes with very little real European competences, and as a result, little European value added.

In short, if member states want action to be taken at the European level as opposed to the national level, they must also be willing to cede control over decisions to the European level.

3.3 Better serious than sorry

Finally, the current mismatch also has important implications for how the Commission presents and communicates this agenda. Where there is a gap between policy ambitions and institutional realities that member states remain unwilling to fix – from industrial policy to crisis management or joint procurement of essential goods – the Commission must stop the practice of over-promising and then under-delivering.

Experience shows time and again that falsely raising expectations that the EU cannot meet comes with huge reputational costs. Legitimacy of joint EU action hinges upon its effectiveness and its ability to deliver. Whether or not the delivered output is deemed satisfactory to a large extent depends on how such joint action has been framed by the Commission and the member states in the first place. This can be seen in the economic realm with the European vaccine procurement, but also beyond that, on more principled levels, such as the *Spitzenkandidaten* process in the 2019 European elections. This means that the Commission must consider the EU's institutional and financial limits when communicating future joint EU actions. But it also means that member states must stop blaming Brussels for policy outcomes on which they were not willing to cede control to the EU in the first place.

4 Conclusion

The issues facing the EU today are manifold, and a principled debate about how the EU should respond to them is well-warranted. Importantly, the debate does not just take place against the backdrop of a shifting geo-economic landscape and structural challenges that have become impossible to ignore. It also happens at a point in time in which the contours of the EU's economic institutions seem to be more versatile than they have been in a long time. For those who want to strengthen Europe's capacity to act, this constitutes a window of opportunity.

However, in order to use this window, the debate needs to appreciate the fact that reforms of the EU's financial tools and decision-making procedures constitute an essential part of the agenda. Strengthening Europe's capacity to act in the economic realm ultimately depends on strengthening its capacity for joint economic policy-making. For that, institutional updates are essential. Proponents of a stronger Europe have to be clear about what kind of financial resources they are willing to make part of their agenda and to what extent they are willing to cede control over decisions to the benefit of joint policy-making. Otherwise, they risk piling up long lists of policy ambitions on which the EU is bound to disappoint.

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