

# What type of differentiation in EU economic governance after COVID?

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Roughly one year since the beginning of the COVID-19 crisis, the pandemic's long-term consequences on the EU's economic governance are still unclear. Will the crisis lead the EU on the path towards more integration, more fragmentation, or create a push towards further differentiation in the coming years?

The 2007–2012 financial and economic crisis led to more differentiation, in the form of strengthening Eurozone governance, following from the perception of the crisis as partly resulting from the shortcomings of the existing Maastricht EMU architecture. In the current COVID-19 crisis, the establishment of an EU recovery plan supported by all 27 member states and the launch of a Union-wide common vaccination strategy seem to indicate a strong determination on the part of member states and EU institutions to act together. The narrative of this crisis, which puts the focus on an exogenous common threat that requires a common response, has helped in this respect. Yet, one cannot exclude fragmentation risks or the use of differentiated integration as a fallback option in the years ahead.

## Fragmentation risks

To start with, many national COVID-19 measures have been uncoordinated, threatening the integrity of the Single Market. Apart from temporary border closures and mobility restrictions, there has been a large degree of divergence in national health responses, even in cases of very similar epidemiological situations. In addition to that, the economic consequences of the pandemic are asymmetrical and some of the EU's fiscal measures in response to the crisis – particularly the temporary suspension of the EU's fiscal and state aid rules – may exacerbate these economic divides. While the temporary European recovery plan aims at minimising the variations in budgetary capacities between member states, it might not be sufficient to limit or even reduce country divergences in the medium term. Differences in



national crisis responses and post-COVID recovery pathways may render it difficult to reach a consensus on making the European recovery plan permanent or to move forward in areas such as health or taxation. As often in the past, differentiated integration (DI) may become the “second-best” solution to overcome deadlock and advance in new areas of European integration.

### **New patterns of differentiation may emerge**

The Eurozone crisis led to the creation of new EMU differentiated institutions (the European Stability Mechanism, the Single Supervisory Mechanism, the Single Resolution Board) and the strengthening of the EMU-related procedures and rules (reform of the Stability and Growth Pact, creation of a new macro-economic imbalance procedure, etc.). Since the main goal of the new arrangements was risk-prevention and risk-sharing, they had to include, at minimum, all Eurozone countries to be effective. They were also highly institutionalised, as their success depended on strict compliance with commonly agreed rules and decisions.

In the aftermath of the COVID crisis, economic differentiation may take another shape. We might see the renaissance of some “old” Eurozone reform proposals, such as the creation of a European Deposit Insurance Scheme in the framework of the Banking Union project. Yet we also see other cleavages emerge related with new prominent issues such as climate, taxation or the new EU industrial strategy. Brexit has also changed the power relations in the Council and has led some countries to re-define their coalition-making strategies. This may lead to the emergence of new patterns of differentiation. These could be less institutionalised and less centred on the Eurozone, involving different coalitions of EU countries willing to join forces and resources to finance specific projects. We already see these patterns of differentiation emerging in the EU industrial policy field with the creation of “industrial alliances” and “Important Projects of European Economic Interest”.

### **How to make post-COVID differentiation work? Lessons from existing arrangements**

Even if differentiation is frequently seen as a temporary step forward to overcome the unanimity deadlock, the past shows that, once created, differentiated arrangements have a tendency to persist over time. It is thus important to render them effective in terms of policy-making. In our recent EU IDEA research paper “How Effective Is Differentiation in the EU Economic Policy Field?” we tackled this issue. By analysing and comparing the policy performance of various differentiated integration arrangements in the EMU, the Single Market and in third country access to the Single Market, we identified several institutional factors that are key in achieving policy success in differentiated policy areas. These findings lay a useful foundation for discussions on the design of economic differentiated integration arrangements in the post-COVID era.

First, more institutionalised arrangements are not necessarily synonymous with better performance. Rather, it is important to have an institutional set-up tailored to the specific goals of the differentiated institution. In some cases, a high level of institutionalisation is required to secure the adoption and enforcement of difficult joint decisions. In other cases, compliance is not a major issue of concern. A “softer” and more flexible governance structure may be more appropriate to organise the joint financing of projects, to promote the exchange of information and to foster mutual

learning.

Second, well-performing differentiated arrangements typically have some capacity to adapt to changing circumstances and evolving political preferences. Such a capacity is very much related to the existence of appropriate accountability mechanisms, able to legitimise policy-makers' decisions to recalibrate institutions and procedures in response to new or altered problems.

Third, differentiated arrangements should be designed in a way that minimises undesirable effects on non-participating countries. This may consist of legal safeguards obliging participating members to take the interests of non-members into account when adopting certain decisions, or directly giving some participation rights to non-differentiated countries in the policy-shaping or policy-making process.

Taking these elements into account will help policy-makers to construct differentiated integration arrangements that can better achieve their policy objectives, depending on the concrete policy areas in which differentiation might be necessary to overcome unanimity requirements and to advance European integration.

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