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Merkel on EU reform: a decryption

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For eight months, the EU had waited for a German response to President Macron's ideas on EU reform. On 3 June 2018, Chancellor Merkel outlined her own proposals in an [interview](#) with the Frankfurter Allgemeine Sonntagszeitung. While lacking an overarching vision, she provided some concrete proposals on what she saw as priority policy areas: Eurozone, asylum and border management, as well as foreign and security policy. Here's what she said and what it means.

Introduction

On 3 June, the German chancellor finally gave her long-awaited answer to the proposals of the French president to reform the European Union (EU) – or at least that is how the chancellery wants the [interview given to Frankfurter Allgemeine Sonntagszeitung](#) to be seen. The interview spans a wide range of issues. In this text, we focus on the three main policy areas that will be discussed at the June European Council meeting: the reform of the euro area, the future of asylum and migration policy, and the next steps in foreign and security policy.

The reply to Macron follows a very different approach than that of the French president. It does not provide an overarching vision that would enshrine the next steps to be taken in a greater political narrative. Instead, the chancellor presents a list of desirable instruments, which are then presented in rather great detail. The proposals are thus more concrete – but also a lot less justified. The interview provides a firm basis for negotiations in the weeks to come. At the same time, it is somewhat sobering as the level of ambition is very closely bounded by what is deemed politically feasible in Germany. That is not necessarily the worst starting point this late in the negotiations.

1 Eurozone reform

What's there and how it's said

The interview describes in great detail the chancellor's position on two central pillars of Eurozone reform: How to reform the European Stability Mechanism (ESM) and how to build a potential budget for the euro area. Banking union and capital markets union – i.e. the two main vehicles to promote private risk sharing – are only mentioned in passing in one sentence. This is a message in itself: Merkel explicitly acknowledges that euro area reform needs to go beyond finishing touches on the financial side but has to include steps on fiscal policy. This is new – and was a sine-qua-non for the Élysée. This also indicates that the next steps on banking union are now seen as a done deal (i.e. there will be a backstop for the Single Resolution Fund in the ESM) but that there will be no further opening in this round of negotiations on a European deposit insurance scheme.

There is also a second overarching element in there. Up until now, German positions on EMU were usually framed as a sequence: If we reach point x, we can go for measure y. In the interview, Merkel does none of that. Instead she describes an institutional setup as she would like to see it without any sequence or quid-pro-quo. This is of course ambiguous: On the one hand, it signals openness and does not indicate conditions for concessions. On the other hand, it gives other players very little indication where red lines lie and which parts are really important to her.

Build a European Monetary Fund

Merkel gives several detailed indications on how the ESM should be turned into a European Monetary Fund (EMF):

- Credit line with shorter maturity: In the spirit of giving the EMF the same tools as the IMF, Merkel talks about a new ESM credit line to help countries that are in peril due to “external circumstances”. Loans should have a maturity of five years, in contrast to the 30 years in the normal ESM programme. Interestingly, the description she gives (five year maturity, conditionality, limited access) sounds exactly like the IMF’s Stand-By Agreement (SBA). The SBA however is the Fund’s most standard instrument and was for instance used in the first Greek programme. It is by no means a light-touch instrument, but differentiates itself from the Fund’s longer-term facility in that it focuses more on fiscal measures and less on structural reforms. Thus, one should be careful to interpret this proposal as indicating support for a more lenient conditionality for shorter-term ESM programmes.
- Continuously evaluate countries: To be able to deliver on this suggestion, the EMF would build up permanent country desks to track member states regardless whether they are in a programme or not. This is an old idea of the German finance ministry and the Bundesbank who do not trust the European Commission in its economic surveillance of member states. But it is not clear what such a move would change. Formally giving the EMF the competence for surveillance would mean stripping it from the Commission, which would require changing the treaties. This is not in the cards. But short of that, such a move would just mean duplicating the Commission structures. It would also imply giving surveillance competence to a body directly controlled by finance ministers and hence would likely be no less political than the Commission today.
- Determine debt sustainability and get the instruments to restore it: Merkel says two things here: First, give the EMF the competence to determine debt sustainability. Formally, this is done under the ESM treaty by the Commission and the ECB, even though ESM staff *de facto* already have a significant role here. Whoever carries out the debt sustainability analysis (DSA) determines whether there is a need for debt restructuring – in the case of Greece now this is the crucial question. The idea to give the EMF, i.e. the member states, a more direct grip on the DSA is certainly not a coincidence. Second, the chancellor argues that the EMF should have the instruments to make debt sustainable again if necessary. This is an internationally-known euphemism for making debt restructuring part of programme conditionality in case debt is unsustainable. If she insists on this in the negotiations, it could become the thorniest point: France, Italy and many smaller member states firmly reject any move to make debt restructuring a more formal part of Eurozone emergency lending procedures. They fear it might spark a selloff of government bonds if they are all of a sudden seen as unsafe.
- Intergovernmental setup and under the control of national parliaments: In short, the EMF will have the exact same decision-making structure as the ESM, including a veto for all member states and a strong role for those national parliaments like the Bundestag that already have a say. Forget the clause in the German coalition agreement that the EMF should be anchored in EU law, this is only for (much) later.

The EMF is the necessary counterpart for Merkel to domestically justify the backstop for the Single Resolution Fund within the ESM/EMF. German officials have been clear that the ESM treaty will only be opened once - and hence the need to change the ESM treaty for the backstop is also the moment to discuss the German long-standing ideas for ESM reform. Now we know along which lines to think here.

Establish an investment budget for the euro area

The chancellor endorsed in the interview the idea of an “investment budget” for the euro area and filled it with more detail:

- Low double-digit billion euros: For the first time, the chancellor gives a ballpark number and explains that it should increase step-wise. The interesting question is: Are we talking per year or for seven years? If for seven years – i.e. the duration of the next Multiannual Financial Framework - this would sound a lot like the 25 billion euros that the Commission has proposed to help countries with structural reforms. In the interview, Merkel says that she supports the idea, not without reminding the reader that it was once her to propose this in the first place. She also explicitly leaves open whether this new pot should be placed within or outside the EU budget.
- Support catch-up in key technologies: According to the chancellor, the euro area investment budget should help countries that are not in a crisis situation to converge towards best performers in a number of economic fields (she mentions Germany, France and the Baltics as best performers in the area of artificial intelligence). This also makes clear what the budget should not do – it should not be a tool for macroeconomic fine-tuning or fiscal stabilisation.

Merkel accepts a euro area budget in name – but not in substance. An investment budget as described above is too small to have a material macroeconomic impact and largely duplicates what the EU budget already does, namely provide catch-up support.

Yet, it is a starting point. The fact that the German side is now ready to include fiscal policy into the June package opens the door for an agreement on all three fronts: Banking union, ESM reform, and a euro area budget. The crucial question is what exactly the German red lines will be – and that we still do not know after this interview.

2 Asylum, borders and development

In the interview, Merkel outlines a possible way forward in three areas that she considers crucial for the EU’s migration policy. The chancellor declares that there are “existential questions” for the EU in the fields of “border protection, a common European asylum policy and fighting the root causes of migration”. Free movement, she argues, is constitutive for the EU’s internal market and a lack of trust in the aforementioned policy fields could put the Union’s prosperity at risk.

The chancellor advocates stronger engagement on the African continent in the attempt to mitigate the root causes of displacement. Her proposals in this regard are vaguely formulated, but essentially gravitate around the continuation of closely linking development cooperation and migration management in the EU’s relationship with third countries. More interesting are Merkel’s ideas on border control and asylum policy. The respective proposals are carefully formulated, underlining her intention to move ahead on the reform of the Dublin Regulation.

Border control: Expand Frontex' mandate

Merkel proposes to transform the EU border agency Frontex in the medium-term into a “genuine European border police” able to “independently act at the EU’s external borders”.

- Concrete measures in this direction have already been taken at EU level. In the aftermath of the ‘migration crisis’, Frontex’ mandate has been significantly expanded, most notably by establishing the European Border and Coast Guard in 2016. However, thus far the agency has to be invited by a member state to patrol its borders. Taken literally, Merkel’s proposal would require countries such as Poland or Greece to overcome their opposition of having an EU agency, staffed with foreign officers, controlling their borders. It would also presuppose that Frontex acquires its own border guard staff. So far, it had to rely on national border guards, which have often been deployed slowly and in insufficient numbers.

Common EU Asylum Policy: Towards a flexible system of solidarity

With regard to the Common European Asylum System (CEAS), the chancellor outlines three critical areas of reform.

- Merkel presents the harmonization of asylum standards and procedures as a way to arrive at comparable acceptance rates for refugees in the member states. Although not explicitly mentioned in the interview, similar asylum standards across the EU are perceived by the German government as a means to curb secondary movements of asylum seekers. Negotiations on this issue have been ongoing at the European level since 2017 – with limited success.
- In what she ambiguously calls “Endausbaustufe” (final expansion step), Merkel advocates creating a European refugee agency, which would be responsible for handling asylum cases at the EU’s external borders. At what time such an agency would be established and under what conditions is not further specified. The idea comes close to an [proposal by the European Commission](#) from April 2016, which stipulated that asylum procedures would foremost be handled by a central EU agency, which then allocates refugees across the member states. However, the reform proposal currently under negotiation, which foresees transforming the European Asylum Support Office (EASO) into the EU Agency for Asylum (EUAA), is far from including such a mandate.
- In the short term, Merkel suggests overcoming the current deadlock in the European Council on a reform of the Dublin Regulation by introducing a “flexible system” of solidarity. She proposes a “distribution of tasks, in which every country makes its own, yet comparable, contribution”. In practice this means that member states would be able to opt out of a mandatory relocation quota for refugees by making financial contributions, for example in the field of border management. The proposal marks a turn in the German position. Previously, Germany had argued in favour of a mandatory relocation mechanism. By picking up the idea of a “flexible system”, Merkel thus makes a concession to the *Visegrad* countries, which vehemently oppose any obligatory relocation quotas.

A contradictory picture

Reviewing Merkel's answer to what she considers an existential challenge for the EU, a somewhat contradictory picture emerges. She calls for more Europe when it comes to the role of relevant EU agencies. At some point in the future, the European border and coast guard as well as the EU asylum agency should have broader competences. At the same time, she advocates a flexible solidarity mechanism with a view to reaching a shorter-term compromise on the Dublin reform. Yet, such flexibility is likely to imply less concerted EU action. We would thus end up with stronger EU agencies but less binding member state commitment on the balance between responsibility and solidarity.

Finally, she expresses doubts on whether her concession to the *Visegrad* countries will lead to a compromise by the June European Council meeting. An agreement seems indeed out of reach, considering that Southern member states have voiced equally strong opposition to any compromise that does not provide for more responsibility-sharing regarding asylum processing on their territory. While Merkel suggests that discussions might have to continue for a "few more weeks", it seems more likely for them to drag on for a few more years.

3 Foreign and security policy

Defence: cautious steps towards Macron

In his [Sorbonne speech](#) in September 2017 President Macron called for a European Intervention Initiative to foster a common European strategic culture, a common defence budget, and a common doctrine for action. In the interview, Merkel was asked about all three aspects and answers with varying degrees of concreteness.

- European Intervention Initiative: "I am favourable towards Macron's proposal of a European Intervention Initiative". This statement by Merkel was picked up by the [press](#) as it seemingly contrasts with Germany's henceforth reluctant attitude towards the French-led initiative that is (a) largely intergovernmental and (b) restricted to a small number of invited European states, including the British and the Danes. However, it is important to read on. The chancellor then stresses that the French-led initiative and the common military-strategic culture it seeks to forge have to be aligned with the Permanent Structured Cooperation (PESCO) on defence, launched in late 2017 by 25 EU member states. The message is: we are willing to support the European Intervention Initiative, but it should be part of the broader EU-led defence cooperation efforts (i.e. PESCO), which would only in a second step be opened up for third countries such as the UK.
- European "defence budget": Concerning financial and personnel resources for the above initiative, Merkel says that the basic decision thereon remained to be taken. She then states that the European Defence Fund could be used for such interventions. However, the latter is supposed to co-finance collaborative defence research and capability development efforts. It is not a mechanism to finance EU interventions abroad. The chancellor might allude to the intergovernmental [ATHENA mechanism](#) that finances the

common costs of EU military operations. But although the category of common costs has recently been broadened, the member states will continue to carry around 80% of the expenses nationally ('costs lie where they fall'). The chancellor's rather vague comments indicate that Germany is not willing to commit additional resources to European defence initiatives beyond what has already been agreed in the EU framework.

- Common doctrine for action: the interview shows that this remains the most difficult part. It is essentially about the conditions under which the use of force is considered appropriate. Merkel stresses that none of the newer developments in European defence cooperation creates an automatism for German military contributions. Any deployment of the *Bundeswehr* will be decided on a case-by-case basis and in light of the boundaries of a parliamentary army. In a [speech](#) on 4 June she added that there should be a European white book on security policy and challenges. The idea of a white book that would translate the EU Global Strategy into a more concrete level of ambition is not new. To what extent it would bridge the member states' differences in strategic culture and foster more political will to jointly take risks and invest in the name of European defence remains to be seen.

EU foreign policy: more effective decision-making

While the chancellor's comments on defence can largely be seen as reactions to Macron's proposals, she took more own initiative on EU foreign policy. She underlined the need for "much more commonality" in this field and made two proposals for more joined up, effective and faster decision-making.

- Non-permanent EU seat in the UN Security Council: According to the chancellor, this should facilitate common EU action in coordination with France, the sole permanent UNSC member post-Brexit. The single EU seat is an old German proposal that also finds itself in the coalition agreement. One obstacle is that only states can be full UN members and thus occupy seats in the Security Council. The other obstacle is political: EU member states are in different regional groupings in the UN and often compete for non-permanent seats. Even a more [flexible 'pooling and sharing'](#) of non-permanent seats would require an important change in mind-set. These obstacles might explain why the chancellor designated it as a proposal for an unspecified 'medium-term'.
- A European Security Council: To the surprise of many observers, Merkel said she could imagine a European Security Council composed of a sub-group of EU member states that would rotate. It would closely consult with the EU's High Representative as well as European members of the UN Security Council. The aim would be quicker and more effective decision-making. While the proposal of a European Security Council is [not new](#), the rotation principle is. The key question is whether this Council would constitute some kind of informal consultation mechanism or whether it should be able to take decisions on behalf of the whole EU. The latter would raise important legal and political questions. It currently seems unlikely that member states would agree to cede their veto right, even temporarily, in an area that remains at the very heart of national sovereignty.

There are thus a number of open questions on the implementation of these institutional proposals. In any case they signal Berlin's willingness to give up a degree of sovereignty in order to strengthen the EU's global role and voice. Discussions on this topic are likely to go on beyond the short-term. A key question will be how Macron applies his vision of 'European sovereignty' to France's role as 'grande nation' on the international stage.

Conclusion

Even if they arrive rather late in the process, the German proposals for EU reform represent a good first step. This also summarises the reactions from Paris and Brussels. It was not the “new dawn for Europe” that the German coalition agreement promised. Many of the proposals reflect a pragmatic attempt to bridge the divide between expectations in other member states and domestic constraints ahead of a summer that will temporarily close the window of opportunity for significant EU reform. Germany will have to make more important second steps in the months and years ahead to avoid a prolonged phase of reform stagnation. As the chancellor [said](#), Europe is at a crossroads and “if we stand still, we will be pulverised by the big global structures”.