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"Economic and Monetary Union after the Crisis: Europe at Two Speeds"

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2014 will hopefully be remembered as a year during which we saw a modest and cautious recovery from the crisis.

But it will also remain in the European history as a year when the existing challenges Ukraine is facing were brought to the fore.

2014 also marks the tenth anniversary of the big 2004 enlargement. We Poles can appreciate more than ever the miracle that happened 10 years ago when we joined the European Union. What this reminds me of is that we hoped that after 2004, the EU would become more outward looking and develop a more effective neighbourhood policy. Again however, the EU remained rather focused on itself and on the crisis driven reforms.

What we see outside, around us, is also a rather messy world. We also witness globalisation, which is no longer built around a transatlantic consumer and an Asian producer. Gradually, a demand driven growth model in emerging economies generates new demands from millions, if not billions, of new consumers coming to the world market. Consumption habits change in Europe, they change across the world. If Europe is to remain competitive in the world of today, it will have to keep its windows open, with all its territories measuring their competitiveness against the global backdrop.

And last, but certainly not least, 2014 is the year of the European elections and thus a year which gives us a chance to look at the institutional potential of the Union.

Europe is strikingly different today, when compared to a mere five or ten years ago. The crisis has brought about an unprecedented range of financial sector and economic governance reforms and has posed novel challenges to the Union's institutional capacity. The challenges concern primarily legitimacy, efficiency and flexibility of its policymaking and the Union will have to live up to them.

Firstly, the broad range of EU reforms in economic governance and financial sector matters generated a need for accompanying mechanisms of democratic legitimacy. These were not sufficiently provided for however. A paradox slowly emerged, between national interests, which due to the crisis have become more visible in the Union, and the multiplicity of EU level solutions ignited by the crisis. The cooperation between the European and national parliamentary levels also remained deficient, giving rise to a severe democratic deficit. The distance between the Union and its citizens has once again grown.

Secondly, the crisis also brought to the fore the issue of institutional efficiency and the questions of whether we have in place the adequate institutional structures to deal with the problems of the Union and whether inter-institutional cooperation can live up to the challenges of the day. Serious concerns about the efficiency of the Union's institutions thus emerged.

Thirdly, the crisis also generated novel layers of differentiation in the Union. The bulk of crisis driven reforms targeted the common currency area. Non-euro area members aspiring to join the euro were not always taken on board in the reforms on an equal footing with their euro counterparts. Moreover, different appetites for reform were also displayed both within euro as well as within the non-euro groups of member states. These trends exposed the difficulty the EU faces in dealing with heterogeneity. The required flexibility called into question the cohesion, solidarity and integrity of the Union, adding to the challenges generated by a slowing down of the convergence machinery.

So what exactly do we mean by a multi-speed Europe, is this trend worrying, what challenges does it bring along and how may we address them? I will attempt to provide some food for thought on these questions.

What kind of multi-speed Europe are we dealing with?

The old discussion is back with us. The terms multi-tier, multi-speed Europe, variable geometry, among others, have flooded policy discussions over recent years and have hinted at various European sub-configurations. The scope and scale of needed reforms revealed different appetites and capabilities for integration. I can tell you that before the big enlargement of 2004 we, Poles, had been extremely sensitive to the idea of a variable geometry, rejecting it in a fear of becoming marginalized. Today, we see the need of deepening eurozone integration.

The most prominent divisive dimension is certainly the euro/non-euro one

When we think of two-speed Europe, one division that comes to mind is certainly the euro/non-euro divide. This has become a fact of life over recent years, one which is here to stay.

For obvious reasons, the focus of crisis driven reform efforts has been largely on the euro area. These include the wave of economic governance measures, meant to better enforce the Stability and Growth Pact, while also adding to its ammunition. The recently adopted two-pack element of economic governance, with its focus on budgetary surveillance and financial assistance, for instance applies to the euro area only. Beyond the two-pack, financial assistance for the single currency has in particular witnessed a radical rethink as a result of the crisis, with the creation of the temporary European Financial Stability Facility (EFSF) and subsequently of the permanent European Stability Mechanism (ESM).

Europe has also experienced a gradual strengthening of the Eurogroup, the gathering of euro area finance ministers, a trend likely to continue over the years to come, and has seen the establishment of Euro area summits. The ECB has also led the crisis management bandwagon, reaching well beyond its mandate of price stability and promising to do whatever it takes to keep the euro area together. The ECB however remains a eurozone institution and its strong role played during the crisis adds to the euro/non-euro divide.

Looking ahead, the Commission blueprint for the future of the EMU, released in the fall of 2012, put forward the idea of a separate euro area budget and a separate euro area committee in the Parliament. The latter issue is still a subject of debate. Such intentions merely reinforce the concern that the future parliamentary cycle will focus on the euro area to the detriment of the remaining 10 member states of the Union.

The same Commission blueprint also put forward the idea of a separate seat for the euro area in international institutions such as the IMF. This hints at the euro/non-euro division potentially moving beyond European borders and affecting the Union's international position.

Europe has also witnessed a number of eurozone related reforms with a partial openness towards non-euro member states (the six-pack, the fiscal compact, the Single Supervisory Mechanism -SSM-).

In general, one could say that the euro-non-euro divide is a product of necessity. It is also worth mentioning in this context that with the Treaty limitations and an urgent need for solutions, reaching out to intergovernmental agreements was at times inevitable. This added fuel to the existing dividing lines.

And then the famous North-South divide within the euro area, which always existed, become more pronounced. In this context, it is certainly interesting to understand where and why the convergence machinery of the single market has slowed down.

For decades, the architecture of European policymaking, together with the whole internal market construction, have been based on a one-size fits all approach. This was justified since our goal was the achievement of a single European market. Alignment was more of a cosmetic surgery, when member states represented a relatively small group of rather homogenous economies. With a growing heterogeneity with each new enlargement, the one size fits all approach required more different adjustment capacities.

The ECB policy was clearly challenged by the missing adjustment capacities of the member states and fit better the needs of more competitive economies. Less developed economies have not developed the needed adjustment capacities.

So when the crisis struck, we could see how differentiated the EU was on all accounts. We could see asymmetries in internal and external imbalances, different levels and degrees of competitiveness across the EU. The crisis has revealed different and dramatic differences in adjustment capacities across various sectors of our economies.

So it does not come as a surprise. We see it clearly that the eurozone's heterogeneity requires a strong push towards structural reforms, taking into account asymmetries and policy spillovers.

It would be worth looking from that point of view at all those quasi-federal policies and instruments, which emerged out of the crisis episode (the European Semester, the Macroeconomic Imbalances Procedure, ideas on the genuine EMU). Do they address the different situations with regards to the adjustment capacities? Also, do they take into account potential spillovers of differentiated adjustment processes?

The Country specific recommendations target the usually referred to policy areas in a general way. Recommendations for the eurozone as a whole are ambiguous, as it is not clear to which institutional body they are actually targeted. They are still to be tested

The Macroeconomic Imbalances Procedure is trying to make progress on this front and has thus far pointed to the imbalances of Slovenia and Spain as being excessive.

Federal solutions face a number of risks. They can bring in the problem of moral hazard on the one hand. This is a particular concern in the case of the future contractual arrangements underpinned by financial support (the competitiveness and convergence instrument). Moreover, without treaty change, decisions are too often based on political will and this tends to come and go. My worry is that once the end of the crisis has become reality, the momentum for reforms will evaporate.

Going back to the one-size fits all and dividing lines, Europe also has its set of emerging economies. These emerging economies from central and Eastern Europe promise high growth and profits, business friendly environments and sound public finances to investor. Nonetheless, they also still face some regulatory shortcomings, suffer from domestic infrastructure problems and offer only a limited availability of liquid markets on local stock exchanges for outside investors. Not all of them are euro members.

These characteristics create different capacities for adjustment, potentially requiring more of a tailor made approach, which cannot go with a one-size fits all philosophy. Moreover, differentiations exist within the emerging economies group themselves, so even here an overarching policy approach may not work.

As we have seen, divisions abound at the Union level. The most important one is clearly the euro/non-euro one. I would like to say a few words on those member states which are committed to joining the single currency one day, the so-called pre-ins.

So what are the challenges that a two-speed Europe brings along?

Recent reforms paint the picture of an increasingly eurozone focused single market. There is no reason to assume that this trend will come to an end in the near future. Efforts on reforming the EMU are likely to be stepped up over the years to come.

In this context, securing the position of non-euro members in the newly emerging reality of eurozone integration is a must but remains a constant struggle. The Commission has the tendency to put forward proposals which are in some way biased towards the euro area (either open only to it or with a form of opt-in envisaged, which however does not provide equal rights for the two groups, as was the case of the SSM). On the other hand, the European Parliament and Council are more open towards the idea than the Commission.

The policy stance on the non-euro area remains largely confused. Whenever a new measure is proposed, a debate then emerges within the European Parliament and European Council on whether non-euro members should be allowed to opt-in, and, if so, on what conditions. Slowly, such a stance might create further uncertainty about the role of these member states in the Union.

A way to address this concern could involve formalising the opt-in system and putting forward a type of opt-in blueprint, which can be easily made use of whenever a new EMU initiative is put on the table.

One option to always take on board these opt-ins could involve making use of enhanced cooperation, thus keeping policies within the Treaty. This would keep us within current treaties, while allowing us to move forward and attenuate the risks of two-speed Europe.

Policymakers must keep in mind that not only a blueprint which ensures participation in decision-making is important. The opt-ins must have access to full participation in new reforms and structures and this also involves having a fiscal backstop (as should be the case in the banking union). Thus a good blueprint must strive to go beyond decision-making.

Opt-in indecisiveness when to join the single currency is also adding fuel to the fire

The lack of an opt-in blueprint is certainly not the only challenge facing today's two-speed Europe. Also concerning is the attitude that the opt-ins have towards current reforms and their indecisiveness concerning potential euro area accession. To some extent, the confused EU policymaking approach towards the opt-ins is certainly adding fuel to the fire. Things could be made better however if the opt-ins took a clear stance about their intention to join the euro as soon as is feasible and possible. The policy of keeping their foot in the door and keeping all options open is not helping.

A decisive factor in their decision should be the awareness of the fact that, with multi-tier Europe here to stay, an abundant number of risks could materialize fir those outside.

Oftentimes unfortunately, political discourse in pre-in member states focuses on the risks of joining the euro area. I believe that we should instead focus on the risks of staying outside. Let me mention a few of them.

One such risk is a lack of impact in the decision-making process. Remaining outside the eurozone, the pre-ins will not be effective in influencing the reconstruction of the eurozone. As a player on the inside, their impact could be decisive. Waiting for the eurozone to fix all its problems before they join is an unacceptable argument. The pre-ins should be participating in the fixing process.

Moreover, by staying on the outside, the only way the pre-ins can get on board current and future new institutional mechanisms, which are created, is by opting-in. The opt-in status is however an uncertain one, as mentioned previously. Even if policymakers manage to create an opt-in status, as was the case for instance in the context of single supervision of the banking union, the pre-ins receive a decision-making backstop, but no fiscal backstop. The opt-in status effectively delivers limited benefits in terms of impact, with potentially prohibitive costs. At the same time however, a fully-fledged membership of the eurozone would come with some costs, but would certainly offer a higher number of benefits (access to a fiscal backstop, to the ECB non-standard monetary policy measures, such as the Long Term Refinancing Operations (in several rounds, the central bank provided cheap loans to eurozone banks to stimulate lending to the real economy and to ECB supervision, which can be attractive for market confidence etc.), if compared to the opt-in status.)

Additionally, staying outside could risk putting the pre-ins into a different category of EU membership, which would impact the way they are perceived by investors and would weaken the confidence markets place in them. Their membership in the eurozone financial sector reforms are crucial here, with the banking union reform standing out in particular. While for a regular consumer, the membership of a country in the banking union would probably not be decisive for where he or she opens a bank account, banking union membership can be pivotal for bank bond market investors. We cannot ignore this consideration.

Let me also mention the monetary policy issue. The conventional line on this is that the use of the exchange rate tool can help increase competitiveness. We often hear that the loss of monetary policy independence is a major drawback when a country joins a currency union. I would like to reverse this argument. Monetary policy independence can be a risky tool in a member state that has to build its long-term competitiveness and go through deep structural reforms, especially if a government is tempted to use exchange rate policy to compensate for structural weaknesses.

Additionally, the single currency can also cushion the danger of speculative attacks on national currencies, as these currencies might not be sufficiently strong to resist such episodes on their own.

If we accept this, then joining the euro area could actually bind the pre-ins in a positive way and determine them to push towards deeper, genuine reforms, as opposed to relying on short-term fixes. They will need to look out for new growth factors and genuinely boost their competitiveness.

Staying outside the euro area, at this stage of the development of the pre-ins, given also their status of emerging economies, when many factors, especially those related to the global world, can impact their competitiveness and stability, can lead to many risks. Globalisation is bringing new superpowers onto the world stage and exposing them to the new waves of threats of global competition. The eurozone could shelter them from emerging risks and offer more stability.

The previous concerns are very important for the medium and long-term. Looking at the short-term horizon, the pre-ins' preparation for euro area accession is pivotal.

In this context, a very important decision when it comes to joining the euro area will be timing. In particular, the time must be ripe for them to join the ERM II. This entails entering the ERM II at a moment when the risks of speculative attacks, which may force devaluations of the national currency, are at a minimum. Member states must avoid a devaluation episode during the ERM II phase. To send an even stronger signal that they are ready to join, they could even consider committing to a narrower fluctuation band, than the standard one of +/- 15%.

One option to explore is also that of whether the pre-ins could directly join the euro without entering into ERMII at all. Avoiding ERMII would make it possible to avoid currency speculation and could smooth the transition into the euro.

Thinking about what the pre-ins need to do, it is clearly desirable for them to join the on-going reforms of the Union, which up to now, have been and will continue to be largely euro-centred.

While the euro area is often perceived solely as a monetary union, the trend of current reforms is clearly taking us further, into the realm of fiscal, financial and political union. Not joining the reform bandwagon must be a well thought through political choice.

The banking union reform comes to mind as a key reform. Also important are economic governance related policies, an example of such a choice is the competitiveness and convergence instrument, currently in the making. The instrument is based on a contract and agreement between the Member State and the European Commission.

In brief, for the time being, the pre-ins can actively endorse the participation of non-euro member states in euro area reforms, while communicating on the benefits of eurozone membership and carefully preparing their entry into the ERMII, which would eventually lead to their accession to the single currency area.

The pre-ins cannot afford to remain mere observers.

So what can the pre-ins do today to ensure that two-speed Europe does not adversely impact them and the Union?

Until a clear blueprint option is decided, opt-ins can resort to enhanced cooperation for new reforms which may have the euro area at its core. The Commission should also in the meantime ensure that the proposals it puts forward remain open to all member states willing and able to take part in them. Beyond this, the pre-ins will need to carefully think about the risks linked to staying outside the euro and take a clear stance on their eventual participation in the common currency area.

My conclusion is that two-speed/ tier Europe should not just happen; it should be carefully designed on the base of the only mechanism we have in the Treaty, which is enhanced cooperation. Only then will we be able to avoid EU fragmentation that could weaken it. The single market should remain at the heart of EU integration.

While we must certainly be cautious about the risks that a two-speed Europe brings along with it, we must at the same time however not get carried away and keep a cool head about these developments. This is due to the fact that there are clearly also glimmers of hope, which suggest that two-speed Europe will not radically alter the future of European integration. They include the following factors:

- For now, separate euro area economic, financial and fiscal configurations remain informal (whether they are euro summits or the meetings of the eurogroup). No formal separation exists as of yet in the Commission or European Parliament on eurozone matters (although debates are on-going for the potential creation of a eurozone focused sub-committee in ECON)
- The eurozone is also not a fixed membership group; other countries, will join, as Latvia did recently
- The euro group remains avant garde only on topics linked to the common currency; there is no common stance on foreign policy, justice, environment, transport, agriculture, fishing, consumer protection or competition policy
- The single market still remains for now at the heart of European integration and encompasses the 28; it is the glue holding the EU together and generating the bulk of EU legislation
- It is very likely that the outside world looks at us now as at "a single entity with some complications". This does not necessarily imply that Europe's leverage on the world scene will decrease, provided of course these complications are perceived to be only temporary. In the meantime, the EU will continue to be represented as a whole by the Commission or the External Actions Services, both of which speak with one voice for the whole of the Union.

So, worries about a two-speed Europe certainly need to be nuanced by the range of factors above, which blur divisions and help us retain our faith in the future integrity of the Union.

This does not mean that we can become complacent in the meantime. We need more clarity when it comes to the pre-ins and their involvement in Union reforms. This clarity will on the one hand need to come from the pre-ins themselves. The remaining clarity will then need to come from policymakers and take the form of a concrete blueprint for the participation of the pre-ins in future reforms.