

Europe can do better.
A new agenda for the European Union.

A Report of the
Reflection Group



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A new agenda for the European Union.

**A report of a Reflection Group initiated and formed by
demosEuropa – Centre for European Strategy and weekly “Polityka”**

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INTRODUCTION

IN UNITY STRENGTH

A dream is dead, long live the dream! In the face of an unprecedented, global economic crisis the European Union must awake from the apathy that resulted from the failure of the federalist project envisaged in the European Constitution rejected by citizens of France and the Netherlands in 2005. The only way to achieve this goal is to advance European integration wherever it is desirable from the point of view of Europe's position in the web of global interdependencies.

The naive faith that the European Union will last forever thanks to its past achievements and that it will keep its attractiveness as a civilisation model without making an effort to preserve its own vitality is a memento mori for the European dream. If we do not join forces and overcome insignificant differences, if we do not stop petty arguments so common in the European narrative born of political helplessness, calculation or short-sightedness, the European Union will lose influence.

The European Union is a political project and a civilisation model. It is based on a belief that it may be more than the sum of its parts. A new stage in the process of integration should begin where the European Union meets the slowly emerging, radically changed, global community as well as where it faces post-crisis expectations and aspirations of Europeans. Only such a European Union will be able to successfully meet future challenges.

We must free ourselves from the deadlock of the European debate and the practice of integration

oscillating between the dream of the United States of Europe and the pragmatism of the current decade, which seeks political inspiration in practical issues and which is no more than a fig leaf hiding the lack of vision and determination.

A new formula of the integration, based on an agenda focused on strategic challenges and innovative approaches is the only way for the Europeans, who lack a formal European polis, to believe in European citizenship and treat it as a vital part of their own personal identity. Only then will the European Union's member states become a natural context for the nourishment of national, regional and local identities without harming European solidarity.

THE CRISIS: HAS THE EMPEROR GOT NO CLOTHES?

The current economic crisis is the toughest challenge for the foundations of the European Union in its fifty years of history. **It is a test for the whole European construction, and especially for European institutions which have come under immense pressure.** This leads to a verification of the axiological basis on which the EU was founded.

Although the project of integration is not questioned openly on the political level by any of the significant European factions, the durability of its tenets is eroded by some actions of the member states. **We are witnessing growing pursuit of particular rather than common interest.** National markets and industries are supported often despite irreversible harm to the single European market. This points to **strong centrifugal forces** driven by concealed protectionist instincts and pressure to strengthen national and

regional identities. **The disappointing level of coordination of the national responses to the first signs of the crisis gives evidence of the incomplete character of the EU.**

The crisis did prove, however, that the very foundations of the European Union are solid and resilient. The European Central Bank proved to be one of the institutions best prepared to handle the economic crisis. The common currency, the euro, proved to be the strongest possible instrument against protectionism, preventing a wave of beggar-thy-neighbour devaluations which would have taken place if each member state still had its own currency. Of course this does not mean that the euro will not be subject to strong pressure in the future.

Despite the euro's success so far, the European Union may be pushed to the sidelines of political and economic processes taking place on the continent. It may survive merely as background for key decisions and events rather than their driving force. **Under the opposite scenario, the EU could begin a new phase of integration** by breaking away from the current stagnation and by recognising that unity is the best answer to global challenges. Closer integration should not have an ideological character but be based on seeking solutions to specific problems faced by the European Union.

Among economic challenges, the following top the list: a) the lack of political and economic cohesion among member states; b) the unfinished character of the single market; c) protectionist tendencies which, if not eliminated from Europe's political reality, get entrenched during the economic crisis. All these challenges require new political mechanisms which will allow the completion of such projects as the single European currency and the creation of an economic government.

THE WORLD IN THE EUROPEAN UNION'S IMAGE

Besides the economic themes, the biggest challenge for the EU is its decreasing role in the world. It is the consequence of objective and irreversible trends, resulting in an increasingly multi-polar world. **The answer to this new international situation can only be the development of a strategic culture in the European Union. Only further integration and enhanced cooperation will allow Europe to become one of future centres of gravity in the global balance of power.**

This should be achieved through a common concept of the EU's participation in global affairs, including strategies for diplomatic relations with the main global actors as well as for dealing with global threats such as climate change and the proliferation of weapons of mass destruction. This task would be easier if the EU introduces majority decision-making in foreign policy and streamlines European representation at international organisations.

"AUTO-DA-FÉ" OR EUROPEAN RENAISSANCE?

The current crisis caught the European Union struggling to shake off the trauma of the failed federalist dream. The past eight years have been spent on slow internal reforms, which began as a highly ambitious project but which were ultimately reduced to a bare minimum to ensure the effort did not get completely abandoned.

Re-defining its aspirations is a principal challenge facing the European Union. Today, there are at least **three possible scenarios for its future.**

1. **EXHAUSTION: The EU reaches the limit of its development, a natural level of sharing sovereignty.** The failure of successive attempts to achieve mandate for further integration through

referenda as well as a conservative approach of constitutional lawyers, seemingly determined to defend prerogatives of nation states (as reflected in the recent judgment on the Lisbon Treaty by the German Constitutional Tribunal), show that we may be nearing the natural barrier for the EU's evolution.

2. DECONSTRUCTION: Member countries dismantle by stealth what has been already achieved in the process of integration.

There are many examples of the questioning of the European consensus. The argument of the democratic legitimacy is used to justify supporting jobs only in one's own country even if that makes little economic sense in the EU context. Opportunities for hidden protectionism are plentiful and some of them are being tested even if their consequences are far from clear.

3. RENAISSANCE: The EU reinvents its ambition to be a major political project and a major

actor on the world scene in the context of the new global balance of power. It strives to shape the foundations of the international order so that it becomes a projection of the "European Model", based on sovereignty-sharing and co-responsibility that had been highly effective for Europe for the past 50 years.

WHO IF NOT US? WHEN IF NOT NOW?

The European Union finds itself in a formative moment. The new institutional cycle has just begun, with a new European Parliament and European Commission, which is significant because both institutions are the bloodstream and the driving force of the Union.

The way we use the coming months will decide whether over the next five years the European Union will remain a political project and a model of civilisation of which we can still be proud, or whether it will prove to be a source of increasing frustration.

Recommendations:

- 1. CONTINUATION OF REFORMS AND THEMATIC TREATIES: The European Union cannot stop the process of internal reform.** New challenges will require constant evolution and modernisation of the ways in which reforms are carried out. The EU must come to terms with the necessity of constant change and accept it as a requirement of the contemporary world. The first to change should be the approach to treaties as the main method of introducing reforms. **Instead of a broad overview leading to modification in the full spectrum of the EU's functioning, treaty changes should focus on selected and specific policies or themes,** for example energy or energy and climate. This would mean acceptance of the current treaty as the actual European constitution and amending it in response to specific needs as they arise. Such an approach would make public debate on the process of integration more focused. Currently it is impossible to meaningfully discuss complex treaty revisions even if they only bring about small changes in the whole spectrum of EU activities. **"Thematic" treaties** would decisively improve this situation.

2. **MAKING EUROPE MORE POLITICAL: The European process must feature more prominently in the political debate.** The falling turnout in the European parliamentary elections proves that there is a lack of necessary political engagement in the European debate. Now, right after the election to the European Parliament, is the time to act rather than wait until the next one. A straightforward method of making the EU debate more political, which does not require treaty changes, is to **develop truly pan-European political parties.** It should be those parties rather than their national equivalents that campaign in European elections. This would enforce a greater European focus in the debate and prevent campaigns to the European parliament from becoming even more trivial and nationalism-driven.

CHAPTER 1.

FACING THE TRUTH

CLOSING RANKS

At its current stage, the financial and economic crisis is only beginning to be a real test for the European Union's institutions. Most likely it will not be before summer 2010 when unemployment peaks. This is going to be a critical moment for the European leaders.

The economic institutions and mechanisms of the EU will be the first to prove themselves. Among them there are those which function soundly as well as those which do not fulfill expectations. **The crisis consolidates the euro zone countries** which are aware of the scale of the political threat they face together. Protecting the credibility of the common currency is at the moment their main priority.

At the same time Europe seems to be adrift in the storm. There is a wide spectrum of government responses, weak internal coordination and lack of a single voice on the international arena. Europe needs a steady, coherent and long-term view rather than a collection of individual and *ad-hoc* solutions.

On a more general level, we are seeing the **return to the basics** as the crisis highlights the importance of principles fundamental to the EU: the free flow of goods and financial services as well as a fair competition policy. This is especially so against

Unprecedented budget deficits and debt

If the euro zone was to be formed now, it might fail to materialise because most countries would not meet the criteria. The public sector budget deficit in the euro zone, which was 1.4 percent of GDP in 2008, will shoot up to 5 percent now. Debt will grow from 67 percent to 76 percent of GDP.

the background of attempts to limit the economic freedom and indulge in protectionist measures.

As regards institutions, the crisis is an opportunity to tighten the internal discipline and display political leadership through initiating new processes and mechanisms.

HOW MUCH STATE?

One of the most pertinent issues arising from the crisis is the question of the scale of state intervention and the establishment of a common European denominator for it in the face of significantly differing approaches across the EU.

A number of member states have launched fiscal stimuli through public expenditure, credit guarantees, handouts or subsidies. They coincide with automatic stabilisers common in the European economic models. The result is a significant increase of the budget deficits and subsequent expectations of rising public debt. The key task in this situation is to ensure that public expenditure does not just burden but benefit future generations.

Recommendations:

3. THE UNION AS A REFORMER OF THE STATE: The crisis must be used to make the state more efficient and not just to sanction its role in the economy and public life. There is a wide spectrum of practices defining the engagement of the state in the economy across the EU. A key task for the EU will be to increase the effectiveness of public spending from the point of view of its ability to spur innovation and growth as well as making public spending more transparent and better regulated.

4. **BACK TO THE FUTURE AS REGARDS STATE INTERVENTION: The European Commission should open a debate on how to gradually pull back state intervention as the economy improves and a more community-focused thinking is reactivated.** This debate must focus on the condition of the single European market in the context of the likely greater role of the state support for economic processes.

CHAPTER 2. WORLD LEADER OR... (UN)HAPPY RETIREMENT?

The question of how the European Union will define its role in the world will determine its future. Participation in the shaping of the new international order will be essential. If the European Union loses the case for world influence, it will diminish as a political project. If the European way of sharing sovereignty and responsibility does not rub onto the rest of the world, the European Union will find itself under great centrifugal pressure.

G3 INSTEAD OF G2

The starting point for creating a strategic culture in the European Union is an adequate understanding of the shifts on the international stage. **In political terms, the United States remains the main actor.** Without US involvement, no major regional conflict can be solved. The United States is the only country with an ambition to lead the world. The rising global powers are so far satisfied with their role of alternative centres of gravity and are not seeking hegemony on the world stage. China, however, may choose such a path in the future. It means that the European Union must prioritise relations with the United States and China.

In order to achieve this goal, the European Union must urgently develop a strategic culture. The European Security Strategy was the first step in this direction. It proved to be useful in easing tensions between member states following their differing stances on the war in Iraq. It engaged member states in a reflection on common foreign policy objectives. European capitals must acknowledge that only the EU as a whole has the

capacity for a successful dialogue with both the United States and China.

SECURITY ALERT

Even though the likelihood of a threat to the territorial integrity of any EU member state seems limited at the moment, **the international situation is becoming increasingly unpredictable. Terrorism remains a significant threat.** Proliferation of weapons of mass destruction has been adequately described in the European Security Strategy as “the biggest potential threat to our security”. Factors that may further destabilise the world include regional conflicts, disintegration of states in some areas of the world and organised crime. We all are exposed to risks resulting from climate change, threats to energy security, financial destabilisation and cyber and genetic terrorism as well as global pandemics.

GO FOR PRO-ACTIVITY

What the European Union needs is a change in its way of “being” in the world. Today it reacts only when danger becomes real. In the future it should become proactive to anticipate and stabilise threats, with all the consequences that brings to its neutrality in some specific cases. **The EU also requires an improved ability to set political priorities.** The European Union should intervene in the world in situations where it can add value. It should also get engaged in cases where the UN or local organisations are unable to do so.

Looking more broadly, the EU must define what **model of effective multilateralism** it wants to pursue and in what direction it wants to reform global governance. This means a more inclusive approach to the international bodies where the EU is over-proportionally represented, and more cohesion in the international system as currently too many processes, for example trade and climate negotiations, run independently of one another.

A major test for the European Union's ability to find a common voice in global matters will be its attempt to reshape relations with Russia. The economic crisis strengthened Russia's hostility to Western socio-economic recipes, but more importantly, made Moscow aware of the boundaries of what it can achieve when basing its power on natural resources. Russia's dependency on Western capital and energy consumers has already produced a more tempered tone between Russia and the West. Like Washington, Europe should use the current situation to break the deadlock and present Russia with a new offer of its

role in Europe, which would be a counter proposal to the poorly defined model of cooperation and security mooted by President Medvedev. It should be based on the one hand on a declaration of openness to a strategic partnership with Russia, and on the other on a clear message about policy changes Europe expects from Russia. The European Union should also achieve the largest possible internal consensus in evaluating what in Russia's position is authentic national interest and what is calculated rhetoric. Negotiations on reducing conventional forces in Europe should be one promising area for rapprochement.

Recommendations:

5. **FULL IMPLEMENTATION OF THE LISBON TREATY PROVISIONS: The European Union must fully take advantage of the opportunities provided by the Lisbon Treaty to strengthen its foreign and security policies.** Institutional changes concerning the external dimension of the EU's activities are the biggest innovation of the Treaty. Their success requires full determination during the implementation of the agreed solutions and mechanisms. This particularly concerns the role of the High Representative and the functioning of the future European external service – the nascent European diplomacy. **A high level of ambitions that would allow a fast and full initiation of the structures entailed in the Treaty** is required from the very beginning. It would be highly important to start transforming the Commission representations in the third countries into EU ones.
6. **“CLIMATIC WTO”:** The EU has long been the advocate of “effective multilateralism”, a mechanism which manages conflicts of interests through dialogue and which produces compromises via international organisations and bodies. The EU should try to enhance the existing practices of multilateral cooperation which are most effective on the level of the World Trade Organisation, one of the most successful projects of recent years. Equally significant could be the **establishment of a mechanism for the climate change policy**, with a global trade system of emissions being one of its most important aspects. Such a system should allow for a constant adaptation of the global climate policy to the changing scientific evidence and economic conditions. On the other hand, a mechanism creating equal footing for countries with different levels of technological advancement in energy production should also be taken into account. Areas such as energy supply agreements between producers and consumers should also be regulated on a multilateral level to ensure transparency and security.
7. **MORE FREE TRADE:** The main pillar of the world's political and economic system has to be free trade, which the EU should feel especially obliged to promote as its own success stems largely from a trade liberalisation agenda. **The global recession and resulting global inequalities will**

not be overcome without the strengthening of free trade cooperation in the world. To become a leader of this process, the EU must become more open in the areas of agricultural trade and food self-sufficiency which has been pursued since World War Two.

8. **PARTNERSHIP WITH THE CANDIDATES: The EU must cooperate more closely with the candidate and aspiring countries in the sphere of foreign policy, especially with Turkey,** which is a significant regional power and cannot be strategically positioned only as a potential, sometimes unwanted, member of the Union.
9. **DEFENCE – A NEGLECTED AGENDA: The European Union must also have better operational abilities in the area of defense policy, which has been a neglected sphere of integration.** The deployment of 10,000 tanks and 2,500 military aircraft is not justified by an analysis of the threats faced by Europe. **The EU should earmark funds in the 2014-2020 budget to be able to fulfill the basic common aims in the security and defense policies, including strategic transport.** This would be a step forward to increase the effectiveness of defense expenditure and divert savings achieved in the national budgets to other goals.
10. **ALLIANCE OF EU AND NATO: It is a key objective to forge a really close cooperation between the EU and NATO.** Such cooperation is hampered by peripheral political problems as well as bureaucratic deadlock. **A new phase should begin with a better understanding of the strategic environment in which both organisations function.** We must know what scenario we should be ready for, how to invest in the armed forces in order to achieve the highest strengthening of the common security. This can only be done through finding a common denominator between the European Security Strategy and NATO's new Strategic Concept. The EU and NATO must also return to a culture of sharing risks. The EU needs more than access to NATO's operation planning mechanisms. The development of the EU's Common Foreign and Security Policy requires an autonomous contingency planning capacity of the Union, which would replace individual actions of the member states. There has to be a better exchange of intelligence as well as a further adaptation of the NATO planning system to facilitate integration with the EU processes. The EU should formulate a Supreme Objective 2020, under which battle units of 5,000 soldiers, compatible with NATO's Rapid Reaction forces, would be formed. Cooperation of NATO and the EU should also focus on making a better use of lessons drawn from the civilian and military missions run by both of them around the world. The EU and NATO must work together at the earliest possible stage of a conflict, especially before engaging in any operations on the ground. This would mean information-sharing between crisis centres at both organisations to assess threats and risks scenarios. There is a scope for sharing materiel, particularly where there are well-known shortages such as in the sphere of strategic transport. Joint exercises of NATO rapid reaction forces and EU battle units would also be required to strengthen their interoperation ability. **The EU should institutionally take part in the Alliance's work by allowing the High Representative to take part in meetings of the North-Atlantic Council.**

CHAPTER 3. ENLARGEMENT IMPERATIVE – CONSCIOUS CHOICE RATHER THAN NECESSITY

It is a great paradox that the eastward expansion of the European Union is on one hand judged to be its greatest success, while on the other it is a source of major fears and prejudices. The projection of the EU's position in the world 20-30 years from now leaves little doubt. If the European Union wants to be influential in the world, it will not achieve this through closing its doors to new members. In doing so, it would contradict its essential value which is to induce others to follow the EU civilisation model. Openness is the essential aspect of the EU. According to the Treaty all countries on the European continent which meet EU criteria have the right to seek membership. This means that the debate about “boundaries of Europe” cannot be reconciled with the spirit of the European Union as an open community based on law.

Enlargement remains a great driver of transformation in the candidate countries, although its impact is not universal. The European Union has developed an efficient methodology for accepting new members. Even before the opening of particular chapters of negotiations, specific goals are set. This means that the candidate countries have more time to prepare their position. The methodology has been advanced to such a degree that the Negotiation Framework for talks with Turkey entails ambiguous provisions, creating room

for discretionary interpretation of what is compatible with the Treaty. Accordingly, the negotiations are defined as an open process, the result of which cannot be predefined. If they fail to result in the accession of Turkey to the EU, the country can be bound in the European structures in “the strongest manner possible”. Prolonged transition clauses envisaged by the Negotiation Framework in reference to the free passage of persons, regional and agricultural policies also stand in contrast with the spirit and letter of the Treaty, in which paragraph Two obliges the EU to adhere to the entire content of the *acquis*. Long-lasting transition clauses mean a watering down rather than respect for the *acquis*. Hence, it is clear that the EU is trying to adapt its enlargement policy to the current realities.

The most significant question about the EU enlargement is the question of the European Union's character and the role it intends to play in the world and the influence it wants to wield beyond its borders. If the EU wants to pursue its vision of being a global regulatory power, then the more countries it represents, the better. The accession process has an enormous influence in the world acting as a reform paradigm. Countries in the Middle East are closely watching relations between the EU and Turkey, seeing the latter as an example of a state model combining modernity and tradition and viewing the whole process as a litmus test of the West's attitude to Islam.

EU enlargement remains the best answer to the double challenge of consolidating the global role of Europe and stabilising its neighbourhood. There are three possible methods of continuing expansion. One is to maintain the current method and adjusting the speed of accepting new members to the political realities of the moment. The second option is to forge a model of “membership minus”, which would remove certain parts of the *acquis* from

the membership package. To a certain extent, this model has already been present in the EU in the cases of the euro, elements of the European security and defence policy and the Charter of Fundamental Rights. This form of membership can become common if there is a push for even more cooperation among some EU members.

The third model would require the creation of a new category of the “observer nations” in the EU, which would allow participation in the EU bodies without the right to take part in its decision-making. Full integration would subsequently be the function of progress in the key areas of the community acquis.

Recommendations:

- 11. GLOBAL EUROPE IS WIDENING EUROPE: Further enlargement of the EU must be a conscious choice** rather than an unwanted necessity. The enlargement imperative comes directly from Europe’s ambition to play a significant role in the future global balance of power. **A “Global Europe” can exist only if the EU continues to expand** in spite of the sometimes unfavourable external and internal circumstances.
- 12. EUROPEAN DREAM OR MERCANTILISM: The European Union is a political project and a model of civilisation – a fact that is central to its approach to enlargement.** Continuing or halting the process of expansion will define the European Union’s essence and future. The EU can either continue to project its model of governance beyond its current borders, or it will take a mercantilist approach to the outside world in which there will be no room for a political strategy.

CHAPTER 4. TOWARDS A EUROPEAN ECONOMIC ORDER

Even though the EU's agenda will become more political and concentrated on the external affairs in the coming years, economic integration will remain its principal sphere of activity after being the pillar of the European project so far. Unfortunately, after 50 years of trying the EU has not yet produced a fully integrated European economy.

The single market project is not complete, with businesses still encountering barriers in the flow of people, goods, capital and services. Differences in labour laws, corporate taxation, trade unions' role and extent of welfare protection among member countries are so significant that any talk of a "European economic model" is premature. It is hard to talk about common macroeconomic management when the Stability and Growth Pact provisions are widely violated and fiscal discipline varies greatly among the member states.

Despite attempts to formulate common goals in the sphere of social cohesion and human capital, member states pursue distinctively individual approaches. The Lisbon Strategy, a laudable attempt to create a common denominator for setting economic policy objectives, has failed to produce spectacular results or benchmarks for policy actions of the national governments.

A comprehensive approach to the European economic order should encompass the following priorities:

- Strengthening the foundations of the common market and giving the European Commission more clout to implement it;

- Introduction of new mechanism of macroeconomic management;
- Determined push to enlarge the euro zone;
- Fostering the culture of innovation in the Union;
- Making the EU social models more flexible and focused on boosting employment.

Lack of respect for the Stability and Growth Pact among most euro zone members is increasingly pointing towards a review of its efficiency. There is no doubt that the Pact and the enforcement of its provisions will be one of the key areas for the future reforms in the EU. It would be advantageous to unify EU tax bases as a prelude to tax harmonisation. The first months of the financial crisis demonstrated that the independent European Central Bank successfully passed a major stress test, strengthening its credibility.

Its approach to the crisis is unambiguous and determined – it does not go as far as the Federal Reserve in loosening monetary policy and is cautious with quantitative easing. This is because in the EU there is little taste for extensive monetisation of the public debt through printing presses and raising the risk of runaway inflation further down the road.

When the common European currency was coming into existence, many predicted it would come under pressure due to numerous internal tensions resulting from the unfinished nature of the economic and monetary union. Indeed the economic and financial crisis has led to turbulence and divergence in the euro zone into first and second class members. It is remarkable, however, that even the weaker euro zone states such as Greece or Italy have been spared major financial shocks which would have surely affected them if they stayed outside the monetary union. **The euro's resilience has become a magnet for countries – such as Denmark or Sweden – which so far have been sceptical about adopting the single currency.** For many observers it is only a matter of time before Britain swaps the pound for the single European currency. For

the majority of the new member states from central and eastern Europe adopting the euro is the most important political and economic task in the next decade. They are not meeting entry criteria now, but it is important that they stay on track to membership.

The biggest problem remaining for the euro zone is the absence of a political counterbalance to the monetary union.

The economic crisis has highlighted this issue as the political mechanisms deployed to coordinate responses have largely failed. The question is whether the EU will have the courage to form a community body to manage the members' fiscal policies or at least some aspects of them. This would require limits on the national competences in this area and an increase in the EU budget – ideas which may find little traction among the member states at the moment.

Recommendations:

13. **SINGLE MARKET FIRST: The pillar of the single market, that is the free flow of goods, services, capital and people on the EU territory, must be honoured at every stage of the economic cycle.** A major push is required to lift the remaining restrictions on the single market freedoms. The global crisis must not become an excuse for protectionist measures aiming to shield individual economies at the expense of EU partners.
14. **THE EURO AS A TOP POLITICAL PRIORITY: The European Council should adopt a political recommendation making euro zone enlargement a key priority for the next decade.** The widest possible use of the common currency on the EU territory should be pursued as it would enhance internal EU cohesion. The candidate countries need a clear signal that they are welcome in the euro zone. It seems opportune to **review the criteria of membership in the economic and monetary union**, which seem out of sync with reality. The least that can be done is to make the inflation criterion consistent with the ECB's inflation target, which would mean setting the reference rate for HICP at "close but below two percent". Another point worth reassessing is the currency stability criterion in its current shape (the two-year stay in ERM-2 and the fluctuation band), which confronts the central banks of applicant countries with what often becomes a contradictory goal – meeting the direct inflation the target and indirect exchange rate objective.
15. **REFORMING EU'S MACROECONOMIC MANAGEMENT: An independent High Level Group should be to analyse the scope for reforming the macroeconomic management in the EU.** The Group should be appointed by the European Council in December 2009 and make specific recommendations in June 2010, paving the way to concrete decisions. Among the first issues to analyse should be the **introduction of mechanisms regulating and ensuring financial stability in different phases of the economic cycle**. A solution worth considering is an obligatory rating and weighting of various investment risk categories so that bank balance sheets would not require massive shoring-up through capital increases or cuts in credit action in time of asset price falls and economic contraction. **The role of the European Commission in the EU's macroeconomic management should be increased, possibly by appointing the commissioner responsible for the economic and monetary affairs as chairperson of the Euro Group.**

16. **EU BUDGET TO PROMOTE GROWTH AND POST-LISBON STRATEGY: EU funds must be better directed at supporting productivity increases, especially in the new member states.** Spending should increase on low-budget programmes that create huge value-added for Europe, such as increasing mobility of students within the EU. **The mechanism of allocating funds from the EU budget should be reviewed.** In some areas, such as research and development, EU procedures discourage from undertaking innovative projects. In other, the sheer EU bureaucracy limits the effectiveness of EU programmes. In the **new EU economic programme**, due to succeed the Lisbon Strategy, more stress should be placed on creating sources of growth. More attention should be given to the financing of education, research and innovation. **Greater emphasis on ensuring balance between different sectors of the economy and a flexible, open labour market based on continuous learning seems necessary.**
17. **SINGLE VOICE IN G-20: The EU must make its presence in the world more coherent.** The first step should be a common representation in the G-20, the role of which will grow in the debate about the future global order. At the moment, the EU is represented in the G-20 by six member states, the EU presidency and the ECB. A more unified, narrower participation would enforce a greater internal coordination and more consistency in the EU views presented at the forum.

CHAPTER 5. INNOVATION IMPERATIVE

The EU is an economic power and there is no reason why it should not lead the world in innovation and science. Innovation is the EU's "to be or not to be" in the 21st century. As much as the 19th century was dominated by Europe and the 20th by America, the 21st century will belong to Asia. China and India are improving the competitiveness of their economies and spend more and more on R&D.

New World Order

In 2005, emerging economies for the first time generated over half of the global output. In the EU's Lisbon Strategy adopted in 2000, the reference point is the United States. This is changing rapidly – if current trends continue, EU GDP will be half of China's in 2050.

To maintain high standards of living, the EU must keep ahead of the others. Availability of talent around the world will be much more evenly distributed than it is at the moment. Global interdependencies are set to grow – right now the Google search engine is accessed 20 billion times a day. In each of the last few years, we stored more information than recorded throughout history. **Globalisation is a challenge for the EU but also a source of new demand for products and ideas.** Effectively managed globalisation generates demand for change and fuels modernisation. Competition is often triggered by knowledge developed by single corporations or networking groups. **Innovation is horizontal, working itself out across many fields.**

Many corporations are active in hundreds of networks, often including direct market rivals. Companies must know how to navigate in such a complex environment. Ongoing rather than sequential knowledge-sharing and transfer are the new paradigm because such a mutually reinforcing cooperation revolutionises economic progress.

Another reason why innovation is key for the EU's future is internal. At the moment, there are four EU citizens who are employed for one who is retired or depends on the social protection system. The choice is obvious – either the social safety net must be curtailed or productivity through innovation must increase.

Higher productivity means not only advanced technology but also better management of the public services and culture. It encompasses investment in education, skills and human capital.

The biggest challenge is the political economy of reforms, particularly in the context of the need for the fast implementation of changes due to globalisation pressures as well as the inevitable lack of symmetry in the distribution of the benefits of change. European diversity should be an advantage in this respect. After all, diversity and competition have driven the high level of innovation in the United States.

Today's crisis of the financial capitalism is crying loudly for creative capitalism and talent capable of driving it. Innovation is more than just R&D. Apple Corporation's R&D budget is much smaller than that of other leading technology firms. While not trying to play down the significance of R&D, the key to success often lies in meeting challenges through cooperation within open global networks devoted to innovation.

Science and education are huge challenges for the EU. It is characteristic that best universities and research centres are based in the United States and Asia. Only few EU countries, such as Finland,

have developed education systems supportive of innovation. In general, spending on higher education and science should be tilted towards best performing institutions. Europe also needs a system preventing the brain drain across the Atlantic.

The EU remains far behind the United States in its R&D spending – the gap is close to one percent of GDP. **This partly reflects the structure of the economies, with European firms holding a stronger position in sectors with low or medium intensity of R&D.** In Japan, Korea, the United States and China the main source of funding for R&D comes from the private sector. This sector is also the main recipient of R&D flows in those countries, while in Europe the corporate interest

in EU programmes (which anyway represent just 4 percent of total R&D spend) is shrinking.

Increasing EU competitiveness requires an open market and the absence of barriers in relations with third countries as well as the completion of the single European market and growth of the leading universities characterised by strong cooperation culture.

Open markets have a key importance for innovation. European firms depend on the knowledge and services originated outside the EU. Innovations must be implemented fast to deliver economic value, which means a better intellectual property protection in Europe.

Recommendations:

18. INNOVATION STRATEGY: Long-term economic growth depends on the formation of new markets for selected sectors of the economy, such as e-health, digital technology, new services in climate and energy (including energy efficiency). China, which will overtake Europe in R&D intensity within the next two years, is pursuing a strategy of creating between 30 and 50 firms, which will become global leaders in their sectors in the foreseeable future. The European Union's response must be to identify priority sectors where public and private investment should be directed. These must be markets where the EU has a good chance of gaining a competitive advantage.

There is an urgent need to **lower patent introduction costs**, which amount to about 20,000 euros in the EU and which are several times higher than in the United States or Japan. **Europe needs to fully exploit new ways of supporting innovation.** One such new tool could be credit lines or tax breaks for companies that form clusters with universities and publicly owned research laboratories rather than for those that simply boost R&D spending.

Closer coordination between the national and EU-level policies in this area would be advisable, especially those aiming to strengthen public spending as a lever to boost R&D. The EU cohesion funds should play a bigger role in the financing of such projects although it should be accompanied by strict performance criteria.

CHAPTER 6.

THE REALLY TOUGH PART STILL AHEAD OF US

The ongoing financial crisis seems to be overshadowing autonomous and inevitable processes taking place at the moment, which can become much bigger challenges for the European Union. They include demographic changes, which see a growing divergence between population growth in the developed and developing nations and which are likely to spur more intensive south-north migration pressure, as well as climate changes, which may lead to social tensions if they result in a substantial drop in the living standards.

European Union societies are characterised by **low birth rates coupled with high life expectancy**. Today's Europeans will live longest and have least

Demographic roulette

According to forecasts, that by 2050 world population will grow to 9 billion people from 6.6 billion now, with bulk of this increase in developing nations. By the end of this century, the population of Europe will stand at 4 percent of the total global population. Age structure is a growing challenge because without changes in the demographic and immigration policies, by 2050 there will be 85 pensioners for every 100 working people.

children in the history of humankind. **We lack understanding of how a society with a significant share of people over 80 will work.** Already within the next two-three years, half of the European citizens will be older than 50. **There is no economy in the world with a similar demographic profile and the impact of this phenomenon on the EU's position in the world will grow in significance.**

Recommendations:

19. **DEMOGRAPHIC REVITALISATION: Countering the ageing of populations must become a top EU priority.** In the next few years we will see a fast increasing volume of people leaving the job market. It is therefore imperative to forge a demographic revitalisation strategy encompassed in an EU political pact.

It would entail provisions such as extending the retirement age and incentives for older citizens to remain active on the labour market; active pro-family policies in areas such as child care and better productivity achieved through a better primary level education. Pro-family policies should focus on instruments with a proven positive impact on the demographic trends – availability of child care from infancy, gender equality initiatives and support for women's return to the labour market after childbirth.

20. **INEVITABLE PENSION REFORM: It is worth to recommend a wider deployment of Poland's new pension model,** envisaging gradual phasing out of the pay-as-you-go system in favour of the defined contributions model. Under the defined contributions system, benefits correspond to the capital and interest on it accumulated during an individual's working life rather than the current labour market conditions. Introducing pension models based on the capital markets and defined contributions should be promoted rather than penalised by the EU as is the case now. According to the current interpretation under ESA-95 rules, government subsidies to the pension administrators, making up for the gap in the contributions in the transition period between the two systems, are included in the public sector deficit. This rule constitutes a huge disincentive to reform pension systems and therefore should be promptly abolished.

OPENING UP TO IMMIGRATION

Labour force mobility has been one of the chief indicators of progressing globalisation. The EU will require an immigration policy to respond to this trend and to meet the challenge of its own demographic situation.

According to estimates, immigration into the EU should double to compensate for the expected contraction in its labour market. The need for a common policy in this area is evident from the point of view of an efficient control of immigration as well as basic requirement of conformity and solidarity between member states, which had been tested by differing national approaches. Advantages of controlled, targeted immigration in terms of maintaining EU competitiveness have been clearly demonstrated in the public debate and yet very little progress has been made in areas such as prevention of illegal immigration or integrating legal migrants into broader society.

Global “gastarbeiters”

In the 1990s, the global labour market doubled to 2.95 billion workers following market reforms in China, the opening up of the India economy and the economic liberalisation of the ex-Soviet bloc. Big-scale immigration into the EU began in the 1980s. In Britain, immigration overtook emigration only in 1983. Interestingly, more people emigrate today from Germany to Poland than to the United States.

The EU has become accustomed that its immigration policies are driven by crises, terrorism threats or dramatic attempts to gain entry illegally. Controversies over immigration and the place of migrants in society have distinctly national and local character, which confronts the EU immigration policy

with an often short-sighted political expediency in the member countries. Requirements for the language testing or restrictions placed on the migrants’ cultural and religious practices are classic examples of national-driven agendas. The EU role is limited to setting general rules and information-sharing as well as dealing with illegal employment in the member states. This situation is aggravated by the fact that even within national administrations there is no uniform model of dealing with the immigration issues. Often, immigration policies are influenced at the local government level, making EU-wide coordination extremely hard.

The ongoing economic crisis and the resulting rise in joblessness increases popular pressure on curbing immigration while at the same time the EU is seeking to stimulate targeted immigration programmes for skilled workers from the third countries, plans to set universal rules for seasonal workers and facilitate mobility within transnational companies. The EU also wants to set up a Forum devoted to immigration issues. The external dimension of immigration policies will be gaining in importance. After the adoption of the return directive, third countries are becoming more vocally critical of the EU’s immigration policies, which may complicate cooperation in this area.

Each EU nation is determined to define its own scope for accepting immigrants. Hence, actions such as political commitments to prevent mass legalisation of migrants without legal entry prove toothless. Member states jealously guard their competences in this area and are allergic to criticism of their approach. Tasks set out in the 2004 Hague Programme are sidestepped, including the commitment to a common processing of asylum applications. This shows that the member states do not necessarily have divergent interests, but different priorities in this area.

On the other hand, the EU will be forced soon to take a more coordinated action or again be

reduced to ad-hoc emergency-type responses. A bare minimum would be the requirement for the member states to inform one another of actions planned in the framework of national immigration policies, going beyond the existing commitments to share information on policies affecting other member states.

At the moment, cooperation takes place in the areas where actions by one member state could impact interests of the others. Hence, there is no real solidarity but a sum of individual interests of the member states. The outcome of legislative efforts to introduce the EU's "blue card" show that member states prefer initiatives complementing their national policies over truly pan-European regulations.

Recommendations:

21. **COMMUNITY IMMIGRATION POLICY:** The only effective way of managing immigration is to make it a common policy. Without institutional changes, member states will not undertake actions based on true solidarity and defence of the common rather than individual interest. That is why in the area of immigration, the Lisbon Treaty's "passarelle clause" needs to be deployed in order to bring about a qualified majority decision-making in the Council and co-deciding with the European Parliament.
22. **ENHANCING HUMAN RESOURCES:** The EU should seek more daring and innovative ways of bringing in skilled employees, following Sweden's example of allowing business to co-decide on the scope of immigration by making industry-specific recommendations.

RATIONALISING CLIMATE POLICY ACTIONS

Climate change is another process running independently of the financial crisis and whose impact will be more significant than envisaged two years ago when the Council enshrined the 20-20-20 goal in its energy and climate policy.

Failure to diversify sources of energy or introduce new technologies to generate it will cause a huge increase in global CO₂ emissions within the next decades.

While it is important for the EU to seek and implement new energy solutions, only willingness by all states around the world to cooperate in this area can stem climate change. The EU can play a pivotal role in this regard by becoming a leader in eco-technologies and by pursuing a balanced, sustainable growth model. The task is daunting

given the scale of financing required for innovative projects as well as the international competition in this field, which has seen some countries overtaking the EU both in terms of financing for eco-friendly technologies relevant legislative changes.

To have cake and eat it

Researchers from the IPCC believe that we should aim to stabilise average temperature at 1.5 degree Celsius above pre-industrial levels. In their view, that implies pursuing zero-emissions economy by 2050. However, further economic growth will require a rise in energy consumption. It is estimated that that demand for energy will raise by 55 percent by 2030, which may result in the doubling of CO₂ emissions when conventional sources of energy are used.

We are living not just on borrowed money, but also on air and bio-diversity borrowed from the future generations. If we want to avoid a drastic fall in their living standards, we must react now. It will not be easy to bring developing nations on board for some of the actions needed, which means the EU and the United States will have to pay for a lion's share of the bill resulting from the introduction of a new global climate agreement. If we want this pact to be more effective than Kyoto, it must translate into expenditure several times bigger than one percent of GDP annually.

The European climate policy must take into account different levels of development in the EU and its variable impact on the economic competitiveness of the individual member states.

One clear EU achievement is that it has reached a common political platform despite differences in the economic potential among the member states. The EU can make this case while negotiating with global partners, but less developed member states cannot endlessly assume new responsibilities without securing such conditions that will enable them to continue catching up with the leaders.

The EU's climate policy must also be constantly tested as regards its economic viability. Some of its pillar programmes, including huge support for the renewable energy sources, are not necessarily the most cost-efficient way to reduce the emissions of greenhouse gasses. **The most realistic method of achieving climate policy objectives on the global scale are clean coal technology, especially carbon capture and storage (CCS), and nuclear power generation.**

Investment in technologies limiting climate change are likely to have a positive impact on the economy if they are based on sound business principles. The EU has the potential to maintain its role of an exporter of the green technologies, including clean coal, to developing nations, provided it picks the right technologies and gets their financing right. The CCS technology is one example where the EU has yet to make decisions enabling full financing of pilot projects or formulation of the legal framework for the system of transmission and storage of the CO₂.

Recommendations:

23. **LOW-EMISSION TECHNOLOGIES FUND:** The EU should set up a **strategic fund for low-emission technologies**, with special attention given to the clean coal technologies such as CCS, as well as for innovative renewable energy technologies. In the current financial perspective, the means for this fund should come from unused budget outlays and from contributions of the member states. In the 2014-2020 perspective, **a new, designated financial instrument should be added.**

CONCLUSIONS

HOW TO LIBERATE THE UNION?

THE EUROPEAN UNION IS NOT IMMORTAL

Even though many care about the EU's further existence, an act of faith will not be enough to make this a reality. Even before the crisis European leaders seemed not to be entirely clear how to shape Europe's future and what added value a united Europe should offer to its citizens. The lack of high-profile projects, the inability to capture popular imagination and engage Europeans in formulating an attractive vision of the European civilisation produce the omnipresent strategy of political drift.

On the one hand, **we are getting accustomed that the EU is part and parcel of our reality, on the other, there is a shortage of leaders for whom the EU is an unfinished project requiring passion, continuous effort and risk-taking. The problem is not in what is often described as the EU's democratic deficit because it is not substantially different from what we can see on the national level. The EU's Constitutional Treaty had no equal in history in terms of how democratically it was negotiated and ultimately defeated. There is an issue, however, of the distance – visible also on the national level – between the citizen and the decision-making centre.** In the future, it would make sense to forge political forces able to communicate with all Europeans at the same time.

The key to releasing the EU's hidden energy lies in the following:

- Confronting real rather than secondary problems inside the EU and in the world;

- New European leadership constellation;
- Strengthening the sense of ownership of the EU by its citizens;
- Generation change.

EU LEADERSHIP IS FOR GRABS

Looking at the attitude of the individual member states to the EU integration, it seems that the leading roles will be played by big nations traditionally seen as leaders – Germany, France and Britain – followed by Spain, Italy and Poland. The Federal Republic has been the engine of integration for decades, treating it as a response to the traumatic experiences of European nations and to the threat of Soviet-style communism. With active support of the United States and its Marshall Plan, Germany assumed the position of the EU's principal "paymaster" – a role it took on as a form of compensation for World War Two and seeing it as a barrier against the return to its own past. In recent years, however, the costs of German re-unification, the eastward enlargement and constraints on growth encountered by the ageing population have limited Germany's propensity to make sacrifices for the "greater good". It was visible in Berlin's conduct in the last budget negotiations and it is visible today when it rejects proposal is for a Europe-wide rescue of the banking sector or common Eurobonds, for which it would in effect have to pay to finance reckless financial policies of the weaker euro zone members.

Yet it would be unfair to say Germany is turning away from Europe and succumbing to national egoism. Looking at the bulk of decisions made in the EU, it is hard to see a less egoistic nation than Germany. Even in respect of supporting the weaker euro zone members, no less than a promise not to allow any of them to go bust was made in Berlin. The problem lies elsewhere – Germany is sick and tired of being the only driving force behind the EU, of blazing the trail alone. It is also less than before able to finance the EU, while feeling blocked by smaller countries

on the political front. Germany's partners who care about further integration must find a way of supporting Berlin. Community institutions are not robust enough to take the leadership baton from Germany, therefore other member states must be ready to share this burden. So far this role had been played by France, yet since the rejection of the Constitutional Treaty by the French people, its credibility as a driver of integration has suffered while the engagement of French leaders in promoting EU integration slackened. On top of that we can see a clear rise in the anti-integration sentiment in Britain, which showed in a surge of support for eurosceptic parties in the last European election. The likely victory of the British Conservatives in the next national election may well enough turn Britain into the main show-stopper in the EU. It is possible that medium-sized and small nations will join Germany in carrying the banner of integration. **If Poland weathers the economic crisis relatively well, it will get a good opportunity to present a credible vision of the EU future.** The approaching EU presidency makes the moment even more opportune. What is required, however, is more determination to pursue EU-wide goals.

LET'S RECLAIM THE EU FOR AND WITH CITIZENS

The retreat of the federalist forces in the EU, the rejection of the Constitutional Treaty and difficulties in getting the Lisbon Treaty ratified reflect a European identity crisis.

It is hard not to see the French and Dutch rejection of the Constitutional Treaty partly as a demonstration of frustration and alienation in the EU. EU citizens, feeling that they have no influence on the EU decision-making, turn their back on community projects and seek national identification. It is often juxtaposed with "Europe-centrism" understood as something hostile and alien.

It is important to stress that this resistance to Europe in countries that had been the leaders of integration predates the economic crisis. It has been partly influenced by the EU enlargement because in a Union of 27 it is harder to identify with European institutions and there is less sense of participation. It is some sort of membership without belonging. Another indication, at first sight of little significance, is the rejection of the common mythology and symbols. The Lisbon Treaty lacks references to the common EU flag and anthem, which were present in the Constitutional Treaty. All of that has a bearing on the political and economic processes in the Union. Many citizens have the impression that the EU is to blame for the worsening material condition of ageing societies, which may not be based on fact but which results in shrinking support for the European integration.

Simultaneously, **there is an opposing current in favour of a deeper integration.** Millions of people are comfortable with the EU and respect the achievements of the European process. The outside view is often helpful in determining one's own identity. "One is how one is seen" goes the saying and for EU outsiders, we are less and less nation state citizens and more and more "Europeans". Such perceptions have been manifest in "Transatlantic Trends" surveys describing social attitudes in Europe and the United States. Even loosely linked EU countries show close similarities over some issues when compared with the United States, suggesting that a common European identity is not pure fiction. **Both these tendencies – pro- and anti-integrationist – require careful balancing but it is hard not to see the opportunity they create to move things forward.**

The lack of leadership often stems from the fact that the Union is a comfort zone. It is curious that entering the EU or joining the euro zone **blunts reforms.** The reform effort is often at its peak when countries scramble to meet the

membership criteria, but the motivation tails off very quickly afterwards. This lack of initiative and agility hurts when external shocks or internal crises strike.

WHO'S NEXT?

A significant driving force of the forthcoming changes in the European democracy might emerge from processes of the development of the new social sphere and community networks and the new forms of the political autonomy attached to them. The youngest generation of Europeans, taking an active role in forging the new digital communication era, is likely to become the main agent of revitalising the public sphere and re-casting the European civic society.

This generation, living daily in the networked Internet reality, treating the net as the main source of knowledge about the world and creating transnational, virtual communities of practice, will transgress **limitations of periphery and tribalism**, creating a community of experience not limited to one country or particular culture. **For the new generation of Europeans, these are the sources of the new identifications, identity politics and social commitments that very often lead to the political action.**

In consequence, just like in the United States where Barack Obama owed his presidential victory partly to the “new” Internet electorate, Europe will see **new forms of political autonomy** driven by the change in the communication technology. The possibility of fast, direct and almost limitless mobilisation of the large numbers of people around some common causes may become a mode of functioning for the European *demos* in the postmodern age, in which the virtual and real worlds merge. **With the rise of the importance of elected European bodies such as the European parliament and the formation of**

pan-European political groupings, the role of social communication networks and their political autonomy will become significant.

The first test of strength for the political autonomy of such networks and a lesson given by the “digital” citizens to the elites was the spontaneous, SMS- and e-mail driven mass protest against the manipulation of information and official media coverage of the Madrid bombings in 2004. Demonstrations by millions of people on the streets of Spanish cities and the subsequent defeat of the then ruling centre-right *Partido Popular* (PP) in the parliamentary elections showed the growing power of such networks.

For the next several years, the EU faces two modes of existence. It can be driven by inertia, struggling to hold on to its past achievements, consuming their effects but failing to score spectacular successes. Or it can launch a new stage of integration marked by ambitious projects in the key areas of its activity. It may cause the new global order to be forged in its likeness and under its influence. The EU's political role in the global balance of power is a function of the EU's own desires, vision and determination. There is no backing away from this challenge.

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