The Contribution of 16 European Think Tanks to the Polish, Danish and Cypriot Trio Presidency of the European Union

Directed by Elvire Fabry, Notre Europe
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At a time of intense debate over such symbolic achievements as the euro and Schengen, the difficult task of presiding over the Council falls to Poland, Denmark and Cyprus. These countries have a chance to help shape the future of European integration.

Europe’s economic and financial crisis was of historic proportions and its negative social and political effects are still being measured. The twin challenges of the environment and energy remain at the top of European and international agendas. The “Arab spring” is an opportunity for the EU to lay the foundations of a new partnership with its neighbours. Across the world, powerful and emerging countries alike continue to assert themselves, on the basis of more or less cooperative relationships with Europe.

In these complex and stimulating circumstances, the Polish, Danish and Cypriot Trio Presidency will be able to make use of the newly implemented Lisbon Treaty to coordinate its action with that of the President of the European Council. The Trio will be able to focus on implementing the policies and projects that the European Union needs – and which this report aims to inspire.

A product of multinational, multicultural cooperation, with contributions by 16 eminent European think tanks, this third report lives up its title, “Think Global – Act European”. Given the current trend of national introspection, such a credo is more necessary than ever. In an increasingly globalised world, the merits of the go-it-alone approach are unconvincing. EU countries have an interest in being “united in diversity”.

To illustrate this motto, Notre Europe coordinated the report in conjunction with an editorial committee composed of three think tanks based in the countries of the Trio Presidency: demosEUROPA, the Danish Institute for International Studies, and the Cyprus Center for European and International Affairs. In the same spirit, some of the report’s 54 contributions were co-authored. And to show that European aims can converge, the report highlights a short list of concrete recommendations for action.

As the new president of Notre Europe, I am proud to present the fruit of this deep cooperation between think tanks. I would like to thank them for their constructive efforts.

To the Trio Presidency, to the President of the European Council and to all decision-makers and interested observers, my wish is that the analyses and propositions in this third TGAE report serve as food for thought and action during the upcoming semesters.

Antonio Vitorino President, Notre Europe
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Introduction

**What is left to the rotating presidency?**

New power relationships resulting from the Lisbon-reforms and more co-decisions involving the European Parliament – in increasingly sensitive policy areas – may generate further complexity and political tension in the EU’s political system.

The rotating presidency’s political role was limited during the financial crisis and it has since then not addressed the most difficult dossiers. But its “administrative leadership”, which guarantees successful legislative negotiations, has proven to be crucial. The rotating presidency’s responsibilities – such as chairing the Council, committees and working-group meetings (except for the Foreign Affairs Council and committees, chaired by the High Representative of the Union for Foreign Affairs and Security Policy) and organizing behind-the-scenes legislative procedures – will continue to be vital to the proper functioning of the EU’s political system.

Although the Polish, Danish and Cypriot Trio Presidency (July 2011-December 2012) can co-shape some of the priorities on the EU’s agenda, it will nevertheless continue to be only one of many agenda-setters. The crisis-context has, in and of itself, forced priorities into the Community agenda, thus leaving the rotating presidency with less room for promoting priorities linked to the Union’s own interests. But it is worth mentioning that following the French Presidency’s launch of the Union for the Mediterranean and the Swedish Presidency’s inauguration of the Baltic Sea Strategy, the Hungarian presidency has successfully implemented its project for sustainable development and environmental protection in the Danube macro-region – i.e. the EU Danube Region Strategy. Until now, forming a Trio out of three rotating presidencies has not brought many benefits. Strengthening their cooperation could however enforce their agenda-setting capacity and would foster consensus during Member States negotiations. This is why, in this report, the term “Trio Presidency” is given preference whenever appropriate.

The rotating presidency – formerly a key function within the EU’s institutional landscape – is now greatly counter-balanced by the permanent Presidency of the European Council. If the rotating presidency wants to regain visibility and influence, it will have to use the Lisbon Treaty to its advantage. The role of the General Affairs Council (GAC) should be reaffirmed, notably by politically channelling the work of the council formations or by sometimes upgrading issues from the Council level to the European Council level. Having the prime minister of the rotating presidency chair the GAC would allow for a stronger GAC – without having to amend the treaties.

**Stress tests for EU governance**

These are the times that try Europe’s soul. Over the past 18 months – under the auspices of the Spanish, Belgian and Hungarian Trio Presidency of the European Union (EU) – EU leaders have had to test their mettle. Not only did they have also to salvage the euro and implement the Lisbon Treaty, but they were also under pressure to boost Europe’s economies and implement the Schengen Area – two of the EU’s greatest achievements. These stress tests – which have not yet division and dunes, testing whether Europe was determined to stay united.

Yet overall, the Community decision-making system has demonstrated an extraordinary capacity for reaction. Not only has the number of initiatives been great, but they have also been well-chosen and relevant. Economic and financial surveillance, regarding fiscal, macro-economic and financial stability, has been strengthened and risks have been reduced. Regarding the Stability and Growth Pact, the fiscal position of the EU member states has been put under pressure and, in the end, a fiscal compact has been signed, with a fiscal treaty expected to be validated by the end of 2012. These are great achievements which have led to the sovereign debt crisis.

Nevertheless, the future might be just as testing. It is yet too soon to conduct an in-depth assessment of the EU’s capacity to manage the crisis. With the eurozone crisis, and in danger of being backtracked on, the EU member states may need to strengthen their mutual confidence and their desire to cooperate. This might mean that the measures taken so far will not be enough to push the economies back to growth.

Stress tests for EU governance are effective tools for coordination. And it is still an open question whether the measures strengthening mutual confidence will be effective.

This said, looking to the future, Europe will have to get used to this type of risks management. More and more, unexpected events will require Member States to collaborate; the debate on the Schengen Area – triggered by North African migrants arriving on Europe’s shores – is just the latest example of this.
The Trio Presidency should also waste no time in joining forces with influential Member States, who gain relative importance through their direct access to the European Council president. Moreover, if it wants to define the EU’s political priorities, the Commission will have to be included in its agenda-setting scope even further. On the other hand, the Trio Presidency must work on developing a productive alliance with the European Parliament, the European Council and the Member States.

Economic governance

EU leaders recently set-up several projects that will buttress European growth policies—namely: the Europe 2020 Strategy, designed to turn the EU into “a smart, sustainable and inclusive economy”; the Single Market Act, aimed at improving the functioning of the internal market and the integration of the eurozone economy; and a review of Cohesion Policy, designed to provide cohesion and development and investment policy for closing the Member States’ competitiveness gap. Implementing this plethora of European strategies will require a high degree of coordination. Such coherence between strategies would not only help avoid overlapping, but would also increase citizens’ understanding of what the EU does. And increasing the complementarity of all policies is paramount, with the current focus on the Single Market, the European Semester, the Euro-Plus Pact and the European Stability Mechanism, which tend to paralyse ambitious projects. Concerning legislative negotiation, rather than adopting pick-and-choose tactics—which tend to paralyse ambitious projects—the Trio Presidency must be inclined to scrutinise more intensively.

Economic growth

Over the next year-and-a-half, the EU’s two main priorities will continue to be monetary stability and economic growth. However, the Trio Presidency should also waste no time in joining forces with influential Member States, who gain relative importance through their direct access to the European Council president. Moreover, if it wants to define the EU's political priorities, the Commission will have to be included in its agenda-setting scope even further. On the other hand, the Trio Presidency must work on developing a productive alliance with the European Parliament, the European Council and the Member States.

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Mario Monti. This technique involves bundling legislative measures into complete packages, which are then considered in their entirety—thereby facilitating across-the-board trade-offs.

Multiannual Financial Framework 2014-2020

To this picture, the institutional agenda adds the major issue of negotiating the forthcoming financial perspectives for 2014-2020, which is due to commence under the Polish Presidency. In light of the public-finance cuts being implemented at the national level, these negotiations look set to be particularly complex. The political authorities tasked with conducting the negotiations should begin by addressing the key players on their respective agendas. The High Representative (HR) for Foreign Affairs and Security Policy, the HR’s working party on the newly established presidency, and the European External Action Service (EEAS) will have to be fully engaged and assist the HR and the EEAS in establishing effective coordination mechanisms with the European Parliament, which will enable the HR and her team to act as a single voice in front of the European institutions.

In pursuit of interconnectivity between national and European administrations, the Trio should take the smooth exchange of national diplomats and EU delegations, the preparation of Europolization, the coordination between national embassies and EU delegations, the preparation of Europolization, the coordination between national embassies and EU delegations, and the development of a new common EU strategy for security and justice.

Foreign policy

As far as foreign and security policy challenges are concerned, the entry into force of the Lisbon Treaty has shifted responsibility to the Union’s High Representative for the Union’s security and defense policy. The institutional dimension of security and defense policy is becoming more prominent, with the external dimension of internal policies related to trade, energy, climate or the Single Market.

Area of Freedom, Security and Justice

In the area of security and justice, the implementation of the Stockholm Programme, the European Security Strategy in Action, and the Third European Neighbourhood Policy (ENP) will all be the object of greater public attention. Furthermore, the debate on the Schengen Area—relating to Bulgaria and Romania’s future accession to the Schengen Area—will continue to attract significant interest.

Foreign policy

In this regard, the Trio must continue to play an active role in facilitating cross-border trade-offs, particularly in view of the increasing importance of the external dimension of internal policies.
In the area of Common Security and Defence Policy (CSDP), increasing or at least stabilising Member States’ defence capabilities and strengthening collective European capabilities remains an area of concern. Fragmentation, duplication and opening of chapters are mobility partnerships and visa liberalisation. Turkey’s place in EU policies should also be better defined – especially with regard to the ENP and to the Common Security and Defence Policy.

Enlargement and Neighbourhood Policy

In light of the Arab uprisings, the auspicious review of the ENP is most welcome. While redesigning the ENP, the EU should compensate for its slow response to pro-democracy demands by getting involved in favour of the democratic transitions in North Africa and the Middle-East. The EU should also not neglect its commitment to the neighbourhood policy, shared by the Hungarian and Polish Presidencies, should allow for a smooth transition between the two. The Trio should ensure that the next MFF negotiations are conducted with the right criteria and benchmarks.

Common Security and Defence Policy

The Commission, while all enlargement issues are now dealt with by the General Affairs Council (GAC), which continues to be chaired by the rotating presidency, is also subject to unanimous decisions on all enlargement issues. The Council Working Group on Enlargement (COELA) is currently dealing with Turkey, Iceland and Croatia. This means that the rotating presidency’s role is limited to the negotiations in the COELA, which mainly decided on the closing and opening of chapters. Thus, two subjects of immediate concern are the Trio presidency’s mobility partnerships and visa liberalisation. Turkey’s place in EU policies should also be better defined – especially with regard to the ENP and to the Common Security and Defence Policy.

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The structure of this report

As in the two previous editions of *Think Global – Act European (TGAE)*, this report focuses on a medium-term scenario, covering the Polish, Danish and Cypriot Trio Presidency, running from July 2011 to December 2012.¹

Focusing on the Trio Presidency has allowed the authors to analyse the development of rotating presidencies’ (direct and indirect) role in the context of the Lisbon Treaty, while highlighting, on a sector-by-sector basis, the way in which the role interacts with those of other EU institutions. This explains the attention devoted to external policy – over which rotating duty presidencies now only exercise an indirect influence, but which, according to the authors, might yet prove to be vital to the EU as a global actor.

Each part of the report is introduced by a summary that underlines possible consensus or divergence of views between the authors. In each chapter, the authors have three aims: to take stock of the initiatives adopted over the past eighteen months, to identify the challenges that have emerged during this time, and to formulate concrete short- to medium-term proposals targeting rapid progress for Community policies. Overall, the 18-month time frame to which each new edition of TGAE is devoted produces, from one report to the next, a comprehensive chronological picture of the EU’s development.

This introduction reflects the analyses of the experts of the 16 think tanks, but it remains under the sole responsibility of its authors.

Some of the proposals below lie beyond the Trio Presidency’s responsibilities, as defined by the Lisbon Treaty; yet, via their coordinating role, the Polish, Danish and Cypriot governments should not hesitate to fully support these proposals.

COMPLETION OF THE INTERNAL MARKET

1 The EU should keep new Single Market legislation high on the agenda, notably by using the “package deal technique” – advocated by Mario Monti, albeit not taken up in the Single Market Act. This negotiating technique would facilitate trade-offs and would help avoid pick-and-choose tactics, which are capable of paralysing any ambitious project.

2 Specific attention should be given to making the new European financial supervision system reliable, in particular concerning banking regulation. Future stress tests must be more rigorous and provide for transparency, thus creating a solid foundation for the necessary recapitalisation and restructuring of banks in some Member States.

BEYOND ON-GOING EU ECONOMIC GOVERNANCE REFORM

3 For some Member States, particularly in the eurozone periphery, short term economic growth is likely to be anaemic. Given the tightness of fiscal policy at national level, the EU should consider practical ways to stimulate growth, through vital investment sectors, such as R&D, infrastructures and energy. Innovative financial instruments such as EU project bonds – mentioned in the Budget Review – should be given strong political support.

4 The European Stability Mechanism (ESM) will most probably not be able to provide for an “orderly default” for Member States that are insolvent and need debt restructuring. To make debt restructuring easier and more foreseeable in future cases, Member States should move beyond the current framework and set up the legal basis for a formal mechanism allowing the majority of creditors (private and other sovereigns) and the debtor to reach agreement in an orderly and swift manner.

5 Current and further EU economic governance reforms require strong public support. Thus, national actors should anticipate popular resentment and explain to their electorates that fiscal solidarity is in their long-term economic and political interest.

BUDGET REFORM

6 If the EU wants to deliver on challenges such as economic recovery/growth, the transition towards a low-carbon economy and EU cohesion – which all require substantial investments – it needs to align its means with its ambitions. In this respect, the Multiannual Financial Framework (MFF) should play a decisive role:

– On the one hand, MFF negotiations should focus on efficiency gains, which could be obtained by improving coordination between national and EU spending (in diplomatic services, defence or research, for example) and by rendering EU spending more responsive to economic fluctuations.

– On the other hand, new EU own resources, via a genuine EU VAT tax or an EU carbon/energy tax, would help increase the overall budget volume with independent sources of revenue. Such an initiative would be a first step towards diversifying EU funding, and should thus be taken seriously.

7 A way of avoiding a deadlock over CAP financing negotiations could be to simultaneously co-finance the first pillar of the CAP and deeply reform the policy, which would entail assessing, in conjunction with states and regions, an appropriate spending level.

8 EU economic integration is at risk of running at a two speeds. To foster less developed Member States’ competitiveness, EU Cohesion Policy should be turned into the leading EU development and investment policy, notably by equipping it with sufficient funds in the next MFF.

THE EU AS A GLOBAL PLAYER

9 The EU has a specific role to play in its neighbourhood’s transition process. The EU should compensate for the slowness of its response to South Mediterranean countries’ pro-democratic demands by now firmly involving itself in favour of democratic transitions. At the same time, the EU should not neglect its committed neighbourhood policy in the East and should therefore be determined to conclude far-reaching association agreements with Eastern Europe countries, making substantial commitments towards market-opening and regulatory alignment.
10 The EU needs to consolidate its immigration, border control and asylum policies. Schengen, one of the EU’s main achievements, should not be weakened. At the same time asylum rules need to be looked at. The current “first safe country” principle could be replaced with a quota system where countries accept a set number of asylum seekers in proportion to their population size, available facilities and budget constraints. Those countries that do not reach their asylum quotas should accept some bone fide refugees from those that are over-burdened. Concerning labour migration, it should not be regarded as a security issue but rather as a way to meet sustainable growth objectives.

11 Coordinating external and internal EU policies would help avoid conflicting strategies. The EU has to produce integrated policy proposals by bridging traditional foreign policy with other issues, such as energy, migration, climate, security, development and trade concerns. As an illustration, to develop and strengthen the Union’s external relations in the field of energy, a full set of EU foreign policy instruments should be used in a more coherent and multidisciplinary manner.

12 To develop strategic partnerships with major emerging powers and raise the EU’s standing in international negotiations, the EU leaders should, for each specific partnership, prioritise the Union’s interests and overcome the Member States’ bilateral reflexes, which favour short-term national benefits over long-term European ones.

Filippa Chatzistavrou ELIA MEP, Janis A. Emmanouilidis EPC, Elvire Fabry Notre Europe, Piotr Maciej Kaczyński CEPS, Jacques Keller-Noëllet Egmont, Thomas Klau ECFR, David Král Europeum, Ignacio Molina Real Instituto Elcano, Clara Marina O’Donnell CER, Daniela Schwarzer SWP, Paweł Świeboda demoEUROPA, Fabrizio Tassinari DIIS, Andreas Theophanus CCEIA, András Vértes GKI

As a policy, Bruegel does not take institutional policy positions.
INTERNAL MARKET

In October 2010, the Commission presented its draft “Single Market Act” (SMA). The plans were based on reports by former Commissioner Mario Monti and the European Parliament. The Commission’s 50 proposals were then followed by a four-month public consultation period. The European Parliament agreed to resolutions on the SMA in April 2011 and the Commission issued key initiatives the same month.

The strategic nature of the SMA is the first element discussed here. The first author believes the Commission’s draft SMA breaks with the tradition of lists, but that “the next Trio Presidency should make sure the relaunch is not diluted into a list of unrelated proposals”. Monti’s idea of an overarching political consensus – “great bargain” – should be maintained via the bundling of legislative measures in packages (Egmont). A second author argues that the SMA, as a milestone, is not sufficiently holistic. For this author, the SMA is in fact a list (SIEPS).

PART I

ABSTRACT

The two papers do agree that Single Market legislation is already vast and seldom applied – notably due to Member States’ protectionist reactions during the recent economic and financial crises. Thus, attention should be given to already existing, but not fully-functioning areas. This is why both authors focus on the importance of communication as a means to properly applying Single Market legislation.

The first author underlines the Commission’s argument that in order for the SMA to be successful, political actors (at all levels) need to be involved in all stages of the project. Co-management of the Single Market could occur via the “increased use of mutual evaluation processes and the extension of the Internal Market Information System” (Egmont). In order to link the internal market to other political and economic projects, such as sustainability, social protection, innovation, cohesion, etc., it is also suggested “to create an overarching Single Market Group of Commissioners” and entrust the competitiveness council with a coordinating role in this treatment of Single Market priorities within the different council formations.

With reference to communication, the second paper develops Monti’s call for better legal implementation and enforcement. This would entail an improved partnership between the Commission and the Member States, administrative cooperation between national authorities, mutual evaluation of national legislation, and better resolution mechanisms (SIEPS). The establishment of Single Market authorities could also help ensure that Single Market rules are correctly implemented. But this author warns against an excessive use of regulations – as opposed to Directives: the efficiency gains the Commission often perceives in the use of regulations (which do require national transposition legislation) must be weighed against the long-term efficiency losses (incurred due to incorrectly applied provisions and diverse national conditions).

SMART AND SUSTAINABLE GROWTH

Concerning growth, the European Union (EU) has, in principle, a clear strategy. The Commission presented a new version of this strategy – Europe 2020 – in March 2010. That same month, the European Parliament debated the Europe 2020 Strategy and gave its opinion on the topic. The European Council’s final approval of the Europe 2020 Strategy, and of its 5 EU-level targets, took place on 17 June 2010. More recently, the Commission released its “Annual Growth Survey” in January 2011. This April, Member States submitted their National Reform Programmes. And in June, the Commission is to release country-specific opinions.

The main objective of the Europe 2020 Strategy is for the “EU to become a smart, sustainable and inclusive economy” – notably via five “headline targets”: employment, innovation, education, social inclusion and climate/energy. The Commission also presented seven flagship initiatives: a digital agenda, the innovation union, youth mobility, resource efficiency, industrial policy, an agenda for new skills and jobs, and a platform against poverty. But the crucial question remains of how Member States and EU institutions are going to finance these initiatives in a period of economic turmoil and monetary instability. Recent austerity measures and the EU’s overall reduced economic potential are currently reducing the EU’s (and its Member States’) capacity to fund growth. Consequently, three measures are proposed here to facilitate the implementation of Europe 2020: public sector reform (not mentioned in the Europe 2020 strategy), EU-level investments (which should also reduce divergence in the EU), and the completion of the Single Market (as mentioned above), notably concerning digital markets (EPC) and energy markets (CEPS, Bruegel).

Although most of the papers below focus on specific policy fields – namely energy, innovation and demography, they nevertheless continue to keep the Single Market in sight: the creation of a single energy market is an example of
As it turns out, the EU’s innovation policies, per se, also affect the future of the internal market, notably in relation to the notion of specialisation. In the EU’s new Innovation Union, “an entrepreneurial learning process” is to take priority – over a top-down approach of choosing the most promising sectors – through the new European Innovation Partnerships (EIPs). A pilot EIP on “Active and Healthy Ageing” was launched in February 2011.

Lead Market Initiatives (LMIs) – which were launched in December 2007 – have already played a crucial role in promoting demand-side innovation policies within the EU. But as they focus on “promising sectors”, whereas the EU’s new philosophy focuses on “societal changes”, the final evaluation of LMIs which should take place during the Polish Presidency – could lead to a replacement of them by the EIPs, whose ambition is “to enhance European competitiveness while tackling societal challenges” (demosEUROPA).

However if “smart specialisations” – i.e., innovation niches – serve as key criteria in the distribution of structural funds in the next Multiannual Financial Framework, this could lead to a further widening of the development gap between Member States; and the new EIPs might favour such divergence as well (demosEUROPA). Still the future of EIPs is just as uncertain as that of LMIs – dependent on the results of the pilot project that will be made public this autumn.

DEMOGRAPHIC CHALLENGES

Concerning European prospects for growth, completion of the internal market, energy issues and innovation writ large are not the only variables: the aging and decreasing population of the EU is also an important factor. Longevity and low birth rates are changing demographic structures and restraining both economic growth and budgets. Smaller and older populations mean a smaller workforce, and therefore fewer contributors to public social security systems (PSS). Under current policies, a growing and unsustainable PSS debt will make the financial system of almost all Member States insolvent.

Governments would usually try to repay their debt by either extending their revenues or cutting on other expenditures. A tentative calculation will immediately make clear that the required primary budget surpluses have to be double digit and thus are impossible to achieve for most Member States. Moreover, increasing the tax ratio may not be a solution for states where the ratio is already high. Other solutions to these current and future debt problems are found in three areas where Member States should move closer...
The Single Market Act in Search of a Strategy

Tinne Hermans
Senior Research Fellow, Egmont

The Single Market dream in urgent need of new momentum

Over the last two years, most of the EU’s attention has been inevitably absorbed by efforts to weather the storms plaguing the monetary union. Hence, the focus has been on crisis management and economic governance.

Yet, one piece of the puzzle vital to the EU’s economic recovery as well as long-term growth has, up to now, not received the interest it deserves, i.e., the effort to relaunch the Single Market. Indeed, given that a more integrated European market is an important catalyst for stimulating growth in the face of the economic and financial crisis, this component of the EU’s Economic and Monetary Union should urgently be given a more prominent role in the drive for economic recovery. One of the most stimulating examples of this untapped growth potential in the Single Market Project is undoubtedly the services sector, which, although it accounts for 7% of EU Gross Domestic Product (GDP), only makes up 2% of total EU trade.

The context in which today’s Single Market Act operates is, however, different from that in 1992. For one, the financial crisis, rather than prompting increased market integration zeal, triggered a chain of protectionist reactions, thereby painfully revealing the remaining fragility of this cornerstone of European integration, so often taken for granted. However, even before the woes of the recent crises, the enthusiasm for further completing the Single Market had already faded considerably. Arguably, both the enlargement and the deepening of the}

6 PART I – PROSPECTS FOR ECONOMIC GROWTH

INTERNAL MARKET

A Single Market Act in Search of a Strategy

Tinne Hermans
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A first objective is to reduce the unemployment rate: the more people work, the more they contribute to the national pension schemes. A reduction by two percentage points of the current unemployment rate by 2030 would reduce the sustainability gap by roughly 11% (SWP). But it is currently the most difficult goal to achieve. A second option is immigration (CCEIA, SWP). According to the Commission, net immigration is likely to decline in most Member States and EU citizens’ show a strong unwillingness to accept (and integrate) a greater number of foreigners (CCEIA). However, keeping the net immigration ratio at 2008 levels (around 0.34% of total population) would decrease the sustainability gap around 8.7%, and would be especially useful for new Member States (SWP).

The objective of attracting high-skilled migrants should also be developed at the EU level (CCEIA). Extending the retirement age represents a third option to reduce PPS debt. Raising the retirement age to 66.4 years by 2035 would reduce the sustainability gap at the EU level by 27% (SWP). If these three policies occurred simultaneously, the overall result might be even better. No matter the policy chosen, the best response to the revenue-expenditure gap – the sustainability gap – is to act now (SWP). The longer the delay, the higher the macroeconomic cost. The sooner the scheduled amortisation will decline, the larger the amount of (present value) stock will be realised. With the economic crisis coming to an end, the long-term fiscal sustainability should then become a priority concern in the run-up to the next Trio Presidency.

No matter the policy chosen, the best response to the revenue-expenditure gap – the sustainability gap – is to act now (SWP). The longer the delay, the higher the macroeconomic cost. The sooner the scheduled amortisation will decline, the larger the amount of (present value) stock will be realised. With the economic crisis coming to an end, the long-term fiscal sustainability should then become a priority concern in the run-up to the next Trio Presidency.

The context in which today’s Single Market Act operates is, however, different from that in 1992. For one, the financial crisis, rather than prompting increased market integration zeal, triggered a chain of protectionist reactions, thereby painfully revealing the remaining fragility of this cornerstone of European integration, so often taken for granted. However, even before the woes of the recent crises, the enthusiasm for further completing the Single Market had already faded considerably. Arguably, both the enlargement and the deepening of the
Towards a strategy for the Single Market?

At the core of Monti’s proposed strategy lies a unique attempt to address the issues of the European market integration fatigue. While enlargement has increased diversity within the Union, the gradual deepening of the integration process has meant that the single market has faced new challenges. Monti argues that forces of resistance, particularly in more nationally sensitive policy fields, are being affected by this process. This is especially noticeable in the area of free movement of workers as well as in the “people-intensive” services sector, which explains much of the socially-inspired resistance. Hence, the polemic surrounding the adoption of the Services Directive seriously tarnished the whole market integration project.

Monti further emphasises the need for a comprehensive approach that integrates policies traditionally not regarded as Single Market policies into a Single Market strategic objective. To engage in a “package deal”, the proposals addressing gaps and bottlenecks are to be grouped together in an overall package deal containing “something for everyone”. This should allow Member States to compromise in certain areas and to strike good deals on others.

Given this increased urgency for a quantum leap in unlocking the Single Market’s growth potential, Monti further emphasises the need for a strategic approach. This strategy should be integrated and address the challenges of the whole market across policy areas. Moreover, globalisation has intensified competitive pressures and encouraged a need to make substantial progress in the domain of market integration.

To maximize the chances of success, Monti proposes a “package deal” approach. In other words, the proposals addressing gaps and bottlenecks are to be grouped together in an overall package deal containing “something for everyone”. This should allow Member States to compromise on certain issues and to strike good deals on others.

During his second term, President of the European Commission José Manuel Barroso, sensed the need to make substantial progress in the domain of market integration and seize the opportunity of the upcoming 20th anniversary of the 1992 Single Market Programme. Monti’s report is a response to this need, and it argues for a “package deal” approach.

Almost in parallel, the European Parliament produced a Resolution on delivering a Single Market to consumers and citizens based on an own-initiative report by Louis Grech. At the core of this report lies the call for a new paradigm of political thinking, which places the Social Market as a key priority. The Monti Report is to be seen as a part of this package deal and to strike good deals on others.

The Monti Report laying out a genuine strategy for the Single Market was published on the occasion of the forthcoming 20th anniversary of the 1992 Single Market Programme and was adopted by the Commission. Monti himself is a committed European Parliament and has been a source of inspiration for the planned new Commission initiative. Monti’s report, however, does not provide new policy proposals but offers a comprehensive analysis of the current state of the Single Market and makes recommendations for future action.

PART I – PROSPECTS FOR ECONOMIC GROWTH

The Single Market Act

On 27 October 2010, the Commission finally published its long-awaited Communication, entitled “Towards a Single Market Act”. The Commission was keen to take advantage of the fact that the Single Market is in the process of being reviewed. According to the Commission’s Draft Single Market Act, the Single Market contains 50 proposals, the Commission decided to limit its final SMA to a total of 12 key priority actions. By doing so, the Commission did not overlook the preparatory fieldwork done by Monti, the Commission relied heavily upon the European Parliament’s concern to make the Single Market a “global” strategic package for the European economy. The Single Market is a key priority for the European Parliament, which is concerned with the wide range of issues that have been addressed in the Draft SMA. The Single Market is one of the core community competences, and the Single Market is probably one of the most important for the European Parliament, both in terms of institutional and political ownership. The Commission relies heavily upon the Commission’s Draft Single Market Act and the Commission’s Draft Single Market Act is a key priority for the European Parliament, which is concerned with the wide range of issues that have been addressed in the Draft SMA. The Single Market is one of the core community competences, and the Single Market is probably one of the most important for the European Parliament, both in terms of institutional and political ownership. The Commission relies heavily upon the Commission’s Draft Single Market Act and the Commission’s Draft Single Market Act is a key priority for the European Parliament, which is concerned with the wide range of issues that have been addressed in the Draft SMA. The Single Market is one of the core community competences, and the Single Market is probably one of the most important for the European Parliament, both in terms of institutional and political ownership. The Commission relies heavily upon the Commission’s Draft Single Market Act and the Commission’s Draft Single Market Act is a key priority for the European Parliament, which is concerned with the wide range of issues that have been addressed in the Draft SMA. The Single Market is one of the core community competences, and the Single Market is probably one of the most important for the European Parliament, both in terms of institutional and political ownership. The Commission relies heavily upon the Commission’s Draft Single Market Act and the Commission’s Draft Single Market Act is a key priority for the European Parliament, which is concerned with the wide range of issues that have been addressed in the Draft SMA. The Single Market is one of the core community competences, and the Single Market is probably one of the most important for the European Parliament, both in terms of institutional and political ownership. The Commission relies heavily upon the Commission’s Draft Single Market Act and the Commission’s Draft Single Market Act is a key priority for the European Parliament, which is concerned with the wide range of issues that have been addressed in the Draft SMA. The Single Market is one of the core community competences, and the Single Market is probably one of the most important for the European Parliament, both in terms of institutional and political ownership. The Commission relies heavily upon the Commission’s Draft Single Market Act and the Commission’s Draft Single Market Act is a key priority for the European Parliament, which is concerned with the wide range of issues that have been addressed in the Draft SMA.
Therefore, within the Council, the Presidency should:

- ensure that the legislative proposals implementing the 12 key priorities are put high on the agenda and their adoption is fast-tracked.
- attempt to use the “package deal technique”, as also advocated by Monti and which, at the time of the 1992 Single Market Project, aided the British and Belgian Presidencies in unblocking the adoption of the necessary legislative measures in the Council. In essence, this involves the bundling of legislative measures in packages, which are then to be, in principle, considered as a whole, thereby making across the board trade-offs possible and avoiding pick-and-choose exercises capable of paralyzing any ambitious project.
- seek to obtain a more general political consensus between Member States on an ambitious relaunch of the Single Market Project as whole. Indeed, although the intention to take into account the citizens’ concerns and to place the citizen at the heart of the Single Market is essential, it should not distract from the fact that what is really needed to make headway in completing the Single Market is political agreement between Member States. Even though the draft SMA and SMA did, regrettably, not take up the “grand bargain”-idea carefully constructed by Monti, the rotating presidency should strive to convince the different positions about their mutual interest in a stronger Single Market corrected with, or complemented by, specific social measures.
- ensure an integrated approach by treating Single Market measures beyond the confines of the Competitiveness Council formation; while entrusting the Competitiveness Council a coordinating role in this treatment of Single Market priorities within the different Council formations.

Lastly, the Trio Presidency should also strive to strengthen political commitment to this project at the highest level, assisting and encouraging President Barroso and the President of the European Council, Herman Van Rompuy, in their efforts to create the necessary political momentum.

The Single Market is, as is noted in the Commission Communication, not an end in itself, but it is instead a tool used to support policies in other areas. This observation may seem self-evident, but it is an often forgotten very important point. This is why it has always been wrong to speak about the Single Market as a final goal in the shape of a particular date. This applied in 1992 and still applies for 2012. The Single Market remains the most important tool to achieve the targets of the European Union (EU). It is, however, important not to disregard the dynamics and changeability of the process. If the Single Market is regarded as a completed project, progress will stagnate and there is a risk that the European integration process may slow down profoundly. In this light, the fact that the Single Market has been put into focus again in recent years is naturally welcome.

The aim of the SMA is to be a milestone in the development of the Single Market, in a similar way to the Delors White Paper of 1985. From this perspective however, the SMA (Single Market Act) is a disappointment. It is difficult to discern a coherent and overarching vision. The paper gives the impression more of a smorgasbord, where efforts have been made to scrape together 50 concrete proposed measures.

“First things first”

In its Communication, the Commission includes 50 proposed measures; some of which are old issues that remain important, for instance the EU patent, while others are newer, like the “Ecological Footprint of Products”. There is no reason to criticise the innovativeness of the
In this context, a warning flag needs to be raised against the increased use of regulations at the cost of Directives. The SMA does not raise this issue specifically, but Monti does and an increased use of regulations is also mentioned as a proposal in the Europe 2020 Strategy. Such an important development should not take place without a great deal of reflection, especially in the context of single market rules and regulations.

In many areas, the single market exists in the books, but, in practice, multiple barriers to trade and harm economic activity. These barriers are not only the result of insufficient implementation of existing rules but also the result of a lack of enforcement of these rules. Thus, the situation is diametrically different to the year 1985 when the Delors White Paper was presented. At that time, there was a great need for rules. Today, the single market's bulk currently consists of 1,221 Directives and 976 regulations in the area.

In fact, the potential for greater economic gains is frustrated by lack of physical and legal infrastructure or by absence of dialogue between administrative systems.

Thus, the situation is diametrically different to the year 1985 when the Delors White Paper was presented. At that time, there was a great need for rules. Today, the single market's bulk consists of 1,221 Directives and 976 regulations in the area. In other words, there is a need to take a different approach to the implementation of rules.

Several EU legal instruments are aimed at facilitating administrative cooperation between Member States and their competent authorities. Several specific networks of collaborating authorities have been created to this end. However, the Single Market rules in all Member States.

One issue that is not raised in the SMA is that it is important that Member States ensure that the Single Market exists only in books. The expansion of the single market legislation and the Single Market rules in all Member States.
PART I – PROSPECTS FOR ECONOMIC GROWTH

The Service Directive has not entailed any extensive changes to the basic rules that used to apply to the free movement of services, but it entails two fundamental changes. Firstly, the legal situation has been specified and fine-tuned, which has rendered the conditions under which a company can establish itself in the country in question. As regards companies that are already established in other EU countries, it should instead be possible for host country authorities to retrieve information and receive other assistance from the home country's authorities when the need arises. What is of particular importance in this context is the Service Directive's goal of promoting a safer market for consumers. No market can function and lead to the desired growth without the safety of the market.

The development of mutual trust would appear to be one of the most important issues at the moment. It is only through close cross-border cooperation between the competent authorities of the Member States that an increase in trust can be achieved. This was specifically noted in the above-mentioned Commission Recommendation of 29 June 2009, on measures to improve the functioning of the single and necessary measures to ensure the management of existing cross-border networks or electronic information systems.

It is evident that administrative cooperation can only be efficient if it is used. Here, Member States can seize the opportunity to gain some control if they are not needed to fulfill legislative aims. Administrative networks should therefore be developed and analysed and this should be identified towards those authorities that operate in a market or similar system. However, this negative attitude must be balanced against the interests of obtaining better functioning administrative cooperation. It is in this case that enhanced mutual trust can be created between national authorities in the market, which is a precondition for a better-functioning Single Market.

Dispute resolution mechanisms

Already established systems for alternative dispute resolution (ADR) can have a far greater reach than trying to solve each individual case at hand. These disputes mechanisms may generate information about areas that do not function well and can hopefully lead to better functioning Single Market. The outcome of the dispute resolution should also be given greater publicity, both at the national and the European level.
Conclusion

The Single Market obviously needs to be improved and the SMA is a step in that direction. However, there is a risk that the SMA’s very broad scope and lack of coherent strategy turn it into a failure. It is therefore highly recommended that the Trio Presidency works out an agenda based on the SMA that specifies the most imperative measures to be taken. The Single Market is a never-ending story where the importance of quality outweighs quantity in the long run. It is submitted that much more emphasis should be added to already existing, but not fully functioning areas. In this article, it has been argued that such areas include an improved partnership between the Commission and the Member States, administrative cooperation between national authorities, mutual evaluation of national legislation and the need for dispute resolution mechanisms. Of paramount importance is the building of stronger mutual confidence in the market. No market can function and lead to desired growth without the faith of consumers.

SMART AND SUSTAINABLE GROWTH

Implementation of Europe 2020: Time to Act

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The agreement on the Europe 2020 Strategy in 2010 came amidst a period of economic upheaval. Europe has been facing a deep recession, suffering a setback in fulfilling its long-term ambition of achieving "the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment".\(^1\)

The economic crisis has made the achievement of the central goal of Europe 2020 – smart, sustainable and inclusive growth – even more important, but at the same time has limited the resources available to pursue the Europe 2020 objectives. This article sets out what critical actions are necessary to drive forward the implementation of Europe 2020 to avoid the Lisbon Agenda’s fate of having the right ambitions, but insufficient implementation.

The long term impact of the crisis\(^2\)

While most of Europe is now on the tentative road to recovery, the economic crisis has not only had a profound impact in the short term, but it looks increasingly likely that the crisis will also result in long-term impacts, which will influence Europe’s ability to deliver on its development priorities.

The more difficult economic position of the European Union (EU) is not due to the crisis alone: the crisis has aggravated pre-crisis challenges. Growth rates in Europe were already relatively low, for example with average growth from 2002-2006 at around 2%. In part, this is due to

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1. Treaty on European Union
2. Economic data in this section is taken from the Autumn 2010 forecast, European Commission
the long-term challenges Europe faces, including a significant ageing of its population, global competition, increasing resource prices and the need to finance climate-change adaptation and mitigation. But policy also played a significant role, with some of Europe’s economies – Portugal, France and the United Kingdom will be somewhere around the 90% mark. On average, debt financing costs will be around 3% of GDP in the EU, but the situation in Greece is in a precarious situation at 2.4% of GDP. These levels of debt will necessitate fiscal consolidation. While in the short term there is a need to avoid potentially difficult public spending reductions, in the medium-term fiscal consolidation will be inevitable. Given the scale of the debt mountain, this will require more than a simple cutback in expenditure and a slight increase in taxation – there is a need to reorganise public services fundamentally. In addition, it is unlikely that the public sector will be able to provide significant public investments which are needed to increase further growth potential.

Debt levels have a marked impact on the cost of borrowing. As can be seen in the table below, municipal debt levels are highest in Greece and Cypriot, at around 120% and 150% of GDP respectively, while Italy is at 120% and Greece 156%. Portugal, France and the United Kingdom will be somewhere around the 90% mark. On average, debt financing costs will be around 3% of GDP in the EU, but Greece is in a precarious situation at 2.4% of GDP.

There is not only a growth crisis across the EU when compared to the rest of the world, but also increasing divergence within the EU, which is a major driver behind the current eurozone crisis. While divergence pre-dates the economic crisis, most notably in balance-of-payments performance, it looks increasingly likely that some of the weakest economies will be left even further behind. While some countries such as Germany are rebounding strongly, economies such as Portugal and Greece are experiencing growing problems of reconstruction strongly

Reduced economic potential

The most direct impact of the crisis has been a sharp reduction in Gross Domestic Product (GDP) – the EU lost on average 4.2% in 2009, with the growth rate for 2010-2012 at 1.2% or 1.3%, which is significantly lower than the EU’s average GDP growth rate of around 2%. This masks significant variation within the EU, with some EU Member States consistent among the top 10 in the World Economic Forum’s Global Competitiveness Index and some falling well back, not least due to the global economic downturn and challenges faced by some economies. These levels of debt will necessitate fiscal consolidation. While in the short term there is a need to avoid potentially difficult public spending reductions, in the medium-term fiscal consolidation will be inevitable. Given the scale of the debt mountain, this will require more than a simple cutback in expenditure and a slight increase in taxation – there is a need to reorganise public services fundamentally. In addition, it is unlikely that the public sector will be able to provide significant public investments which are needed to increase further growth potential.

Falling GDP

The future inability to fuel future economic growth means that a debt-financed spending extends to the public sector. The crisis has also led to a significant reduction in public spending, with a negative impact on economic growth. The future inability to fuel future economic growth means that a debt-financed spending extends to the public sector. The crisis has also led to a significant reduction in public spending, with a negative impact on economic growth.

Prospects for economic growth

The developments charted above make it essential that a significant focus of EU policy must be on encouraging economic growth, with a particular focus on growth in Europe’s weakest economies. As a starting point, the EU has agreed on the Europe 2020 Strategy, which aims at a significant focus of EU policy must be on encouraging economic growth, with a particular focus on growth in Europe’s weakest economies. As a starting point, the EU has agreed on the Europe 2020 Strategy, which aims to stimulate “smart, sustainable and inclusive” growth.

The Europe 2020 Strategy does represent an improvement on its predecessor, the Lisbon Strategy. For a start, it has a clearer focus with only five headline objectives – on innovation, education, combating poverty and climate change that has been driven by global competition in a big share of the global economy.

A mountain of debt

The future inability to fuel future economic growth through debt-financed spending extends to the public sector. The crisis has also led to a significant reduction in public spending, with a negative impact on economic growth. The future inability to fuel future economic growth means that a debt-financed spending extends to the public sector. The crisis has also led to a significant reduction in public spending, with a negative impact on economic growth.
The achievement of such public-sector reform could be supported more effectively at the European level. As a crucial first step, more emphasis should be given to public sector reform and social innovation. In monitoring the implementation and promoting structural reform that can simultaneously help to reduce public-sector deficits and encourage early labour-market exit, in short, public-sector reform should be a fundamental and integral component of Europe 2020 implementation.

The political emphasis is currently on better governance for fiscal policy with a real question as to whether a loss of confidence in the economic stability mechanism of the eurozone is a problem. The architects of Europe 2020 have tried to overcome this by creating more buy-in. The achievement of such public-sector reform could be supported more effectively at the European level. As a crucial first step, much more emphasis should be given to public sector reform and social innovation. In monitoring the implementation and promoting structural reform that can simultaneously help to reduce public-sector deficits and encourage early labour-market exit, in short, public-sector reform should be a fundamental and integral component of Europe 2020 implementation.

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But the potential benefits for the EU economy are large; it could add at least 4% to EU GDP, help create potential benefits for EU companies, and more investment in the development of human capital. In addition, the activities of the European Investment Bank could be greatly expanded to provide more low-cost investments.

At EU level, there has been much progress: the Digital Agenda, the Citizen's Agenda, the consultation on the Single Market Act. The latter two followed on directly from the Monti Report, which provided a comprehensive blueprint for the development of the Single Market.

However, it remains to be seen exactly how ambitious, integrated and visionary the concrete proposals will be and what, in the end, will be translated from ambition to reality, given the difficult economic and political environment as well as protracted European decision making mechanisms.

Many of the problems encountered by firms and consumers within today’s Single Market are not due to the overall framework of rules, but to its incomplete or ineffective implementation. Not only more work is required in realising the original four freedoms, but the Single Market also needs to be made ready for the future.

Innovation is the key to turn Europe 2020 ambitions into reality. Concerns without decisive action in these areas.

To generate additional growth and enable the transformation to the knowledge economy, creation of the Digital Single Market is critical, which is recognised in Europe 2020: “The aim of the Single Market, as it stands, is to deliver sustainable economic and social benefits from a Digital Single Market.”

This requires making progress on a number of key issues including, for example, harmonisation of consumer and data protection, common standards for e-invoicing and e-signatures, a pan European patent, IPR and licensing framework and significant investment in hard (broadband) and soft (skills) infrastructure.

To ensure that the Single Market has delivered the desired market integration.

The EU budget and associated loan-based instruments with a particular view towards generating the investment needed to underpin Europe 2020, and pushing forward the further development of the Single Market, in particular the Digital Single Market – much could be achieved if the coming presidencies put their weight behind reform in these three crucial areas – inclusion of the public sector in economic governance and Europe 2020 considerations, reform of the size matters
Judging by the scant attention devoted to innovation during the extraordinary European Union (EU) summit in February 2011, the European Council has not started yet to treat this question seriously. In spite of this, over the span of one year the European Commission has managed to launch a silent innovative revolution in the EU. One could reasonably ask about the meaning of this new innovative spirit for the future of the Lead Market Initiative, whose final evaluation has been planned for autumn 2011.

A silent revolution

A discussion on innovation had initially been planned for the EU Summit in October 2010, but that had to be postponed until December and then, once more, until early 2011. Finally, European leaders looked into it during the last moments of the February Summit. Some may conclude that this has clearly demonstrated that innovation does not belong to the most pressing European priorities. Yet, such an estimation would be misleading. Contrary to appearances, the EU Innovation Commissioner, Maire Geoghegan-Quinn, has already managed to introduce innovation into the hard core of the EU agenda. What is more, unlike in the case of this new philosophy, the Commission has managed to introduce into the European agenda two relatively novel ideas – “smart specialisation” and “conditionality clauses” – which should turn out to be unexpectedly invaluable for innovation.

It was thanks to the Commission’s initiative that the conclusions of the February Summit included a number of solutions that are key to innovation in the EU. For instance, the Commission has been obliged to draft, by the end of the year, a proposition on a pan-European venture capital market, as well as a proposition on a Small Business Innovation Research Program (which would correspond to a very successful American programme of supporting demand for innovative solutions produced by small and medium-sized businesses). The Council has also agreed to launch a pilot European Innovation Partnership (EIP) in the area of healthy aging.

At the same time, the Commission has managed to introduce into the European agenda two relatively novel ideas – “smart specialisation” and “conditionality clauses” – which should turn out to be unexpectedly invaluable for innovation.

Firstly, innovation is supposed to become one of the key criteria in the distribution of the Structural Funds within the Next Financial Perspective. In a country like Poland, it may therefore be easier to obtain financing for the development of clean coal technologies, than for basic research in nanotechnologies. According to this new philosophy, the Commission would support different sectors of expertise and on different stages of development. The concept of “smart specialisation” is still very fresh, and it provides a multitude of potential opportunities. The current experts argue that it may turn out to be a new instrument of the development gap between EU countries. Others, to the contrary, say that it should induce Member States to adopt different strategies, and to greater competitiveness of the EU as a whole. Given the uncertainty about its real impact, it might seem very risky to include it in the EU strategies at this stage.
As regards the conditionality clauses, they are not such a new concept, but the Commission passed over national governments, focusing solely on strengthening links between the ministries responsible on the ground. What this often provided was a strange situation where the ministries, responsible for leading innovation initiatives, in particular a country’s policies, may feel the need to sustain innovation efforts in a particular country involved, only a small number of stakeholders, in sectors where innovation was still emerging, and only in particular countries. It is no accident that the LMI, a so-called “New Member States”, in particular, the EU in 2004 and 2007, had to be put off for the LMI was designed for first, and therefore could not participate in the initial stages when the LMI was designed, and therefore could not participate in the decision-making process. In the beginning, they happened to lack access, they had a whole other problem to tackle and usually did not return much innovation policy.

The story of the LMI

Both the new EU philosophy and the launching of European Innovation Partnerships (EIPs) are of crucial importance for the future of the Lead Market Initiative (LMI), whose final evaluation is to take place during the Polish Presidency. The story of the LMI helps to make it effective at all.

The European 2020 is often described as an otherworldly document, detached from the current socio-economic context. But as far as the long-term perspective is concerned, it is much more concrete than the Lisbon Strategy. Instead, it draws attention to specific objectives that the EU should pursue, matches them with indices, and forces the Member States to fit into this scheme. Thanks to the conditionality clauses, as well as to the new better coordinate economic policy between Member States), the new European strategy has a fair chance of being carried out not only in words, but also in deeds.

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The European 2020 is often described as an otherworldly document, detached from the current socio-economic context. But as far as the long-term perspective is concerned, it is much more concrete than the Lisbon Strategy. Instead, it draws attention to specific objectives that the EU should pursue, matches them with indices, and forces the Member States to fit into this scheme. Thanks to the conditionality clauses, as well as to the new better coordinate economic policy between Member States), the new European strategy has a fair chance of being carried out not only in words, but also in deeds.

As regards the conditionality clauses, they are not such a new concept, but the Commission passed over national governments, focusing solely on strengthening links between the ministries responsible on the ground. What this often provided was a strange situation where the ministries, responsible for leading innovation initiatives, in particular a country’s policies, may feel the need to sustain innovation efforts in a particular country involved, only a small number of stakeholders, in sectors where innovation was still emerging, and only in particular countries. It is no accident that the LMI, a so-called “New Member States”, in particular, the EU in 2004 and 2007, had to be put off for the LMI was designed for first, and therefore could not participate in the initial stages when the LMI was designed, and therefore could not participate in the decision-making process. In the beginning, they happened to lack access, they had a whole other problem to tackle and usually did not return much innovation policy.

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Recalibrating the Single Market Objective

during the last two decades, large amounts of political capital have been spent on developing the liberalised market for electricity. At the same time, administrative measures have been introduced in terms of increasing shares of renewable success of these administrative measures is challenging the development of the liberalised market. Consequently, institutional settings that are compatible across the EU are essential to achieve the long-term target of decarbonising the power sector without putting the internal electricity market at peril. EIPs have already gained a hype that lead markets have never known, and this may suggest that “symbolically” they have already managed to absorb them. EIPs have already gained a hype that lead markets have never known, and this may suggest that “symbolically” they have already managed to absorb them. Nevertheless, the final decision on whether LMI would be absorbed formally by EIPs, should be taken in October or December 2011, after the results of the healthy aging pilot project are unveiled and discussed.

The success of the renewable energy policy is starting to affect other dimensions of European energy policy. Among the headline targets of the European energy policy is the creation of a single energy market. By combining the strength of 27 energy systems, such an internal market should lead to more competition, more efficient use of resources and installations.

Conclusion

We want to focus on renewable electricity sources, as this is supposed to bring the largest contribution to the overall renewable energy targets. Renewable energy is high on the European political agenda. By 2020, Europe wants to use 20% of its energy from renewable sources, such as wind, biomass and the sun. The corresponding targets of the Energy and Climate Package from 2009 have been released in the Europe 2020 Strategy. It appears that these goals are among the most ambitious that can actually be reached. National support schemes incentivise the deployment of significant amounts of solar cells and wind turbines. Member States have to transform their national renewable energy targets into action plans that can actually be implemented. It is impressive to see how many observers thought that this was not possible.

The good news is that this would happen because innovation has lost, but just the opposite – because, at last, it is starting to win itself a proper place among the EU’s top priorities.
Renewables success challenges the Single Market

The European renewable energy policy is in conflict with the internal market on at least four issues. First, electricity generated from renewable sources is not traded in a European market. This leads to an artificial divergence of the price for renewable energy in Europe. This is inefficient, because renewable energy is not integrated into a single market.

Second, renewable deployment is one source for congestion in cross-border transmission lines and thus reduces the potential for intra-EU trade of electricity. Third, RES-E are characterised by limited predictability and generation far from centres of electricity consumption. Thus, the existing electricity network has to accommodate higher security margins and new flow patterns. In the current design of congestion management, both effects decrease the capacity for commercially available transmission capacity, consequently, intra-EU electricity trade – a cornerstone of the internal market – will decline, if no measures are taken.

A second impact of RES-E deployment on the internal electricity market is linked to the technology portfolio. RES-E are characterised by limited predictability and generation far from centres of electricity consumption. Thus, the existing electricity network has to accommodate higher security margins and new flow patterns. In the current design of congestion management, both effects decrease the capacity for commercially available transmission capacity, consequently, intra-EU electricity trade – a cornerstone of the internal market – will decline, if no measures are taken.

To achieve their national renewable energy targets, each Member State has developed a different policy mix. Policy tools include “green certificates”, “feed-in tariffs”, obligations, direct subsidies, preferential grid access regulations, tax breaks, etc. Due to the use of different fiscal, parafiscal and non-fiscal instruments, the actual size of the state support for RES-E is very difficult to assess. Data on state aid for environmental protection, collected in the Directorate-General Competition state aid scoreboard – by many means an imperfect indicator for RES-E support – reveals a total of €3.2 billion on credits to large facilities and €17.2 billion for grants. This is 1.1% of the Gross Domestic Product (GDP) in 2015, which represents 13% of the total installed capacity. Through the zero-variable cost of wind and solar power, renewable power plants are much less often called upon and median wholesale prices decrease. But, some conventional plants might be essential to meet consumption when a cloudy, windy or cloudy, low-wind hour coincides with high-demand. However, in the current system these conventional power plants are much more often called upon and wholesale prices increase. Consequently, demand for high, volatile prices is low, but RES-E plants are sufficient to meet demand at high, volatile prices. Consequently, demand for high, volatile prices is low, but RES-E plants are sufficient to meet demand at high, volatile prices. Consequently, demand for high, volatile prices is low, but RES-E plants are sufficient to meet demand at high, volatile prices. Consequently, demand for high, volatile prices is low, but RES-E plants are sufficient to meet demand at high, volatile prices. Consequently, demand for high, volatile prices is low, but RES-E plants are sufficient to meet demand at high, volatile prices.
The electricity sector is a complex system with many actors. The corresponding market designs are quite heterogeneous. At the high voltage level alone, the spectrum ranges from state-owned monopolies with regulated prices to countries that separate power delivery from the production. In Europe, the most widespread system is an independent national wholesale market with wholesale prices that determine the revenue for energy production and the prices charged to grid users. Wholesale electricity markets exist in all EU countries with the exception of Malta, which operates a single market. The corresponding market designs have been implemented in different ways across Europe. While Poland seems to accept that prices for electricity at different locations of the network cannot have the same price in the presence of internal congestion and network losses, Germany is still fighting this insight. And while Nordic countries allow integration of demand-side measures to increase predictability and intermittency of RES-E system, operators will have to provide significantly higher volumes of these services than in the past. Consequently, many Member States allowed system operators to procure these services and bill them to the customers as a part of their regulated tariffs. Due to the limited predictability and intermittency of RES-E generation, operators need to provide significant amounts of services to maintain system reliability. The big advantage of linking electricity systems is that a joint system can be much more than the sum of its parts. But to make the RES-E feed-in tradable across Member States should be revised. Recalling the renewable energy target within the internal market is feasible and beneficial. Only if a functioning single electricity market can accommodate the increasing amount of renewable electricity be managed at reasonable cost. Wide geographic averaging of intermittent generation and consumption reduces the need for expensive back-up capacities. Trade of electricity at forward and spot markets, ancillary services are typically traded across border – because market arrangements in Member States are incompatible. Thus, a new market design choice is essential for the internal market to be truly tradable on the European level.

Compatibility of national market design choices is essential for the internal market to be truly tradable on the European level. Reconciling the renewable energy target with the internal market target is feasible and beneficial. Only if a functioning single electricity market can accommodate the increasing amount of renewable electricity can the feed-in tradable across the single market. In the following section, a couple of recommendations are presented to solve the outlined issues and accommodate both the renewable and the internal market targets.
Carbon Capture and Storage: EU Advancing, but not Fast Enough

Stephen Tindale
Associate Fellow, CER

Carbon capture and storage (CCS) is an essential low-carbon bridge technology, to be used in the several decades it will take before Europe can be totally reliant on renewable energy. The EU’s energy commissioner Günther Oettinger recognises this, and the EU has a programme to subsidise large-scale demonstrator projects by 2015. The money will come from auctioning permits under the Emissions Trading Scheme (ETS). CCS is not only essential to meet the EU’s climate objectives; it is also a major business opportunity. So, it is welcome that the Commission is serious about promoting this technology.

However, the timeline for selecting projects and awarding grants makes the 2015 deadline look unlikely. The amount of money available, having been based on the ETS price per ton of carbon, is uncertain. The portfolio of technology types and industrial sectors to be covered is very uncertain.

Beyond demonstration, rapid deployment will be necessary. This could best be achieved through regulation, limiting the amount of carbon emissions permitted per unit of production. Yet, the current ETS price is significantly below what would be needed to think beyond demonstration and highlight the need for carbon dioxide transport as a key part of the EU’s future energy infrastructure.

The greatest threat to CCS success in Europe appears to be strong public opposition to underground storage in several Member States, notably in the Netherlands and Germany.

1. For example: “Carbon capture and storage (CCS) stands out as one of the most important technological solutions for reducing emissions.” Available at: http://www.powergenworldwide.com/index/display/articledisplay/2121886504/articles/powergenworldwide/coal-generation/coal-generation-equipment/2011/01/ec-commissioner_backs.html

Large scale demonstration projects are needed because CCS has only so far been shown to work at small scale and at various stages of the process, not at all large scale or integrated throughout the process. But CCS will only contribute significantly to climate objectives if demonstration is followed by large scale  projects. So, how should deployment be achieved? There is the usual debate between supporters of market mechanisms and those favouring a regulatory approach.

Some money should go to demonstrate CCS on gas power stations. The Commission's grant awards to CCS projects under the European Economic Recovery Plan did contain one award to a gas power station in France, so it has a good track record on this. Nevertheless, the Deployment Commission should make it clear that the NER portfolio will also cover gas.

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The main criterion that the EIB and Commission are proposing to use is cost per tonne of carbon abated. Clearly, cost-effectiveness is an important consideration, though the justification for publicly-supported demonstration projects is that CCS has yet to be demonstrated at large scale or integrated throughout the process, which means that costs are very uncertain estimates. Beyond this general point, a criterion of cost per tonne of carbon abated will provide a perverse advantage to higher carbon power stations i.e. coal or inefficient power stations. This is a result of the higher concentration of CO₂ produced, the cheaper it is to collect CO₂ in large volumes. A more appropriate measure would be £/MWh of ultra-low CO₂ electricity.

Which Member States are interested in CCS?

The European Parliament tried to insert a regulatory limit on the amount of greenhouse gases emitted into the Industrial Emissions Directive in 2009. The Parliament was unsuccessful, but the directive did at least acknowledge the right of Member States to set their own emissions performance standard to limit the amount of carbon dioxide per unit of electricity (based on the Californian approach). The UK government is taking a lead on these issues, currently consulting on setting a de facto €TS floor price by converting the carbon tax into a carbon tax and making the power sector pay it out energy tax rather than a carbon tax. Germany, the Netherlands, the United Kingdom (UK), and Spain, all have CCS projects awarded a total of €180 million under the European Economic Recovery Plan (EERP), and are aiming to submit projects for the NER 300 grants. A number of countries that
German environmental NGO BUND has claimed that there are "enormous risks" associated with CCS; there is little scientific evidence to back up his claim and BUND is part of Friends of the Earth International, which supports CCS as a better bridge technology than nuclear. Nevertheless, a prominent and large environmental group speaking out against CCS has great potential for damage and delay.

**Local opposition**

A major worry for CCS supporters is strong and apparently increasing opposition from those who live near proposed storage sites and from some environmental Non-Governmental Organisations (NGOs). The next two Presidencies of the European Council of Ministers, Poland and Denmark, have significant interest in CCS. Poland gets around 90% of its electricity and heat from coal, and received a grant from the European Economic Recovery Program for the construction of a large demonstration. China is constructing large demonstrations, largely with US financial support. Australia is doing likewise (though without US money).

In order to take advantage of the business opportunity and make a major contribution to global climate protection, the EU should continue its support on CCS. Demonstration will require a combination of regulation and market mechanisms. The EU should therefore speed up the timetable for the NER 300 grants with the aim of making awards by the end of 2011.

The next two Presidencies of the European Council of Ministers, Poland and Denmark, have received a grant from the European Economic Recovery Plan for a CCS demonstration plant. Denmark gets around half its electricity and a quarter of its heat from coal and when she was Danish Climate and Energy minister – before becoming Europe’s Climate Action Commissioner – she aimed to block any storage of carbon dioxide on their territory. They probably do not have the constitutional powers to do this but the federal government is said to be considering offering them the right to set a maximum limit, which might well be too low to allow any commercially viable projects.

**A business opportunity for Europe**

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Connie Hedegaard said she was determined to ensure that one of the EU’s CCS demonstration plants should be in Denmark.

After Denmark comes Cyprus, which has no clear interest in CCS (its electricity comes from oil. CCS could and should be used at oil refineries and oil power stations, but the Cypriot government sees other issues as being more important). So in the second half of 2012, progress on CCS will be largely down to the Commission and Council President Herman van Rompuy.

Money for CCS will be hard to protect, given the economic circumstances and the high-level political arguments about the EU budget. The most sensible way to get more money available for CCS would be to stop giving public money to dirty coal. Member States should transfer all remaining subsidies to the coal sector to CCS programmes and the loan that the EIB has given Slovenia to build a new coal power station, without CCS, should be cancelled.

### The SECURE context

The SECURE project (Security of Energy Considering its Uncertainty, Risk and Economic implications) analysed the risks associated with the supply of various energy sources in the European Union (EU) in order to come up with concrete policy proposals for their mitigation. It was funded by the European Commission under the Seventh Framework Programme. A key conclusion of the project was that security of supply and climate change cannot be considered separately and that there are clear synergies between strong climate action and energy security policies.

### Oil

The functioning of markets is a key determinant of energy security. While geopolitical and other threats to physical supply may cause price shocks, they are unlikely to cause any significant physical shortage. Price volatility is in many ways more important and more devastating than potential threats to physical supplies because related costs are much higher than the potential costs of supply disruptions. The root cause of price volatility is the rigidity of demand and supply in the short-term. Unfortunately,
The importance of a functioning internal market cannot be overstressed in terms of security of supply. However, markets alone will not solve the current issues if low security of supply is maintained in some countries, especially where markets are poorly developed (in Baltic countries, for example). Thus, increasing security of gas supplies in these regions is likely to be dependent on government intervention and/or EU regulations. Further regional diversification can be achieved by increasing trade and interconnections as well as new supply routes, both pipelines and liquefied natural gas (LNG). Demand issues in the EU should be studied further regarding their ability to mitigate security of supply issues. The development and strengthening of early warning and crisis prevention mechanisms at the EU level, as well as the implementation of regional emergency plans, should be encouraged.

Another key SECURE recommendation is related to climate policies. Ambitious targets aimed at decarbonisation and energy efficiency may lead (oil and gas) producing countries to reduce investments in expanding or maintaining capacity for fears of demand destruction. This can pose a risk to long-term EU supplies in case climate change policies are not met. Hence, it is recommended not to pursue policy objectives that cannot realistically be reached but to emphasise cooperation with exporters and pragmatism.

As regards unconventional gas, an accurate survey of recoverable resources in Europe should be carried out in order to evaluate its potential impact on supply security. In addition, legislation should be streamlined and efficient in order to reduce regulatory gaps and accompany any potential future development.

Regarding transit risks, the possibility of an independent transmission operator in the Ukraine composed of Ukrainian, EU and Russian operators should be evaluated. Such cooperation would reduce the chances of bilateral disputes affecting gas supply and ensure the much-needed investments in Ukrainian transmission infrastructure.

With the decline of traditional suppliers such as Norway and Algeria, about to decline in the medium term, Europe needs to mitigate the danger of closure of critical sea lanes, first and foremost of the Strait of Hormuz. Although such a closure is not easily accomplished in the short term, the EU should aim at mitigating the danger of closure of the Strait of Hormuz by implementing the following policy actions:

- Seeking revision of the Montreux Convention of 1936, to allow for the imposition of size limitations and passage charges on tankers, to discourage free riding and create conditions for the commercial development of pipeline bypasses. The EU should aim at facilitating investment in infrastructure adapted to reduce the danger of accidents and vulnerable oil and chemical tankers.

Security of demand and security of supply are complementary issues in ensuring an overall balance in the security of natural gas supply in the EU. Security of demand requires the EU to provide clearer signals regarding future gas demand to avoid underinvestment in exporting countries. Therefore, the EU should develop gas demand forecasts based on the amalgamation of energy policies and individual national plans.

Coal

Due to the fact that virtually all major exporters of coal can be considered reliable in the long-term, the real issue for European steam coal supply security is in the absence of an economically and politically sustainable use of coal due to obstacles to the implementation of an economic framework. This can lead to the closure of critical sea lanes. An example is the closure of the Strait of Hormuz, which might cause a shortage of oil supplies, leading to economic damage and political instability. To mitigate this risk, the EU should consider developing alternative supply routes such as LNG or pipeline imports. Additionally, the EU should focus on diversifying its energy sources and reducing its dependence on coal.

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PART I – PROSPECTS FOR ECONOMIC GROWTH

Nuclear energy

The sensitive issues for nuclear energy include risk aversion among very low probability accidents with severe consequences, the necessity to assure safe storage and final disposal of radioactive waste over an extremely long period of time and the possibility of nuclear proliferation. These aspects strongly influence the public opinion and consequently also the social acceptability of nuclear power.

In the EU, the nuclear renaissance is facing a difficult birth. According to International Energy Agency (IEA) and European Commission energy scenarios, EU nuclear share may rise between 20% and 30% by 2030. Because nuclear share is currently providing almost two thirds of all low-carbon electricity in the EU, this will make the achievement of EU climate objectives more difficult.

Renewable energy sources

A high share of Renewable Energy Sources (RES) in the mid- to long-term cannot be reached without strong increases in all three sectors: renewable electricity (RES-E), heat (RES-H), and biofuels. While the currently limited and dispersed support for RES-E needs to be addressed in the future, existing efforts should be directed to develop second generation biofuels, which have lower GHG emissions performance, and reduce competition for food supplies and biodiversity.

The uneven distribution of RES potentials and costs emphasizes the need for integrated co-operation between Member States. Suitable accompanying flexibility mechanisms can assist the achievement of national RES targets in an efficient and effective manner.

The general approach should be to keep a level playing field among different technologies, so that most efficient solutions can emerge from market forces rather than being selected by policy makers. Present technological uncertainties suggest the need to maintain some public support for a wide range of technologies. Consequently, any future policy framework should contain periodic reviews of the incentive schemes, on the basis of experience. Nevertheless, this policy should allow for minor adjustments of the incentive schemes, on the basis of experience. Consequently, any future policy framework should contain periodic reviews of the incentive schemes, on the basis of experience.
To face the challenges resulting from an increased share of variable wind electricity, several potential remedies may be applied:

- Improvement of the tools to forecast the variations of wind power outputs.
- Trading at the intra-day market platform would correct all imbalances (contrary to imbalance payments, which only apply for the net system imbalances).
- Although not all storage systems are yet economically competitive, they can facilitate the integration of fluctuating generation (for example: pumped-storage hydropower plants, hydro reservoirs, compressed air storage, flywheels, or batteries).
- By enabling intelligent monitoring and an improved control of supply and demand, smart grids can improve system reliability and the security of supply.
- Finally, the reinforcement and extension of the electricity grid represents a key option to integrate large amounts of fluctuating electricity into the electricity system.

In order to achieve more efficient system operation in the short-term and more optimised siting of new generation sources and loads in the long-term, regulation should also be designed to provide “locational marginal value”, i.e. providing spatial (zonal / nodal) differentiation of electricity prices (related to maximum transfer capability constraints and losses along the lines) and of transmission charges (calculated on the basis of how much each agent uses the network).

As to the progressive transformation of distribution networks, “intelligent” networks, cooperation among international, European and national standardisation bodies, grid operators and manufacturers should be encouraged to further improve grid capabilities and interoperability of smart grid devices and systems, and to anticipate technical barriers to their deployment. From a regulatory point of view, a key issue is how to support investments of distribution network companies in such innovative technologies, as they are more efficient and flexible than actions to support RES development, but they may also require strong demand response programmes, such as smart metering. Moreover, strong incentives should be provided to the individual network users. From this perspective, both incentive and minimum requirements of such investments should be based on the quantification of the effects and benefits of such investments through appropriate indicators.

Regulatory certainty is key to ensuring (capital intensive) investments in the electricity sector, in order to let investors correctly assess their risks.

In terms of electricity generation, meeting and monitoring an adequate level of capacity is essential. To this end, transmission system operators (TSOs) should determine how much capacity of each type (base load, mid-merit, peak, for example) may be needed to meet the security standards, and also when and where it is needed (e.g. via blockchain or similar instruments to identify significant security issues and costs). The development of capacity markets (capacity payment schemes, etc.) is necessary to induce investors to pursue the optimal development of the generation set outlined by TSOs. This process should be coordinated at the level of the European Network of Transmission System Operators for Electricity (ENTSO-E) and the Authority for Cooperation of Energy Regulators (ACER) to increase the effectiveness and avoid market distortions.

Although significant improvements in energy efficiency have been achieved in Western Europe, more fine-tuning and coordination among Member States is required in order to respect the potential benefits also in terms of energy security. This suggests that EU measures should have a binding character, whereas effective in this process, differences in the responsiveness of energy consuming sectors to energy policies should be taken into account: SECUR’s analysis has highlighted, for instance, that mandatory standards are being set up for electricity, gas, and transport in several Member States, but the framework is highly desirable to the aim. Also for developing national transmission lines, it is necessary to increase the effectiveness and avoid market distortions.
appliances seem to work better for the residential sector, whereas measures supporting information, education and training are more effective in the industrial sector.

Cross cutting measures, in particular those related to marked-based instruments, have the strongest influence both on energy security and energy efficiency. From this perspective, it is recommended to consider the development of white certificate market models at the EU-level.

The role of a public intervention aimed at curbing structural inefficiencies should be evaluated, not only in terms of financial support, but also in terms of creating a market with a clear and stable regulatory framework, in which Europe-wide standardisation will reduce the costs of adaptation to national markets.

Conclusions

The importance of energy security for Europe will need to be reflected in the upcoming Trio Presidency's agenda. This paper has given an overview of key strategies to increase the security of European energy systems. On the European level, the Trio Presidency should work closely with the European Commission to speed up progress on key issues. Those measures that remain in the hands of Member States can still be influenced by the Trio Presidency by means of discussing, coordinating and streamlining them.

Key issues to be addressed include the completion of the internal market, which — inter alia — requires regulatory policies to enhance interconnections in gas and electricity in order to foster competition. With regard to renewables, the Trio should facilitate the Europeanisation of technology neutral support schemes, while aiming for policies that can increase the share of RES in heating. Renewables and energy efficiency can only unfold their potential with the development of super grids and smart grids. Policies to support the modernisation of European electricity grids should thus be designed soon. As regards external energy policy, the Trio should continue to enhance cooperation with resource exporting countries, balancing security of supply with security of demand concerns in order to ensure an appropriate level of investments in production and transport facilities. It should also use its influence internationally to advocate measures to reduce the volatility of global oil markets. Finally, the slow implementation of CCTS needs to be addressed by setting the right incentives, including a credible CO₂ price path.

The implicit public debt: General context and specific challenges

Implicit public debt (or liabilities, IPL) refers to uncovered future government expenditures grounded in promises to pay pensions, offer medical treatment to the insured, and to provide long-term care to the elderly. What if a nation’s current and future spending on health, pensions and care for the elderly is not covered by the revenues of the health care, pension and long-term care insurance? There will be a revenue-expenditure gap, a sustainability gap. Adding up all gaps to infinity yields the total IPL. A consequence of this phenomenon is that the longer the debt service is postponed the higher the macroeconomic cost – the present value of the scheduled amortisation will decline, meaning that a larger amount of money (at present value) will be required. IPL also implies an intergenerational overlapping, which calls for intergenerational justice: a timid response to the IPL causes the burden to shift to the disadvantage of future generations.

Table 1 | Implicit public liabilities (IPL) as a percentage of 2009 GDP

<table>
<thead>
<tr>
<th>Country</th>
<th>IPL</th>
<th>Country</th>
<th>IPL</th>
<th>Country</th>
<th>IPL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Luxembourg</td>
<td>860</td>
<td>Finland</td>
<td>300</td>
<td>France</td>
<td>120</td>
</tr>
<tr>
<td>Greece</td>
<td>575</td>
<td>Slovakia</td>
<td>290</td>
<td>Sweden</td>
<td>107</td>
</tr>
<tr>
<td>Slovenia</td>
<td>553</td>
<td>Spain</td>
<td>285</td>
<td>Italy</td>
<td>100</td>
</tr>
<tr>
<td>Cyprus</td>
<td>490</td>
<td>Germany</td>
<td>220</td>
<td>Denmark</td>
<td>93</td>
</tr>
<tr>
<td>Romania</td>
<td>380</td>
<td>Austria</td>
<td>207</td>
<td>Latvia</td>
<td>50</td>
</tr>
<tr>
<td>Malta</td>
<td>370</td>
<td>Lithuania</td>
<td>160</td>
<td>Estonia</td>
<td>10</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>335</td>
<td>Bulgaria</td>
<td>150</td>
<td>Poland</td>
<td>-10</td>
</tr>
<tr>
<td>Ireland</td>
<td>285</td>
<td>Hungary</td>
<td>150</td>
<td>EU-27</td>
<td>211</td>
</tr>
<tr>
<td>Netherlands</td>
<td>333</td>
<td>Portugal</td>
<td>127</td>
<td>€-Area</td>
<td>232</td>
</tr>
<tr>
<td>Belgium</td>
<td>320</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Own calculations. Source: EU Commission; DG Research
Current status and fiscal room for manoeuvre

Usually, a government would try to repay its debt by either extending its revenues or cutting other expenditures to free money for the debt service. The countries in the upper part of Table 1 would have great difficulty trying to achieve large primary budget surpluses. Better would be to raise the nation’s tax ratio – the share of taxes and social security contributions in Gross Domestic Product (GDP). The required tax ratio is IPL divided by the present value of all future taxes and contributions. A new, larger tax ratio, especially in the heavily indebted countries, will be needed.

A raised tax ratio expands the government’s room for fiscal manoeuvre without putting a strain on other spending. The disadvantage is that if the tax ratio is already large, a further increase will be hard to achieve. Table 3 demonstrates this. Other things being equal, Greece, a deeply indebted country, will remain relatively well-off. Athens will have to achieve a new tax ratio (48.5% of GDP) that is still less than the current figure in many Member States (mostly in Northern Europe) and that will remain less than the figure in some Western European Member States or in Slovenia (Table 2).

Table 2 2009 tax ratios, required tax ratios to repay the implicit public liabilities, and growth rate of tax ratios (% of GDP)

<table>
<thead>
<tr>
<th>Country</th>
<th>2009 tax ratio</th>
<th>New tax ratio</th>
<th>Required permanent adjustment of the tax ratio, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Luxembourg</td>
<td>39.4</td>
<td>52.3</td>
<td>32.7</td>
</tr>
<tr>
<td>Greece</td>
<td>37.0</td>
<td>48.5</td>
<td>31.1</td>
</tr>
<tr>
<td>Ireland</td>
<td>33.8</td>
<td>40.5</td>
<td>19.8</td>
</tr>
<tr>
<td>Cyprus</td>
<td>42.1</td>
<td>50.4</td>
<td>19.7</td>
</tr>
<tr>
<td>Slovenia</td>
<td>42.9</td>
<td>51.2</td>
<td>19.3</td>
</tr>
<tr>
<td>Spain</td>
<td>36.0</td>
<td>41.7</td>
<td>15.8</td>
</tr>
<tr>
<td>Romania</td>
<td>32.0</td>
<td>36.9</td>
<td>15.3</td>
</tr>
<tr>
<td>Malta</td>
<td>42.0</td>
<td>47.7</td>
<td>13.6</td>
</tr>
<tr>
<td>Netherlands</td>
<td>45.1</td>
<td>50.1</td>
<td>11.1</td>
</tr>
<tr>
<td>Belgium</td>
<td>48.2</td>
<td>53.0</td>
<td>10.0</td>
</tr>
<tr>
<td>Slovakia</td>
<td>31.4</td>
<td>34.3</td>
<td>9.2</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>39.6</td>
<td>43.0</td>
<td>9.1</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>40.9</td>
<td>44.6</td>
<td>9.0</td>
</tr>
<tr>
<td>Finland</td>
<td>50.6</td>
<td>55.1</td>
<td>8.9</td>
</tr>
<tr>
<td>Lithuania</td>
<td>36.3</td>
<td>39.5</td>
<td>8.8</td>
</tr>
</tbody>
</table>

Table 2 provides an scenario based on the assumption that Europe’s governments have decided to wait ten years, until 2020, before beginning to service the IPL. For instance, Luxembourg and Greece would have to raise their 2009 tax ratio even more: not 32.7 and 31.1%, respectively, but 38 and 37.9%.

Table 3 Required increase in tax ratios (%) if the implicit debt service is postponed by ten years

<table>
<thead>
<tr>
<th>Country</th>
<th>Change, %</th>
<th>Country</th>
<th>Change, %</th>
<th>Country</th>
<th>Change, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Luxembourg</td>
<td>38.0</td>
<td>Greece</td>
<td>37.9</td>
<td>Irish</td>
<td>24.2</td>
</tr>
<tr>
<td>Cyprus</td>
<td>22.9</td>
<td>Slovenia</td>
<td>22.5</td>
<td>Spain</td>
<td>19.3</td>
</tr>
<tr>
<td>Romania</td>
<td>16.9</td>
<td>Malta</td>
<td>15.8</td>
<td>Netherlands</td>
<td>12.9</td>
</tr>
<tr>
<td>Belgium</td>
<td>11.6</td>
<td>Bulgaria</td>
<td>4.4</td>
<td>France</td>
<td>4.3</td>
</tr>
<tr>
<td>EU 27</td>
<td>8.5</td>
<td>EU-Area</td>
<td>9.2</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

As far as burden-sharing between present and future generations is desired, a deferral of the start of debt service will cause a higher cost to the not-yet-born and benefit the currently living generations. The cost can be expressed as a percentage of GDP (Table 4): future taxpayers in Luxembourg and Greece would feel the greatest pressure because the additional cost of delayed reforms is 15% and 14% of their present GDP, respectively. Others would face additional fiscal pressure, as well. Unless these countries implemented debt reduction mechanisms soon, the financial burden would increase.

But, for Estonia and Poland, Eurostat projects a growing net wealth in their public social security system (PSS). If the baseline assumptions hold, the Estonian and Polish PSS will accumulate assets (unlike the rest of the countries struggling with growing liabilities). Enjoying assets is advantageous as they allow for the absorption of unforeseen shocks – economic crises, technological shifts, trade wars, etc.
Table 4: Cost borne by future generations if debt reduction is delayed by 10 years (% of present GDP)

<table>
<thead>
<tr>
<th>Country</th>
<th>Cost borne by future generations</th>
<th>Cost borne by future generations</th>
<th>Cost borne by future generations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Luxembourg</td>
<td>13.7</td>
<td>Finland</td>
<td>5.1</td>
</tr>
<tr>
<td>Greece</td>
<td>13.7</td>
<td>United Kingdom</td>
<td>4.1</td>
</tr>
<tr>
<td>Cyprus</td>
<td>8.0</td>
<td>Slovakia</td>
<td>3.8</td>
</tr>
<tr>
<td>Malta</td>
<td>6.5</td>
<td>Malta</td>
<td>3.2</td>
</tr>
<tr>
<td>Netherlands</td>
<td>5.7</td>
<td>Portugal</td>
<td>2.2</td>
</tr>
<tr>
<td>Belgium</td>
<td>5.5</td>
<td>France</td>
<td>2.1</td>
</tr>
<tr>
<td>Ireland</td>
<td>5.0</td>
<td>Spain</td>
<td>1.8</td>
</tr>
<tr>
<td>Italy</td>
<td>4.9</td>
<td>Germany</td>
<td>1.6</td>
</tr>
<tr>
<td>Slovenia</td>
<td>4.0</td>
<td>Hungary</td>
<td>1.8</td>
</tr>
<tr>
<td>Cyprus</td>
<td>3.8</td>
<td>Austria</td>
<td>1.6</td>
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<tr>
<td>Estonia</td>
<td>3.5</td>
<td>Sweden</td>
<td>1.1</td>
</tr>
<tr>
<td>Malta</td>
<td>3.2</td>
<td>Poland</td>
<td>0.6</td>
</tr>
<tr>
<td>Ireland</td>
<td>2.2</td>
<td>Latvia</td>
<td>-0.1</td>
</tr>
<tr>
<td>Belgium</td>
<td>2.1</td>
<td>France</td>
<td>-1.3</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>1.8</td>
<td>Slovakia</td>
<td>-2.3</td>
</tr>
<tr>
<td>Greece</td>
<td>1.6</td>
<td>France</td>
<td>-2.3</td>
</tr>
<tr>
<td>Cyprus</td>
<td>1.6</td>
<td>Austria</td>
<td>-2.3</td>
</tr>
<tr>
<td>Malta</td>
<td>1.3</td>
<td>Sweden</td>
<td>-2.3</td>
</tr>
<tr>
<td>Ireland</td>
<td>1.1</td>
<td>Poland</td>
<td>-2.3</td>
</tr>
<tr>
<td>Belgium</td>
<td>0.6</td>
<td>Latvia</td>
<td>-2.3</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>-0.1</td>
<td>Slovakia</td>
<td>-2.3</td>
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<td>Greece</td>
<td>-1.3</td>
<td>France</td>
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<td>Malta</td>
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<td>-2.3</td>
</tr>
<tr>
<td>Ireland</td>
<td>-2.3</td>
<td>Poland</td>
<td>-2.3</td>
</tr>
</tbody>
</table>

With regard to the new Pact, the Trio is suggested to take measures in order to make public finances sustainable in the medium-run, working on the basis of the same sustainability gap indicators used in this study.

In the first place, countries should work faster in bringing pension and health care systems into line with national demographic trends. The Trio Presidency, especially by reducing early retirement schemes. But also, steps to reduce unemployment and raise employment rates, such as increasing participation shares and using tailored incentives to employ older workers (in the age group above 55), should be pursued by the Trio Presidency.

The Spain-Belgium-Hungary Trio did not pay attention to the implicit debt question. But reducing IPL relying on fiscal measures alone would not deliver. Rather, a variety of policies must be drawn up to close the sustainability gap (Graph 1).
The proposal to raise the retirement age is often criticized on the grounds that older people working longer would make it harder for the young to find appropriate jobs. This critique is known as the lump of labour fallacy. In reality, workers are not perfect substitutes, so younger employees usually would replace the old only at high cost. Early retirement as a job machine is an idea that has never been supported by serious statistics. Rather, experiments in this domain – especially in France in the 1990s, but also in Germany and other countries – failed to deliver and these countries soon returned to higher retirement ages. Germany has even taken the lead by introducing the so-called “Pension at 67”.

Immigration from the rest of the world: modelling assuming constant net migration ratios

Immigration tends to counterbalance the disadvantages of the demographic shock, as it causes labour supply to increase. The total dependency ratio (the number of young and old people as a percentage of population aged 15-64) would fall. While the Commission projects declining net immigration in the EU as a whole and by most Member States, the following considerations are based upon the idea that migration would stay constant over time (meaning that it would contribute more to lowering the sustainability gap). If the EU pursued a policy of keeping the net immigration ratio in the coming decades at the 2008 level of 0.34% of total population, the effect would be a sustainability gap that is 8.7% smaller (Graph 2). This is two percentage points better than the result based on the Commission’s projection of declining net immigration (a 6.9% cut of the sustainability gap). In practically all new Member States the implicit

1. To keep the analysis realistic, calculations assume that only half of all immigrants enter the labour market—a quite conservative assessment.
2. Of course, immigration does not come for free, but rather at a given social cost. But, it is widely accepted that its economic effect is positive.

Reducing unemployment/raising employment rate

Unemployment is not just a social issue; it also affects the handling of the IPL. Fewer unemployed and more people working translate into better revenue for the PSS. Because the social security contributions as a share of the gross wage are assumed to be the same, revenue would catch up with expenditure. A reduction by two percentage points of the current unemployment rate would reduce the sustainability gap by roughly 11%. There are more effects though; the old-age dependency ratio would fall in the long run.

Calculations by Member States show that Slovakia, Portugal, Bulgaria and Germany might enjoy the largest gains. In particular, all countries with an already narrow sustainability gap would clearly benefit. But in countries with a very large sustainability gap even a much better labour-market situation would be less helpful—in Greece and Romania, for example. A reduced unemployment rate does not play a role in Luxembourg at all, as that country’s gap is very large and more cuts in its already minimal unemployment rate are not likely (Graph 3).
To sum up, three factors are more or less sufficient to close the sustainability gap in most countries: retirement age extension, reduction in unemployment and more generous immigration. In this paper, the factor analysis was conducted by changing one indicator while keeping all other indicators constant. In reality this is of course not the case: the overall result might be even better if the respective policies happened simultaneously. Politicians might hope for a trick to escape the debt service of the implicit debt. Yet this is impossible: implicit debt puts the same burden on the economy as the explicit one, because the two concepts are economically equivalent.

DEMOGRAPHIC CHALLENGES

Europe’s Demographic Challenge and Immigration

Yiannis Tirkides Senior Research Fellow, CCEIA

Immigration in Europe remains an unsettled issue, caught between worries about growing numbers of migrant populations, and the need for them, all in a context of demographic decline. The reality is that Europe today faces a demographic crisis of considerable proportions, which, left on to its own dynamics will have dire consequences, economically, socially and politically. In order to keep the labour force at current levels, and to avoid shrinkage of population, Europe will have to take in an increasing number of immigrants. Europe thus needs to become more open and more receptive of immigration. Yet, Europe finds it difficult to assimilate migrant populations because of own historic and cultural reasons. But what are the options and the implications? In this paper we examine immigration in the context of demographic decline. We examine the reasons for the lack of integration of immigrant populations and consider immigration policies generally in the context of demographic decline.

The demographic problem revisited

The European Union (EU) is faced with a difficult demographic situation. This is exemplified in falling fertility, rising life expectancy and the resulting ageing of the population. The fertility rate in the 27 countries of the EU was 1.6 children per woman in 2009, which is considerably below the replacement rate of 2.1 children per woman. At the same time, the life expectancy of people is rising everywhere. Between 2000 and 2009, life expectancy at birth rose from 74.5 to 76.4 years for males and from 80.9 to 82.4 years for females (Table 1). In many countries, life expectancy at birth had risen considerably more than the EU average. It is expected that by 2050, the average expectancy of males will reach 83 years in some places and correspondingly the female life expectancy will reach up to 88 years.1

As a result of these trends, population in Europe is decreasing at a considerable pace and the corresponding age profile is fast ageing with far reaching implications.

According to the United Nations, European populations will shrink considerably between 2010 and 2050. Under constant fertility assumptions, the population of the whole of Europe will shrink from 732 million in 2010 to 657 million in 2050 (Table 2). Under low fertility assumptions, the population of Europe will shrink to 609 million in 2050 for a total decline of 124 million people. Population declines will be even more pronounced in Eastern Europe and in some individual countries, most notably Russia, but also Germany. Even if birth rates are increased in the next ten years for instance, the impact of low fertility rates for a long period in the past will still be felt.

Excluding normal migration flows the decline in population will be even more dramatic. Net migration flows per year as projected by the United Nations are summarised in Table 3 below. On the basis of these projections, we can easily calculate the total net migration between 2010 and 2050. Specifically, total net migration is projected at 38.5 million in the whole of Europe in the period. In order to restore populations to 2010 levels, however, the net flow of migration will have to be considerably larger, depending on fertility assumptions. Under a low fertility scenario, as discussed above, to keep current population levels, net migration will have to be well over a 100 million people. Added to current population levels, the ratio of migrants to native populations will rise steeply. It is conceivable to arrive at a result that for every five native persons there will be two immigrants. This underlines the importance of assimilating immigrant populations.

<table>
<thead>
<tr>
<th>Life expectancy at birth</th>
<th>Fertility rate (number of children per woman)</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU 27</td>
<td>74.5</td>
</tr>
<tr>
<td>Belgium</td>
<td>74.6</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>68.4</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>71.7</td>
</tr>
<tr>
<td>Denmark</td>
<td>74.5</td>
</tr>
<tr>
<td>Germany</td>
<td>75.1</td>
</tr>
<tr>
<td>Estonia</td>
<td>65.2</td>
</tr>
<tr>
<td>Belgium</td>
<td>68.4</td>
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<td>Austria</td>
<td>75.5</td>
</tr>
<tr>
<td>Spain</td>
<td>75.8</td>
</tr>
<tr>
<td>France</td>
<td>75.3</td>
</tr>
<tr>
<td>Italy</td>
<td>76.9</td>
</tr>
<tr>
<td>Cyprus</td>
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<td>Latvia</td>
<td>64.7</td>
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<tr>
<td>Poland</td>
<td>69.6</td>
</tr>
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<td>Portugal</td>
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<tr>
<td>Romania</td>
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<td>Slovenia</td>
<td>72.2</td>
</tr>
<tr>
<td>Slovakia</td>
<td>69.2</td>
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<tr>
<td>Finland</td>
<td>74.2</td>
</tr>
<tr>
<td>Sweden</td>
<td>77.4</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>75.5</td>
</tr>
</tbody>
</table>

Table 1 | Demographic statistics in the European Union

Table 2 | Population projections to 2050

<table>
<thead>
<tr>
<th>Region</th>
<th>Actual</th>
<th>Projected populations to 2050</th>
<th>Population change 2010-2050</th>
</tr>
</thead>
<tbody>
<tr>
<td>Europe</td>
<td>726.6</td>
<td>732.8</td>
<td>691.0</td>
</tr>
<tr>
<td>Eastern Europe</td>
<td>304.1</td>
<td>291.5</td>
<td>240.0</td>
</tr>
<tr>
<td>Northern Europe</td>
<td>94.6</td>
<td>98.9</td>
<td>112.5</td>
</tr>
<tr>
<td>Southern Europe</td>
<td>145.1</td>
<td>153.8</td>
<td>153.7</td>
</tr>
<tr>
<td>Western Europe</td>
<td>183.0</td>
<td>188.6</td>
<td>184.9</td>
</tr>
</tbody>
</table>

Source: Eurostat, Population Division. 4

The alternative scenarios – low, medium and constant fertility – are defined on the basis of differing assumptions regarding the evolution of the fertility rate between 2010 and 2050.

The country groupings are as defined by the United Nations. Europe includes Russia and other ex-soviet Republics. 5

This total breaks down as follows: 1.9 million in Eastern Europe; 9.8 million in Northern Europe; 15.1 million in Southern Europe; and 31.8 million in Western Europe.
Table 3 | Net migration per year in thousands

<table>
<thead>
<tr>
<th></th>
<th>Europe</th>
<th>East Europe</th>
<th>North Europe</th>
<th>South Europe</th>
<th>West Europe</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000-2005</td>
<td>1,669</td>
<td>26</td>
<td>236</td>
<td>859</td>
<td>488</td>
</tr>
<tr>
<td>2005-2010</td>
<td>1,341</td>
<td>-10</td>
<td>286</td>
<td>739</td>
<td>326</td>
</tr>
<tr>
<td>2010-2015</td>
<td>1,100</td>
<td>-2</td>
<td>258</td>
<td>550</td>
<td>294</td>
</tr>
<tr>
<td>2015-2020</td>
<td>993</td>
<td>42</td>
<td>238</td>
<td>419</td>
<td>294</td>
</tr>
<tr>
<td>2020-2025</td>
<td>932</td>
<td>57</td>
<td>239</td>
<td>341</td>
<td>294</td>
</tr>
<tr>
<td>2025-2030</td>
<td>929</td>
<td>57</td>
<td>263</td>
<td>334</td>
<td>294</td>
</tr>
<tr>
<td>2030-2035</td>
<td>931</td>
<td>57</td>
<td>267</td>
<td>345</td>
<td>294</td>
</tr>
<tr>
<td>2035-2040</td>
<td>943</td>
<td>57</td>
<td>268</td>
<td>344</td>
<td>294</td>
</tr>
<tr>
<td>2040-2045</td>
<td>946</td>
<td>57</td>
<td>268</td>
<td>344</td>
<td>294</td>
</tr>
</tbody>
</table>

Source: Eurostat, Population Division.

Rising old age dependency ratios

The combination of a low fertility rate and an ever increasing life expectancy means that the proportion of the older people in the demographic profile increases. That is, as the fertility rate stays constant below the replacement rate, and as the death rate drops, the old age dependency ratio, the percentage of people aged 65 years and above as a percentage of the working age population of 15 to 64 years, increases sharply.

In the EU 27, the old dependency ratio is projected to rise from 25.9% in 2010 to 50.4% in 2050 (Table 4). That is, the dependency ratio is expected to double in the next four decades, when there will be one old age person who must be supported by social security for every two of working age. A similar dire prospect awaits the majority of countries in the EU. The old age dependency ratio is projected to rise to 59.2% in Italy, 58.7% in Spain, 57% in Greece, and 56.4% in Germany.

This changing demographic profile in Europe has serious economic, social and political implications. The increase in the old age dependency ratio will make it more difficult to maintain the current social welfare systems. Also, smaller populations reduce productive capacity and tighten conditions in labour markets. Labour shortages in turn will tend to put upward pressure on wages. The tax burden will have to increase, something that is likely to lead to intergenerational conflict.

A sustained influx of young immigrant workers would relieve labour market pressures, support low inflation economic growth, allow for steady population growth, and keep pension commitments under control.

7. The country groupings are as defined by the United Nations. Europe includes Russia and other ex-soviet Republics.

Table 4 | Old age dependency ratio actual and projected (in %)

<table>
<thead>
<tr>
<th></th>
<th>Actual dependency ratio</th>
<th>Projected dependency ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>20.6</td>
<td>23.2</td>
</tr>
<tr>
<td>2000</td>
<td>22.1</td>
<td>25.5</td>
</tr>
<tr>
<td>2010</td>
<td>22.0</td>
<td>24.9</td>
</tr>
<tr>
<td>2020</td>
<td>21.5</td>
<td>24.2</td>
</tr>
<tr>
<td>2030</td>
<td>17.7</td>
<td>21.5</td>
</tr>
<tr>
<td>2050</td>
<td>16.2</td>
<td>20.8</td>
</tr>
<tr>
<td>EU 27</td>
<td>23.6</td>
<td>25.9</td>
</tr>
<tr>
<td>Belgium</td>
<td>20.2</td>
<td>23.2</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>19.5</td>
<td>23.8</td>
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<tr>
<td>Czech Republic</td>
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<tr>
<td>Denmark</td>
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<td>Germany</td>
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<tr>
<td>Estonia</td>
<td>17.5</td>
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<tr>
<td>Ireland</td>
<td>18.6</td>
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</tr>
<tr>
<td>Greece</td>
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<td>24.2</td>
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<td>Spain</td>
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<td>24.5</td>
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<td>Italy</td>
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<td>Luxembourg</td>
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<td>Hungary</td>
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<td>Malta</td>
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<td>Netherlands</td>
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<td>Austria</td>
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<td>Poland</td>
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<td>Portugal</td>
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<td>Romania</td>
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<td>Slovenia</td>
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<td>Slovakia</td>
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<td>Sweden</td>
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</tr>
<tr>
<td>United Kingdom</td>
<td>24.1</td>
<td>24.3</td>
</tr>
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</table>

Source: Eurostat.

The challenge for Europe

The challenge for Europe is to maintain the working age population necessary to support the retired population, whilst at the same time avoiding social tensions. The problem will become even more acute as the baby boomers retire and start to leave the labour force. Policies to raise the fertility rate are important and should be part of an overall solution to the
Europe is facing a demographic crisis of considerable proportions. The demographic crisis in turn poses a tremendous economic problem. To sustain economic growth, it is necessary to have growing (and not declining) populations. The need for an increasing influx of young immigrants to fill labour shortages and keep pension commitments manageable. The problem is that Europe finds it difficult to assimilate immigrant populations. For the same time however, Merke’s remarks stoked the debate over the lack of integration and immigration need to be taken seriously. Integration is a two-way process involving the host country and the immigrants themselves. The host country must support immigrants. In their part, immigrants have to accept the core values of the host country and learn its language.

Angela Merke’s recent remarks that the vision of a multicultural Germany had “failed, absolutely failed,” focused on the need to work harder at integrating immigrant populations. At the same time however, Merke’s remarks stoked the debate over the lack of integration and immigration need to be taken seriously. Integration is a two-way process involving the host country and the immigrants themselves. The host country must support immigrants. In their part, immigrants have to accept the core values of the host country and learn its language.

It is not difficult to project immigration needs long into the future. A large number of immigrants will be aging. The median age of the working-age population in Europe is around 40 years. Without immigration, Europe’s labour force in the next forty years or so will require additional immigration flows. Europe’s labour force in the next forty years or so will require additional immigration flows. Germany needs an annual inflow of at least 500,000 immigrants in the medium term. A large number of immigrants will be aging and will take years to have an effect. Consequently, sustaining economic growth will require immigration. Increasing the labour force participation rate, or raising the retirement age, will be arresting economic decline without increasing immigration. However, Europe is not capable of integrating large numbers of immigrants. European societies are less tolerant to cultural and ethnic disruption. This is evident in rising xenophobia and emerging extreme right-wing politics in Europe today.

It is clear that Europe will need to address this issue effectively. It will have to encourage its own population to work harder. The nation-state in Europe includes, besides the geographical base, a common culture, language, history, religion and set of values. The nation-state is not the same thing in Europe. This is the result of the nature of the nation-state in Europe.

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Concerns about integration and immigration need to be taken seriously. Immigration and integration in Europe are among the elements that make Europe unique compared to other parts of the world. Immigration and integration in Europe are among the elements that make Europe unique compared to other parts of the world.

It is not difficult to project immigration needs long into the future. A large number of immigrants will be aging. The median age of the working-age population in Europe is around 40 years. Without immigration, Europe’s labour force in the next forty years or so will require additional immigration flows. Germany needs an annual inflow of at least 500,000 immigrants in the medium term. This stresses the need for well-structured and targeted immigration and integration policies. The task is multifaceted and policies should aim in a number of directions at the same time. The nation-state in Europe includes, besides the geographical base, a common culture, language, history, religion and set of values. The nation-state is not the same thing in Europe. This is the result of the nature of the nation-state in Europe.
- Education systems should adjust to accommodate larger numbers of foreign students, many of whom will choose to stay after their studies.
- Integration programmes should be pervasive, permeating various aspects of life, from education to health care and social security.

Indeed, immigration should be addressed in the context of demographic decline and the need for socioeconomic integration. Policies and approaches should be multifaceted both at the national and EU levels.
fiscal austerity could also cause demand to break down. External demand and external developments related to appreciation of the euro will also influence the EU’s economic performance. Overall, average Gross Domestic Product (GDP) growth is expected to be modest, with indebted countries experiencing extremely low growth and competitiveness. As a result, intra-EU economic divergences – which are already occurring – may increase (SWP).

The combination of a modest economic outlook and a fragile banking system means that crisis management will be required in 2011 and 2012. Since the Trio Presidency chairs the Economic and Financial Affairs Council (Ecofin), it will be involved in such management. But as a result of two factors, its role will be limited. First, in the case of a severe debt crisis, the European Council will play the leading role. Second, since most relevant issues involve the eurozone, these issues will be debated in the Eurogroup – where Poland and Denmark are absent. However, if the crisis hits the banking sector, cooperation will be needed in the entire EU-27. Furthermore, the EU could also face a political crisis if the government of one or more Member States in crisis deviates from its reform agenda. This underlines the fact that the 2011-2012 period will most likely be marked by an increased polarisation between EU core and EU periphery Member States (SWP).

The current management of this debt crisis consists of a number of measures and reforms which have as aim to strengthen the eurozone: namely, the creation of a permanent stabilisation fund (the European Stability Mechanism), the strengthening of economic governance, and the inclusion of the private sector in bailout funding (CCEIA).

PART II
ABSTRACT

The European Stability Mechanism (ESM), which will replace the European Financial Stability Facility (EFSF) in 2013, will be a supranational institution. Access to the ESM will be on the basis of strict conditionality, while the need to have a serious debate on sovereign debt restructuring is likely to grow. With a formal default policy in place the interest rate spreads in the eurozone would diverge further. Hence, the new mechanism would have the inherent problem that the private sector would be less willing to hold sovereign debt (CCEIA).

The European Council had also agreed on the Euro-Plus Pact, which commits eurozone Member States, and the non-euro countries that opted in, to reforms aiming at long-term fiscal consolidation and competitiveness.

During the next Trio Presidency, economic governance issues are thus bound to remain a focus point: not only are current reforms still incomplete, but future financial and economic crises are bound to occur.

The economic outlook for the EU in 2011 and 2012 remains mixed. The greatest risk to economic recovery in the EU lies in the financial sector. Yet, increasing
crisis. At the same time, transferring funds from one Member State to another remains controversial (SWP).

As mentioned, a main difficulty to a rapid resolution of the eurozone debt crisis is the difficulty tackling the spill over effects. Consequently, the implementation of more rigorous and credible stress tests in the eurozone are a pre-condition to addressing sovereign insolvency. Given the inadequacies of the previous round of stress tests, it will be preferable to involve the International Monetary Fund (IMF) and the Bank for International Settlements. Following the stress tests, two authors below argue that the eurozone should proceed with debt restructuring as necessary (Bruegel).

Concerning the sovereign debt crisis in the eurozone, some authors make a particular reference to the case of Greece. They argue in favour of a mechanism for orderly debt restructuring and propose a European Crisis Resolution Mechanism, consisting of three separate and distinct bodies: legal, economic and financial (Bruegel). Greece may share common characteristics with other debtor countries like Ireland, Spain and Portugal, but it stands out because the country is practically insolvent. The sizes of primary surpluses needed to return the country to sustainable levels of public debt are very large and lowering the interest rate charged on official EU loans or extending respective maturities will not be sufficient to restore solvency. Hence a significant reduction of Greek debt is needed and the sooner the better (Bruegel).

Enhancing growth perspectives will require a mix of old methods and new. Raising productivity through investment and supporting innovation will not suffice. New sources of growth will be required: developing the internet, communication technologies, environmental protection and alternative energy technologies. European integration itself could be made an additional source of growth and employment through the further development of the Single Market, a review of the Europe 2020 Strategy, and the new financial framework (SWP).

Regarding the Single Market, the Monti Report sets out a broad strategy which now requires implementation. In relation to the Europe 2020 Strategy, failure of some countries to fulfil their targets impacts on cohesion and convergence and raises the question how the necessary infrastructure for growth can be provided in these Member States. Concerning the debate on the 2014-2020 Multiannual Financial Framework (MFF), the Trio Presidency could focus the debate on political priorities rather than on the size of the budget or net contributions (SWP).

In the long run, the success of the euro also depends on a sustained rate of growth, necessary for convergence and political stability. The greatest challenge for the EU and the eurozone is to encourage structural reform for real convergence (CCEIA).

By and large, indebted countries will have to cope with high unemployment and ongoing pressure on public finances, and will thus have to face high political and social costs – hence the need to consider instruments and mechanisms that can help increase convergence in the eurozone (SWP). The debate on economic governance led, via the Van Rompuy Task-Force and legislative proposals from the Commission, to the strengthening of the Stability and Growth Pact, the creation of a new excessive imbalances procedure (based on the monitoring of a set of indicators for detecting the potential for dangerous imbalances), and the introduction of the Euro-Plus Pact (to strengthen the competitiveness of participating countries).

But not all believe these measures are fitting. According to two authors below, the current system of economic governance is, essentially, a dictatorship of the large, creditor countries, with its modus operandi creating a two-tiered EU. They say an emphasis on competitiveness risks making the policy agenda lopsided. In their paper, the authors argue that the effort to create a grand competitiveness design, aiming for reducing divergences between countries, will neither help solve the eurozone crisis, nor enhance economic governance. According to them, the measures proposed to measure competitiveness are flawed: focusing on divergence and competitiveness shifts attention to the symptoms instead of the causes. For them, the debate on governance has failed to address the debt issue and thus has been unable to resolve the crisis (CEPS).

According to these authors, because the policy agenda risks being lopsided, the next Trio Presidency should try to restore balance. Specifically, the Trio Presidency should deal with undercapitalised banks and refocus attention on financial stability – mentioned below. Competitiveness divergences during the last decade were driven mainly by capital flows. Since these flows are now reversing themselves, so will the imbalances. But for this to happen, financial markets must be stable. According to the authors, an obsession with competitiveness will not solve the problem (CEPS).

Another author also looks at the eurozone’s macroeconomic imbalances. After discussing the prevailing situation in terms of current account imbalances, she considers possible adjustment paths, while also highlighting gaps in the economic governance reform package (Bruegel).

According to this author, in the context of the current crisis, current account imbalances are important for two reasons. First, current account imbalances are
countries such as Greece, Spain and Portugal. The design of the economic governance reform was based on the idea that a tolerable level of budgetary deficits is sustainable in the long run and that changes in competitiveness are necessary to achieve this. The design of the economic governance reform was based on the idea that a tolerable level of budgetary deficits is sustainable in the long run and that changes in competitiveness are necessary to achieve this.

There are two approaches to the design of sovereign debt restructuring procedures: the contractual approach and the statutory approach. The contractual approach incorporates collective action clauses in the sovereign bond contract, which is an advantage, but it is unsuited for the eurozone where a default procedure for negotiations with the creditors. For the eurozone such a framework would have to have four main elements: a formal way to initiate a debt restructuring procedure; a mechanism to conduct the negotiations; a rule for the proportion of fresh credit from the EU to the debtor country; and a conflict settlement mechanism.

According to one author, the nature of sovereign debt restructuring procedures is intertwined with the way in which the debt crisis has evolved. Countries with high private sector debt and low current account surpluses (Germany, Austria, Netherlands) had relatively high current account deficits, which were mostly accumulated in the private sector. Second, excessive current account imbalances are unsustainable in the long term and signal the need to intervene mostly through fiscal consolidation and structural reform (Bruegel).

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