

# THE STATE OF THE EUROPEAN UNION

The new legislature: eleven  
challenges facing Europe





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# Presentation

*The new legislature: eleven challenges facing Europe* is the fourth State of the Union Report that the Ebert Foundation and Fundación Alternativas have published jointly. Its title reflects the new composition of the European Parliament in the wake of the most recent European parliamentary elections as well as the inaugurations of a new Commission and new presidents of the European Commission and the Council of Europe. The beginning of this new legislature, which marks the advent of a new phase for the Union, is getting underway at a decisive moment in the construction of our beloved Europe.

As the Union embarks on this new phase, we have identified what in our estimation are the eleven most pressing challenges that it will be facing during 2015 and the next few years and analyse the advances and setbacks that marked the difficult year of 2014. The first topic we will address is the need to put the recession and the failed across-the-board austerity policy –which we indicated two years ago was the wrong course to take– and move forward with a new approach that promotes economic growth, investment and job creation. What the current situation clearly calls for is strong measures that will help us regain confidence in our common project and tackle the problems misguided austerity measures have provoked: a growing inequality that has reached unsustainable levels and a subsequent decline in the quality of social welfare, one of the European Union’s distinctive signs of identity. The resolution of these two pressing problems is high on most Europeans citizens’ lists of priorities. Closely related to the aforementioned challenges are the pending issues of tax evasion and avoidance and the harmonisation of national tax systems. Equality, social welfare, and when all is said and done, democracy itself, depend on the existence of a fair, efficient and comprehensive fiscal system. Tax evasion and tax havens undermine the health of our political system, and their eradication will be an essential part of the solution to the problems we are currently facing.

However, growth going forward must be sustainable. The fight against climate change and its relationship to industrial competitiveness and the creation a secure, diverse and interconnected European energy market must be top priorities in this area. Creating a single digital market is just as

important as moving towards an integrated energy market. Digitalisation is transforming the way we produce, consume and communicate. The European Union must therefore ensure that it does not lag behind the rest of the world in adapting to this revolution and develop the means to channel it constructively and protect European citizens from the fraudulent or unethical use of digital technology.

The current crisis, the toxic effects of which have seriously compromised our economic productivity, social fabric and political institutions, was provoked by financial speculation and malpractice in the banking sector. The only way to avoid a repetition of the same tragic scenario is to undertake a fundamental reform of our financial system and implement an effective system of supervision and control that will guide the financial sector back to its authentic role of facilitating credit to families and businesses. A chapter of this report deals with this issue.

Another of the social and economic issues we considered important enough to address in this report is the Transatlantic Trade and Investment Partnership (TTIP) agreement between the EU and the United States. Business transactions between the EU and the United States account for a large share of world trade, and a successful conclusion to the negotiations underway would have a positive impact on the future of partners on both sides of the Atlantic. However, it must also be kept in mind that an agreement reached at any cost would have negative consequences for both.

Another pending challenge is the open question of economic and political migration. The harrowing fact that the Mediterranean Sea has become a vast graveyard attests to the failure of current EU policy and underlines our inability to date to cope with this human drama. Chapter VIII of this report approaches this issue from a Mediterranean perspective.

We believe that Europe's greatest security risk today is radical jihadism, which from its base in the recently proclaimed Islamic State has spread like a cancer throughout a vast area that extends from the Sahel to the Middle East. The deadly attack on the offices of *Charlie Hebdo* in Paris, a never-ending succession of hostage situations in scores of other countries and the deaths of hundreds of innocent people that occur daily in Syria, Iraq and Libya underscore the serious nature of this problem. The EU needs to develop a security policy that focuses on this threat in concert with its allies and Arab countries. We have devoted an entire chapter to this issue.

Although the idea that Europe is teetering on the edge of a new Cold War might at first appear to be a gross exaggeration, if the Ukrainian conflict is not cautiously and intelligently addressed and resolved, such a premonition could well become a real situation that quickly degenerates—and to some extent has already degenerated—into a “hot” war. Ukraine

and Russia are both part of Europe, and any confrontation between them could destabilize the entire continent. Therefore, a negotiated political solution that takes the strategic interests of all parties involved must be found. Wars between major states have always been sparked by stand-offs involving “intermediaries”, which is to say, smaller states with strong allies. Chapter IX provides a thorough analysis of the origins and evolution of the current crisis in the region and possible paths to a negotiated resolution.

Last, but no less importantly, this report addresses the question of political union and examines the recent high and low watermarks of the Union’s democratic legitimacy from two key perspectives: the new configuration of community institutions, namely the European Parliament and the European Commission and the current status of ongoing Europeanist aspirations to forge a federal Europe and Treaty reform.

The futures of the Union and every one of its citizens rest upon how successfully these challenges are approached and dealt with. As European citizens, we must never forget that road towards a fairer and more democratic society lies squarely within Europe and the framework of Union. Public passivity cannot be allowed to become a stumbling block; citizen participation is the key to all further progress. On a final note, in the name of our respective organisations, we would like to thank the authors who contributed to this report for their fine work and dedication. Thanks is also due to the director, coordinator and advisory committee of Fundación Alternativas (CAE-FA) for their invaluable advice and guidance and the Spanish Ministry of Foreign Affairs and Cooperation (MAEC), which has supported the preparation of this report via its “Hablamos de Europa” (Let’s Talk About Europe) initiative.

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# Introduction. The EU's main challenge: growth, jobs and investment to emerge from the crisis

Diego López Garrido

Seven years after the onset of the crisis, 2014 only confirmed the deep division in the Western world when it came to how to tackle it. The mixed results in the Union and in the United States are a clear sign that, more than ever, politics matters. In the Union, the doctrine of the creditor countries continued to predominate (with increasing difficulty), unbending in the commitment to cutting public spending as the priority. In the United States, another viewpoint prevailed: bolstering a recession-stricken economy by means of fiscal and monetary stimuli for growth. In the clash of models, the second option clearly came out on top.

The figures we saw in the United States at the end of 2014 are irrefutable. The country today enjoys virtually full employment. In Europe, however, joblessness still stands at around 11%, that is to say, 24 million people are out of work.

In the United States, there is growth (almost 4% in the final quarter of 2014). In the Union –particularly in the south–, there is a painfully slow increase in industrial activity, after seven years of paralysis, with further internal duality between the centre-north and the south. On top of that, Europe is mired in deflation.

So unacceptable is the situation that there has been a move towards a kind of veiled neo-Keynesianism. One example is the Juncker plan: 315 billion euros of anticipated investment and the possibility that certain investments will not count as deficit (Commission Communication, 13 January 2015). While clearly insufficient, the investment proposal is acknowledgement of the failure of monolithic austerity and of the need to

introduce some flexibility into the rigid principle of budget stability and broaden the Commission's interpretative capacity in that respect. It will be beneficial for countries such as Italy, France and Spain, in other words, three of the biggest states in the Union. However, despite that, public investment in the euro zone in 2015 will be equivalent to 2.7% of GDP, that is to say, 18% below the US level and 25% below Japan (European Commission figures).

Another example of change is the ECB's decision to implement a massive debt-purchase programme, in a departure from so many years of sterilely conservative monetary policy, facilitating the devaluation of the euro.

The Union went too far with fiscal adjustment and now it has been forced to climb down, without wanting to admit its mistake –a mistake that has resulted in most of the countries in the Union having a lower per capita GDP than they had before the onset of the crisis (2% lower in the euro zone), and a higher public debt.

The Union is now at the heart of the global economic group (Europe, Asia and Latin America) that is suffering from the malaise of stagnation in production and trade. The emerging countries have caught it (China reported its lowest percentage growth since 1990: 7.4%; industrial output in Japan fell by 3.4% in early 2015). The OECD has said that the world's economy grew by 30% over the last seven years, a percentage point below the average in the 15 years prior to the crisis. In the OECD alone, there are 11 million more people out of work than in 2007. That is why opinions like those of the G20 that are predicting global growth for the coming years sound like wishful thinking when we see that public and private debt on the planet have increased by \$57 trillion since the onset of the crisis, in other words, by 286% of the world's GDP (according to the McKinsey Global Institute, 2015), and deflation has spread like a plague.

The political response has to be global and it has to be one of public and private investment, of exogenous stimulus, not austerity as the only medicine until the patient ends up malnourished. Nor is monetary policy the only remedy, which is what the European Union has been using over the last few years, to the point of negative interest rates set by the central banks in some countries (Sweden and other Nordic banks).

Such a response is the right one in the face of two major but different problems.

The first problem is the productive system's difficulties in providing goods and services. There is not enough manpower, among other reasons because the working population, those who are seeking employment, plummeted in Europe between 2007 and 2014 and in the United States too. Despondency is rife.

Nor is there enough capital being ploughed into the real economy. The Economic and Monetary Union relies much more on financing through debt than through private equity shareholders.

The cash injection by the ECB is a step forward, but it is primarily going to mobilise speculative financial investments; not the flow of credit to businesses.

This means that economic policy will have to influence supply and the strengthening of the European productive apparatus. Investment in RD&I and education is central in this respect as an effective demonstration of what are being called “structural reforms” and which so far have been limited to stripping wage earners of their rights and to distorting the European social model.

Naturally, any public investment policy needs the support of a progressive taxation system as regards direct taxes, as well as tax harmonisation. They are conspicuous by their absence in the European countries, which are responsible for their own taxation policies. If that is not the case, the Union will continue to drift further away from one of the core goals of the 2020 Strategy and the growth just visible on the horizon will remain powerless to create quality jobs in a solid and firm manner. It will also remain incapable of building a demand base that is essential to sustainable growth - growth that in the first half of 2015 is the result of temporary phenomena: the drop in the price of oil, the depreciation of the euro, the ECB's sovereign debt-purchase programme. Therefore, there are risks and uncertainties of an economic nature (financial instability, deflation) and a political nature (the Ukraine crisis), against a backdrop of a weak global economy (the emerging countries).

The other major issue arising from the crisis –actually the quintessential European challenge– is the deterioration of the welfare state. It can be seen in salary devaluation, precarious employment, inequality and poverty. It can also be seen in especially painful effects on young people and children; not so much on the elderly and pensioners, who have a more solid protective shield, with the resulting generation gap that divides Europe.

In Spain, youth unemployment is as high as 50%; in Italy, it is nearly 40%; in France, 25%; and 17% in the United Kingdom. The percentage of people severely deprived of material resources in Europe went from 9.1% to 9.9% during the crisis.

It is a proven fact that child poverty will have indelible cultural, social and physical effects in the course of the children's lives. In Spain, child poverty went from 28.2% to 36.3% in five years of crisis (UNICEF figures).

Labour costs in the euro zone fell by 1.1% in 2014 and by 1.4% in the EU as a whole, in stark contrast with the very visible increase in business profits, not to mention the massive support for the financial sector during the crisis, which amounted to 592 billion euros (4.6% of GDP) between 2008 and 2012 in the EU in the shape of bank recapitalisation and 906 billion euros (7.7% of GDP) in guarantees and liquidity measures (according to European Parliament figures). All of it was paid for by the taxpayer.

There was no minimum redress to meet social needs, or a progressive taxation reform to make it possible. On the contrary, indirect taxes went up and direct taxation went down.

The challenge facing the Union, then, is very clear. It must spend more on social and labour rights, it has to invest much more in research, innovation and education and it must raise more cash by broadening tax bases along progressive taxation lines.

This is surely the best way of ensuring that the incipient growth in Europe remains on an upward trend and is capable of creating worthwhile employment.

The other challenges facing the EU, which are set out in the following report and its recommendations, will only be met adequately under the umbrella of an economy based firmly on production, jobs and demand.



# Portugal 2014: the consequences of a bailout

Manuel Carvalho da Silva, José Castro Caldas and João Ramos de Almeida

In May 2014, the Portuguese government announced the end of the Troika's programme. For Portugal, this programme, which had been implemented three years previously, represented an entrenchment of the approach to the crisis adopted by the government in May 2010, based on austerity and "internal devaluation", in accordance with the decisions of the European institutions.

During these three years, the programme has been subject to close quarterly monitoring. However, oddly enough, after it ended there was no call from the Portuguese government or the IMF or the European Union or the European Central Bank for an in-depth assessment of the programme comparing its objectives to the results obtained.

The pages that follow only claim to be an outline of what such an assessment could and should be and what might result from it. The assessment should start by identifying the objectives of the rescue programme and the logic underlying it. It should then look at the results obtained and compare them with the objectives and forecasts.

We start with a brief survey of the IMF's diagnosis and the objectives of the rescue programme

as they were presented in the memorandum signed in 2011. Since any assessment involves a prior selection of the most important aspects, depending on the assessor's evaluation criteria, we have broken down the exercise presented below into two parts. The first evaluates the results of the bailout based on the programme's own criteria, and the second looks at other aspects that were omitted or underestimated by the Troika but are nonetheless important.

## **The objectives and logic of the portuguese bailout**

The bailout programme was based on a diagnosis that highlighted the aggravation of the imbalances in the Portuguese economy after joining the Euro. According to the IMF<sup>1</sup>, a substantial drop in interest rates, linked to the adoption of the Euro, led to a substantial real appreciation, created fiscal and external imbalances and reduced savings. A loss of competitiveness, unsustainable fiscal

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<sup>1</sup> IMF (2011), "Request for a Three-Year Arrangement Under the Extended Fund Facility", IMF Country Report No. 11/127.

deficits and the high indebtedness of the financial and corporate sectors were the main problems of the Portuguese economy.

The IMF attributed the loss of competitiveness and the resulting current account deficits to the increase in unit labour costs and to the concentration of resources in the lucrative non-tradable sector, rather than the tradable sector. The fiscal deficits were the result of an uncontrolled increase in social benefits, healthcare costs and the “non-transparent” operation of state-owned enterprises and public-private partnerships (PPP). In regard to indebtedness, noting the absence in Portugal of a real estate bubble, the IMF underlined the high leveraging of the banks and the extremely high indebtedness (especially external) of the private sector.

Implicit in the IMF’s diagnosis was the idea that joining the Euro was not a cause of the imbalances in the Portuguese economy but rather a change of context that exposed “deep-rooted” deficiencies in the Portuguese economy, namely, barriers to competition and the protection of the non-tradable sector, labour market rigidities (wage setting, unemployment benefits and severance pay), a large stock of unskilled labour and the inefficiency of the judicial system.

From this diagnosis, the rescue programme was presented as not just a palliative but as part of a therapy capable of eradicating the structural deficiencies in the Portuguese economy. Its objectives were: a) to boost competitiveness and growth; b) to regain confidence in and ensure fiscal stability; and c) to safeguard financial stability.

The logic of the programme, based on the ideas of “internal devaluation” (as an alternative to exchange rate devaluation) and “expansionist austerity”, was presented with great clarity. In the absence of an exchange rate policy,

competitiveness and growth would be obtained through “internal devaluation” – labour market flexibility, more competition in the non-tradable sector and lower social security contributions to increase profitability in the tradable sector. Fiscal consolidation should strike a balance between restoring market confidence and growth through a credible “front-loading” of measures. Safeguarding the stability of the financial sector should be obtained through “market-based” solutions to boost the banks’ capital positions and public support to help them regain access to the capital markets.

### **The results of the bailout in light of the IMF’s objectives**

Taking into account the Troika institutions’ diagnosis summarized above and the objectives of the programme, an assessment of its results from the IMF’s viewpoint would probably highlight three aspects: a) the impact on growth, employment and competitiveness; b) the impact on the fiscal deficit and the trajectory of public debt; and c) bank deleveraging and access to credit.

The adjustment programme had a recessionary impact that far exceeded the expectations of its authors. According to the IMF’s forecasts, the Portuguese economy would undergo two years of recession, in 2011 and 2012, and growth would start up again in 2013. In 2014, GDP would be just 0.4% below its 2010 level in real terms. In fact, the recession lasted three years and in 2014 GDP was 5.5% below its 2010 level. In terms of employment, the IMF predicted that in 2014 employment would be 1.1% lower than the 2010 rate. In fact, employment fell by 7.1%.

The differences found in the depth of the recession can be attributed above all to the fact

that private consumption shrank more than expected. The shrinkage of private consumption, despite its (undesirable) recessionary effect, led to a (desirable) reduction in imports that far exceeded the IMF's forecast and gave rise to a very rapid rebalancing of the current account in 2013, despite a smaller rise in exports than expected.

Fueled by budget cuts and increased tax rates, the recession would cause, as a paradoxical side-effect, an obvious difficulty in lowering fiscal deficits by the amount hoped for and steering public debt back onto a sustainable path. Not once during the programme were the original annual fiscal deficit targets met. At the end of the programme, in 2014, instead of the IMF's target deficit of 2.3% of GDP, a deficit of 4.6% was recorded. Public debt, which supposedly should start to reverse in 2014 and to reach 115% of GDP, in fact hit 129% in the same year.

The deleveraging of the banking sector that was sought by the programme did in fact take place. However, although the banks were capitalised with funds from the programme, the deleveraging was accompanied by a noticeable credit squeeze and a rise in bad debt, which forced the banks to post very high levels of impairment. Instead of stabilising the financial sector, in 2014 the recession caused the bankruptcy and resulting resolution of one of the biggest private banks in Portugal – Banco Espírito Santo.

When the programme ended, the Portuguese government and its authors claimed that it had been a success. According to the IMF<sup>2</sup>, the programme had stabilised the Portuguese economy, restored access to sovereign debt markets, permitted a (moderate) return to growth in the

last seven quarters, brought about substantial fiscal consolidation and produced current account surpluses.

However, the IMF itself could not help qualifying this appraisal by noting in the above-mentioned post-program monitoring report that: 1) the recovery recorded in the last seven months was tending to weaken, since it was driven by private consumption and not net exports; 2) the drop in the unemployment rate, faster than the growth rate, was overestimated in the statistical measures of unemployment; 3) there was a risk of deflation; 4) the current account surplus was narrowing and a loss of market share had been recorded in 2014.

In conclusion, even in the aspects evaluated by the IMF, an independent assessment could permit one to conclude that the programme was limited to producing an adjustment in the external balance (current account) at the cost of increasing the internal imbalance (employment and level of activity). The programme barely contained the growth of external debt, having replaced the external bank debt by public external debt, leaving behind a trail of company and family bankruptcies, with survivors who are as far or further in debt than at the beginning of the process. None of the problems Portuguese economy diagnosed by the IMF – weak competitiveness, unsustainable budget deficits and the high indebtedness of the financial and company sector – have been solved. This is almost acknowledged by the IMF in its post-programme evaluation. However, far from proposing a change in the policies, the IMF is suggesting simply what it proposed before: greater fiscal consolidation and even greater reductions in “wage costs”.

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<sup>2</sup> IMF (2015), Portugal, First Post-Program Monitoring, IMF Country Report No. 15/21.

## The social and political consequences of the bailout

In respect to the aspects underestimated by the IMF the consequences of the programme can be summarised in three words: impoverishment, inequality and emigration.

The impoverishment of Portuguese society, attributable above all to unemployment, lower wages and a lack of social protection, is clearly reflected in the official statistics. The National Statistics Institute's annual living conditions and income survey shows that the percentage of people at risk of poverty rose from 18.1% in 2010 to 19.5% in 2013<sup>3</sup>. The increase in the risk of poverty affected all age groups, but especially those under the age of 18. For children, it went from 22.3% in 2010, to 24.4% in 2012 and 25.6% in 2013. This impoverishment is confirmed by the worsening of the material deprivation indexes. In 2011, 20.9% of the residents of Portugal were living in material deprivation and 8.3% in severe material deprivation. By 2014, these levels had risen to 25.7% and 10.6%, respectively.

Unemployment is the major cause of impoverishment. In 2010, 36% of the unemployed were at risk of poverty but this percentage rose to 40.3% in 2012 and 40.5% in 2013. However, the situation of those in employment also deteriorated. The risk of poverty for the employed rose from a rate of 10.3% in 2010 to 10.7% in 2013.

The "internal devaluation" inscribed in the memorandum has been translated into an effective devaluation of work and the transfer of

the income from labour to capital. The measures cutting public sector salaries, which served as a benchmark for the private sector, were the precursors of a process that would affect all of Portuguese society.

In April 2011, the average wage was €962.90. By April 2014, average compensation had fallen to €948.80. Despite the national minimum wage being frozen at €485, the number of workers covered by the minimum wage went up from 10.9% of all workers in April 2011 to around 15% in April 2014.

The devaluation of work, due to increased unemployment, and changes in labour legislation designed to reduce "wage costs" for companies led to a regressive distribution of huge proportions<sup>4</sup>.

Between the second quarter of 2011 and the third quarter of 2014 there was a noticeable drop in income from wages (of €5.8 million, or 6.9%), accompanied by a significant increase in income from capital (an increase of €3.5 million, or 36%, in income from property and €860 million, or 2.8%, in the gross operating surplus of companies).

In spite of the increase in unemployment and the fall in the value of wages, the programme increased the restrictions on access to and the value of social benefits. Since 2010, even before the adjustment programme came into force, mechanisms to assess the resources of recipients became generalised, setting limits above which support would not be given. The mesh was even tighter in 2012, under the guidance of the Troika.

<sup>3</sup> This indicator has a limitation in that it is sensitive to changes in the median income. If we remove the median variation effect, anchoring the indicator to 2009 values, the increase in the percentage of people at risk of poverty would be much higher: rising from 17.9% in 2009 to 25.9% in 2013.

<sup>4</sup> See Reis, José (coord.) (2014), *A Economia Política do Retrocesso: Crises, Causas e Objetivos (Regressive Economic Policy: Crises, Causes and Objectives)*, Crises and Alternatives Observatory, Almedina, Ch. 3.

In 2011, recipients of unemployment benefits were 53.6% of the total number of registered unemployed. Three years later, this number had fallen to 52.7%. At the same time, the duration of unemployment benefits and their value decreased. The result was a reduction in the spending on unemployment throughout the period, precisely when unemployment grew most.

Other social benefits (except for pensions, which increased their overall value despite cuts) suffered a cut of 6.3% between 2011 and 2014<sup>5</sup>. At the same time, social policies were subject to a deep-seated reorganisation, which translated into promoting and financing the activities of institutions that offer social support in the form of handouts.

In addition to unemployment, the devaluation of work and the downturn in social support, the rescue significantly increased the tax burden on income from employment, while offering tax relief on company revenues.

The corollary of this process obviously had to be a deepening of social inequalities in Portugal. The statistics released by the National Institute of Statistics (INE) only hint at this situation when they show that the Gini Index, for income distribution, rose from 34.2% in 2010 to 34.5% in 2013. In fact, the worsening inequality is expressed in terms that the direct distribution of income does not properly characterise: children and adolescents that have to abandon the education system even earlier, people who cease to have access to healthcare because of the cost or become subject to long queues, or families that can no longer afford to pay their rent or mortgage interest and find their right to a home compromised.

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<sup>5</sup> Social Security Institute, Statistics.

None of this was measured, or even taken into account, by the Troika. Least of all did they consider the worst result of the rescue: the destruction of hope in an entire generation of young people. If it were possible to measure despair, the emigration figures would be the most eloquent: more than one hundred thousand emigrants per year between 2001 and 2013 – figures only comparable to Portugal in the 1960's.

## Conclusion

The Portuguese rescue was much more than an “adjustment programme” imposed on an indebted economy in exchange for funding. In reality, the right wing government and the internal and external economic elites took advantage of it, making it into an instrument for reorganising the Portuguese political economy.

Under the pretext of fiscal consolidation, the public provision of health, education and pensions shrunk and new opportunities for expanding private provision were created, especially by subcontracting the services out. Under the pretext of a need to alter the unsustainable growth of public debt, the privatisation of the public enterprise sector was practically finished. Under the pretext of a need to contain the growth of expenditure on social benefits, supportive, emancipatory social policies were replaced by a social support network offering handouts and based on not-for-profit charities. Under the pretext of fighting unemployment and restoring competitiveness, labour legislation gutted the crucial mechanisms that protect workers and the instruments that allow them to collectively bargain for their wages and working conditions. The bailout was the driving force that the right wing and the internal and external economic

elites needed to reorganise a state, an economy and a society, in which fruits that were sown by the revolution of 25th April 1974 still continue to live on. The right wing and the economic elites, unable to obtain a mandate for this reorganisation democratically through the ballot box, took advantage as best they could of the opportunity created by the state of emergency.

The rescue did not solve any of the structural problems of the Portuguese economy and society, nor its indebtedness. It impoverished

the country and the Portuguese, destabilised employment, worsened the inequalities, pushed young people into emigrating. These are the most visible results of the troika's programme. But in reality, beyond the more visible wounds, there are other, deeper ones, such as despair, a lack of trust in the feasibility of alternatives, growing suspicion of politicians and politics, which are perhaps even more corrosive and difficult to cure.

# Inequality in Europe in the early 21st century

Alfred Pfaller

Forty years ago, the majority of rich European countries were satisfied with how material living standards in their societies were distributed. Of course inequality still did exist and many groups of the population did not yet enjoy their fair share of the increasing national prosperity but there was optimism that society would get ever closer to “prosperity for all”. The poorer countries on the southern fringes of Europe, as well as Ireland, saw themselves on the way towards emulating their richer neighbours. The people in the eastern countries dreamed of introducing western prosperity into their egalitarian distribution structures.

Things turned out very differently. Several of the richer societies (but not all) experienced dramatic increases in both inequality and poverty. The poorer countries stayed the course regarding per capita income but there was no significant decrease in inequality and during the last two decades some areas even saw dramatic increases, along with rising poverty rates. In eastern parts of Central Europe, after the transition of 1989/90, a definite trend towards social polarisation emerged, despite the fact that a number of these countries are still relatively egalitarian today when compared to the rest of Europe.

Some key figures:

In the EU of fifteen, i.e. before the large wave of eastern expansion, from the period stretching between 1995 and the 2008 crisis, seven out of the ten deciles of income distribution saw their average disposable income increase by between 1.22% and 1.28% each year. For the richest decile, however, it increased by 2.26% each year and for the poorest by 1.06%. For the second richest this figure was 1.31%. Across a plethora of countries, the increase in inequality occurred on a dramatic scale. In Germany, the disposable income for the top decile increased by 1.32% each year, multiple times greater than the increase in all other deciles. The poorest tenth registered an annual decline in income of 0.14% over the 15-year period, the second poorest by 0.2% and the third poorest still by 0.03%. In the Netherlands these figures were -0.27% for the poorest and +2.44% for the richest, whilst the lower middle classes experienced a greater increase than the upper middle classes. In the UK as well as the more egalitarian Nordic countries the poorest decile lagged significantly behind the rest whilst the richest decile was well above average. Other patterns, however, emerged too. In France, as in the majority of Member States,

income in the richest decile rose by well above average but the increase in the poorest decile was faster than the upper middle classes (sixth to eighth deciles). In Italy and Greece the lower deciles even saw the largest growth in income, which marked a complete reversal for Italy in the trends seen during the previous ten years (1985-95). Trends in the direction of greater equality were seen in the Eastern countries of Central Europe, but not in the Baltic countries, Bulgaria or Romania.

For the post-2008 period we only have data on income distribution per quintile. They show a worsening for the majority of richer EU countries and a slight improvement for the poorer Eastern European Member States. The most noticeable backsliding, however, was seen in Spain, which topped the poll as the country with the most unequal levels of distribution. Germany, where income distribution had dramatically worsened during the two decades leading up to 2008, showed an improvement. Notwithstanding various changes, the relatively egalitarian pattern remained in place in the Scandinavian and the Central European former communist countries, as well as Austria and Belgium, but with one exception: Denmark seemed to have taken a different course to that of the rest of the group of egalitarian EU countries. The poorest quintile had become poorer and the richer half of the population had grown richer.

For a society intent on allowing all of its members to enjoy their fair share of the prosperity generated by the economy, it is crucial for the lower income groups to keep pace, regardless of how rich the richest become. If we take the average income measured in terms of purchasing power for the lower fifth as a provisional indication (and nothing more!) of how fair their share is, and look at how it relates to their fair share, we see that in nine EU Member States

(not counting the special case of Luxembourg), the figure is above 9000 euros with the highest value (Netherlands) being just 15% above the lowest one (Belgium). The values for the top quintile (Q5), on the other hand, differ by 44%. Naturally the 9000 euros of the lowest quintile (Q1) could be concealing very different poverty rates. But without any additional information to hand we would attest that all nine countries had "fair shares", regardless of the values for the upper quintile. The 9000-10,000 euros that we find as the standard income of the lower social classes in richer EU countries made up approximately half of the average income of the middle quintile (Q3) in 2012 (as was already the case by 2008) almost everywhere –there was only Finland where it was considerably higher.

Naturally the income of the lower social classes is lower in the countries where gross domestic product (GDP) is lower. If we first take a look at the five relatively egalitarian Central European countries where the Q1 value measured according to purchasing power is between 4,000 euros (Hungary) and 7,400 euros (Slovenia), we find roughly the same ratio of Q1 to Q3. The situation is completely different in Spain and Greece where the income in Q3 is three times the amount of Q1. The United Kingdom, Denmark, Portugal and Italy are somewhere in between. In the altogether still rather poor South Eastern Europe and Baltic Member States, the real income for Q1 is so low that the situation can only be described as poverty (with the possible exception of Estonia). Moreover, in Bulgaria, Romania and Latvia, poverty is embedded within a highly polarised distribution structure. Lithuania and Estonia are more comparable in this respect to Italy, Portugal and the UK.



### **An overview of the causes of trends towards social polarisation**

The polarisation recorded by statistics that is being seen across broad swathes of Europe essentially derives from two basic tendencies: the rich are becoming richer and the incomes of the poorer members of society are becoming disconnected from economic growth. It is not our intention here to delve further into the dynamics of accumulation at the top of the income scale and will instead leave that aside by making the obligatory reference to Thomas Piketty and the ensuing debate. Rather we are more concerned with what is happening at the lower end of the income scale. Here some propositions: the percentage of people whose income lies far below the national standard (or the median income, in more precise terms) can primarily be ascribed to the shortage of “decently” paid jobs. A great many of the people who are dependent on the income they derive from work either cannot find a job at all or only one that is poorly paid. At the time of the aforementioned reference, forty years ago, the number of people in both categories, the unemployed and those on low wages, was considerably lower in the richer countries of Europe.

An additional factor is the decline in family solidarity in many countries. This means that people have access to a lesser extent to income earned by others, spouses in particular, but also parents or grown up children. They live alone in their homes, which they alone are left to pay for. More and more mothers, but fathers too, are raising children without the support of a partner. This reduces their earning opportunities on the labour market and at the same time increases their irrefutable costs.

Finally, mention must be made of qualification for the labour market. This has always

essentially hinged on education. Even though formal access to the education system is no more exclusive than it was in the past, at least in the West, because of the increase in migration, the issue of a language and culture barrier has become more important. Migrants now make up a significant share of the population across the Union and many of them are at a clear disadvantage when it comes to acquiring qualifications that will count on the labour market. This is reinforced and consolidated to a certain extent by the formation of corresponding sub-cultures in certain residential districts. In the former socialist countries where immigration plays a less prominent role, trends towards a certain polarisation of what was once an egalitarian education system took hold –good private schools for high-income groups and not so good public schools for the rest.

Part of this social polarisation syndrome also has to do with the welfare state. From country to country to differing degrees and in different ways, the welfare state has clearly had a cushioning effect on polarisation. But its architecture and its resources were never meant to compensate for a lack of earned income on a massive scale. The part of the welfare state that is intended to uphold earlier living standards once a person’s working life had reached an end (the pension system), is reinforcing social polarisation because low earnings inevitably lead to low pensions. The part intended to prevent income from dipping below a certain poverty threshold (known as “welfare” in America) is increasingly in demand because earnings no longer offer protection from poverty. In this respect, increasing social polarisation has gone hand in hand with increased welfare state spending. The welfare state, however, has been coming under increased financial pressure not only because more people are having to resort to using it but

also because there are fewer people paying in. This pressure is combined with the financial pressure coming from an ageing society as well as the preference for a lean state as rooted in neoliberal discourse.

### **The dynamics of the labour market**

For a long time, a large proportion of the working-age population in Europe have had no chance of finding a job to finance a standard of living that would correspond to the productive capacities of the national economy in question or, in statistical terms: that would not be too far below the national average. They are unemployed or earn so little throughout the year on average that their income will only permit a level of consumption that is not in line with national prosperity. Additionally, it often means accepting working and contractual conditions that render it impossible to plan for the long-term and which make it far more complicated to forge lasting personal relationships.

The key reason for this is the low scarcity price of manpower, especially (but by no means only) low skilled manpower. On the one hand, the demand for labour is not enough to employ all jobseekers on an “appropriate” wage. On the other hand, jobseekers often undercut one another and therefore depress their market price, *i.e.* their wage. Fuelled by the fear of remaining unemployed, they accept poorly-paid job offers and in doing so set the standard to which other jobseekers have to adjust. However, the competition for jobs does not offer a sufficient explanation for the social polarisation that has taken hold in Europe. Additionally, the segmentation of the labour markets must be taken into account. Oversupply, which puts pressure on wages, characterises only part of

the labour market. There are also various mechanisms at play that prevent wages from being pushed downwards. Workers with certain qualifications are just as rare as they were in the past and can therefore command a high market price. Across a range of labour market segments, well organised workers can secure higher than market-clearing wage. This is supported by employers’ efforts to avoid excessive turnover among their staff and to keep together a “tried and tested team” as company-owned capital (“core workforce”). Legal regulations also offer protection to part of the workforce against competition from rampant undercutting.

The pay gap between the protected and unprotected segments of the labour market that has been on the rise at least in the richer EU countries in recent decades represents a state of polarisation in and of itself. But it also deepens and consolidates the polarisation with its effect on prices on the goods and services markets. Low labour costs tend to lead to lower prices, which benefit the people buying the corresponding goods and services. People with secure incomes benefit from the fall in wages in the unprotected segment. Products in the protected sectors, *e.g.* dentistry, either remain expensive or even go up in price. Workers affected by the decrease in wages tend to be able to afford less of them. Moreover, economic structures have emerged which correspond to the wage differentials. If wages went up significantly, some economic activities would be driven out by imports or else there would be much reduced demand for them (*e.g.* private cleaning services). Once established, these structures tend to assert themselves; with decreed or brokered wage increases threatening to expand that pool of surplus labour that formed the starting point for this whole polarisation process seen in recent decades. After all, implicit exploitation of

low wage earners by the rest of society came about because there were sufficient numbers of workers on hand to exploit: in other words, unemployed people with no alternatives. Until this reservoir completely dries up, this form of segmentation will always find a way of rearing its head. How exactly to go about draining the reservoir remains to be discussed.

### **The education system as part of the polarisation syndrome**

The segmented labour market (in reality of course not only divided but complex and with differing structures from country to country) combines with other societal mechanisms when life opportunities are allocated. Who ends up in which segment of the labour market depends, wherever you are, on the qualifications obtained in the formal education system. But access to education opportunities is segmented in itself and is by no means dictated by children's genetic makeup only – perhaps not even primarily. In general (to a lesser extent in Denmark, to a greater extent in the UK), children from lower social classes have much lower chances of qualifying for the protected segment of the labour market than their richer counterparts. Factors enter into play such as the affinity for education which is often lower in households from lower social classes, including many immigrant households, and which has an impact on children's early intellectual challenges and is also seen in the parents' determination to succeed where the school career of their offspring is concerned. But everyday issues such as having the money to pay for a good education also have a role to play. All of this means that belonging to the lower segments of the labour market where wages are low and working conditions are poor

tends to be handed down from generation to generation. Positions on the sunnier side of working life are largely reserved for the sons and daughters of better-off families, without categorically ruling out both upwards and downwards social mobility.

During times of rapid growth in demand for well-qualified employees the door to upwards social mobility was naturally flung wide open. Even then, however, the education system served to maintain the status of the "upper" classes whereas ascent to these classes was mainly based on meritocratic criteria. Most children of "ordinary people" remained "ordinary people". The difference compared to development in the previous 20-30 years was that prosperity for all (an election slogan of the German Christian Democrats in the 1950s) was standard for the richer European countries and offered prospects in the poorer countries that the lower wage groups were not disconnected from the average standard of living or were at least drawing closer to it.

The education system allocates labour market chances and, hence, claims to an "acceptable" or higher standard of living. But when it results in more people aspiring to well-paid and semi well-paid jobs than the labour market can absorb, other selection mechanisms are used, for instance, the quality or reputation of educational establishments or social networks. The excess supply of aspirants to well-paying jobs can lead to low-skilled jobs in the unprotected sector being performed in large numbers by overqualified employees. It can also lead to large-scale unemployment among the "overqualified" if they do not want to jeopardise their aspirations with stop-gap jobs in call centres, building sites, warehouses and the like which may disqualify them for other jobs and if they have other survival strategies on hand (living with parents, etc.).

## **The weakening role of the family on stability**

The social vulnerability that can be brought on by the mere fact of having a low income has increased across Europe because the process of secular modernisation has meant a gradual erosion of the traditional societal structures where the family was at the heart. Growing numbers of people are living in single-person a household, which means having no family members, notably a husband or a wife, with whom to share goods, as was traditionally the case for the majority of households in the past. The number of people, women in particular, who are raising children alone, has also increased dramatically and this trend looks set to continue unabated. This means that more and more people with lower individual incomes have to derive their housing and living costs from this income alone. Statistics show that people in single-person households, and especially young people, are particularly at risk of hovering either close to or below the poverty threshold. Single mothers and fathers have a particular disadvantage with regard to the job market; not only do they have to be able to cover all of their expenditure with their (sometimes very low) incomes, including expenses relating to their children, but their child-rearing duties mean that they are more at risk of having to enter very low-paid employment.

Even without any polarisation of the labour market, the progressive isolation of people forms the basis for precarious living conditions to varying degrees. When combined with the developments seen on many European labour markets, however, it has morphed into a systemic risk of poverty since an “acceptable” standard of living without a second income is now widely regarded as unrealistic.

On the other hand, it has also been observed that the remaining family solidarity often acts as the all-important cushion for the effects of the polarised labour market. It is not only in Europe’s Mediterranean countries where many young adults are spending far longer living with their parents (“hotel mama”) than corresponds to the standard image we have of the course of a person’s life.

One further observation regarding family models is relevant here. In the stages of industrial development that saw a huge increase in “professional” occupations, many women saw marriage as a gateway to upwards-social mobility (the stereotype of a doctor marrying a nurse). The effect of this was a blending of the social classes. With the increasing occupational emancipation of women, this societal unlocking mechanism has faded somewhat into the background. Today the social strata tend to remain as they are (doctors marrying doctors), which can also be viewed as a part of the polarisation process.

## **Welfare state: helpful yet overburdened**

Were there to be no welfare provisions at all, the social polarisation of Europe would be much more extreme; many more people would be living in poverty or would even be destitute, life expectancy would be considerably lower and the children of poorer parents would barely have any hope of improving their chances of social mobility. The welfare state adjusts the results of the labour market essentially in two ways:

- People on low incomes who need welfare to be able to achieve a certain minimum standard of living receive extra income, which is financed by taxpayers. For a percentage of the population these transfers from the state are their only source of income. The generosity of

- the payments differs from country to country and varying conditions have to be met in order to claim them. In several countries this includes the readiness to accept a job that becomes available even if the pay is well below one's aspirations (workfare).
- The welfare state provides essential services and infrastructure to all citizens or residents either free of charge or at heavily subsidised prices. This mainly benefits people on lower incomes, who have a disproportionately low level of participation in the financing of these services. Furthermore, they benefit those who make disproportionately higher use of these services. The most important of these services are (a) public education services, which work on the principle of making it possible for everyone to acquire good qualifications for the labour market, and (b) public healthcare which (also on principle) makes medical treatment and prevention against diseases available universally, independently of individual purchasing power.

The pension system, which is the most costly component of the welfare state in almost any country, has much less of a mitigating effect on social polarisation. The income it provides once a person's working life has come to an end normally reflects what a person has paid into the system over the course of their working life. The formulae used to calculate the payments are often rather complex and are constantly changing along with the financial situation of the pension system. Since contributions and entitlements are, in the majority of countries, linked to formally registered (paid) jobs (although not in Denmark, for instance), wage developments have a direct impact on pensions. Regardless of the system used to finance and calculate pension funds, it generally holds true that consistently low wages result in low pension entitlements. This link

leads us to expect a drastic increase in old age poverty in the future, a phenomenon which had almost been eradicated in the richer countries of the Union and which, until recently, was only commonly found in a handful of former socialist Member States. Quite apart from the wage-pension-nexus, the pay-as-you-go-type pension system is suffering from unfavourable demographic developments (fewer and fewer people of working age are paying in and more and more people are claiming pensions due to longer life expectancy). Funded systems, in turn, have been suffering since the financial crisis of the recent past from a shortage of yield-producing investment opportunities. These problems also tend to depress future pensions.

Those welfare state measures that clearly work on the basis of distributing from rich to poor (state transfers to a diverse range of people in need, public services and public health systems, which are often structured in a highly complex way) as a whole neither have the ability nor are intended to create a socially integrated society, without the labour market first having provided the foundations. Education, health and other subsidised services only ever make up part of a "living standard". Theoretically, government transfers could top up raise low wages to the point that the resulting overall income is sufficient for a "decent" living standard. It is not only the reality, however, that is far removed from this. The very idea contradicts current thinking about a well-functioning society in which earned income is the central mechanism of allocating consumption rights.

In several countries, even those elements of material living standards that the welfare state intended to allocate independently of persons' purchasing power (education, healthcare, among others) are being superseded by markets in which purchasing power decides. Private

healthcare and private education run parallel to public healthcare and public education, often providing better services. The consequences: higher earners have better chances of recovering from illnesses, tend to live longer and their children have better chances of succeeding on the job market. This is especially the case in many ex-communist countries where, because of a lack of financial resources, public services are not very (or are no longer) good and are superseded, in addition, by an informal rationing of service delivery that responds to private top-up payments “under the counter”. Trends towards a two-tier medical system and (to a lesser extent) a two-tier education system can be seen as well in a number of countries which were previously relatively egalitarian, such as Germany.

When comparing European countries with regard to (a) income distribution and (b) the share of welfare spending of the gross domestic product, it appears that countries with relatively high levels of social spending (Scandinavian and Western Central European countries) tend to have a relatively equal income distribution pattern (when examining the ratio of the second richest and second poorest quintiles of the income scale). But there are two outliers with income distribution patterns that place them rather in the middle of the European rankings: France and Germany. On the other hand there are decidedly egalitarian countries where social spending is a long way below the European average, namely the Czech Republic, Slovakia, Slovenia and Hungary. If we look towards the labour market we see that countries with more equal distribution of income, with the exception of Austria, also have considerably lower numbers of “working poor” (not quite as prevalent in Hungary). Again, the values for France and Germany are considerably higher. This finding

suggests that the labour market is undoubtedly more important for eventual income distribution and the extent of social polarisation than the welfare state.

### **The political challenge**

If we understand a “good” society as being one in which all citizens share adequately in a nation’s wealth, we cannot be satisfied with the situation that has progressively come to light in many European countries. And if we truly want a “good” society, we cannot be content with shrugging our shoulders and observing that the market is simply not producing anything else at the moment. The political challenge would then consist of somehow “wresting” from the market something, which it does not wish to deliver if left to its own devices. The ideal solution to a more equal form of income distribution would surely be, at least at the lower end of the distribution pyramid, to usher in economic growth so that manpower quickly becomes scarce and can then command a higher market price. Of course this would require qualification profiles that match the demand structure – certainly not a workforce that is purely highly skilled. And of course it would make it easier if growth took place throughout large scale and workers could go to where the jobs were being created, so preferably across intra-EU borders. The disappearance from the market of companies and economic activities that cannot survive with higher wages would have to be tolerated. The price increases that go hand in hand with this type of structural change would have to be accepted.

Growth that makes manpower a prized commodity across a broad range of qualifications much talked about highly skilled variety) (not only the much talked about highly skilled

variety) is not in sight for the time being, neither in export-strong Germany, which is currently very satisfied with its economic fortunes, nor in the rapidly growing Baltic States, which are still nonetheless pretty underdeveloped. If we were, however, to achieve this again one day (preferably of the sort that is ecologically sustainable and geared to the quality of life rather than the quantity of goods), this would be a welcome development. It may lead to many people having better material standards of living. However, economic growth cannot be politically decreed. And here is not the place to enter into the discussion of how to go about achieving it.

The more fundamental question is whether a socially integrated society that offers prosperity to all should continue to be held hostage by economic growth. Whether or not it should be something that is actually achieved under extraordinarily favourable circumstances, but usually not. To make social integration dependent on growth seems to be the dominant position in current political discourse. Markets are accorded the reality-defining power of a natural force which simply has to be accepted. Anyone who opposes the market is being punished by it. People who do not earn a halfway decent income in this market that is governed by nature are, on the one hand, seen as not fully equipped to deal with the demands of life (since life itself is a competition). On the other hand, their misfortune is considered as the sacrifice that unfortunately has to be made to the market for the sake of general well-being. Where not ruled by interests, this discourse is still rather timid.

Intra-European comparisons suggest that this does not necessarily have to be the case. Over long stretches of time, a number of countries have largely managed to avoid social polarisation to this day even though their economic growth was not on such a scale that demand

alone would have cleared the labour market. Nevertheless the labour market is the key to a low (albeit growing) degree of social exclusion. In the relatively egalitarian countries, organisational structures have emerged which have been the source of market power as well as political power. Thus, it was possible to rule out undercutting competition on the labour market and to avoid responding with wage concessions (down to market-clearing levels) to the threat of unemployment. Instead, unemployment was fought with public policies (tax-funded public jobs, enhanced matching efforts on the labour market, requalification, emphasis on re-employment rather than defending jobs) and by restricting the supply of manpower with rationing of the labour force (for instance, reducing annual working time). No effort was spared, as it were, from preventing a low wage sector from forming.

It must not be overlooked, however, that such high wage strategies always tried to make sure that the market supported them as much as possible. In other words: near-full employment at "acceptable" wages had to be viable on the market. Since these were all small, open economies, success on internationally contested markets was always an important strategy element. Low-wage jobs could therefore ultimately not be avoided, as a large proportion of the labour force was being placed in competitive highly paid jobs. Education policy and a modern industrial policy aiming at commercial success and competitiveness were crucial for this strategy.

The widespread acceptance from the market, however, is also the vulnerable flank of the strategy. If large-scale unemployment sets in for a long duration, either because of the general economic climate or because of declining competitiveness, underbidding competition creeps in. If the unemployed are not either soon taken from the market (early retirement, further training,

etc.), without suffering a major loss of income, or find themselves back in employment with an “acceptable” wage, there is a threat that the high-wage strategy will collapse and a low-wage sector will emerge. It is then no longer as easy to impede the dynamics of social polarisation because it will (as mentioned above) give rise to a specific economic structure that is based on polarization. The experience of this was particularly dramatic in Germany, which escaped endemic unemployment with the politically sanctioned establishment of a low-wage sector (and the acceptance of social polarisation). Without entering into an in-depth discussion of the route chosen by Germany, it can be observed that in contrast to the Scandinavian countries and also the Netherlands, Austria and Switzerland, Germany was not able to reintegrate the growing number of unemployed people that were the fallout of the slowdown of economic growth since the “Wonder Years” and the ensuing structural change into a restructured high-wage economy. For all of the flexibility of Germany’s businesses, there was a considerable degree of structural rigidity in the labour market. The trade union *focus on the protection* of vested interests and on the sectors that had been the foundation of union power may well have contributed to this. Trade unions focus on the protection of vested interests and on the sectors that originally formed their power base may well have contributed to this. It is characteristic of the hopelessness that prevailed at the time that it was ultimately a social democrat government that entrusted the solution to the problem to the laws of the market, letting them have their deregulated way.

In contrast to Germany, the Scandinavian countries, the Netherlands and Austria have to date pursued a “high road” strategy which aims at running as many economic activities as possible

in “high wage mode” and keeping or re-employing as many workers in highly paid sectors of the economy. It has been relatively successful thus far through the previously mentioned interplay of 1) trade unions who use their organisational strength to oppose low wages and precarious working conditions, 2) a policy which keeps the work-force as employable as possible (qualifications, inter-sector and geographical mobility), and 3) a rather multi-layered policy which keeps the domestic economy and domestic business locations as competitive as possible on the markets that generate high wages. The instrument of reducing labour supply on a large scale has so far only been deployed in the Netherlands with its widespread part time scheme.

In none of the countries where social polarisation has been kept within narrow parameters is the future of the socially integrated working society guaranteed. The challenge of rising unemployment which threatens to shake the trade union supply cartel remains. It comes from sluggish growth of the global economy and from the prospect of huge future increases in productivity, brought about by the advances in data processing and sensor technology. It stems from the fact that *different national modes of regulating the economy compete* with each other and *that competitiveness has priority if needed*. It also comes from the ideological disposition to give in to market forces rather than imposing a political will. And finally it comes from the capital owners’ (not necessarily businesses’) interest that this ideological predisposition will remain in place. In other words: even in the countries that have managed to suppress the trend towards social polarisation so far, the struggle has by no means been won forever.

The cause of a socially integrated working society has a powerful supporter, though: demographic developments that could turn (qualified)



manpower into a scarce commodity. The challenges posed to generational solidarity make up a different issue that is complex enough merely to be mentioned here without being given further consideration. Demographic relief for the job market, however, and its respective transformation from a “sellers’ market” into a “buyers’ market” is just one scenario. It is counteracted by an increase in migration from labour-surplus regions as well as the previously mentioned prospect of a massive wave of labour-streamlining now that computers and the machines operated by them have begun to think and learn.

### **Alternatives for the future**

The erstwhile certainty of economically advanced countries ensuring prosperity for all and of emerging countries following this model, some earlier some later, is now a thing of the past. The previously admired model of Germany has come undone where social matters are concerned and the models of Sweden, Denmark, etc. are on the defensive. In large parts of the population the new reality is being accepted with resignation (“more is unrealistic”, “for those who strive there are real opportunities”). However, it seems unlikely that after the special period of the “golden” years of welfare capitalism, we are about to usher in a “silver” reality, so to speak, of the globalised, post-industrial economy that is somewhat tougher but where, ultimately, life is good. It rather is to be expected that the challenges of creating sustainable societies will only grow. The key to this expectation is once again the labour market.

Societal integration through the labour market in which any person willing to work finds an “acceptable” subsistence (and which also leaves space for lasting human relations ) can be called

into question merely by the fact that under the pressure of economic changes , the power structures collapse that have once “wrested” that integration from the market. The upshot would be the proliferation of the American, British and German segmentation pattern. Regardless of how political will is developing, a number of economic challenges are also looming which can no longer be dealt with using the (Scandinavian, Austrian, Dutch) success recipes of the past. In the future this may require major corrections to be made to the labour market in order to keep it as a social inclusion mechanism rather than allowing it to become a social exclusion mechanism. This would be the case, for example, if the previously mentioned waves of streamlining significantly reduce the volumes of work needed by society. Full employment on “acceptable” wages, i.e. without allowing a low wage sector to emerge, would then no longer be possible without some perceptible adjustments to the labour market. If earned income is to remain the key mechanism of income distribution for the masses in a socially integrated society, all of those who are able to work must participate in this source of income. The quantity of good jobs that corresponds to the state of economic and technological development would then have to be distributed in a different way (4 instead of 3 shifts per nurse, 7 instead of 10 projects per contributor etc.). This not at all new discussion might soon come to the fore once more.

We can, and perhaps must at some point, go one step further and move away from the focus on earned income. Then there would be two ways of counteracting societal polarisation between those with good jobs on the one hand and precariousness on the other:

- Increase in transfer incomes paid from the state’s coffers.

- Redistribution of yield-generating assets.

The magnitude of these two ways of redistribution would have to be such that every person can enjoy a standard of living that is in line with the national economy's productive potential. Needless to say this would be tantamount to overhauling the dominant economic order completely and even at the conceptual stage would raise a huge need for discussion that can only be mentioned here. This would mean that consideration should first be granted to adapting the working society rather than doing away with it.

### **The problem of polarisation on the European periphery**

For large parts of Europe, looking into the future the way we have done above may seem irrelevant with regard to the polarisation problem of today. Since the periphery has a considerable labour surplus, the cartelisation of the workforce cannot serve as a way of preventing social polarisation in the foreseeable future. The number of people who would have to remain outside of the cartel and instead drift into unregulated paid work or precarious self-employment where there is pressure from undercutting and outright exploitation is simply too high. Income support from the state and public goods (education, healthcare, housing, school meals etc.) could alleviate poverty but cannot overcome polarisation, which consists of the fact that an urban middle class (not to mention the wealthy upper classes) is enjoying a standard of living that is simply out of reach for many. A major additional problem can be here that society does not produce a state that actually does what could be done in terms of poverty relief. Alongside these performance limits, which are anchored in societal power structures in the

state that truly exists, all normative considerations regarding a socially integrated society are ultimately deflected. And exasperated calls for a revolution are not helpful. Alongside these performance limits, which are anchored in societal power structures in the state that truly exists. All normative considerations regarding a socially integrated society are ultimately deflected by these performance limits, which are anchored in societal power structures. Exasperated calls for a revolution are not of much help here either.

The periphery, however, is embedded in supranational dynamics, especially in the European Union. These dynamics do not only provide the relevant framework for national development efforts in the course of which productive jobs may arise. They also define a supranational job market, which draws its labour force from around the periphery and tends to alleviate the polarisation problem there but restructures it at European level. If we put aside the sought-after specialists, who also earn well in richer countries, the migrant workers in the host countries strengthen the structures of exploitation and polarisation. In the majority of cases, migrants are not organised and often have an uncertain legal status meaning that they can easily be exploited. They form segments of the labour market which are usually avoided by the local workforce whenever possible. Parallel sectors may also arise from time to time which then compete with the regulated local sectors (construction).

The Europeanisation of the polarisation problems on the periphery tends to make them politically more resilient. The situation of the Romanian harvest workers in Spain has created little political energy to fuel efforts to bring about change, whereas in Romania the social steam, so to speak, is being let off since the Spanish (Italian, Austrian, etc.) option offers many Romanians together with their families a positive

perspective (regardless of exploitation). It is difficult at present to make out where to start in overcoming this alignment of forces. On the contrary, any further economic decline on the

periphery in the wake of the financial crisis, which mutated into debt crises, could consolidate the transnational, politically rather immune structures of exploitation.



# Updating the EU's Energy and Climate Policy. The new 2030 framework and its implications<sup>1</sup>

Severin Fischer, Oliver Geden

## **The EU's energy and climate policy strategy for 2020**

European energy and climate policy in its current state was mainly developed between 2005 and 2007. After the Eastern enlargement process and against the backdrop of the failed European Constitution referenda in France and the Netherlands, the search for new fields of action for the EU had further intensified. Due to recurring problems with Russia as the EU's most important oil and gas supplier, and especially in light of the UN climate negotiations that had raised high hopes for an international agreement at that time, it appeared to be the next logical step for the EU to put an emphasis on this policy field. After Great Britain initiated

some crucial first steps during its EU Council Presidency in 2005, the Federal Republic of Germany took on the task of reaching a strategic policy consensus between the heads of state and government, which also had been vigorously pursued by the European Commission. The energy strategy for Europe, which was finally adopted in March of 2007 under Germany's Presidency, boasts a strong environmental focus and is designed to help Europe evolve into a low-carbon-economy, while at the same time securing its long-term competitiveness.

Agreeing on an energy policy and quantifiable targets for the year 2020, however, was merely a first step in the right direction. Much more difficult was the implementation of the agreed objectives in the years that followed.

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### ***Reducing emissions: easier than expected?***

The EU's goal of unilaterally reducing its greenhouse gas emissions to 20% below 1990 levels by the year 2020 has always served two purposes: First, it was intended to accelerate the process of transforming the European economy into a low-carbon economy. And second, with an eye towards the upcoming international climate negotiations it was to send a strong signal to the outside world that Europe was willing to unilaterally take the first step on climate change.

The crucial step towards implementing the unilateral climate target was taken in the context of the negotiations on the climate-energy package in 2008 (cf. Fischer, 2009). By reforming the EU emissions trading scheme (EU-ETS) and agreeing to reduce greenhouse gas emissions in the sectors not covered by the EU-ETS (transport, agriculture, and buildings), the 20% target was turned into legally binding legislation (European Community, 2009a and 2009c). Since then, roughly half of the greenhouse gas emissions fall under the emissions trading scheme, and the rest are covered by individual country-specific measures. The emissions reduction in non-ETS sectors to be achieved by each Member State has been determined on the basis of their individual economic performance and capacities. The reform also introduced complete harmonization of the system on the EU level from 2013 onward, which means that national allocation plans will be abolished, and with them the possibility for individual Member States to influence the process of free allocation of tradable certificates within the system. Only the revenues from auctioning the allowances are to be given back to the Member States, partly via a solidarity and burden-sharing mechanism.

Since the formal adoption of the climate-energy package in the spring of 2009, the climate

policy discussions in the EU have mainly been shaped by the following two developments. First, the lack of success of international climate protection efforts. Particularly the failed 2009 UN Climate Change Conference in Copenhagen, which clearly illustrated the ineffectiveness of the EU's conditional emissions reduction goals. Second, the EU was hit by the recession in 2008. The global financial and economic crisis caused a drop in industrial production rates in almost all EU Member States, which led to a noticeable reduction in carbon emissions. In 2011, emissions were already 17.6% lower than in 1990. Therefore, the 20% emissions reduction target by 2020 has come within reach earlier than expected and will be much easier to achieve compared to expectations in 2007. On the other hand, this development means that the number of available allowances that are determined by the emissions trading system for the period before 2020 will no longer exercise a strong steering effect. Demand for these allowances and thus the allowance price itself has dropped significantly. The price for one ton of CO<sub>2</sub> has long been well under 10 Euros. It is thus a long way away from a price range of 30-40 Euros initially forecast by the European Commission. It is to be expected that the over-supply of allowances will remain in place until the end of the current trading period in 2020.

### ***Renewable energy: diverging trends***

In addition to the legislation on climate policy, the climate and energy package of 2009 also included a directive on the promotion of the use of energy from renewable sources, which turned the target of a 20% share of renewables in final energy consumption into legislation (European Community, 2009b). While the EU

assumed the role of steering the climate policy side of things in a certain direction, it continued to leave the implementation of measures in the area of renewable support mechanisms up to the Member States. The Renewables Directive sets national targets to be reached by 2020 without deciding on the mechanisms to achieve them. The individual Member States' targets were determined on the basis of the respective stage of development of their renewable energy sector in 2005 and their economic performance at the time. As a consequence, the targets ranged from 10% for Malta to 49% for Sweden. The targets of individual Member States have been set as a percentage of their final energy consumption. Member States can decide for themselves which exact percentage of renewable energy sources to strive for in their electricity, heating/cooling, and transportation sectors, as long as the overall target is fulfilled. The transportation sector is the only sector to have been assigned a specific minimum target of 10% by 2020 that must be achieved by all Member States.

Member States must provide the Commission with annual reports on the state of development and any political measures that have been or are being carried out in the renewable energy sector. The first round of national action plans for the year 2011 painted a very positive picture. With the exception of only a few Member States, the goals were considered likely to be achieved (European Commission, 2011a and 2012b). Since the summer of 2012, however, signs have demonstrated that these positive prognoses can no longer be kept (cf. Fischer/Westphal, 2012). The latest progress report in March 2013 confirmed a more doubtful outlook (c.f. European Commission 2013b). This has mostly been due to two independent developments:

- 1) In the transportation sector, which accounts for roughly one third of energy consumption in the EU, biofuels were supposed to make a major contribution to achieving the renewable energy goal. The sub-target of deriving 10% of the energy used in the transport sector from renewable energy sources was meant to create a Europe-wide market for biofuels, while at the same time promoting the development of new technologies, such as electrically powered cars or second-generation biofuels that no longer pose a threat to food production. Even before the directive was passed in 2009, critical voices were raised, advising against political support measures in favor of biofuels and questioning the sustainability of this development. Meanwhile, the (sometimes exaggerated) "food vs. fuel" conflict, i.e. the competition between fuel and food production, had a disastrous effect on the reputation of the biofuel industry. If the 10% goal in the transport sector is abandoned, the overall objective of raising the share of renewables to 20% as a percentage of final energy consumption would be jeopardized as well.
- 2) In the course of the global financial, economic, and debt crisis, many Member States have significantly cut the amount of financial support used to promote the spread of renewable energies. Particularly in the crisis-torn nations of Spain, Portugal and Greece, renewable energy subsidies have fallen victim to fiscal consolidation. In addition, a number of Central and Eastern European states have curtailed their renewable energy support schemes. In this context, some of these cuts were implemented retroactively, thus not only reducing funds for future projects, but also cutting promised support for facilities that have already been installed,

which proved disastrous for the development of the renewable energy sector in those countries. These measures severely affected the safety of investment, and thus the confidence that investors placed in the development of renewable energies. This further reduces the likelihood of achieving the 20% target by 2020.

### ***Energy efficiency: a lack of ambition***

In contrast to the climate protection and renewable energy targets, EU energy policy since 2007 has somewhat neglected the energy efficiency objective. The target formula has been rather obscure since the beginning because the European Council merely stipulated in its energy action plan of 2007 that “energy efficiency in the EU must be increased, so that [...] the goal of saving 20% of the EU’s energy consumption compared to the prognoses for 2020 can be achieved” (Council of the European Union, 2007). In other words, in 2007 the heads of state and government did not agree to reduce their 2007 energy consumption rates by 20%, but instead agreed on a reduction of the projected consumption rates for 2020; for a long time, it was not even clear exactly upon which projections this agreement was based. This formula, which was not specified further until Energy Commissioner Oettinger gave it a more concrete shape, corresponds to the equally vague final efficiency goal, which serves merely as a recommendation. The 20% energy savings target has always been considered to be merely advisory in nature and –in contrast to the climate protection and renewable energy targets– had never been given the shape of a legally binding regulation in its entirety.

### **Fundamental controversies**

Since the EU Energy Strategy was passed in 2007, the implementation of the 20-20-20 program has been at the very center of political attention. Even though a plethora of other initiatives have been launched in support of it, none of them have been particularly successful. This was made especially obvious by the attempt to develop a resilient external energy policy for the EU, which failed comprehensively and is now hardly ever mentioned. There are still too many differences between the interests of the 27 Member States, which are primarily responsible for the security of energy supply. In light of the mostly domestic focus of individual Member States’ energy markets, the external energy policy preferences of individual states depend mainly on their energy mix and on the specific import dependency structures at hand (cf. Geden/Dröge, 2010).

The future development of the EU energy and climate policy will depend crucially on the European institutions’ solutions in two fundamental but politically contentious areas: first, the expansion of electricity and natural gas grids which are crucial for building an internal energy market in the EU, and second, the increasingly pressing question of the extent to which the EU’s energy and climate policy should be based on coherent long-term planning.

### ***The internal energy market and infrastructure***

Since as early as the end of the 1990s, the EU has pursued its declared goal of creating a fully integrated market for natural gas and electricity. After a few mostly failed attempts, much progress has been made on this project over the last few years, especially after the Third Internal



Energy Market Package was passed in 2009. Politically, the attention was mostly focused on the conflicts caused by tightening provisions regarding the “unbundling” of large energy utilities. But creating new institutions and accelerating the implementation of detailed regulatory provisions have achieved the most far-reaching integration. This development, however, was hardly noticed outside of a small circle of experts. In this context, the focus has been placed mainly on using and expanding the existing electricity and natural gas grids. For instance, the harmonization of trade rules and technical network codes will greatly simplify cross-border flows of electricity and gas. According to new EU regulation, transmission system operators, which had operated mostly domestically up to that point, were required to found cooperation structures (ENTSO-E for electricity grids, ENTSO-G for natural gas grids), and they have been assigned specific tasks, such as regularly developing European ten-year network development plans. An Agency for the Cooperation of Energy Regulators (ACER) has been created, which has the authority to make the final decision on cross-border projects if the authorities of the respective Member States fail to reach an agreement.

While the core area of energy market regulations is gradually and almost silently being Europeanized, the topic of infrastructure development is turning into a new area of conflict. In 2011, the Commission launched a fundamental discussion about the role of the EU in network development by submitting a proposal in favor of harmonizing the permitting procedures and giving the EU more control over the funding aspect of infrastructure development projects. The core of this Energy Infrastructure Package is constituted by a new procedure for identifying “projects of common interest” and the proposal to

have the EU carry a significant part of the financial burden for these projects. Finally about 5 billion Euros have been allocated for energy projects over the duration of the next multiannual financial framework (2014-2020). The envisaged “Connecting Europe Facility” for the 2014-2020 period has been designed as a high-level follow-up funding tool for financing infrastructure projects.

Not all Member States have given their full support to this initiative launched by the Commission, however. In particular, the net contributors among the Member States have expressed reservations about the EU's extensive participation in energy infrastructure projects. Their reservations are based on the argument that in a liberalized market, private companies and not the public sector should make infrastructure investments. Eastern and Southern European governments, however, stress the need for larger EU investments in those sectors and regions in which the market itself does not provide the necessary funding. While it is rather certain that the level of energy infrastructure funding will be significantly above that of the current TEN-E program, net contributors among Member States will probably force large cuts to the Commission's original budget proposal.

### ***Roadmaps for 2050***

Since 2009, the EU's long-term climate policy benchmark of reducing its greenhouse gas emissions by 80-95% until the year 2050 (compared to 1990 levels) has been reflected in a number of Commission papers and conclusions submitted by the European Council and the sector-specific councils of ministers. This benchmark is not a legally binding goal; rather, it reflects a mitigation corridor that the Intergovernmental

Panel on Climate Change (IPCC) suggested in its 2007 assessment report, outlining how industrialized nations could make a fair contribution to reaching the global two-degree target. However, Poland in particular has influenced the corresponding EU declarations in such a way that the 80-95% corridor will only apply if all industrialized nations agree on an appropriate reduction level and if emerging economies and developing countries commit themselves to significant reductions in greenhouse gas emissions, too. This illustrates that even in the post-2020 period, the EU's internal climate policy will continue to be closely linked with international negotiations and their progress.

Shortly before the 2009 Copenhagen Climate Summit, the European Council put the Commission in charge of conducting macroeconomic and sector-specific analyses for implementing an emissions reduction path to 2050. In March 2011, EU Climate Commissioner Hedegaard first presented a cross-sectoral analysis called the "Low Carbon Roadmap" (European Commission, 2011b). Shortly thereafter, a specialized analysis of the effects on the transport sector followed, and some weeks later an examination of the energy sector was presented (European Commission, 2011c and 2011e). In the time after, however, Member States were unable to pass consensual conclusions, which would have sent a signal to the international community that despite the economic and debt crisis, the EU is not only committed to the 80-95% mitigation corridor, but is also willing to agree to ambitious and legally binding energy and climate goals for the year 2030. In the case of the cross-sector "Low Carbon Roadmap," the attempt to reach a consensus failed twice, and in the case of the Energy Roadmap it failed once. Both of these initiatives were blocked because the Polish minister in

charge vetoed the proposals. Poland's unwillingness to compromise came as a surprise to many, not least because no obligations for Member States could have been derived from the Council's conclusions themselves. Rather, the conclusions were intended to send a signal to the Commission about how a proposal that would be amenable to compromise could be given a more concrete shape to the EU's energy and climate policy for the 2021-2030 period. Such a signal was long time awaited; in the case of the transport roadmap, a compromise was far from reach because among other factors there are reservations on the part of many Member States about introducing ambitious emission reduction goals in a sector that has a strong influence on domestic elections.

Regardless of its political resonance, the Commission has nevertheless created an innovative planning tool by submitting three roadmaps, which all contain the same ambitious emission reduction target for 2050. This planning tool offers the possibility of illustrating the consequences of long-term targets for actions taken in the present (and vice versa). Planning processes based on macroeconomic models continue to offer the Commission the possibility of exercising a significant influence on the structure of energy and climate debates. One method of achieving this is by making assumptions that may be disputable but are rarely questioned in practice.

As far as Poland is concerned, there are two main problems. First, the Polish government has criticized the trend of decoupling European emissions reduction policies from progress made in the context of international climate negotiations. Second, Poland would be faced with significant pressure to change its domestic energy mix and high costs for the transformation process if the roadmaps were implemented.

Even though the Polish government was the only one to publicly and effectively resist the adoption of the climate and energy roadmaps, it can be assumed that a number of other Eastern and Southern European Member States share Poland's reservations. The message spread publicly by the Commission and many North-Western European Member States, according to which 26 of the 27 Member States fully subscribe to an ambitious European climate policy, is misleading; this becomes very obvious when looking at the ongoing legislative process for reforming the emissions trading scheme. It is true that the biggest objections are once again being raised by Poland. However, the Polish government now enjoys the support of several other governments on this issue, which – unlike the roadmap conclusions – would require a blocking minority in the Council of Ministers.

### **The new framework for 2030**

The 2020 targets set important milestones for the energy industry, which requires medium- and long-term planning in order to be successful. The 2007 energy strategy symbolized the sustainable development paradigm pursued by the European Union which was mostly unquestioned at that time. The two other angles of the energy policy triangle – security of supply and competitiveness – have been somewhat marginalized in energy policy since 2007 because they are almost impossible to measure objectively on the basis of quantifiable indicators, and thus very hard to implement legally. Only the 20-20-20 targets, which primarily focus on the aspect of sustainability, are legally and politically binding. Even in the case of an energy savings goal that is only advisory in nature, the degree to which a certain target is reached or missed is

much easier to evaluate than in the case of a generally phrased objective such as the “completion of the internal energy market by 2014” (cf. European Commission, 2012c).

Against this background, the European Commission's January 2014 proposals on the EU 2030 framework followed a pragmatic approach taking new circumstances into account. An emission reduction target of 40 percent compared to 1990 was accompanied by a target for the share of renewable energy in the range of 27 percent for 2030. However, this time the renewables target was not supposed to be translated into national binding targets as in the 2020-framework, but it would rather be binding at EU level. A new governance mechanism was proposed to guarantee that the national plans and the overall EU strategy correspond with one another. Only in July 2014 did the Commission propose a new energy efficiency target in the range of 30 percent by 2030. The designated European Commission President Jean-Claude Juncker was explicitly pushing for it.

Since the decision on long-term goals for energy and climate policy is a fundamental question for the strategic development of the policy field, the 2030 framework debate was shifted to the level of the heads of state and government. It is important to note that the principle of consensus is the rule for decision-making in the European Council (Article 15 TEU). This essentially means that there's a unanimity requirement with a veto option for every single government. In 2007 and 2008, the 2020 framework and essential parts of its implementation were agreed upon under the conditions of this decision-making procedure.

In view of the consensus rule in the European Council and the Polish government's public announcement to be ready to prevent adverse decisions by using its veto, it became clear that an

outcome of the summit would very much depend on Warsaw's willingness to compromise. Thus in the end, it was Poland's domestic politics that defined the scope for the EU 2030 framework's negotiation.

### ***Elements of the 2030 compromise***

Although the President of the European Council, Herman Van Rompuy, had been mandated to explore possible pathways for a compromise concerning the EU 2030 framework already in spring 2014, by the beginning of the European Council meeting on 23 October 2014 only a few components of the package were in place. Despite Van Rompuy's numerous bilateral meetings in European capitals, the Visegrád states led by Poland appeared just as unsatisfied with the state of negotiations as other Member States who wanted to see their individual interests reflected in the conclusions. For example, a group including Spain, Portugal and the Baltic states, wanted to link their electricity market more closely with the rest of Europe and asked for a binding interconnection target. But they met with strong opposition from France, which wanted to avoid an obligation to link the Iberian Peninsula to its electricity market. Therefore, not only the overarching target architecture, but also satisfying individual interests played a role in finding a compromise for the whole framework.

In the end, three classical mechanisms of compromise-building in the European Council were responsible for the outcome: a high degree of ambiguity in the formulation of the conclusions; the assurance of being able to change conclusions only through consensual intergovernmental decisions; as well as extensive financial transfers and exemptions for the blocking states.

The drafting of compromise formulas in the European Council is characterized by the principle that all participants have to be able to save face at the end of the negotiations. This can often be achieved only through a high degree of *ambiguity* in formulations that can allow for different interpretations.

For a majority of the Northern and Western European Member States holding onto the target triad of emission reduction, expansion of renewable energies, and increasing energy efficiency was of great importance in terms of the reception of their respective national publics. In the European Council conclusions, all three areas were treated with quantified targets (40 percent; 27 percent; 27 percent) and an "at least" formula, which opens the floor for raising the target at a later date. For energy efficiency, there was even the notice of a possible change to 30 percent after an assessment in the coming years. At the same time, the conclusions also reflect the demands of the Central and Eastern European Member States as well as the United Kingdom because neither the renewable energy target nor the energy efficiency formula will directly influence national decisions on energy mix and national energy strategies. Thus no direct implementation on member-state level is foreseen. Also, the ambition of the two targets is at the lower end of the spectrum of negotiating positions – another concession to the Central and Eastern European Member States.

Similarly ambiguous is the text on the extent to which decisions can be revised. The conclusions include a review of the decisions of the European Council after the climate conference in Paris in December 2015 (COP 21). In North-Western member states, this clause was mostly interpreted as opening the way to increase the minimum target of a 40 percent reduction in

greenhouse gases. In contrast, the Central and Eastern Europeans underscored their belief that the emissions mitigations agenda will in the future be more closely linked to the successes of international climate negotiations. If these turn out to be unsatisfactory, the level of EU ambitions would be lowered.

Therefore the conclusions of the European Council will not end the debate on the energy policy framework for 2030. Instead, calls for renewed engagement on the dossier that is expected in coming months, and particularly after the Paris Conference. This situation implies a high degree of uncertainty about the actual commitments that the EU is willing to make.

The major differences in Member States' perspectives with respect to structure and content of EU energy and climate policy after 2020 on the one hand, and government concerns about a broad interpretation of the negotiation results by EU level institutions on the other hand, are the reasons why the compromise was secured under the condition of the need for intergovernmental agreement to change certain provisions. The most telling evidence for the increase of unanimity conditions can be found in a formulation saying that all the elements of the policy framework will be reviewed by the European Council. Explicitly, the heads of state and government reserved the right to address the development of the emissions trading scheme, decisions about national commitments to reduce emissions in the sectors not covered by the ETS, and commitments for the development of interconnectors and energy efficiency to themselves. This way Poland (which wanted to reserve this caveat mainly for climate policy), France (interconnectors) and Great Britain (energy efficiency) could be assured that the central parameters of the agreed framework would not be adjusted without their consent.

The European Council's conclusions on the 2030 framework for energy and climate policy represent a new quality of an ongoing *intergovernmentalisation* process in the EU. Although in the treaties such a transfer of competence is not foreseen and the European Council cannot formally act as a legislative body, the result is still that these decisions are politically binding. In the coming years, it will be crucial to see how the "ordinary legislative procedure" under Article 294 TFEU (with the Commission as an initiative organ and equal participation of the European Parliament and the Council) competes with the political influence of the European Council in this area. However, it seems difficult to imagine in this context that in the future a majority decision is taken by the relevant Council formations without a prior decision of the heads of state and government. Already in recent years, many climate policy decisions had to be delayed because of the lack of consensus among Member States until an informal agreement was reached at the level of the heads of state and government.

While there's a trend towards intergovernmental decision-making on climate policy, there's also a stronger emphasis on the national planning of energy policies. Thus, not only those governments that are generally skeptical of new EU targets in the area of renewable energy and energy efficiency policies wanted a confirmation in the conclusion text that they are allowed to determine their own energy mix on the basis of Article 194 TFEU, but also the environmentally more progressive states were granted a provision that their more ambitious national measures in the field of renewable energy and energy efficiency will not violate EU law. Given the growing difficulties in the foreseeable future for the EU to take common decisions, all of this is likely to result in a re-nationalization of energy

policies in the EU. The design of the new governance mechanism will have to address this challenge.

Just as with the implementation of the 2020 package, the consent of Central and Eastern European Member States was ensured only by conceding substantial financial compensation and exemptions to them. From 2021 onwards, emission certificates in the range of 12 percent of the total annual EU output will be distributed to Member States with a lower than average gross domestic product and can be sold by them. Member States are largely free to dispose of the proceeds as they choose. In addition, the Central and Eastern European Member States may keep on allocating 40 percent of their allowances in the electricity sector for free.

A consequence of these extensive concessions to the governments of Central and Eastern Europe is likely to be a regional *fragmentation* of the transformation to a low-carbon energy system in Europe. Through free allocation, the resulting costs of the EU emissions trading system for coal-based power can be significantly reduced. Even if there were increasing costs, they could be compensated directly or indirectly through additional revenue from auctioning. These provisions in combination with the increased flexibility in the design of the energy mix will reduce the EU's influence on the energy sector in Central and Eastern to a minimum. As a result, the EU is on track towards a transformation of two speeds: one for the east, one for the west.

### ***Implementing the new framework***

In the coming months, the Commission will be asked to give the political compromises forged by the European Council a legal form, to submit

legislative proposals, and to address outstanding issues. This will also be a first practical test for the new Commission of Jean-Claude Juncker. In the future, the Spanish Climate Action and Energy Commissioner, Miguel Arias Cañete, will be in charge of preparing the content for this process. Maroš Šef ovi , as vice president, will be responsible for the coherence of the Energy Union program.

Three dossiers will be at the centre of the implementation process on EU level –every single one of which has significant potential for conflict.

### **Reform of the EU Emissions Trading Scheme**

As a key instrument of EU climate policy, the emissions trading system (ETS) has been in need of reform for quite some time. Although it still fulfills its function as a volume control instrument to limit EU-wide greenhouse gas emissions caused by industry and electricity generation, due to the oversupply of emission certificates, the system currently doesn't send shortage signals to the market, which would spur investments in low-carbon technologies and energy efficiency. Still under EU Climate Action Commissioner Connie Hedegaard, therefore, a legislative proposal was presented that called for the introduction of a Market Stability Reserve (MSR) from 2021 on.

In response to this proposal, the European Council agreed on introducing "an instrument to stabilise the market in line with the Commission proposal". The central point of conflict in the coming months will not be the question of "if" but rather of "when" the MSR will be set up. Germany, Britain and France want it up as early as 2017, while Poland insists on the Commission proposal for 2021, having the backing of European Council conclusions. It will

also depend on the date of the MSR's introduction whether the 900 million allowances that were taken out of the market through the so-called "backloading mechanism", should be reintroduced into the market or flow directly into the MSR. In this context, the consequences of the European Council's engagement with detailed questions of EU climate policy will most likely be seen for the first time.

#### Effort-sharing in sectors not covered by the emissions trading system

About half of the EU-wide emissions are covered by the EU-wide harmonized ETS (electricity generation and industry). For the remaining sectors (mainly transport, buildings, agriculture), Member States have in the past agreed upon a differentiated effort-sharing based on individual national commitments. Between 2005 and 2020, emission reductions of 21 percent were directed through the ETS; 10 percent through national targets in the other sectors. For 2030 this structure will be maintained, the targets however will be increased to a 43 percent reduction through emissions trading and to 30 percent through national measures in the non-ETS sectors. The European Council has now formulated two criteria by which the national targets for reaching the 30 percent target shall be defined in the non-ETS sectors: First, the range of national commitments should be between 0 and 40 percent emission reduction compared to 2005. Second, it should be distributed equally according to economic performance (using GDP per capita) as well as with respect to the difficulties of wealthier member states to find cost-effective mitigation potentials. Given that each Member State will find arguments for reducing its own commitment, the distribution of the overall target is likely to create a major conflict

in which the Central and Eastern European governments once again appeal for more solidarity from the Northern and Western European countries. Also on this point, the fact that the European Council is bound to the principle of unanimity will make it complicated to find a compromise in the coming months.

#### Energy Union and governance mechanism

While most of the framework conditions for the climate policy decisions were already formulated by the European Council, the Commission will have to be very creative in developing its proposals on the Energy Union and the governance mechanism. The leeway provided by the European Council for the structuring of both processes initially appears narrow since the Commission must leave the energy mix of the Member States untouched. The Energy Union will have to be built on the basis of existing instruments; ultimately, in terms of content, it will be a continuation of the internal energy market agenda with a likely extension of measures for security of gas supply. Thus the project's impact could have merely a symbolic effect and act as a surrogate for an increasingly renationalized energy policy.

The design of the governance structure will probably be structured along the lines of the well-known instrument of the European Semester. But even the definition of relevant indicators for evaluating national energy plans will, politically, be a highly sensitive undertaking. If it were really possible to reach an agreement, the question of the impact of the Commission's recommendations would be another open flank. As long as it remains mere recommendations, the process is unlikely to prove effective.

The elaboration of the two projects and the subsequent political decision-making process

will develop into a field in which the Commission and the European Parliament will wrestle with national governments over the impending loss of responsibility for energy and climate issues.

In the context of the three dossiers, there will not only be the question of how, but also in which sequence the relevant decisions are made. In particular, for the climate policy-related aspects of the implementation package the December 2015 climate summit in Paris will be an important milestone. Depending on how they assess the probability of success in Paris, some Member State governments are likely to push for a fast implementation of the decisions of October 2014, while others will try to delay them. The design of the review clause in the conclusions, the unanimity requirement in climate policy, and the historical experiences with the troubles around adjusting a EU climate targets leads one to assume that no actor will succeed in forcing a shift from the 40 percent target for the reduction of emissions 2030 in either direction.

## Conclusions

The discussion about the climate and energy policy for 2030 has uncovered several key areas of conflict. The way these conflicts are dealt

with will determine the future direction of the EU's energy and climate policy. Priority will be given to the question of whether emission reductions should continue to be the dominant benchmark in the area of energy policy. The much more fundamental question, which is currently simmering under the surface, is whether Member States are going to be willing to surrender further parts of their sovereignty in the area of energy policy to the EU. The envisaged transformation process will have a considerable effect on the energy supply structures in individual Member States, but it has also illustrated that this transformation process cannot be carried out successfully as long as 27 different energy strategies are in place. If the poorly coordinated energy policy approach pursued by Member States continues, the transformation costs will likely be significant due to the interdependence of individual Member States' energy markets. However, a fully European integrated approach –a necessity if the energy roadmap is to be implemented successfully– violates Art. 194, Section 3, of the Treaty on the Functioning of the European Union, which legally established the Member States' sovereignty on energy supply structures, and there is no evidence of Member States being willing to give it up (cf. Fischer/Geden, 2012). This is true irrespective of individual Member States' energy policy designs.



# Progress towards a european digital single market in 2014

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## What is the digital single market and why is it necessary?

In 2010, with Europe in the midst of a macroeconomic crisis, the new European strategy for the coming decade was published under the title *Europe 2020*. The role of this strategy, the successor to the Lisbon Strategy, was to establish the goals and actions that would not just enable Europe to come out of the crisis but would also put it back on the path to growth. Three adjectives describe this growth: *smart*, based on the added value that comes from innovation; *sustainable*, reducing our economy's carbon footprint; and *inclusive*, seeking social cohesion and poverty reduction.

These ideas about what Europe should be like in 2020 were used as the basis for defining a set of specific goals that make it possible to measure progress and to identify how much work still needs to be done. The Europe 2020 Strategy establishes five objectives: employment, R&D, climate change, education, and the fight against poverty and social exclusion. Each of these objectives is accompanied by a series of indicators, adapted to reflect the actual situation in each country, which has to exceed a given threshold by 2020.

In order to achieve these objectives, seven key initiatives have been established to develop the smart, sustainable, inclusive growth that the strategy aims to deliver. The first of these initiatives is the Digital Agenda for Europe, whose aim is to promote the use of new technologies in order to foster innovation and economic growth. This Digital Agenda for Europe, in turn, consists of seven pillars, one of which is the achievement of the Digital Single Market which is the focus of this report.

## Digital Single Market

As noted above, in 2010 Europe was in the midst of a major economic crisis that required measures to enable it to exit the crisis and recover lost growth. One of the objectives is to increase the efficiency of European businesses and to help them become more competitive globally, in turn enabling them to generate jobs and resources.

Another issue that required attention was the need to strengthen Europe's position in the internet economy. In an more and more interconnected and globalized world, the low profile of

European businesses in the digital sector can be seen as indicative of an increasing absence in the world economy. Since the appearance of the digital world, and of the internet in particular, we have seen how disruptive innovations have changed the competitive situation in a wide variety of sectors, in some cases completely redefining them. Failure to correct this situation would lead Europe facing losing its historical added value, which would be instead captured by foreign companies.

If we analyse the causes of this situation, we can identify the absence of a single market (with a single regulatory framework) as a negative factor for the development of paneuropean companies, particularly those related to the internet and the provision of transnational services. The majority of internet companies are based on what is called 'zero marginal cost': in other words, once a certain level of users has been reached, the additional cost to the company of providing services to another user tends towards zero, in contrast with the income generated by this user. As a result, it is important for companies to reach a critical mass of users, and to do this they need to access large markets, operating on a global scale in search of the maximum number of potential customers. The Internet is also used by the remaining companies as a means of advertising and selling their products that gives them access to a far larger potential market than can be accessed through traditional channels.

However, this need for large markets is in contrast with the reality in Europe, where there is a political union but no regulatory one in many areas. In practice, these means that companies have to adapt to different regulations to operate in each state, a situation that translates into inefficiencies and higher costs. This situation contrasts, for example, with the United

States, which dominates the internet economy, where a single set of regulations makes it possible to offer services to over 300 million people in the same language.

The concept of the Digital Single Market is the response to this problem. Although Europe is one of the largest markets in the world, it lacks powerful internet businesses, and as the internet grows to encompass more areas of our economy, it becomes increasingly important for us to reverse this situation. At the same time, unifying regulations, improving connectivity and creating a Digital Single Market will enable other companies to become more efficient and to expand their potential market to all Member States.

To sum up, achieving this Digital Single Market would facilitate the provision of services throughout the European Union, eliminating the administrative barriers and costs associated with the need to adapt services to the regulations of each country. The result would be the creation of a true single market, capable of generating the economies of scale needed for the creation and consolidation of the companies that generate growth and employment in Europe, and enabling European companies to compete both at the European and at global level with major American and Asian companies.

To address the creation of this Digital Single Market, 28 specific tasks have been defined with the objective of unifying regulation with regard to telecommunications, copyright and data protection, management of radio spectrum, and application of competition law, in order to create a genuine Digital Single Market.

## **Summary of 2014**

During 2014, actions have been taken in a range of fields with the aim of harmonizing

regulations throughout the European Union. We describe some of the most important of these actions below.

### ***Copyright and data protection***

In respect to the issue of copyright in a single market, the European Commission originally planned to publish a white paper that year. The purpose of publishing this document was to summarize the current legislation, identifying possible problems in order to facilitate an understanding of the issues and to propose possible solutions.

The first stage was a public consultation<sup>1</sup> about a possible revision of the European copyright legislation. This consultation ran from 5 December 2013 to 5 March 2014, received over 9,500 responses, and prompted over 11,000 messages contributing opinions, complaints and suggestions. In addition to the responses to the public consultation, the European Commission has commissioned a range of reports on the copyright situation and its impact in recent years<sup>2</sup> and organized a multistakeholder meeting during 2013 under the title *Licences for Europe*.

The white paper was originally scheduled for publication by mid-2014 but has been delayed. All that is known about this possible reform comes from what appears to be a draft of the document<sup>3</sup> (“A copyright policy for Creativity and Innovation in the European Union”) leaked

in June. This document focuses on three objectives, analysing the current situation and proposing possible paths of action.

It starts by analysing the problem of the lack of an European copyright, which means that currently content is protected by one of the 28 national legislative frameworks instead. One of the consequences of this is that users are unable to access certain content when they are travelling in a Member State, even when the user is subscribed to the content in his/her country of origin. It was to mitigate this situation that Directive 2014/26/EU<sup>4</sup> was approved on 26<sup>th</sup> February 2014 to address the problem of granting multi-territorial licensing of rights to musical works for online use by content management organizations.

The second aspect the white paper considers is how to harmonize copyright policies with other public policies. The public policies analysed in this section include: applying rights in browsing and hyperlinking; harnessing new possibilities in education and research; improving access to information for people with a disability; and private copying and the single market.

Finally, this document analyses the copyright market and the value chain to ensure its optimal functioning, and to ensure fair remuneration for authors and performers.

The text does not mention the need for major regulatory reform at European level, instead proposing a set of measures to adapt existing legislation in specific areas to achieve greater harmonization.

<sup>1</sup> [http://ec.europa.eu/internal\\_market/consultations/2013/copyright-rules/docs/contributions/consultation-report\\_en.pdf](http://ec.europa.eu/internal_market/consultations/2013/copyright-rules/docs/contributions/consultation-report_en.pdf)

<sup>2</sup> [http://ec.europa.eu/internal\\_market/copyright/studies/index\\_en.htm](http://ec.europa.eu/internal_market/copyright/studies/index_en.htm)

<sup>3</sup> <https://www.dropbox.com/s/0xcflgrav01tqlb/White%20Paper%20%28internal%20draft%29%20%281%29.PDF>

<sup>4</sup> <http://eur-lex.europa.eu/legal-content/ES/TXT/PDF/?uri=CELEX:32014L0026&from=EN>

### ***Managing radio spectrum (Radio Spectrum Policy)***

Harmonizing management of radio spectrum is one of the major challenges the European Union faces. There are a number of reasons why such harmonization is needed. From the perspective of physics, electromagnetic waves do not recognize borders and international coordination is therefore required. From the economic perspective, the harmonization of frequency bands is needed in order to create economies of scale and reduce the cost of equipment. Strategically, telecommunications operators must be allocated the spectrum they need to develop networks that will maximize the benefits to be derived from a connected society. However, there are also major obstacles to reach a full harmonization. Radio spectrum management competences has always been held by Member States, because it is an asset considered to be part of the public domain. As a result, it has been responsibility of national governments, who are very reluctant to accept the loss of sovereignty that transferring these competencies to Europe would entail, particularly in light of their great strategic importance.

In response to this issue, in 2012 the Radio Spectrum Policy Programme (RSPP) was published, establishing the guidelines to be followed in this area, with the first implementation report<sup>5</sup> being issued in 2014. Key points of this report include the need for cooperation in allocating 1,200 MHz of spectrum for 2015 (currently only 990 MHz have been harmonized), the delays in some countries in allocating the 800 MHz band, and proposals for shared use of the spectrum for certain services.

On 1<sup>st</sup> September 2014 the report<sup>6</sup> on spectrum inventory was published, setting out the principal conclusions of a study drawing on harmonized, centralized access to all information relating to spectrum use in the different Member States.

Finally, 2014 also was important with regard to the future of the UHF band, currently used by the DTT. At the end of the year, Pascal Lamy published the "2020-2030-2025" approach as a result of this study. This formula consists in the use of the 700 MHz band by wireless broadband services in 2020 +/- 2 years, and the need to ensure the stability of the rest of the band for DTT until 2030, with 2025 proposed as the date for reviewing its future.

### ***Telecommunications regulation: Single Telecom Market***

One of the major developments of the past year has been the drafting (but not the approval) of new European electronic communications regulation. This document was the key project of commissioner Neelie Kroes, given that before a true Digital Single Market can be achieved, it is necessary to first establish the foundations for a Single Telecom Market to permit the development of a digital economy and to promote innovation.

These regulations have grabbed much of the media attention, due to the major impact that the introduction of net neutrality and the elimination of roaming charges within the EU could have on telecommunications operators.

Indeed, it is precisely because of their importance (and the scale of the pressure being

<sup>5</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1401178255384&uri=CELEX:52014DC0228>

<sup>6</sup> <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=COM:2014:536:FIN>

exerted by the different stakeholders) that the Commission's proposal for a Regulation has not been approved yet. It has subsequently been amended by the European Parliament and is currently the subject of debate in the Council. The new measures proposed by this regulation are explained below.

### Single EU authorisation

Despite continuous talk of the benefits that could flow from a single market, telecommunications operators have to apply for licences in each of the Member States in which they wish to provide services. This contradiction between the desired outcomes and the administrative reality has led to the development of the concept of a single authorisation, making possible for an operator to provide services in all Member States without having to apply for license on a state by state basis.

The purpose of this measure was to reduce the barriers to entry to national markets, preventing states from obstructing the entrance of competitors by imposing different licence requirements. The single EU authorisation, accompanied by the introduction of European virtual access products, is designed to be a harmonization process that would reduce the administrative load and thus the costs to operators.

This proposal would also favour the provision of transnational services, and thus the appearance of pan-European operators able to compete globally and invest in infrastructure due to their increased investment capacities and economies of scale. The elimination of national fragmentation by these operators would also make it possible to offer better services and to reduce the price paid for them. This concept was eliminated by the European Parliament.

### European virtual access products

The European Commission Regulation proposes the creation of standardized Europe-wide virtual access products. This measure, together with the single EU authorisation, would make it possible to reduce barriers to entry to national markets as it would dramatically reduce the administrative requirements. However, this could also be seen as a threat to European operators, as the approval of such measures would make it possible for an entrant operator to provide services throughout the European Union very easily, simply by establishing itself in one Member State.

### Roaming services

Roaming was one of the central measures of this Regulation. Commissioner Neelie Kroes has repeated on several occasions the need to eliminate this difference between tariffs, as it makes no sense to speak of a single market when there are differences between the prices paid by citizens depending on which Member State they are in. This is one of the most popular measures, because citizens also want the elimination of roaming so that they don't have to switch their phones off while travelling for fear of running up huge bills while using roaming services.

The complete elimination of roaming would be the final step in the glidepath that has gradually reduced the cost of providing these services during recent years as a result of Roaming Regulations I, II and III. At present, following the latest reduction in tariffs, the maximum amount that users can be charged for roaming are: €0.19 per minute for making calls, €0.05 per minute for receiving calls, €0.06 for sending a SMS and €0.20 per MB of data.

The Commission proposed the elimination of the difference between roaming and domestic

charges, so that consumers would be charged the same tariffs wherever their location. A deadline of 30 June 2016 was established for operators to reach agreement and reflect this in their tariffs.

After its passage through the European Parliament, this point was also amended, but the final goal has been maintained, setting 15<sup>th</sup> November 2015 as the deadline for roaming suppliers not to apply “any surcharge in comparison to the charges for mobile communications services at domestic level on roaming customers in any Member States for any regulated roaming call made or received, for any regulated roaming SMS/MMS message sent and for any regulated data roaming services used, nor any general charge to enable the terminal equipment or service to be used abroad”.

These measures have been heavily criticized by telecommunications operators because, according to them, the total elimination of roaming would mean that domestic customers would subsidize the extra cost of providing roaming charges through standard tariffs.

### Net Neutrality

The Regulation proposed by the Commission also addresses the issue of net neutrality and the possible management of traffic by operators. This regulation differentiates between two types of services: internet access services and managed services. The Regulation thus permits the appearance of a new kind of service with characteristics that differ from internet access services. At the same time, it protects internet services against these new managed services, as long as “the provision of specialised services shall not impair in a recurring or continuous manner the general quality of internet access services”.

In addition, the suppliers of these services are obliged to inform their customers of any traffic management technique used on their networks, and of any other kind of procedure that could alter the quality of the service or the security of their personal data.

The Parliament, in turn, has maintained the distinction introduced by the Commission between internet access services and managed services that operators may offer. These specialized services can only be offered “if the network capacity is sufficient to provide them in addition to internet access services and they are not to the detriment of the availability or quality of internet access services”.

Despite the fact that both proposals of regulation distinguish between the two services – internet access services and specialized services – these definitions have been widely criticized by many stakeholders because they do not make their scope clear. Neither of the two regulations describes the procedures for analysing whether the availability or quality of internet access services has been impaired or what would constitute a substantial deterioration. Instead, they limit themselves to defining concepts which, in the absence of specific technical details regarding their application, may be implemented with a greater or lesser degree of rigour. This lack of precision is particularly important in this area because it relates to services that depend upon the use of shared physical resources to reach users.

At the same time, on 20<sup>th</sup> November 2014 the Council discussed a draft<sup>7</sup> on the problem of net neutrality, and organized further meetings on this topic in January 2015. This report sets out general guidelines on the basic principles,

<sup>7</sup> [https://www.edri.org/files/CDMSI\\_20\\_November.pdf](https://www.edri.org/files/CDMSI_20_November.pdf)

traffic management, pluralism and diversity of information, privacy, transparency and accountability.

### Consumer protection

In respect to consumer protection, the Regulation approved by the Commission establishes the obligation on operators to supply information about the quality of service and to enhance transparency. Among the information that operators have to publish are real upload and download speeds, including peak times, the techniques used in the event of network congestion or any other traffic management technique, and the right of users to access independent evaluation tools that enable them to compare access performance.

Finally, the regulation also proposes measures to facilitate switching between providers, including: a prohibition on the payment of penalty clauses in the event of portability, with any charges being based on costs, switchover to take no more than one day, and any outstanding credit on pre-payment tariffs to be returned following cancellation of the contract.

### *Other measures*

#### eSignature

This year a new Regulation<sup>8</sup> related to electronic identification in the European Union was approved, replacing directive 1999/93/EC. The

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<sup>8</sup> Regulation EU No. 910/2014 of the European Parliament and of the Council of 23 July 2014 on electronic identification and trust services for electronic transactions in the internal market and repealing Directive 1999/93/EC.

European Commission had already highlighted the fact that the increase in cybercrime constituted a major obstacle to the adoption of online services by citizens, and was therefore a major obstacle to the development of a virtuous cycle of internet use, and that this made it necessary to take measures to improve security in the provision of these services.

In addition, the lack of harmonization in electronic authentication and identification methods throughout the European Union has meant that, in the majority of cases, citizens of one Member State cannot use these electronic identification methods to identify themselves in another Member State, thus preventing them from enjoying the full the benefits that derive from a single market. In practice, this lack of harmonization obstructs cross-border operations and creates unnecessary obstacles for citizens and businesses.

Because of the fragmentation of regulation in different states, the Regulation proposes “ensuring the proper functioning of the internal market while aiming at an adequate level of security of electronic identification means and trust services”.

The Regulation thus establishes the rules, procedures and conditions under which Member States should accept the electronic identification methods of other Member States. It also establishes rules for trust services, with special attention to electronic transactions. Finally, it establishes a legal framework for electronic signatures and certificates and other types of authentication service.

#### E-billing

E-billing suffered from the same problems as electronic signatures throughout the European Union. Despite campaigns by public institutions to raise awareness of its benefits, its use has

been limited and growth has been slow. Furthermore, Member States that have backed its use have created nationally regulated systems that are not interoperable with the systems of other Member States.

The lack of regulation in this area was causing fragmentation between different Member States with two key consequences. Firstly, it constitutes an added cost for business, which needs to adapt to different procedures in order to provide services across national borders. Secondly, it reduces the benefits that could be derived from an interoperable information system throughout the European Union. In this way, e-billing, which was meant to simplify processes, was actually becoming a barrier to entry that obstructed these cross-border services.

To address this problem, Directive 2014/55/EU on electronic invoicing in public procurement was approved on 16<sup>th</sup> April, establishing the compulsory acceptance of electronic invoices that comply with the new European standard, but leaving users free to use other standards simultaneously in each state, as this approach has proven to be the best compromise between harmonization and flexibility.

## Outlook for 2015

Following the European elections and the appointment of Jean-Claude Juncker, the creation of a single digital market has become one of the European Commission's ten priorities. Juncker has insisted on the need to achieve progress in the Digital Single Market during the first six months of his mandate, with more ambitious measures in the reform of regulations in telecommunications, copyright and online purchases and services. There must also be progress in the European data protection law.

We therefore expect a lot of activity at European level in 2015, particularly with regard to the single market in telecommunications. In particular, we can expect that a new Regulation will start being discussed. Two issues will be particularly important: roaming and net neutrality.

In respect to roaming, it is important to note that, while there is a general commitment among governments and institutions to eliminating such charges, there is a lot of debate about how to address the issue. Spain and, in particular, Greece and Cyprus, as net recipients of tourists, have expressed their opposition to the complete elimination of roaming charges as is being proposed. This is due to the fact that the current draft allocates these costs primarily to the countries in which these services are provided. Instead, these countries argue for a rapid elimination of the surcharge to users but based on a different division of costs between operators. The difficulty reaching an agreement in this area makes it unlikely roaming charges being fully eliminated in 2015; in fact, the Council has just postponed this decision until 2018. However we do still expect a Regulation that will continue the glidepath of tariff reduction, including a basic connectivity packet (5 minutes and 5 MB) for free. These new measures have to be discussed within the European Institutions, where a big fight is expected because of the opposed positions of the Council and the Parliament.

The issue of net neutrality is likely to be another important field in 2015 because of its potential impact on the services offered by telecommunications operators and the repercussions these services could have on the internet ecosystem. The recently appointed Vice President for the Digital Single Market, Andrus Ansip, has identified this area as one of his priorities. He set out his intentions in a recent speech, in which he stated that: "The internet is universal and



should remain free and open. We should put this principle into law...”.

We also need to follow the debate in the USA very closely, as the Federal Communications Commission (FCC) has taken an important step forwards on net neutrality this year. The 26<sup>th</sup> February the FCC has reclassified the Internet access service as a telecommunications service instead of an information service, empowering it to regulate the provision of these services in order to ensure net neutrality. The most important measures include no blocking, no throttling, no paid prioritization and stricter transparency rules. This decision has been fiercely criticized by telecom operators and by the Republican Party, so the evolution of the debate will be really important to elaborate an European Net Neutrality Regulation.

Another area where we expect activity in 2015 is copyright. Following the delay in publi-

cation of the white paper originally planned for this year, we expect some of the key problems to be addressed during the course of 2015. One of the main issues to be resolved is the question of European copyright, given the difficulty of applying 28 different national regulations in the borderless environment of the internet. Other important issues include the struggle against piracy and mechanisms for fair payment.

Finally, we expect to see a lot of activity with regard to online safety and privacy, and possible regulation to address the monopolistic power of internet giants. In particular, close attention should be paid to the European Parliament motion calling for web search engines to be unbundled from other business, and the potential for new proposals in other sectors of the digital economy and their consequences.



# The Transatlantic Trade and Investment Partnership Agreement (TTIP): making a good deal for Europe

Vicente Palacio

## **Introduction: the TTIP, two years later**

Two years after their inception, Transatlantic Trade and Investment Partnership (TTIP) negotiations have reached a critical point on a number of pending issues that will determine the US-EU relations and their relative international standing in areas as diverse as financial power, political influence, and social, energy, and environmental policy *vis a vis* the emerging powers.

On February 2013, US President Barack Obama and European Commission President José Manuel Barroso announced plans to work jointly on a US-EU free trade agreement now known as TTIP and negotiations were initiated in June of that year. A working draft of the proposal was leaked in March 2014 and later made public for consultation. Finalization of the agreement, which was originally expected to take place by the end of 2014, was rescheduled for 2015. Since then, strong political factors

have had a continual impact on the process. Both the evolution of the two parties' bargaining positions and the reactions of China, Russia, and Brazil to the process over the two years since talks were initiated in 2013 suggest that the TTIP agreement represents an integral step in the realignment of American and European geopolitics—a shift that is occurring at a moment when the US is enjoying a post-crisis momentum that Europe has yet to achieve.

The eighth and nine rounds of TTIP negotiations of February (Brussels) and April (Washington), respectively, during the year 2015, should mark a critical point in an extended process in that it will focus on a number of pending issues. These negotiations are part of a much larger process of readjustment on the part of the United States and the European Union to a shifting geopolitical environment. Yet The official discourse of the European Commission has always maintained that the TTIP agreement

was conceived to eliminate industrial and agricultural tariffs, open services and public procurement markets, align regulation affecting manufacturers, the banking sector, and safety standards, set international rules on finance, and address similar trade issues. According to initial estimates contained in a report prepared by the Centre for Economic Policy Research, the increased trade and reduced tariff barriers supposed by the implementation of the agreement would increase the EU GDP by an additional 0.5%. Given that the economies of the EU and the US together account for 46% of global GDP, a liberalization of trade between them would have a positive impact on the economies of other major exporting countries as well. The TTIP agreement would also have additional positive side effects for other countries, although it is not yet clear if it would reinvigorate multilateral post-Bali trade negotiations in the WTO or be compatible with existing cross-regional free trade agreements such as Mercosur or the new Transpacific Partnership (TPP) negotiations, expected to be concluded in June 2015<sup>1</sup>.

Interestingly, as negotiations have progressed, each succeeding round has focused less and less on economic benefits—which further research has considerably downgraded—and taken on a greater *political* dimension. Since it was first discussed in June 2013, the proposed agreement has increasingly become a means for the partners at the negotiating table to affirm themselves both at home and abroad. However, further progress towards a final agreement is being hampered by geopolitical shifts,

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<sup>1</sup> The TTIP and the TPP openly reject the old most-favored nation principle—a pillar of GATT and the WTO systems—by offering concessions and enhanced access to EU and US markets to signatory countries only. The TPP is set to eliminate trade barriers between the US and eleven Asian countries. It includes Japan but not China.

an economic slowdown in emerging markets, and, overall, domestic political and institutional constraints.

### **Geopolitical change and the TTIP negotiations**

TTIP was largely conceived as a way to rebalance world power between the US and Europe as a block and the emerging powers (BRICS). Trade has never been neutral; it has always been “politics by other means”, a highly sensitive matter in international relations. The initiation of negotiations toward a transatlantic partnership coincided with the first signs of a fall in the growth of Brazil’s domestic market, the deceleration of the Chinese and Russian economies, and the slowdown of commodities prices. Not surprisingly, the emerging powers such as China, Russia, and Brazil have in some way or another attempted to overturn the existing balance of power. China’s territorial ambitions in Asia have triggered tensions with both the US and Japan<sup>2</sup>. Putin’s new Russia has been playing the geopolitical card in the post-soviet area, challenging Crimea and stoking the flames of civil conflict in Ukraine. Dilma’s Brazil, despite the rhetoric, has kept its distance from the US in many areas, from world trade to the regional politics (Mercosur, Unasur). Finally, although the leaders of BRICS (Brazil, Russia, China, India, and South Africa) did not formally expressed their opposition to the TTIP agreement as a block at the July 2014 Fortaleza Summit, they have privately expressed their reservations

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<sup>2</sup> During the Asia Pacific Economic Cooperation (APEC) summit held in Beijing in November 2014, President Obama made clear that he preferred the TTP to the Free Trade Area of the Asia Pacific (FTAAP) promoted by APEC.

at the initiative. The fact that it will not suppose a win-win game for all non-TTIP countries and there will inevitably be winners and losers gives it a strong geopolitical dimension on par with other challenging issues such as nuclear non-proliferation, human rights, and climate change.

These recent moves on the part of other major world powers will undoubtedly up the pressure on both TTIP negotiating teams. If the US and the EU want to save face and successfully assert their role as the joint institutors of the international rules of good governance, they must reach an agreement soon – although not any kind of agreement. Failure to do so would result in an enormous loss of credibility and prestige for both that would weaken their bargaining positions with China and Russia and undermine the effectiveness of other free trade initiatives such the recently negotiated TPP and The Pacific Alliance.

### **International turbulence: emerging market economic slowdown in 2015**

Also, the emerging market slowdown forecasted for 2015-16 could have destabilizing effects on the upcoming phase of TTIP negotiations. BRICS countries are now facing new economic challenges. The IMF lowered forecasts for global economic growth to 3.5 % for 2015 and 3.7 % for 2016 in its January 2015 World Economic Outlook, which stressed the flagging growth potential of emerging markets. Forecasted growth for China, whose economy is expected to suffer a gradual slowdown, has been lowered by -0.3 % to 6.8% and growth in Brazil is expected to fall -1.1% to 0.3%. The outlook for Russia is even worse: a plunge of -3.5%, which, according to the IMF, will precipitate a deep

recession. The IMF report also predicts lower oil prices and the further depreciation of both the euro and yen. In contrast, the US economy is expected to grow by 3.6% and growth in the Eurozone to slip slightly (-0.2% to 1.2%). Both partners are set to benefit strongly from lower oil prices, the lower exchange rate of the euro, and an easing of lending conditions. Yet, the Eurozone countries still face the risk of permanent deflation and high unemployment. Furthermore, a tightening of US monetary policy could trigger volatility in the financial markets of emerging countries.

Interdependence matters: the intertwined nature of export and foreign direct investment flows make it impossible to postulate that a slowdown of Russia or China would spark greater support for the TTIP agreement in the US and Europe. In other words, while geopolitics may be a zero-sum game, the world economy is not. Besides, the instrumentalization of world trade rules for geopolitical motives has its limits: as the relative success of the WTO Doha round meeting held in Bali in December 2013 showed, the agenda for world governance also matters. Yet both partners seem trapped between two conflicting political imperatives: attending to current geopolitical concerns and working responsibly toward good governance. All told, it seems reasonable to conclude that BRICS economic slowdown is not good news for the US, the EU, or the TTIP negotiations underway.

### **The US and the EU: the domestic factor**

The above-mentioned geopolitics and emerging market dynamics aside, domestic political dynamics will also play a decisive role in TTIP negotiations to be conducted during 2015 and 2016.

In the **United States**, backers of the TTIP must overcome substantial domestic resistance, although it is still not clear whether or not it will become a hot issue during the 2016 Presidential election campaign. American congressmen on both sides of the aisle have repeatedly expressed their opposition to a “fast track” for international trade agreements such as the TTIP or the TTP - without which it is very difficult to negotiate a meaningful deal. As many left-leaning American voters believe that free trade agreements endanger environmental protection, labor rights, and import safety standards, Democratic representatives naturally tend to shy away from political commitments on trade issues that could erode their electoral base of support. Although Republicans may support free trade at a philosophical level, they could be reluctant to support any agreement that would hand a political victory to President Obama. Furthermore, the call for a renewal of trade promotion authority (TPA) contained in President Obama’s sixth State of the Union address delivered on January 20, 2015 was not warmly received. Obama’s request was fiercely opposed by Democrats such as Harry Reid (majority leader of the Senate at that time) on the grounds that support for fast-track approval would hurt Democrats in the November 2014 midterm elections.

Since the Republicans have retaken control of the Senate perspectives for a deal between the President and the Congress on the TPA have not improved, despite Republican pretensions to support free trade. Options for resolving the current gridlock include the possibility of circumventing the fast-track system provided for in the Trade Act of 1974 by creating specific ad hoc TPAs that covered only certain countries and specific topics such as the environment, labor rights, and health and giving a higher profile to congressmen directly involved

in the negotiations. Nonetheless, given the threat of severe recession now looming over the US’s European allies, the political and security implications of the TTIP agreement could eventually trigger US bipartisan support for making a deal.

By contrast, in **the European Union** no geopolitical sense of urgency to rush to a final agreement can be expected to arise in Europe in the short term. The EU is not a geopolitical player in the sense that the US, Russia, and China have assumed that role. It has no *grand strategy* of dominion over others and continues to maintain a postmodern perspective on world order, an attitude that will become even more deeply entrenched while the Eurozone struggles to recover and the current North-South gap within Europe remains unabridged. It appears that consensus on the desirability of a transatlantic agreement will be more difficult to achieve in Europe, where geopolitical positioning does not have the importance it could be expected to assume during ratification debates in the US Congress.

Resistance in Europe to a liberalizing trade pact can be largely attributed to the effects of low growth rates, high unemployment (especially in states along the continent’s southern periphery), a rise in protectionist sentiment, social unrest, and a general climate of political disaffection. Despite official efforts to sell the agreement as a mechanism for spurring growth and restoring the European economy, public awareness that current economic hardships are largely the result of the economic and financial integration that left European economies exposed to the collateral effects of the American Great Recession serves as a break on any attempt to implement a “liberal” approach.

## **Convergence and divergence through 2015-16**

Once again, the negotiations are highlighting political, social, and economic barriers between the transatlantic partners. The eighth round of talks took place February 2-6 2015 in Brussels under the leadership of EU Trade Commissioner Cecilia Malmström and US Trade Representative Michael Froman. However, lingering doubts about the feasibility of the € 315 billion Juncker plan are generating skepticism in Europe (especially in Southern European countries and France) regarding both the much-trumpeted but fairly anemic European economic “recovery” and the real benefits of a trade deal with the US that may well imply high social costs.

Although negotiators have made progress on points such as technical trade barriers, state-owned enterprises, customs and trade facilitation, and telecom services, they have yet to overcome differences regarding issues Europeans perceive as critical such as labor rights, consumer safety regulations, and environmental protection.

It is therefore no surprise that sensitive points will be negotiated at the highest political level. The first among them is the inclusion of an investor-state dispute settlement (ISDS) mechanism, by which foreign investors may bring cases against the countries in which they have invested before an arbitration tribunal should they feel their financial interests have been harmed or discriminated against. The devil is in the details when it comes to democracy, transparency, environmental protection, labor rights, and consumer protection. Given the close integration of US and EU financial markets, financial sector regulation—especially that targeting currently unregulated derivatives and similar instruments—is bound to be a make-or-break issue

from the European perspective. The present opinion in Europe is that any deal failing to safeguard Europe’s financial resilience to future crises similar to the subprime crisis of 2008 would not be worth signing. Apart from the give and take of negotiations regarding the inclusion of an ISDS instrument or the agriculture, audiovisual, and financial sectors, there is also the economic climate to consider. While the European Parliament’s International Trade Committee (INTA) is expected to present a resolution on TTIP at the May 2015 plenary session, any serious deterioration of economic conditions in the Eurozone could completely derail negotiations.

### **The European Parliament: leading from behind?**

Europe’s institutional framework could also slow down the negotiations to the point that they eventually derailed. Here, the high sensitivity of sector lobbies in member states and European citizens hit by the crisis to issues involving banks and big corporations, should not be neglected. The European Parliament – the only EU institution whose members are directly responsible to European voters – will undoubtedly play a decisive role in the process. No less will the national parliaments, which would have the final voice in the case of a comprehensive agreement that would include the big investment issues.

Paradoxically, the European Parliament, a frequently criticized and undervalued institution, will have the final word on the sensitive issues yet to be resolved during the last lap of the TTIP process. The good news is that progress has been made on transparency. Under pressure by European civil society organizations, in the fall of 2014 INTA chairman Bernd Lange forced the public release of the European Council’s

mandate to negotiate, which had been kept under wraps. This was a first step forward in terms of closing a transparency gap that has loomed over the negotiations from the beginning.

However, no agreement will be possible without cross-party consensus within the EP. In principle, the TTIP agreement enjoys the support of majority groups in the European Parliament (the center-right European People's Party, the Progressive Alliance of Liberals and Democrats for Europe, and the European Conservatives and Reformists), which all regard the deal as a means of promoting employment and growth in Europe. However, groups that focus on highly sensitive environmental or social issues such as the Greens and the United Left have respectively distanced themselves from the process or outwardly rejected it.

On this important aspect of consensus, the Socialist and Democrats Group of the EP deserves much quantitative and qualitative attention. First, the Socialists enjoy the second position in the Eurochamber after the May 2014 elections (191 seats compared to the European People's Party (221), the Conservatives and Reformists (70), or the Alliance of Liberals and Democrats (67). Second, here, as on many other issues, the S&D will have the key to wrapping up a good deal. The Socialists remain reluctant to accept many proposed tenets of TTIP and continue to strongly demand standards protecting the rights of workers and the environment and the inclusion of binding common regulation of transatlantic financial transactions, the Socialists could assume the role of bridge-builder between the two sides. Given that a comprehensive TTIP agreement would need to be ratified by all 28 member states of the European Union, approaching the Greens and left-leaning MEPs who currently reject the deal and attempting to build

strong coalitions on this issue would appear to be a good strategy for easing the path to parliamentary ratification, particularly in the light of the strong gains made by these forces at the national level during elections in Greece and the forecasted success of their Spanish counterparts in the upcoming Spanish general elections.

Recently, the European Socialist Party has turned its look to other similar Treaties, by pointing to the ongoing Canada-EU Comprehensive Economic Trade Agreement (CETA) as an inspiration for ongoing TTIP negotiations specially regarding investor protection and ISDS. Major guidelines for the Socialists include, among others, states' full capacity to regulate; equal treatment of domestic and foreign investors within the EU; the capacity of states to restructure and reschedule sovereign debts with no exposure to investment protection proceedings; and the creation of a Trade and Investment Court able to judge on investment protection cases.

### **Where do we get from here? Making of TTIP a good deal for Europe**

The current differences between the two partners stem largely from the divergent ways in which political factors are affecting them. First, the economic and social post-crisis circumstances that inform their respective positions are radically different. And second, the differences of their respective "strategic cultures" make a big difference in their perceptions, expectations and attitudes.

The real heart of TTIP might not be, as Trade Representative Mallstrom has written, "getting rid of unnecessary red tape". Unavoidably, the stakes are much higher. Can we make US and EU regulation more compatible –*without* lowering health, safety, environment or consumer



protection standards? It seems that Americans and Europeans are moving in the same direction—attempting at increasing their international leverage—but playing on different chessboards. Their most irresolvable differences are related to labor rights, environmental protection, and the regulation of financial market. At the end of the day, these are issues at the very top of the global governance agenda.

There is a great opportunity for Europe in reaching an agreement on trade and investment with the US, but only provided it is a balanced agreement. EU negotiators should make clear to their US counterparts that given the current political and social situation in Europe, any deal that could further imperil a European economic and social “acquis” is out of the question. At this moment, no deal would be better than a bad deal.

The choice for the EU should not be limited neither to a “minimalist” option—a rapid agreement for 2015 limited basically to the elimination of remaining no-tariff barriers, that would offer only dubious, or at best, too modest economic and political benefits. Even if a provisional treaty were reached in 2015, it would definitely not solve the big questions. Nor should it be a “maximalist” option—a “comprehensive” agreement that would include all areas and provisions—which seems unrealistic as of today.

Therefore, a third way should be explored if Europeans want to lead this process somewhere. On the European side, the EU Commission—in its role of negotiator—as well as the EU Parliament—as a depository of democratic legitimacy and decisive actor for final ratification—should draw clear red lines on highly sensitive pending issues of the TTIP, even if it led negotiations beyond 2016. These would include the

following points, to be incorporated to the 9<sup>th</sup> round (April 2015, Washington) and afterwards:

- Lobby against the inclusion of an investor state dispute settlement (ISDS) clause, at least in the form in which it is currently articulated (Pillar 1, Market access). The safeguards and mechanisms provided by the ongoing EU-Canada CETA (Comprehensive Economic Trade Area) to guarantee state regulation powers, could serve as an inspiration for TTIP. Very specially, a Trade and Investment Court, to judge on investment protection cases, would be of outmost importance.
- Include the regulation of financial markets—especially that targeting currently unregulated derivatives and similar instruments—in the final treaty (Pillar 2, regulatory cooperation). Alternatively, the US and the EU should reach specific regulatory agreements on these matters outside the TTIP.
- Ensure that strong guarantees included in the Sustainable Development chapter—labour rights and environmental standards—are incorporated to the treaty (Pillar 3, Rules).
- The European Commission—according to the commitment made by Trade Representative Cecilia Mallström—should monitor the transparency of the negotiation process and incorporate the views of the European citizens and the national sectorial groups affected by the TTIP. Again, the Commission and the Parliament should go hand in hand in this process during the next negotiation rounds. Only this could ease the way for the ongoing negotiations and the eventual ratification of the treaty by the EU Parliament.



# The financial system of the European Union

Domènec Ruiz Devesa

## Introduction

The purpose of the financial system is to channel resources into the real economy. However, the financial and economic crisis that began in the United States in the summer of 2007 has highlighted the fact that the financial sector has been way oversized in comparison with other production and service activities, in a phenomenon that has been called “financialisation”.

Finance, then, has become an activity in itself, characterised by the generating of profit through speculating with assets, be they shares, public debt securities, currency, derivatives, and so on. The process is typical of mature capitalist economies, where the development has coincided - and not by chance - with a series of public policies that deregulated the sector (Basel II, for example) or liberalised it on an international level (the end of the fixed exchange rate system known as Bretton Woods in 1971-1973, the Single European Act, and so on). Meanwhile, since the triumph of Thatcher and Reagan in 1979-1980, fiscal policy has tended to reduce taxation on capital, which has contributed to increasing wealth inequality, as writers such as José Víctor Sevilla or Thomas Piketty, among others, have rightly pointed out.

The fact is that the very term financial system is rather problematic, insofar as it denotes a set of mostly private business entities that, on the other hand, enjoy a more or less explicit public guarantee, as well as access to public loans via the central banks. In any case, its stability is a necessary condition for economic growth and employment.

The challenge, therefore, is to build a true and stable European financial system that is secure and which helps to overcome stagnation and high rates of unemployment.

## Brief overview of the European financial system

In the case of the European Union, the Treaty of Rome of 1957 already enshrined the free movement of capital as one of the four freedoms of the single market. It was necessary in order to ensure the efficient allocation of financial resources within the framework of the customs union and the market on a European scale. And yet it is difficult to speak of a European financial system, since it is segmented on a national scale and does not operate primarily with a single currency and a single central bank.

At the present time, the European financial system consists of the European Central Bank and a further nine national central banks, which issue currencies other than the euro, and around 8,300 financial institutions. Compared with the United States, business financing is much more reliant on the banks, as against turning to the capital markets (that is to say, the issuing of shares and debt securities on the part of companies).

The EU financial system also includes a public financing body, the European Investment Bank, a mechanism responsible for guaranteeing the financial stability of the euro zone (the ESM), a Single Supervisory Mechanism (SSM) overseeing the 130 financial institutions considered to be systemic –also within the framework of the Monetary Union– and even a Single Resolution Fund for winding up or restructuring banks in crisis. The system of supervision and restructuring is known as the Banking Union, though it is restricted to the euro-zone countries and does not include a common deposit guarantee fund. As well as these new institutions or agencies, there is the proposed European Fund for Strategic Investments, whose regulations should be approved by no later than June 2015.

An important package of regulations has been approved for the EU as a whole that includes, among other things, an increase in the banks' capital requirements.

The approach taken is peculiar to say the least. That is to say, the regulations are the same for everybody, but not the supervision. From a technical point of view, it is questionable that a choice has been made not to establish a banking supervisor for the EU as a whole, as there is sufficient scope for it in the treaties. It actually appears that it was taken for granted that there would be opposition to this solution from some member states. On the other hand, it must be taken into account that the supervision has

regulatory effects, for which reason as time passes it may not be so true that the regulations will be the same for all member states, even if the European Banking Authority was set up in order to establish a so-called "single rulebook".

Given that the choice was made to establish the SSM at the European Central Bank, it is possible to infer that there will not be a single or quasi-single supervisor for the Union as a whole as long as the rest of the countries required to adopt the euro (all of them except the United Kingdom and Denmark) do not join.

Lastly, the European financial system lacks the liquidity and stability that the availability of public debt securities issued by the European Union would give the financial markets, as occurs with United States Treasury bonds.

If we assess the European financial system from the point of view of how it performs with regard to its chief *raison d'être*, which is to transform savings into funding for companies and consumers, the fact is that the Union is still far from regaining the investment levels prior to the crisis. This is partly because the financial system before 2007 was inflated as a result of the real estate bubbles, but on the other hand the financial panic prompted a cut in the credit to the self-employed, SMEs and consumers that has lasted to this day. Generally speaking, the banks have preferred to buy public debt of the member states with cash loaned by the ECB at very low interest rates rather than free up more credit to the real economy. Neither the EIB nor the national development banks have managed to make up for the drop in investment and credit. The persistence of high unemployment both in the euro zone and in major economies such as Spain highlights the problem of a suboptimal use of the resources and real growth well below its potential.

By way of a summary, it could be said that since 2008 the European financial system has

been given an institutional and regulatory boost, particularly in the euro zone. The Banking Union has been described as a triangle formed by regulation, supervision and resolution (the winding up or restructuring of lenders). The triangle as a conceptual construction is equally applicable to the European financial system as a whole.

### Regulating the financial system

The EU has come up with a great deal of new regulations as a result of the financial and economic crisis, as part of an abandonment of financial deregulation, which was the prevailing ideological paradigm, at least until the summer of 2007.

The main new legislation is as follows:

- Regulation (EC) 1060/2009 on credit rating agencies
- Regulation (EU) 648/2012 on derivatives.
- Regulation (EU) 575/2013 and Directive 2013/36/EU on capital requirements of credit institutions and investment firms (basically it is Basel III, which reinforces said capitalization requirements in terms of both the quantity and quality of assets, as well as the conditions of reserves and liquidity, compared with Basel II, which, in turn, had in practice replaced Basel I).
- Directive 2014/59/EU for the recovery and resolution of credit institutions and investment firms.

The last directive came into force on 1 January 2015 and it is particularly important because it seeks to put an end to bank bailouts in the future, ensuring that in the event of winding up a bank it is the shareholders and creditors (holders of bank debt securities) who suffer losses.

Also, at the time of writing, two particularly important draft regulations were going through the European Parliament and Council: one on the separation of investment banks from retail banks above certain thresholds and another on the regulation of so-called money market funds. The proposals are especially important because while the purpose of Directive 2014/59/EU is to stop shareholders and creditors from being rescued, it does not solve the issue of systemic banks, that is to say, those that are too big to fail. Hence a complementary regulation is needed to reduce the systemic risk.

A regulation on financial indices is also being drawn up to prevent the manipulation of benchmarks such as the Libor or the Euribor that certain banks were guilty of in the past.

It can be said that as a whole the EU has reregulated the financial sector in two respects. On the one hand, the applicable rules have been reinforced and, on the other, they have been harmonized in the internal market. Both trends are positive. In the course of this term of office, the regulatory framework that began being built in 2009 is expected to be completed.

Lastly, as far as financial regulation is concerned it is worth highlighting the proposed directive to establish a Financial Transactions Tax (FTT), which was initially conceived for the Union as a whole and is currently limited to 11 euro-zone states, including the main economies of the monetary union (Germany, France, Italy and Spain), under the reinforced cooperation procedure, since the Commission's proposal in the Council failed to prosper (on account of the opposition of several countries led by the United Kingdom).

The FTT was proposed by Nobel economics laureate James Tobin in 1972 with the aim of levying a small tax on the international financial movements that proliferated following the end

of the Bretton Woods agreements, so that it would discourage speculation while obtaining resources to fund public goods and the services of the welfare state. The FTT would be levied on the buying and selling of any type of financial asset: shares, bonds, currency, derivatives, and so on. It can be easily implemented as the vast majority of financial transactions are conducted electronically. Moreover, with the FTT, the financial sector, which is exempt from paying VAT, would help towards paying a part of the cost of the crisis. It would also be a fundamental tool for bringing world financial capitalism into line and reducing wealth inequality.

The proposal that is pending approval by the Council of the European Union consists of: a) levying 0.1 percent on the financial transactions in which any financial institution or private individual located in any of the 11 participating member states takes part; b) levying 0.01 percent on the transactions of derivatives in which any financial institution or private individual located in any of the 11 participating member states takes part. This means that the financial transactions of non-participating member states and third countries would also be taxed, provided one of the parties was located in one of the 11 countries that have committed to establishing the FTT. Non-cross-border financial transactions will also be taxed, provided they take place in the 11 participating states. And c) Channelling the money raised from the tax into the European Union budget, proportionally reducing the contributions to the budget of the participating member states.

According to calculations by the European Commission, the FTT could raise as much as 31 billion euros a year for the 11 participating states as a whole. To put the figure into context, it is roughly the yearly cost of unemployment benefit in Spain. It is, then, very important that

the directive is approved once and for all, so that it can be introduced in January 2016 as initially planned.

It is also essential not to exclude derivatives from the scope of the FTT, as it appears certain member states are trying to do, since it would substantially reduce income, as well as favouring one type of financial instrument over the rest without justification - above all bearing in mind that derivatives are high-risk instruments.

Lastly, the FTT must become a new own resource of the European Union, as was suggested in the conclusions of the European Council of 8 February 2013.

In particular, some thought could be given to the income from the FTT being allocated to funding productive and job-creating investments in the 11 participating member states, within the framework of the European Fund for Strategic Investments, so that the tax is truly supranational and is not offset by reductions in national contributions to the meagre community budget.

### **Supervision of the financial system**

Naturally, reinforcement of the supervision of the financial system also takes the shape of regulations and directives. Prominent among them are:

- Regulation (EU) 1093/2010, which establishes the European Banking Agency.
- Council Regulation (EU) 1024/2013, establishing the SSM at the ECB. The SSM has been in operation since the end of 2014, which means that one of the conditions for turning to the ESM for direct recapitalisations of banks has been met.

The second regulation grants the ECB the legal capacity to supervise the 6,000 banks in

the euro zone, particularly the 130 that are considered systemic (those whose assets amount to more than 30 billion euros, 20 percent of national GDP or which have received funding from the EFSF or the ESM). This means that the systemic banks are supervised directly by the ECB, while the rest are monitored by the national supervisors, although the ECB reserves the right to take over direct supervision.

The SSM philosophy also means a strict separation between monetary policy tasks and banking supervision.

As for the states that do not form part of the euro zone, in principle they can join the SSM, but as they do not form part of the ECB their participation will consist of close cooperation between the competent national authority and the ECB. The most practical thing in any case is for interested countries to speed up adherence to the conditions for adopting the single currency.

### **The resolution of financial institutions**

Banking union would not have sufficient credibility if it were limited to the pooled regulation and supervision of financial institutions. Hence the third pillar concerns resolution, although the word restructuring would perhaps have been more appropriate, at least in Spanish. Resolution as a legal term indicates ending (for example, when one of two parties decides to rescind a contract because the counterparty fails to meet their obligations, the contract is resolved). Therefore resolution and liquidation of financial institutions appear to be synonymous terms, but in fact resolution can end either in the liquidation of institutions or in their recapitalisation, or even in a combination of the two (the segregation of divisions to maintain those that are viable and liquidate those that are not).

The Single Resolution Mechanism (SRM) was set up to perform this task, furnished with a Board that decides on the resolution of financial institutions in crisis and with a Single Resolution Fund (SRF), governed by Regulation (EU) 806/2014 and an Intergovernmental Agreement of the participating states. Resolution, insofar as it can mean injections of capital into the institutions, cannot be done at the cost of the taxpayer, in principle, which is why the euro-zone banks will have to make contributions to the SRF. They will be progressive, reaching the figure of 55 billion euros over the course of eight years. During this time, the SRF will maintain a system of national compartments that will be gradually mutualised, starting with 40 percent in the first year.

The SRF is without doubt one of the main achievements of banking union from the point of view of the integration and creation of European solidarity mechanisms on a non-state, inter-business basis in this case. Although it is true that the amount is clearly insufficient to deal with the restructuring of two or three major euro-zone banks, it must be pointed out that when the transitional phase is completed, the recapitalisation of the financial institutions of the participating states is going to be done on not a national, but European basis. In other words, contributions from the German institutions will eventually serve to recapitalise Spanish banks and vice versa.

In this respect, it is important to highlight the absence of a fundamental element in the resolution pillar: a common or single deposit guarantee fund. The purpose of the rules and institutions created is to protect the taxpayer and exclude the rescue of shareholders and holders of bank debt. Yet a solid and reliable financial system has to offer some sort of guarantee to savers. Hence Banking Union should have incorporated a

European deposit guarantee so that an amount up to a certain threshold was covered in the event of the liquidation (failure) of financial institutions. The SRF could have served that purpose with bigger funding and a specific contribution from the banks to that end, with no time limit.

However, the decision was made to maintain the setup of national deposit guarantee funds, reinforcing the directive currently in force (initially approved in 1994) and which already establishes protection of deposits up to 100,000 euros. The changes introduced require all the states to have this type of fund, as well as to finance them in accordance with certain requirements.

### **The role of the ESM**

The ESM is an international organisation formed by the 19 member states that have adopted the euro. It has been provided with capital of 750 billion euros and is authorised to grant official funding to states facing difficulties in their balance of payments or which find it impossible to raise capital in the public debt markets. Since its inception, it has granted loans to Ireland, Portugal, Cyprus and Spain (in the case of Greece, the financial assistance programme was implemented by a joint loan from the euro-area countries and by the ESM's predecessor, the European Financial Stability Facility, actually a company registered in Luxembourg and whose owners are the states).

The ESM has played an important role in offering financing to states that were locked out of the financial markets because of the crisis of confidence that arose in the euro zone starting in the spring of 2010. The ESM, then, is an essential piece in the European financial system in that it counteracts a major failure of the market.

However, the loans have been tied to strong political conditionality not without ideological bias (such as the inclusion of privatisation programmes in the case of Greece), as well as the participation of the International Monetary Fund.

As well as granting loans to the states, the ESM is authorized to buy public debt both in the primary market (which the ECB is not allowed to do) and the secondary market. Therefore, the ESM can act as a stabilizer of the public debt markets if necessary, for instance automatically buying up the sovereign debt of any participating state that is experiencing an abnormal degree of volatility.

Lastly, the ESM will also be able to directly recapitalize financial institutions within the framework of the Banking Union.

Unfortunately, the ESM has a highly inter-governmental structure (in fact, strictly speaking its founding treaty does not form part of community law), also because the Commission does not have the budgetary means to start a fund of this kind, which means that contributions have come from the member states. Therefore, talks on financial assistance programmes end up being a political negotiation among states (ESM stakeholders) where individual interests prevail over the general European interest, and even over common sense, as highlighted at the Eurogroup meeting that agreed the loan to Cyprus and which included a ludicrous clause that imposed losses on depositors, which only increased financial instability and had to be rectified as quickly as possible.

### **The role of the ECB**

The ECB took the lead role in the anti-crisis policies in the EU, at least until Jean-Claude Juncker's election as president of the European



Commission, after a serious abdication of duty in 2010, at the outbreak of the Greek public debt crisis, and making clamorous mistakes such as raising interest rates in the middle of the international financial crisis in the summer of 2008.

As of the summer of 2012, the ECB made it clear that it would not allow further speculative attacks on the euro, showing full readiness to buy sovereign debt in the secondary markets. It also continued its policy of lowering the official cost of borrowing to a hitherto unheard-of 0.05 percent. The announcement had the desired effect, which meant that as of August that year the financial volatility in the euro zone ceased. It is important to draw attention to the fact that the ECB took the measure without overstepping its remit, as the bank's statutes give it the mandate of contributing to financial stability.

In view of the fact that the euro zone closed 2014 in a deflationary situation, on 22 January 2015 the ECB announced a public and private debt purchasing programme to a value of 1.3 billion euros until September 2016, at least. In this case, the ECB did not act to maintain financial stability, but to try to raise the rate of inflation in the euro zone, which currently stands well below the unofficial goal of being under but near 2 percent.

### **The role of the EIB and the European Fund for Strategic Investments**

Since the outbreak of the crisis, the EIB has been considered an ideal lever to offset the drop in private investment and kick-start growth and investment. However, even when it has increased the volume of credit over the last few years, including credit lines to SMEs, it is not clear that it has made a decisive contribution to increasing productive and job-creating investments.

The European Council of June 2012 announced a capital increase at the EIB to the tune of 10 billion euros, thus giving the impression that its limited impact could have been down to insufficient capital.

Yet when European Commission President-elect Jean-Claude Juncker put forward a European plan of public and private investment in July 2014, the EIB did not complete further increases in capital, since the impression is rather what is needed is funding for projects whose risk the Luxembourg-based lender cannot take on if it wants to keep its maximum credit rating (which, in any case, some observers dispute is necessary for fulfilling its mandate).

In any case, the Commission has proposed creating the so-called European Fund for Strategic Investments (EFSI), whose purpose is precisely to fund those projects that would not normally receive the EIB's support.

The EFSI will have 21 billion euros of public seed capital. A total of 5 billion euros are provided by the EIB, while 16 billion have to be provided by the European Commission from the community budget in the shape of guarantees, backed by 8 billion that are set to come from the Connecting Europe Facility (3.3 billion), Horizon 2020 (2.7 billion), and the budget margin (2 billion).

With the 21 billion euros the EFSI would generate long-term investment to the value of 240 billion and 75 billion for SMEs from 1 June 2015 to 2017, which would be raised in the financial markets and from private investors. The leverage ratio, then, is 15 to 1. To be precise, the 21 billion becomes 63 billion in loans, which has to be accompanied by private investment equal to 252 billion euros (which gives the 315 billion).

As mentioned, the EFSI investments will be riskier than those that the EIB group normally finances, though they will be channelled

through the EIB and the European Investment Fund. The instrument will be run by a board formed by the European Commission and the EIB. The selection of projects will be carried out transparently, with a strong component of technical assistance.

The European Commission estimates that the investment plan that the EFSI is to catalyse will have an impact on the rate of GDP growth of between 2.5 and 3.1 percent, with the creation of 1.3 million new jobs, in the period 2015 to 2017. It may be extended to 2020. The priority sectors are infrastructure, including broadband networks and energy, energy efficiency, renewable energies, transport in industrial centres, education, research and financing SMEs.

A plan is also afoot to use the structural and investment funds already budgeted for the period 2014 to 2020 as loans, capital contributions to projects and guarantees, instead of employing them as subsidies, thereby magnifying their impact by between three and four times to hit 35 billion euros in 2017.

The selection criteria are as follows:

- Added value for meeting the EU's goals.
- Economic viability, prioritising projects with high socioeconomic returns.
- Possibility of a prompt start.
- Possibility of having other sources of financing.

The member states will be able to take part if they wish. Any contributions will not be included in the deficit and debt calculations. The door is also open to the participation of national development banks (such as Spain's ICO, for example).

It is certainly positive that the governance of new EFSI will not have an intergovernmental structure. Instead, it will be under the aegis of the Commission and the EIB, which strengthens the community institutions and prevents the

proliferation of parochial projects. The structure will not change in the event of national contributions, hence the creation of an independent board for the selection of projects that will not be made up of 28 representatives of the states.

The weakest point of Juncker's proposal is undoubtedly the leverage ratio of 15 to 1. By using the community budget to raise private capital, doubts are cast on the increase in new public resources, except for the input of capital by the EIB (5 billion euros). This comes from not having required obligatory state contributions nor having raised the idea of an increase in own resources.

If it is to be credible, the EFSI must have more public resources, which can be obtained either from the profits of the ECB (which are set to increase significantly with the asset buying programme), from FTT revenue, or even through the issue of European public debt by the Union (which requires the repeal of Article 17.2 of Regulation 976/2012).

## Conclusions and recommendations

The European Union has to furnish itself with an integrated financial system. In other words, it has to put a stop to financial fragmentation, which is particularly apparent in the different rates of interest on retail credit according to the member state, or in such odd situations as requiring an address in the country in order to open a bank account, the different commissions charged depending on whether the transaction is domestic or cross-border, or even the cancelling of payment card services because the customer moves to another member state. On this point, Spain must swiftly transpose European Parliament and Council Directive 2014/92/EU of 23 July 2014 on the comparability of fees

related to payment accounts, payment account switching and access to payment accounts with basic features.

At the same time, the European financial system has to be stable and contribute to the growth of per capita income and employment. This requires strict regulation of the banks to reduce speculation and minimise the systemic risk, which is under way. Nevertheless, there are still some loose ends, such as the separation of the activity of negotiating loans to consumers and companies. The proposed regulation on the structural reform of the banks, which is currently going through the European Parliament, is perhaps the most important piece of legislation on financial matters of this parliamentary term. It is important that the separation takes place in an objective manner above a certain threshold, measured by the ratio of loans to the real economy to the credit portfolio as a whole.

A stable financial system is achieved by reducing the number of institutions that are too big or too interconnected to fail. This requires, on the one hand, legislation that enables a possible orderly liquidation while ensuring protection for depositors, but also a robust competition policy that reduces the oligopolistic nature of the banking sector.

In short, the financial system remains an economic service in the general interest, comparable to sectors such as electricity or water, and therefore must be regulated as such. This means a high degree not only of regulation and supervision but also of intervention, through the presence of the public development banks, including the EIB and, possibly, the EFSI, if it is finally given legal status providing it with the capacity to issue debt and reinvest profits, thus becoming the EU's permanent anti-cyclical policy instrument. In this respect, the EFSI regulations, which are currently under discussion, would have to include obligatory national contributions, which are not prohibited by the Treaty on the Functioning of the European Union.

The intervention could also come in the shape of either establishing targets of loans to the real economy for private financial institutions or public participation in their share ownership in order to guarantee the economic and social usefulness of the credit portfolio.

Lastly, the EU must issue public debt in euros to increase the stability and liquidity of the euro zone. This requires the repeal of Article 17.2 of Regulation 976/2012.



# The fight against tax evasion and avoidance: towards a harmonisation of corporate income taxes within the EU

José Luis Escario

## Introduction

Over the past few years, pending problems such as tax fraud and aggressive tax planning (tax evasion) have gained renewed importance at the highest levels of the EU and the G20. This topic, which figured prominently on the agenda of the May 2013 European Council meeting, also constitutes an important point of the program recently presented by the new president of the European Commission.

The problem of tax fraud has been an important topic at every G20 summit meeting held since the collapse of Lehman Brothers in 2008, and leaders attending the London Summit in 2009 even officially declared that “the era of banking secrecy is over.” The UN<sup>1</sup> and the IMF have also paid serious attention to this topic. The title of a report issued by the latter, *Taxing*

*Times* (FMI 2013<sup>2</sup>), underlines the pressing importance of this issue for today's society. There is no doubt that taxation has taken centre stage.

Tax evasion and the use of tax havens are reaching staggering levels. The European Commission estimates that one trillion euros in potential tax revenue is lost annually within the EU. This is equivalent to the GDP of Spain, Europe's fifth largest economy, or from another perspective, seven annual EU budgets. According to an estimate provided in the *Financial Secrecy Index*, a report released by the NGO coalition Tax Justice Network, the total value of money hidden in tax havens around the world now stands at approximately USD 21 trillion, a figure that would increase if the value of other assets such as yachts, real estate holding and works of art were included in the calculation as well. This is equal to the combined GDPs

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<sup>1</sup> Work carried out by the UN Tax Committee on this issue has been particularly outstanding.

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<sup>2</sup> Another very important report issued in 2014 by the IMF on this topic was *Spillovers in International Corporate Taxation*.

of the United States and Japan. The Instituto de Estudios Fiscales and the Instituto de Economía de Barcelona (IEB Report 3/204.) calculate that the total money lost to tax fraud in Spain 2012-2013 was equivalent to 20% of that country's total tax revenue for the same period.

The recent spate of tax evasion scandals involving large corporations, politicians and celebrities has provoked both public alarm and intense political debate. The US Security Exchange Commission has criticised manoeuvres by tech giants Apple and Google that have lowered their effective tax rates to on foreign earnings to 2.5% and 3% respectively. The US Senate even summoned executives from Apple, currently the world's richest company, to a public hearing at which they were asked to explain the minimal taxes that the firm pays on its non-US earnings. As the OECD pointed out in its initial BEPS<sup>3</sup> report released in February 2013, the effective corporate rate of large corporations is often as low as 5%. According to the most recent annual revenue report issued by the Spanish National Tax Agency (AEAT), the effective corporate tax rate<sup>4</sup> paid by that country's largest companies in 2013 was, on the average, 5.3%.

However, it would be the outbreak of the Lux Leaks scandal in November 2014 that would unleash the greatest furore in the EU to date regarding tax avoidance. Information leaked by the International Consortium of Investigative Journalists revealed that 340 companies had signed secret, preferential agreements with tax authorities in Luxembourg that, on the average,

lowered their tax rates to 2%, although a few managed to reach deals that lowered their rate to a mere 1%. It must be kept in mind that the average statutory corporate rate in the EU is 22%. In Spain, it has been lowered from 30 % to 28% and will be reduced again next year to 25%.

In the wake of these revelations, the European Parliament is preparing two reports on tax evasion that focus on the thorny issue of preferential tax regimes conceded to certain transnational companies by some Member States. The European Commission has also opened its own investigations into the corporate tax practices in Luxembourg, The Netherlands Ireland and Belgium to determine whether they comply with EU rules on state aid.

### **EU and international initiatives to combat aggressive tax planning on the part of multinational companies**

Firstly, it must be remembered that according to EU Treaties<sup>5</sup>, taxation continues to be a primarily national competence. The European Union still plays a secondary role in this area and adopts its decisions on the basis of unanimous vote, a fact that hinders progress on sensitive issues.

However, the EU can justify interventions geared towards coordinating the tax systems of States within the Union and ensuring their national tax systems are consistent with objectives laid out in the Treaties. There is a legal basis for Community-level intervention in response to tax measures or practices adopted by a given

<sup>3</sup> As defined by the OECD, Base Erosion and Profit Shifting (BEPS) "refers to tax planning strategies that exploit gaps and mismatches in tax rules to shift profits to low or no-tax locations where there is little or no economic activity."

<sup>4</sup> Effective corporate tax rate is calculated by dividing the total tax paid by a company by the amount of its profits before deductions and exemptions are applied.

<sup>5</sup> Article 4 of the Treaty of the European Union establishes that "competences not conferred upon the Union in the Treaties remain with the Member States" (principle of conferred competences).

Member State with the intention of diverting the natural flow of foreign investment away from other EU countries. EU action is also justified whenever national tax systems or regimes distort the functioning of the Single European Market. Some examples of community action in the area of taxation include the dismantling of tax barriers to cross-border trade (double taxation), the elimination of unfair tax competition between Member States and the promotion of cooperation between national tax agencies in anti-fraud initiatives.

The 2009 sovereign debt crisis has impelled Member States to march shoulder-to-shoulder (albeit at a less than desirable pace) in the direction of EU economic governance. Although fiscal affairs have been part of this forward agenda, the emphasis to date has been on budgetary issues rather than on taxation. However, there has been a shift towards a balance between these two aspects of fiscal affairs over the past few months, undoubtedly due in grand part to the growing number of global initiatives related to taxation.

It has become patent at G20 meetings and other international forums that national tax systems have not kept step with the realities of the digital era and globalization. At a time when large corporations design their tax strategies and tax planning at a global level, tax laws continue to be formulated at the national level in a piecemeal fashion that does not take into account how the tax rules in one country interact with those in another. It makes no sense to continue considering subsidiaries located in another country as independent companies (according to the principle of separate entities) at a time when large corporations devise “big picture” marketing and tax strategies that take into account their global operations as whole.

There are instances in which countries intentionally seek to undermine the tax bases of others,

a practice that does nothing but provoke a “race to the bottom” in which all countries feel pressured to offer more and more concessions in order to attract direct foreign investment. This rush to compete has opened up opportunities for a significant number of transnational corporations to minimise their tax burden.

In July 2013<sup>6</sup> the G20 adopted the BEPS action plan developed by the OECD to close these loopholes and rein in the artificial tax structures created by MNCs to avoid paying taxes. The plan, which is based on the premise that multinational companies should pay taxes in the countries in which they carry out business activities and create value, identifies a series of areas in which there are higher risks of international tax evasion and outlines 15 actions to be taken to improve the situation.

In September 2014 the OECD released seven “deliverables” corresponding to a number of the fifteen actions proposed for the action plan<sup>7</sup> presented in September 2014. These documents drew upon input received during a series of public consultations between the OECD and a range of stakeholders. The second phase of the work is now underway and final recommendations are expected to be approved by the OECD in December 2015.<sup>8</sup>

Given the depth and scope of the work undertaken, it is yet to be seen if such ambitious time frames can actually be met. Furthermore,

<sup>6</sup> The OCDE is expected to finish the plan by the end of 2015.

<sup>7</sup> The seven deliverables (intermediate drafts and draft rules) presented by the OECD covered the following topics: the digital economy, hybrid mismatch arrangements, harmful tax practices, treaty abuse, transfer pricing of intangibles, and country-by-country reporting.

<sup>8</sup> Although the deadline for the completion of the majority of the actions proposed is September 2015, the multilateral treaty is not expected to be completed until December 2015.

as all 42 OECD member states must agree to adopt these recommendations, it may only be possible to reach a minimum consensus on certain key points. How this plan designed to effectuate an ambitious reform of corporate taxation in OECD countries unfolds over the next few months will be of crucial interest. One worrying signal regarding the eventual outcome of project has been the exclusion of a number of very important issues that have been postponed for future consideration.<sup>9</sup>

The United Kingdom, which has decided not to wait for the OECD Plan to be put into action, will soon introduce a “diverted profits tax”. This new tax will be applicable only to profits generated in the UK that a company has attempted to artificially shift to more “convenient” jurisdictions. Its purpose is to counteract contrived tax arrangements that result in the erosion of the UK tax base. With a rate of 25% (5% higher than the country’s normal statutory corporate tax rate of 20%), what has come to be popularly known as the “Google tax” clearly seeks to penalize companies caught diverting profits generated by business activity carried out on UK territory.

Other countries such as Australia are considering the possibility of adopting similar measures in the near future. US President Obama has also recently called for the imposition of a 19% tax of foreign corporate earnings.

Although unilateral action is by no means the best way to deal with the current problem,

it may eventually be justified if the BEPS Plan finally adopted lacks sufficient muscle.

### **Main types of tax avoidance and corporate tax schemes**

International transactions offer companies many opportunities to avoid paying taxes. Multinational companies can lower their tax bills by reorganising intra-group operations (revenue, expenses, dividends, interest payments on loans, royalty payments) between the parent company and its subsidiaries and/or between subsidiaries.

Tax avoidance practices exploit the gaps and frictions between national tax systems. For example, a budget item treated in one tax jurisdiction as a loan may be regarded in another as equity, with the varying effects on taxes that these legal definitions imply. Under the tax regimes of many countries such as Spain, third-party financing offers more tax advantages than own financing. However, beyond encouraging excessively high levels of private debt, such policies also open multiple windows of opportunity for tax avoidance in that they constitute an incentive for multinational corporations to artificially increase the indebtedness of subsidiaries located in high tax-rate countries by means of intra-group loans and later declare the inflated interest payments they receive on these loans as deductible expenses. Whereas their subsidiaries in high tax-rate countries devote a significant portion of their financial resources to interest payments made back to the parent company, the parent companies declare income received in the form of interest payments on intragroup loans in countries with lower or zero corporate tax rates. Such mechanisms help multinationals to substantially lower their overall tax burdens.

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<sup>9</sup> Two important issues that have been deferred are the allocation of taxing rights between countries and the question as to whether the arms length principle should serve as the only method for controlling the transfer pricing of intangibles.

Deferred issues include the possibility of questioning of the free market principle for the purposes of controlling transfer mispricing of intangible goods as well as the grounds for determining tax jurisdictions (residence versus source principle).



Another common form of tax avoidance referred to as transfer mispricing or transfer pricing manipulation, is driven by a similar logic. This practice involves artificially distorting the prices of goods and services traded between entities of the same corporate group and localizing profits in subsidiaries based in jurisdictions with lower tax rates.

Nevertheless, companies may also avoid paying taxes by taking advantage of the intricacies of double taxation agreements (referred to as DTAs going forward). DTAs are bilateral agreements forged between two countries for the purpose of determining the legal jurisdiction under which the profits of companies with business activities in both will be taxed. These treaties have been conceived to facilitate cross-border trade by eliminating double taxation, which is to say they avoid situations in which companies would otherwise be obliged to pay taxes on the same profits in two different countries. However, certain corporations' skilful use (or misuse) of the wide network of CDIs has resulted in an unacceptable number of cases of "double non-taxation".

Another aspect of DTAs that must be addressed is the establishment of withholding taxes, which is done to ensure that transnational companies pay at least a minimum tax in the source country or the country in which profits have been generated. This practice is meant to prevent companies from shifting the bulk of their profits gained in a given country to more amenable jurisdictions by means of tax engineering. Some transnational companies resort to "treaty shopping" to avoid paying withholding taxes in countries where their activities generate taxable profits.

It should be remembered that the EU's initial position in this area was relatively lax, in that it favoured freeing transnational companies from

paying retentions in source States under specific circumstances and on certain categories of profit (passive income). Parent-Subsidiary Directive 90/435/CEE, issued in 2003, further relaxed conditions for exempting dividends on the basis of prevailing opinion that taxation of dividends constituted an intra-community trade barrier.

Nevertheless, in 2014 the EU made an about face on this issue and added two key amendments to the directive designed to bring it into line with concerns articulated by the G20 and the OECD. As it now stands, this directive not only deals with the problem of double taxation, but also addresses troubling spectre of double non-taxation.

The first amendment to the Parent-Subsidiary Directive was intended to neutralize the effects of "hybrid mismatch arrangements" (transfers of ownership of assets from one company within a group to another so that they can be collateralised as a loan in another country). Its objective was to ensure that whenever interest on an intra-group loan was deductible in the jurisdiction of the recipient company, loan payments to the lending company within the group would be taxed as income in the corresponding jurisdiction.

The binding a "de minimis" anti-abuse clause added to the directive by the Economic and Financial Affairs Council (ECOFIN) in December 2014 was intended to serve as a prompt to Member States to include special clauses in the DTAs that each had developed to curb tax avoidance practices and aggressive tax planning on the part of corporate groups. This recent revision of the Parent-Subsidiary Directive also requires Member States to refrain from extending the benefits of the directive to any arrangement or series of arrangements that are not genuine in the sense that they have been put into place for the sole purpose of obtaining a tax advantage and do not reflect economic reality.

The various avoidance techniques previously described in this chapter can be fit together like pieces of a puzzle to create labyrinthine corporate tax schemes, and there is no doubt that some transnational companies are doing their best to outwit anti-abuse measures contemplated in the legislation of a number of Member States. A prime example is the tax scheme mounted by Google, which is being used as a model by other Silicon Valley tech companies. Google has designed what is popularly known as a “double Irish” or “Dutch sandwich” scheme, which involves the creation of two companies in Ireland (one of them legally registered in Bermuda) and a third located in The Netherlands, the latter of which is used to channel funds and assets to classical tax havens that only require foreign non-resident companies to pay minimal, token taxes. The Lux Leaks scandal brought to light additional corporate tax avoidance schemes involving a string of other transnational corporations in various sectors.

### ***Corporate transparency and country-by-country financial reporting***

To effectively counteract the negative economic impact of tax avoidance and evasion practices, multinational countries must be legally bound to follow “country-by-country reporting” (CBCR) procedures. According to CBCR requirements, the annual reports of multinational corporations must include breakdowns of their profits, sales, number of employees, assets and taxes paid for each country in which they maintain operations. At present, they consolidate this data into regional or global figures, a practice that makes it difficult for national tax authorities to carry out revenue risk assessments.

The EU assumed a leadership position in 2013 with the fourth revision of its Capital Requirements Directive, which established a country-by-country reporting system for the European banking sector. This Directive has already been transposed into Spanish law<sup>10</sup>. It is worth noting that by stipulating that information contained in CBC reports filed by banks be available to the public rather than being secreted away in the files of tax authorities, this European legislation exceeds the global standard for transparency contemplated in the OECD Action Plan.

The possibility of extending CBCR requirements to all other business sectors is currently being debated within the EU. Although the Council indicated a willingness to do so, negotiations on the issue subsequently ground to a halt following the European parliamentary elections.

Although Action 13 of the BEPS Action Plan also calls for country-by-country reporting using a common template, it falls short of demanding that information filed with tax authorities be made available to the public. According to the Spanish Government, the CBCR template will be transposed to Spanish law during the first semester of 2015.

Nevertheless, although CBCR helps countries identify operations that may lead to tax avoidance, it does not give their tax authorities all the information they need to determine whether multinational corporations are paying their fair share.

The formulary apportionment (unitary) method utilised in the United States to apportion corporate income between states has proved to be an effective tool for determining whether companies are paying the right amount in taxes to each of the jurisdictions in which

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<sup>10</sup> Royal Decree Law 14/2013 of 29 November.

they maintain business operations. It has effectively harmonised corporate taxes throughout that country.

### ***The harmonisation of corporate taxes within the EU***

Although the first attempt to harmonise corporate taxes in the EU was launched more than a decade ago<sup>11</sup>, it was not until 2011 that the European Commission presented a formal proposal for a “Common Consolidated Corporate Tax Base” (CCCTB). The recent Lux Leaks scandal has revived debate regarding this initiative by making it patently clear that tax avoidance is far from being an isolated problem, and, in fact, is rife in a number of sectors and has spawned a cottage industry aided and abetted by the governments of several European states. In the light of recent events, the president of the Commission has spoken in favour of reactivating debate on the proposed measure.

France and Germany expressed a renewed interest in harmonising their corporate tax systems in 2011<sup>12</sup>, going so far as to prepare a green paper on corporate tax convergence.

If finally approved, the CCCTB would provide a common set of rules for computing the tax base of multinational companies operating

in the EU. Adoption of the CCCTB concept would entail the implementation of a single set of rules for calculating corporate tax base of multinational corporations operating in the EU that companies could play by instead of applying 28 different national codes. The present national codes in use are heterogeneous, constantly evolving, and in some instances specifically designed to siphon off part of other countries’ tax bases. Harmonising the corporate tax base across Europe would neutralise these differences and put a brake on the intra-community “race to the bottom” in which some Member States compete with others by means of definitions of deductible expenses, depreciation rules and other tax incentives<sup>13</sup>.

However, the CCCTB concept goes beyond the mere implementation of a common European tax base; it also embraces the notion of “consolidation”, which would entail aggregating (compensating) all of the profits and losses generated by a transnational company in States within the EU. Such a system would, for the purposes of corporate taxation, facilitate the calculation of a single net profit or loss for all of company’s operations within the EU. Were a CCCTB solution to be adopted, it would replace the present complicated system of transfer pricing<sup>14</sup> that offers companies a considerable number of options for avoiding taxation. Another advantage of implementing a CCCTB system is that it would render the establishment of tax withholding regimes in source countries – currently essential to ensure that transnational companies pay at least a minimal amount of taxes in these jurisdictions – unnecessary.

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<sup>11</sup> There have been two important landmarks in this process. The first was the Council’s 1999 request that the European Commission conduct a study on corporate taxation in the EU. The second was the European Commission’s 2004 decision to create a working group devoted to the analysis of the economic impact of harmonisation.

<sup>12</sup> In August 2011, Angela Merkel and Nicolas Sarkozy announced their joint support for harmonising France and Germany’s corporate tax frameworks. They had previously floated the idea of a basic harmonisation of corporate taxes at the time they proposed a competitiveness pact at the European Council meeting of 4 February 2011.

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<sup>13</sup> The CCCTB would put an end to unfair competition mechanisms such as the UK’s “patent box”.

<sup>14</sup> Transfer pricing control is currently based on the so-called arms length principle.

Once a company's tax base was calculated as described above, it would then be apportioned amongst the various Member States in which it had business operations according to a set formula. This formula would take three equally weighted parameters into account: i) assets, which would include but not be limited to a company's fixed tangible assets such as real estate and machinery, R&D costs and advertising and marketing expenses; ii) labour, which would encompass both its number of employees and payroll; iii) and sales measured "at destination", which is to say the points from which products are shipped or received or the location at which services are rendered.

Given that it would suppose the abandonment of the practice of computing corporate tax base on the basis of a company's accounting profit, the implementation of a formulaic system would produce an authentic paradigm shift. The new system calls for corporate taxes base to be computed on the basis of a company's *operating income* – which provides a much clearer picture of a company's economic capacity and true business activities. The practice of calculating a corporate tax base on the basis of accounting profit has several serious downsides, not the least of which are the challenges government tax authorities face when they try to navigate the growing technical complexity of international accounting standards applicable to large corporations. The second problem is that computing corporate tax bases on the basis of accounting profit makes it much easier for companies to artificially transfer profits, especially by means of financial operations, which are taken into account in accounting profits but do not figure in the calculation of operating profits. In brief, given that the elements of the proposed CCCTB formula are more difficult to manipulate or move than accounting items, the

implementation of this system would make it more difficult for multinational companies to artificially transfer funds from one country to another for the purposes of lowering their tax burdens.

The question as to which elements should be integrated into the new formula and the weight each should have is clearly the greatest bone of contention between Member States, each of which seeks a combination that will maximise its own tax revenues. Whereas some place greater importance on factors such as the contribution a country makes toward the creation of intellectual property, others argue that sales (and therefore the geographic points where markets exist and clients are captured) is more important. The formula finally arrived at aside, it is clear that the implementation of the new system will boost the overall tax base.

The CCCTB proposal has two important drawbacks. To start with, as it would only involve the harmonisation of corporate tax bases, it would fail to address the possibility of countries competing amongst themselves in terms of tax rates. Member States would be free to set their own national tax rates on the part of the overall profits apportioned to them. It would make sense to determine a minimum rate, as was done with VAT, to avoid the outbreak of an intracommunity tax rate war.

Secondly, it suffers from a severe and limiting defect, which is that adherence will be completely voluntary. The proposal leaves individual companies free to decide whether to opt for taxation computed on a common consolidated EU tax base or continue to have their tax bases determined at the national level. The existence of two separate regimes within a single jurisdiction is bound to complicate the mechanics of taxation. Furthermore, large companies are bound to opt for the CCCTB system only when

it suits them, which will inevitably be solely in circumstances in which taking that route translates into lower tax bills (and subsequently lower tax revenues). However, it has been agreed that once a company opts to be taxed on the basis of the CCCTB, it will be locked into that regime for a period of five years.

In terms of the CCCTB's viability, it should be noted that some States have taken issue with several aspects of the proposal as it stands<sup>15</sup> and others, such as the United Kingdom, have come out strongly against the overall proposal. Given the fact that the adoption of any initiative related to taxation is subject to unanimous approval, the Council will be unable to adopt the CCCTB in the event that it fails to garner the support of all Member States, although it could be pushed through by a number of countries by means of an enhanced cooperation procedure<sup>16</sup>.

### ***Reconsidering the definition of what constitutes a tax haven***

Tax havens provide the foundation upon which all tax evasion and avoidance schemes are constructed. Nevertheless, there is no internationally agreed-upon and updated definition of what constitutes a tax haven. Prior to recent initiatives, the most widely recognised attempt to define the concept was that developed by the OCDE, which offers three criteria: the imposition of no or only nominal taxes in a given jurisdiction, a jurisdiction's lack of transparency

and its unwillingness to exchange tax-related information. Other suggested definitions, such as that offered in the Tax Justice Network's *Financial Secrecy Index*, place a greater emphasis on the guarantees of opacity and secrecy<sup>17</sup> that such territories extend to non-residents.

In any case, a new, comprehensive European and international definition of tax haven that includes criteria for judging whether a territory can rightfully be placed in this category is sorely needed. Any such definition must include references to the characteristics that typify territories that aid and abet tax avoidance and evasion, including unnaturally low (nominal or effective) tax rates and policies of not requiring non-residents to maintain substantial business activities within their jurisdictions. It is precisely the absence of any necessity to maintain "substantial" business operations that often makes companies decide to transfer profits to tax havens.

Following the G20 2009 London Summit, the OECD drew up three lists that divided tax jurisdictions into three categories according to their relative degrees of opacity and cooperation with tax authorities in other countries. However, the lack of effectiveness of this exercise became patently clear when not a single country remained on the black list only a few days later. The requisites for being removed from the OECD's black list were easy for countries to fulfil and rooted in formalities. The jurisdictions in question were merely required to sign twelve double taxation agreements (DTAs) or tax information exchange agreements (TIEAs).

Nevertheless, the OECD did eventually follow through with the formation of an international "peer review" group charged with the

<sup>15</sup> The Netherlands is in favour of a common tax base but not consolidation.

<sup>16</sup> Enhanced cooperation agreements may be approved by the Council on the basis of majority vote on the basis of Article 329 of the TFEU.

<sup>17</sup> The highest level of secrecy involves shielding the identities of ultimate beneficiaries of hidden assets.

oversight of each other's implementation of global OECD transparency standards, which at that time were based on the principle of information upon request. Peer group members of the OECD's Global Forum examined each other's progress from two perspectives: emphasis was placed on legal frameworks during the first phase and the effective application of the tax treaties or bilateral agreements they had signed was stressed throughout the second.

The OECD may issue recommendations regarding the steps participant countries must take to rectify deficient practices and/or laws, and these jurisdictions are aware that any failure to act on them may provoke censure on the part of the G20. Although this peer review process does have a deterrent effect, it would make sense to implement a system capable of putting more pressure on jurisdictions refusing to cooperate by means of swift, multilateral sanctions.

### ***Banking secrecy and the automatic exchange of information as a new global standard***

The most important development related to banking transparency during the period 2013–2014 was without a doubt the substitution of the existing global standard for information sharing based on the concept of information exchange on request<sup>18</sup> with a new standard of automatic exchange of information (AEOI).

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<sup>18</sup> As opposed to AIE, the principle of “information upon request” calls for national authorities to present a formal request for information on a given account to the government of the country in which the funds in question are held. The petitioning authorities must also provide proof that the information requested is relevant to an investigation, and the decision as to whether or not information is shared rests solely in the hands of the jurisdiction in which the said account is maintained.

The EU has adapted its norms to the new OECD standards to reflect this historic shift. All EU Member States with the exception of Austria have made a commitment to become early adopters of the OECD's standard for the automatic exchange of information. As such, they must implement AEOI standards by September 2017. Austria and other jurisdictions such as Switzerland are on track to complete implementation by early 2018.

It is worth taking a closer look at the process that has led up to this landmark achievement. The EU was a pioneer when it introduced a system of automatic exchange of information in 2005. The EU Savings Tax Directive (EUSTD)<sup>19</sup> contained such a system, but it only covered one specific type of income (the interest payments received by natural persons) and therefore did not affect companies, trusts or foundations. The narrow scope of this directive left a loophole that made it easy to circumvent the EUSTD by either transferring funds from an individual to a legal person or a trust or converting investments into alternative financial instruments such as shares. Furthermore, the EUSTD granted Austria and Luxemburg temporary exemptions from the obligation of exchanging information automatically contingent upon their implementation of tax withholding systems<sup>20</sup>.

Although the European Commission put forward a proposal intended to address these shortcomings in 2008, both countries used their veto power in the Council to maintain these loopholes until they were finally closed in 2014, justifying their position by stating they had no

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<sup>19</sup> Directive 2003/48/EC on taxation of savings income in the form of interest payments (EUSTD)

<sup>20</sup> In exchange for this exemption, these two countries implemented a withholding system that guaranteed a minimum tax payment to account holders' countries of residence.

intention of renouncing this “privilege” until the European Commission convinces five neighbouring jurisdictions (Switzerland, San Marino, Monaco, Liechtenstein and Andorra) to make similar commitments. During the same period, Switzerland set about forging bilateral agreements with major European countries<sup>21</sup> in an attempt to undermine the effectiveness of the EUSTD.

European countries continued on this path of vacillation until the implementation of the US Foreign Account Tax Compliance Act (FATCA<sup>22</sup>) got underway, at which point five major European countries (the G5) not only adopted one of the models of implementation contemplated in FATCA, but also decided to share amongst themselves the same types of information they would be exchanging going forward with the United States. Other countries within and beyond the EU quickly followed suit in a wave of enthusiasm that led to the long-awaited revision of the EUSTD by the European Council, which entered into effect in March 2014. In November of the same year, G20 leaders ratified the OECD’s new global standard on automatic information exchange, which borrowed elements from both FATCA and the EU Directives. The OECD’s Global Forum on Transparency and Exchange of Information for Tax Purposes will monitor for the application of the new automatic sharing standards through its peer review programme.

The OCDE Standard envisages that financial institutions will report a wide range of information to tax authorities. It likewise envisages that source countries will exchange this information on a regular and automatic basis with the tax authorities of countries of residence. At the recent OECD Global Forum meeting in Berlin, fifty-one jurisdictions signed a multilateral competent authority agreement to automatically exchange information as per the new OECD Standard based on the Convention on Mutual Administrative Assistance in Tax Matters<sup>23</sup>. It is interesting to note that the United States has not, to date, become a signatory to this agreement.

Synergies between the EU and the OECD were further strengthened at the ECOFIN meeting held in December 2014 with the amendment of another piece of key community legislation related to taxation, Directive 2011/16/UE on administrative cooperation in the field of taxation. This document complements the EUSTD by requiring AEOI for revenues other than interest on savings. By extending AEOI to items such as dividends, and capital gains, the EU has met, and on certain points, surpassed, the levels of transparency covered by OECD standards.

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<sup>21</sup> One such treaty was signed by Switzerland and the United Kingdom.

<sup>22</sup> FATCA was enacted to curb tax abuses committed by US taxpayers who hold assets in offshore accounts. The novelty of this law the 30% withholding tax it imposes on foreign financial institutions that refuse to sign disclosure agreements with the US Internal Revenue Service to identify and provide information regarding US accounts. This law, which was ratified by the US Congress in 2010, requires financial institutions to implement account procedures to identify US account holders as of July 2014.

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<sup>23</sup> Although it was forged between the OECD and the European Council, participation in this convention is open to developing countries and countries currently serving as tax havens around the world.





# Economic and political immigration: the mediterranean perspective

José Manuel Albares

## **Summing up a difficult year in migration issues**

Migratory movements around the Mediterranean, along an axis that joins Africa with the European Union from south to north, are anything but a new phenomenon. They have been a feature of the shared agenda of the EU and Africa for over a decade. However, over the last twelve months migratory movements on the southern border of the EU have been particularly intense and dramatic, receiving extensive media coverage. Events in the Spanish enclaves of Ceuta and Melilla, and on the Italian island of Lampedusa have all highlighted the importance of a problem that not only persists but grows more acute with each passing day. The images of boats set adrift upon the sea, packed to the gunwales with irregular immigrants, only represent the latest tactic of the mafias whose trade is the traffic in human beings. However, African migration is not focused exclusively on the EU. Rather, we should remember that African migration towards Europe represents only a small

proportion of the migratory movements that occur between countries within the African continent.

The Mediterranean was the principal setting for the arrival of numerous immigrants and refugees in southern Europe by sea during the first half of 2014, under conditions that constitute a major humanitarian crisis. This represented both a qualitative and a quantitative transformation of the migratory phenomenon in the Mediterranean, with a rise of 25 per cent compared to the numbers of people making the same journey in 2013. We are talking about an estimated figure of around 80,000 people. The majority come from Eritrea, Syria and Mali, with the preferred departure point being northern Africa, and Libya in particular, where, due to the lack of a national government capable of exercising effective control over the country's territory and its borders, conditions have been ripe for the appearance of mafias and people-trafficking groups.

In order to meet the challenge of these migratory movements, and of irregular migrants in

particular, the EU has developed a whole array of conventions, agreements and strategies to tackle migration at the regional, bilateral and multilateral level. The main aim of these agreements and instruments is to channel these migratory flows and to combat the mafias, organized crime and people-trafficking that violate people's basic rights.

The most recent EU–Africa Summit, held in Brussels in April 2014, stressed the importance of migration both as a focus of discussions and as a fundamental element of the European–African agenda. This is clearly an issue that both parties are keen to address and tackle together. To coordinate this dialogue and support joint action, the EU uses three mechanisms. Firstly, it establishes mobility partnerships, which are formal agreements with specific countries such as Morocco, Tunisia and Jordan, in which member states are able to participate in specific projects. Secondly, it develops common agendas on mobility – more flexible instruments focusing on dialogue as is the case with Nigeria and Ethiopia. Finally, there are specific migration dialogues, namely the **Rabat Process** and the **Khartoum Process**. The first of these focuses on improving cooperation and dialogue around the West African migration route, while the second focuses on the Horn of Africa. Both processes bring together the countries of origin, transit and destination of these regions and migration routes.

### **Dialogue between the two shores of the Mediterranean: the Rabat Process**

The **Rabat Process**<sup>1</sup> began in July 2006 in the Moroccan capital. During this first meeting, the

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<sup>1</sup> <http://processusderabat.net/web/>

Rabat Declaration and the Rabat Action Plan were approved. Subsequently, at a second meeting in Paris in 2008, a more ambitious and detailed Cooperation Programme was established. At a new meeting in Dakar in November 2011, this process was developed further with the adoption of the Strategy 2012–2014, which evaluated implementation of the Paris Cooperation Programme and established a set of conclusions developed by the experts who participated in these meetings. The parties involved undertook to achieve the ten priority objectives designed to consolidate application of the Paris Cooperation Programme as a framework for cooperation and dialogue.

The Strategy 2015–2017 was presented at the most recent meeting of the Process, in Rome on 27 November 2014. The meeting was organized by the Presidency of the EU, supported by the Rabat Process Support Project funded by the European Commission and managed by the Spanish government's International and Iberoamerica Foundation for Administration and Public Policy (FIIAPP) and by the International Centre for Migration Policy Development (ICMPD). In recent years, the ICMPD has become a key element in the migration dialogue that the European Commission is seeking to promote, and the Rabat Process is a fundamental part of this, converting the ICMPD into a managing agency for migration issues, with direct responsibility for a number of projects, including those relating to asylum. The ICMPD has a strong presence in central and eastern Europe, and also includes Sweden and Switzerland among its membership. However, it is surprising that a body to which the Commission ascribes so much importance in the dialogue with the southern shore of the Mediterranean should scarcely have any participation by countries in the south of Europe (with the exception of Portugal), a shortcoming

that renders it less effective. Despite this, the ICMPD makes it easier for the Commission on Migration and Home Affairs to manage a budget of 380 million euros.

The most recent progress in this dialogue occurred in October 2014 in Rome, when the countries of Central Africa, West Africa, the Maghreb and the EU, together with Switzerland, Norway, the Commission and the Economic Community of West African States (ECOWAS) approved the Rome Programme (2015–2017) setting out very specific lines of intervention. This document sets out the commitment to ensuring the continuity of the goals of the Dakar Strategy. In particular, it stresses the need to maintain a balanced dialogue that addresses the three existing pillars of the Process: organizing legal migration; combating irregular migration; and strengthening the synergies between migration and development. In addition, a fourth pillar was added relating to international protection, as established in the EU's Global Approach to Migration and Mobility (GAMM). This was a consequence of the large numbers of immigrants and refugees who reached Italy, Greece, Spain and Malta by sea during the first half of 2014. Based on data from the UN Refugee Agency (UNHCR), over 800 people died or disappeared in the Mediterranean during 2014 while attempting to reach Europe. This figure is higher than the corresponding figures for 2013 (600) and 2012 (500). The situation in the Mediterranean has intensified, as a result of which it has become the region where the issue of migration is most in need of attention within the EU.

### **Adapting to the new scenarios and challenges of the migration phenomenon**

Faced with the quantitative growth in seaborne migration and the rise in the number of migrants from countries at war, the EU faces two pressing challenges: to offer an alternative to the dangerous journeys by sea that have characterized the last year; and to guarantee rapid access to asylum procedures for people who need protection. For this reason, the Common European Asylum System (CEAS)<sup>2</sup> is a key element in ensuring that the EU is truly a space for the protection of people in very vulnerable situations. Special attention also needs to be paid to the situation of women on these migration routes. It has been estimated that around 60 per cent of them suffer some kind of violence on their journey, but this goes unreported because victims fear being returned to their countries of origin, thus reinforcing the impunity of their attackers. In general, the strategy adopted in Rome needs to be adapted in order to take into account the situation in each participating country, so that it reflects the reality on the ground.

The innovative element of the dialogue between the EU and Africa with regard to migration issues is the Khartoum Process, which forms part of the EU Initiative for migration routes from the Horn of Africa. This new Process is designed to establish a permanent dialogue with the countries of origin and transit for migration routes that until now have received scant attention at the European level. The goal is to establish a political process relating to migration that

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<sup>2</sup> European Commission. *A Common European Asylum System*. Luxembourg: Publications Office of the European Union, 2014. Available at: [http://ec.europa.eu/dgs/home-affairs/e-library/docs/ceas-fact-sheets/ceas\\_factsheet\\_en.pdf](http://ec.europa.eu/dgs/home-affairs/e-library/docs/ceas-fact-sheets/ceas_factsheet_en.pdf)

brings together the countries of the Horn of Africa and East Africa with the main Mediterranean transit countries, focusing primarily on the traffic in migrants and the trade in human beings. Once this goal has been consolidated, the dialogue will extend to the other pillars of the GAMM. In May 2014, an exploratory meeting was held with the African Union Commission (AUC) and the main countries involved (Egypt, Ethiopia, Eritrea and Sudan). This meeting was followed rapidly by another involving Senior Officials held on 15 October, focusing on proposals regarding return and readmission. This dialogue was followed by the Ministerial Conference on 28 November in Rome<sup>3</sup>, at which the Khartoum Process was officially launched and the Rome Declaration was adopted. This new Process facilitates both the political and operational analysis of migration flows from the Horn of Africa that have increased significantly in recent years, in particular those starting in Somalia and Eritrea.

Data from the International Organization for Migration (IOM)<sup>4</sup> shows a rise in the arrival of migrants in Italy, the majority of them Eritreans, who account for a large proportion of the flows towards Europe via North Africa and the Mediterranean. In 2014, 170,100 immigrants arrived in Italy, of whom 20 per cent were from Eritrea. The IOM also reports that the number of migrants who died while crossing the Mediterranean rose from 707 in 2013 to 3,224 in 2014. In addition, it is clear that there is a chilling link between the increase in the total

numbers of migrants and deaths in the Mediterranean and the Horn of Africa and the profits obtained by migrant trafficking networks on these routes.

In addition to these two major regional processes (Rabat and Khartoum) specifically focusing on migration issues, the Regional Process between Africa and the EU, launched in Lisbon in 2007, has also concentrated on deepening cooperation between the EU and African states with regard to migration. The Euro-African Ministerial Conference was held in Brussels in April 2014, and adopted a third action plan for the period 2014 to 2017 which includes a Declaration on Migration and Mobility that establishes annual meetings to review and assess the situation of migration routes. The Dialogue between ACP countries (Africa, the Caribbean and the Pacific) and the EU has also been analysing the migration phenomenon since 2011. Finally, from the perspective of global processes, the EU is part of the Global Forum on Migration and Development, a United Nations initiative that takes a practical and action-oriented approach to the relationship between migration and development. The Forum's most recent meeting took place in Stockholm in May 2014, where the main theme was *Unlocking the potential of migration for inclusive development*.<sup>5</sup>

### **Bilateral agreements with the countries of origin and transit of migration**

The global dialogue between the EU and the regions to the south of the Mediterranean that

<sup>3</sup> *Declaration of the Ministerial Conference of the Khartoum Process*. (EU–Horn of Africa Migration Route Initiative). Rome. 28.11.2014.

<sup>4</sup> MURPHY, T. Craig: *Irregular Migration by Sea from Horn of Africa to Arabian Peninsula Increases*. IOM. 16.01.2015. Available at: <http://www.iom.int/cms/en/sites/iom/home/news-and-views/press-briefing-notes/pbn-2015/pbn-listing/irregular-migration-by-sea-from.html>

<sup>5</sup> Information about all the dialogues, conventions and agreements mentioned in these documents can be found in: Council of Europe. *Meeting document: GAMM update*. DS 1522/14. Brussels, 11 November 2014.

are the main source and transit route of migration flows is complemented by bilateral dialogues between Mediterranean and African countries, providing a basis for a more flexible approach that is tailored to suit local conditions. At the same time, because the political and migration situations differ from country to country, as do the relationships between individual countries and the EU, so too the framework that governs these relationships must vary, giving rise to a range of situations.

In the southern Mediterranean, the EU has reached agreements with Morocco, Tunisia, Egypt, Jordan, Lebanon and Libya. The EU has Association Agreements with the first four. With Morocco and Tunisia, these have given rise to a whole range of instruments, including: Mobility Partnerships; Dialogues on Migration, Mobility and Security; Readmission Agreements; and Visa Facilitation Agreements. These agreements are still under negotiation with Egypt, although an Association Agreement has been in place since 2004. There has been an Association Agreement with Jordan since 2002, a Dialogue on Migration, Mobility and Security since 2012, and a Mobility Agreement was signed in 2014. In Lebanon and Libya the situation is different. With Lebanon, a new EU-Lebanon Action Plan for 2013–15 was adopted in 2014, replacing the previous plan that ran from 2005 to 2010 and was revised in 2012. In July 2014, Lebanon also submitted a formal request for a Dialogue on Migration, Mobility and Security, which was the subject of discussion between September and October, and was launched in December.

The situation with Libya, as is to be expected due to political volatility and growing insecurity, has been far more complicated. Discussions with this country go back to 2008, when negotiations for a Framework Agreement between Libya and the EU began, with the aim of including

provisions relating to migration, mobility, borders and international protection. In October 2010, a press statement about cooperation between the EU and Libya was agreed, covering the issues of borders, mobility, migration and asylum, followed by a meeting of senior officials in February 2011. However, negotiation of the Framework Agreement and subsequent discussions based on the press statement were suspended as a consequence of growing political instability. The migration dialogue itself has come to a standstill, giving way to instruments that seek to alleviate a very complex situation. In June 2013, the EU deployed a mission to Libya under the European Common Security and Defence Policy to support the Libyan authorities in improving and developing the security of the country's borders. In December of the same year, the Commission adopted a programme worth 10 million euros to support a human rights-based migration management and asylum system in Libya. However, the intensification of political conflict, growing insecurity and the huge institutional crisis in the country rendered any planning with regard to migration and border control irrelevant.

In addition to these agreements between the EU and the Mediterranean countries, the EU has important bilateral agreements with countries in sub-Saharan Africa, such as Cape Verde, Nigeria and South Africa. These types of agreement are likely to become even more important in the future, given that the sub-Saharan region is such a major contributor to Mediterranean migration. With respect to Cape Verde, a Special Partnership Agreement was established in 2007, with an EU migration mission visiting the country in May of that year. The Mobility Partnership between the EU and Cape Verde was also signed in the same year. In October 2014, Cape Verde took a further step, ratifying Readmission

and Visa Facilitation Agreements, which came into force in December of that year. Nigeria's relationship with the EU with regard to migration issues dates to April 2008, when an EU migration mission visited the country. Since then there have been six dialogue meetings at a local level on migration and development which have led to the EU presenting a draft Common Agenda on Migration and Mobility to the Nigerian authorities in October 2013. At present a suitable date for the signing of this Agreement is currently being arranged. Finally, South Africa and the EU began a Strategic Association in 2007. Since then, within the framework of the Mixed Cooperation Council established between them, the two parties have organized a Dialogue Forum on Migration.

### **Managing a collateral phenomenon of migratory movements: jihadism**

In recent months, migratory movements around the Mediterranean, both from south to north and from north to south, have been at the centre of a new phenomenon that makes the process of managing such movements more complex and challenging. The journeys of European citizens, many although not all of them from North African or Muslim backgrounds, to countries with a strong Al-Qaeda or DAESH presence – particularly Syria, Iraq and Yemen – and their return, heavily radicalized, to their countries of origin, constitute a major challenge to those seeking to manage flows of migrants between countries on both shores of the Mediterranean, and are an indisputable threat to the security of the EU.

The terrible attacks in Paris in January this year against satirical magazine *Charlie Hebdo* and against a kosher supermarket, in which 17 people died at the hands of terrorists who had

travelled to Syria and Yemen before returning to France to perpetrate these acts, has reopened debate about measures to monitor and control travellers going to and returning from countries such as Syria, Yemen, Libya and Iraq. The added complication arises from the fact that, in order to reach their destinations, many people travel by alternative routes. For example, those travelling to Syria to join DAESH first make their way to Istanbul before crossing the Turkish border. This was the case of Hayat Boumeddiene, the wife of Amedy Coulibaly, one of the Paris terrorists, who drove to Madrid with him before catching a flight from Madrid to Istanbul on 2 January, while her husband returned to Paris to take part in the attacks. However, the solution lies not in restricting freedom of movement but in improving the mechanisms for sharing information and sharing data between security forces and intelligence services, making it possible to fight terrorism effectively at the European level. At the same time, there is the question of how to deal with people who frequently consult jihadist websites and how to prosecute for terrorism offences those who travel to conflict zones to join a violent group. Here, the challenge is how to guarantee security without damaging our freedom. Another complex and controversial issue is the Passenger Name Record (PNR). In the European Parliament, several people have indicated the need to establish limits on the information contained in this record and the filters applied, to prevent the establishment of discriminatory criteria based on the origin or name of passengers. The President of the Commission, Donald Tusk, has stated <sup>6</sup> that he will put pressure on the European Parliament to reduce its opposition to the proposed European

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<sup>6</sup> Reference 5.

directive on Passenger Name Records (PNR). The debate, in any case, is now out in the open: how to increase security without unnecessarily infringing upon individual privacy. What is clear is that the grave threat that jihadism poses to Europe requires an appropriate, proportionate and effective response.

The main profile of jihadists recruited in Europe, and particularly in France, is of Muslims born on this continent but descended from first or second-generation migrants and facing an identity crisis. In this search for identity, some people find an answer in joining jihadist groups whose ideas are disseminated through propaganda on the internet, and become radicalized as a result of systematic exposure and habituation to a radical, violent discourse that gradually becomes more and more meaningful to them, until they incorporate it as a code of conduct. The number of EU citizens who have joined the ranks of Islamic State is estimated at 3,000, a figure that includes all those who have been to the region, including returnees and those who have died in combat.<sup>7</sup> But there are also large numbers of jihadists recruited in the Maghreb. At present, Tunisian fighters are the largest group in the ranks of the Islamic State, followed by Moroccans.

A key issue in the future will be cooperation with Turkey to intercept jihadists crossing the Turkish border to join Islamic State in Syria, an issue that touches on the debate about data protection and checks at airports. Turkey is also the main destination for Syrian citizens who have become refugees as they flee the effects of the civil war in their country. The numbers of Syrian citizens seeking international protection

or asylum have rocketed in the last two years in countries across Europe, including Spain, and this trend seems likely to continue in the coming years, given the way that their country's interminable civil war is unfolding.

### Looking towards the future

The phenomenon of migration around the Mediterranean has become more complex over the last decade, to the point where the EU faces the challenge of managing a range of migration phenomena that include political and economic issues, asylum seekers and refugees, and the need to guarantee security in the face of the jihadist threat. All of these phenomena are inter-related and at times overlap. However, they reflect different dynamics, have different countries of origin, follow different transit routes and pose different threats. At the same time, migration movements around the Mediterranean do not solely involve strictly Mediterranean countries but also include the many sub-Saharan African countries from which migrants come. Finally, over the course of the last year and in particular following the Paris attacks in January, a new aspect of migration that goes beyond economic and political issues has come to the fore. This is the issue of return trips, supposedly for leisure purposes, of European citizens to the jihadist war zones and the fact that when they return they have been radicalized. How can we expect the EU to respond to these threats in the years to come? A three-pronged approach is required. Firstly, regular migration flows need to take place under the best possible conditions. People who access EU territory should do so legally, with the recipient state making sure that there are sufficient guarantees and conditions to enable them to integrate. Secondly, there is

<sup>7</sup> *Islamic State Crisis: '3,000 European jihadists join fight'*. BBC. 26.09.2014. Available at: <http://www.bbc.com/news/world-middle-east-29372494>

the fight against the mafias and networks that traffic in human beings, whether these are women or irregular migrants. In this respect, cooperation with the countries of origin and transit is essential. An example is the excellent cooperation between Spain and Senegal. Frontex has a major role to play in this regard. Finally, there is co-development, understood as joint work between the EU and the countries of origin of migratory movements to offer opportunities for work and subsistence to these populations. The ultimate goal is for emigration to be an option, not an obligation in response to a total lack of opportunities in the country of origin. As a corollary of the above, there is also a need for a balanced and consistent distribution of the reception of asylum seekers.

The civil wars in Libya, Syria and Iraq that have led to a lack of control by these states over their territory and borders mean that we should expect the migration routes with their origins in these countries to continue to intensify in the coming years, in combination with two new migration phenomena that have appeared in recent months: boats packed with irregular migrants set adrift on the sea, and return trips by European citizens to regions controlled by Al-Qaeda, DAESH or their satellites. The coming months will no doubt be characterized by debate as to the best way to control these journeys without abusing citizens' privacy or imposing unjustified restrictions on our rights and freedoms.



# The crisis in Ukraine and relations between the European Union and Russia

Enrique Ayala

Beyond any shade of a doubt, the event that has cast the longest shadow over Europe during 2014 has been the Ukrainian crisis, which has provoked the most serious conflict to take place on European soil since the breakup of Yugoslavia in the 1990s. The year began with protestors occupying Kyiv's Independence Square, which swiftly became known as the "Euromaidan", and drew to a close with a death toll in the thousands attributable to a military confrontation that has left wounds that will be very difficult to heal.

The intervention of Russia, which has annexed the Crimean Peninsula and provided military and economic support to the secessionists in the Donbass, has had an additional and even more dangerous long-term consequence: a bitter confrontation between Russia and the European Union, which came out as an early supporter of the new government in Kyiv and continues to defend the concept of Ukraine's territorial integrity. The EU has opted to exert economic and political pressure on Moscow to reach a negotiated end of the conflict. Nevertheless, this political standoff has negative

implications for both parties, and a fair and realistic resolution to the Ukrainian situation that would set the stage for a renewed dialogue must be found as soon as possible.

## **The Ukrainian crisis**

Ukraine means "borderland", a good, basic description for a country that for historical, ethnic, and linguistic reasons finds itself divided into two clearly distinguishable zones: one in western part of its territory in which the majority of the population speaks Ukrainian and looks toward Europe, and another to the east where the country's industrial and mining activities are concentrated, much of the population speaks Russian and there is a closer affinity with Russia. Since it gained independence in 1991, the country has been caught between these two political poles of attraction, and any attempt on the part of one faction to get the upper hand has resulted in an upheaval such as the 2004 "orange revolution" that swept pro-European Viktor Yuschenko into power.

On 21 November 2013, Viktor Yanukovich, who had been elected president in 2010, announced his decision to suspend final preparations for an association and free trade agreement with the EU that Ukraine had been expected to sign in Vilnius the following week. Although this abrupt about-face was officially framed as a move on his part to strike a better deal, it was universally understood that he had caved in to pressure exerted by Russia, which was anxious to keep Ukraine within its sphere of influence and integrate it into its own Eurasian Union alongside Belarus and Kazakhstan. This perception was confirmed a month later when Moscow offered Yanukovich a 30 percent discount on the price of gas and 15 billion-dollars of credit not contingent on any reforms.

The night of this announcement, students mounted their first demonstration in Kyiv's Independence Square (Maidán Nezalézhnosti) against the country's political shift away from Europe. These protests, which were initially peaceful, grew progressively unruly once demonstrators became aware of the government and security forces' inability to control them. The movement was subsequently radicalised when extreme right-wing paramilitary groups aligned with ultranationalist party Svoboda and Pravy Sektor (Right Sector) militias took control of the square and began to provoke violent disturbances. Following the deaths of several protesters on 22 January, the violence escalated unchecked, reaching a peak on 20 February, a day on which 60 people died in armed clashes.

On 21 February, Yanukovich and the opposition reached an agreement mediated by the foreign ministers of Germany, France and Poland that called for early elections in December, the formation of a government of national unity and the restoration of the 2004 Constitution (which had been altered by Yanukovich in

2010). Nevertheless, Maidan protestors stormed government buildings the following day and issued an ultimatum to Yanukovich, who slipped out of Kyiv and fled to Russia via Kharkiv. The Verkhovna Rada (Ukrainian Parliament) met in a tense session during which the building was blockaded and surrounded by armed protestors and in the forced absence of nearly one hundred deputies. Such as it was, the assembled body then proceeded to impeach Yanukovich, appoint Oleksandr Turchynov interim president and restore the Constitution of 2004. On 27 December, the Rada named Arseniy Yatsenyuk (a candidate openly backed by the US State Department) prime minister. Other members of new government such as the vice-president, three ministers (including the defence minister) and the attorney general were affiliated with the extreme right-wing party Svoboda.

Given that Yanukovich's impeachment was not carried out according to procedures laid out in Article 111 of the Constitution of 2004, it was technically illegal. Among other points, this Article, which had remained unchanged in the Constitution of 2010, called for the formation of an investigative commission and a three-quarter-majority vote in favour of a president's removal from office. The 328 votes cast in favour of Yanukovich's impeachment had been several shy of the 337 out of 450 required. This meant that the president who succeeded Yanukovich was illegitimate, as was the entire government, which under the Ukrainian Constitution is appointed by the head of state. However, this state of affairs did not prevent the EU from forgetting the agreement mediated by European ministers and signed on 21 December and hastily recognising the new government.

The installation of a new government in Kyiv was perceived by Russian-speaking communities in the east and south of the country as a

threat to their identity and a rupture of the former fragile national equilibrium that left them politically disenfranchised. Furthermore, on 23 February, the Rada abolished a law that had made Russian an official language in certain regions. Although Turchynov vetoed the resolution a few days later, the damage was already done. The discontent of the Pro-Russian population had been raised to the boiling point and was ready to spill over.

### **The Crimean secession**

Reaction in the Autonomous Republic of Crimea was almost immediate. Pro-Russian protests broke out on in Sevastopol on 23 February, armed militias took over key border crossings and other strategic points on the 26th, and on the 27th the Supreme Council, whose seat had been stormed by armed self-defence forces, deposed the prime minister appointed in Kyiv in favour of Sergei Aksynov, leader of the Russian Unity party, who had won only 4% of the vote in the 2010 regional elections and would ask Russian president Vladimir Putin for assistance on 1 March. The Council of the Federation, upper house of the Russian Federal Assembly, authorised the intervention of Russian forces in Ukraine on the same day that Aksynov issued his appeal.

Russian troops stationed in Sevastopol, where Russia was authorised to maintain up to 25,000 men, were deployed without badges throughout the peninsula, occupied airports, patrolled highways, and encircled Ukrainian army barracks without engaging in combat. A referendum on independence from Ukraine that the Crimean Supreme Council had previously announced would take place on 25 May was moved up to 16 March. Over 80% of the electorate turned out for the referendum, 96%

casting their votes in favour of secession. Crimea and Sevastopol both declared their independence from Ukraine on the 17th and immediately sought accession to Russia. An admission agreement was signed in Moscow the following day and ratified by both houses of the Russian Parliament on the 21st, after which Crimea became an autonomous republic of Russia and Sevastopol a Russian federal city.

Crimea had been part of Russia from 1783, the year that Catherine the Great wrested it from the Ottoman Empire, until 1954, when Nikita Khrushchev presented it to Ukraine as a gift in celebration of the 300th anniversary of its unification with Russia. Of course, in 1954, no one had asked the inhabitants of Crimea, 60% of which are currently of Russian descent, whether they were in favour of integration with Ukraine or not. As it occurred at a time when both Crimea and Ukraine were fully integrated into to the USSR, the cession was of a mainly administrative nature. In any case, the transfer did not include Sevastopol, which due to its military base had long before been given the special status of a federal city under the direct authority-of Moscow, and as such was not-considered to be part of the *oblast* (region) of Crimea. After Ukraine gained its independence in the wake of the dissolution of the Soviet Union, Crimea adopted its own constitution and made an unsuccessful bid for independence in May 1992. Since another failed attempt in 1994, it has had the status of autonomous republic within Ukraine. Sevastopol also remained under the administrative control of Kyiv during the period that the division of the Black Sea fleet and Russia's maintenance of a military base in that city were negotiated.

In 1992, the Supreme Soviet questioned the constitutionality of Khrushchev's transfer of Crimean sovereignty to Ukraine, and demanded

the return of Sevastopol to Russia a year later. Nevertheless, then-President Boris Yeltsin was far too beleaguered by Russia's waning influence in world affairs to voice public support for either initiative. In December 1994, representatives of the Russian Federation, the United States and the United Kingdom met in Budapest to sign the Budapest Memorandum on Security Assurances, a document that contained pledges to respect the territorial and political integrity of Ukraine negotiated in exchange for Ukrainian nuclear disarmament. By signing this memorandum, Moscow took the historic step of unconditionally recognising Ukraine's borders and its right to territorial integrity (Article 1). This recognition was ratified in Articles 2 and 3 of the Treaty of Friendship, Cooperation and Partnership signed by both countries in 1997 immediately after they had reached an agreement on the division of the Black Sea fleet and Russia's use of Sevastopol as a naval base.

It is clear that Russia's annexation of Crimea violated not only the Budapest Memorandum on Security Assurances and the Treaty of Friendship, Cooperation and Partnership, but the Helsinki Final Act, which enshrined the right of territorial integrity, as well. Nevertheless, it is just as clear that the Crimean question has been a pending issue since the dissolution of the USSR and that the annexation is the result of an historic reality confirmed at the polls by the majority of Crimean voters that might have been facilitated by Russian intervention but was clearly the will of the people. Viewed from a realistic perspective, recognised or not, it is a *fait accompli* not at all likely to be reversed. On 27 March, The United Nations General Assembly approved a non-binding resolution that declared the invalidity of the referendum and the annexation. Although both have also been rejected by the United States and the European Council in the

name of the 28 EU Member States, it must be admitted that the fact of their having recognised the unilateral independence of Kosovo in 2008 leaves many of these countries without valid political or legal arguments for refusing to respect the decision of the inhabitants of Crimea and Sevastopol.

### **The Donbass conflict**

Protests against the Kyiv regime broke out in early March 2014 in most of the eastern and southern areas of the country that had significant ethnic Russian and Russian-speaking minorities including Odessa, where they were quickly suppressed, but were strongest in the Donbass, an industrial and mining region on its eastern border with Russia. Pro-Russian separatists seized government buildings where they raised Russian flags. Independent peoples' republics were declared in Donetsk (DPR) and Kharkiv on April 7 and Luhansk (LPR) on the 28<sup>th</sup>.

Kyiv deployed troops on 14 April to crush the rebellion. Despite an agreement to halt all armed combat reached on 17 April in Geneva between Ukraine, Russia, the European Union and the United States, the Ukrainian army continued its offensive, which was successful at first due to the separatists' lack of organisation and supplies. Although Ukrainian troops were able to take Kharkiv and parts of the oblasts of Donetsk and Luhansk, large expanses of the latter two, including their capital cities, resisted and the lines of confrontation between the two sides hardened. The Kyiv government subsequently accused Russia of supplying the separatists with heavy weapons and covert military personnel.

The turnout was high for referendums held in the RPD and the RPL on 11 May in which voters expressed overwhelming support for

independence. Separatist leaders there followed Crimea's lead and appealed for annexation to Russia. However, when no response was forthcoming from Moscow, which refrained from recognising their independence, the two self-declared republics agreed on 24 May to form their own confederation under the name Federal State of Novorossiia.

On 17 July, Malaysia Airlines flight MH17 was shot down near Luhansk. All 298 people aboard perished in the incident. Each party to the conflict accused the other of bringing down the plane, and although neither has been able to prove its claims, the international news media (especially media networks in Western countries) have laid the blame on the doorstep of the separatists. While controversy over this incident raged on, forces loyal to Kyiv reduced the size of the area controlled by the rebels to approximately a third of the total territory of the two oblasts.

Under the auspices of the Organization for Security and Co-operation in Europe (OSCE), representatives of Ukraine, the RPD, the RPL and the Russian Federation met on 5 September to sign the Minsk Protocol, by which they agreed to an immediate ceasefire monitored by the OSCE, the adoption of a law on local self-governance for "particular districts" of the Donetsk and Luhansk oblasts, local elections in accord with the aforementioned legislation, the permanent monitoring of the Ukrainian-Russian border by the OSCE, a limited amnesty for the rebels and the immediate release of hostages and illegally detained persons. A complementary memorandum that established a 30-kilometer demilitarised zone as well as a ban on the flight of military aircraft and the withdrawal of foreign fighters from the zone was signed on 19 September.

In spite of these agreements, armed confrontations between the two sides continued, beginning with a battle for control of the

Donetsk airport, which was then in the hands of Kyiv forces. Ukraine considered presidential and parliamentary elections held in the RPD and RPL on 2 November to be illegal and in violation of the terms of the Minsk Protocol. Pro-Russian troops sustained an offensive launched to recover territory they had lost in July. The humanitarian crisis deepened with the onset of winter and Kyiv's decision in November to suspend payment of pensions and social services in zones held by the rebels. Talks renewed in Minsk on December 24 in the hope of obtaining a firmer commitment from both sides to comply with the agreements were suspended on the 27 after having achieved no more than the exchange of 300 prisoners.

Two battalions of the Ukrainian National Guard whose members included proto-fascist militants aligned with Pravi Sektor who refused to submit themselves to the discipline of the regular army were accused of impeding humanitarian aid convoys from entering the conflict zone and of launching numerous artillery attacks against rebel cities that caused civilian casualties. On the other hand, Kyiv repeatedly accused Russia of taking advantage of the OSCE's inability to monitor the border to move heavy weaponry and troops (estimated to number anywhere between 3,000 and 9,000 according to the source) into the conflict area. The simple fact is that neither side has respected the Minsk agreements and that both accuse the other of having violated them.

Armed confrontations that intensified during the last two weeks of January reached their peak with the shelling of Mariupol, a pro-Russian city on the Sea of Azov considered to have strategic importance for its potential to serve as a Russian gateway to Crimea and the siege of Devaltseve, an important railway junction. It has been estimated that the rebels have managed

to gain 500 more square miles of territory than they had under their control when the Minsk Protocol was signed. The massive mobilisations that continue to be declared by both Kyiv and the rebel regions are threatening to broaden the scope of the conflict and have further aggravated already tense relations between Russia and the European Union and the United States.

As of the end of January, the Donbass conflict had caused 5,300 fatalities, 11,500 injuries and generated close to 1.5 million refugees, almost half of whom have fled the country – primarily in the direction of Russia. In addition to this massive humanitarian disaster, the conflict has also been responsible for the destruction of homes, infrastructure and industrial installations throughout what was once the most prosperous region of Ukraine, the reconstruction of which will be very expensive.

### **The reaction of the European Union and the New Minsk agreement**

The EU has condemned the actions of Russian troops in Crimea since early March 2014. The first EU political and economic sanctions designed to pressure Russia to suspend its intervention in Crimea were approved on 17 March 2014, immediately following the Crimean status referendum. The most newsworthy measure approved at that time was a list of travel bans and asset freezes targeting specific individuals and businesses<sup>1</sup>. As of January 2015, this list, which has been amplified on a number of occasions, contains the names of 132 individuals and 28 companies. Other measures taken by the EU have included the suspension of cooperation

programmes and the reorganisation of a G 8 meeting originally slated to take place in Sochi, Russia, as a G 7 event in Brussels.

As Ukraine had yet to hold elections, the political part of an Association and Free Trade Agreement between the EU and Ukraine was signed on 21 March by the political leaders who had assumed power in the wake of the Maidan protests. Pro-European businessman Petro Poroshenko, who won a first-round victory in the country's presidential elections on 25 May, signed the economic part of the agreement on 27 June.

In July, shortly after the downing of flight MH17, the EU approved a new packet of sanctions that placed restrictions on access to European capital markets for state-owned Russian financial institutions and prohibited the sale, supply, transfer and exportation to Russia of material and equipment employed by the petroleum and gas industry, or that could be used for military purposes. Moscow retaliated a month later by placing an import ban on European agro-food products, which according to Commission estimates, represent over 5 billion euros in annual EU export revenue. The Spanish Foreign Affairs Minister has calculated that the actual total cost of EU sanctions, in terms of lost export revenues, could be as high as 21 billion euros. In September, the EU approved a new round of sanctions barring several Russian energy firms, including Gazprom, and other Russian companies in the defence sector from raising long-term financing in European capital markets.

Meanwhile, Ukraine's economic situation continues to deteriorate in the absence of revenue once generated by export trade with Russia and its mining and industrial sector, which has been severely affected by the Donbass conflict. A 7% contraction of its economy has provoked drastic cutbacks in social programmes.

<sup>1</sup> [http://europa.eu/newsroom/highlights/special-coverage/eu\\_sanctions/index\\_en.htm](http://europa.eu/newsroom/highlights/special-coverage/eu_sanctions/index_en.htm)

Primer Minister Yatsenyuk, who won election in the wake of a narrow People's Front victory over the Petro Poroshenko Bloc in parliamentary elections held on 26 October, has stated that at least 12 billion euros will be needed to get the Ukrainian economy back on track. The EU has approved three successive aid packets for Ukraine worth a total of 3.2 billion euros, but has also called upon the Kyiv government to implement deep economic, administrative and fiscal reforms and eliminate the corruption and cronyism that continue to be at the heart of many of the country's problems. The International Monetary Fund took action in February, approving 15.5 billion euros in loan money contingent on compliance with a four-year economic and political reform programme.

From the outset of the crisis, the EU has closely coordinated its policy –including points related to sanctions– with policies pursued by the US and other countries such as Canada and Norway. However, it became evident in early 2015 that the perspectives of leaders on different sides of the Atlantic were less than fully aligned when politicians in Washington growing increasingly sceptical of the outlook for a negotiated solution began to talk about the possibility of military aid for Ukraine. European interests obviously differ from those of the US, which has fewer commercial ties with Russia and is not reliant on Russia for energy.

There are also differences of opinion within the EU regarding the approach that Europe should adopt towards the Ukrainian conflict, and by extension, its relations with Russia. Backed by the United Kingdom, Baltic countries such as Estonia and Latvia, both which have Russian minorities subject to official discrimination that comprise more than 25% of their populations, and Poland, which harbours a deeply rooted hostility towards Russia, continue to call

for a hard-line approach without concessions. On the other hand, the majority of other European countries including France and Germany are more interested in seeking a negotiated solution. Although tensions have been aired, to date, the internal unity indispensable for maintaining a successful rapport with Russia has remained intact.

Prompted by a rapidly deteriorating situation in January, German Chancellor Angela Merkel and French President François Hollande flew to the region together in February in the hope of forging a new agreement based on the Minsk Protocol that would halt the escalation and lead to a definitive ceasefire. They stopped in Kyiv on 5 February before moving on to Moscow the following day. The fruit of their efforts was a new summit held in Minsk on 11 February attended by Merkel, Hollande, Putin and Ukrainian President Poroshenko. These leaders made a new pact effective as of 15 February and agreed upon a series of measures that confirm and build upon the initial Minsk Protocol. The Minsk II agreement calls for the creation of a security zone of at least 50 kilometres and the implementation of constitutional reforms and special statutes for Donetsk and Luhansk before the end of 2015, after which the Ukraine government will be given control of its border with Russia, an amnesty will be declared and all foreign troops and arms will be withdrawn.

These new agreements made in Minsk, which are considered to be the last opportunity for securing peace, represent a landmark in European policymaking, albeit tinged by the fact the EU has no single figure with the sufficient capacity to speak and negotiate in the name of the community as a whole and must still rely on the leaders of its most important Member States to assume this role. It remains to be seen if these new accords will be more

successful than those that preceded them in terms of compliance, but it is clear that any failure to respect them could provoke an escalation that could have very dire consequences.

### **The economic and political situation in Russia**

The combined effects of economic sanctions and collapsing oil prices are plunging Russia into an economic downslide that could prove to be as severe as the crisis that forced it to declare a default in 1998 that had a negative ripple effect throughout the world economy. Moscow has already burned through a quarter of its foreign currency reserves (estimated before the crisis to be worth 480 billion dollars) helping Russian companies (especially in the energy sector) manage their international debt situations in the face of sanctions that have cut their access to capital markets and recapitalising banks depleted by capital flight and attempt to shore up the rouble, which nonetheless has lost 50% of its value against the dollar.

Putin blames 25% of the slump of the Russian economy on sanctions, which are expected to provoke a revenue loss of 32 billion euros. However, given that Russia is the world's second largest producer of gas and petroleum—which together account for 68% of its export revenue<sup>2</sup>—the country's most serious problem is the downward spiral of petroleum prices. A barrel of Brent crude, which sold for 115 dollars in July 2014, went for less than 50 in January 2015. Russia needs a minimum price of 80 dollars a barrel to keep its economy afloat. A slide to 60 dollars translates into an annual shortfall of more than 80 billion dollars, which is almost

the amount of its total trade surplus with the EU. Credit rating agencies have downgraded Russian debt to junk bond status. Interest rates have risen to as high as 17%, the rate of inflation has soared as high as 10% and it is estimated that the average household income has decreased by 4.7%. Problems stemming from the Ukrainian conflict complicate the economic situation even further. The cost of bankrolling Crimea is enormous: 2.6 billion euros in 2014 and forecasted to rise to 3.9 billion for 2015. Financial support provided to the people's republics of Donetsk and Luhansk (which have a combined population of 3 million) will probably suppose an annual expenditure of anywhere between 2 and 4 billion more.

According to the International Monetary Fund's January forecast, Russia's economy will contract by 3% in 2015 and the recession will most likely last through 2016 with another contraction of 1%. Nevertheless, pessimists believe that if the price of Brent continues to stay below 60 dollars a barrel, contraction could be as severe as 4%. Although Putin has stated that he expects the current downturn to end in two years, some analysts have predicted it may last anywhere between three and five years, depending on the evolution of oil prices. What is perfectly clear is that although military spending will be maintained and international commitments met, budget cuts of up to 10% are otherwise planned across the board, infrastructure projects will be paralysed and social benefits will be affected.

How long Russia can hold up under these circumstances and whether or not they will force the Kremlin to change its Ukraine policy is an open question. Adopting an attitude that Europe deems acceptable will certainly not raise the price of petroleum, which is its greatest problem, but an end to sanctions would provide a certain degree of economic relief.

<sup>2</sup> <http://www.eia.gov/todayinenergy/detail.cfm?id=17231>



Putin is enormously popular in Russia. His public opinion approval ratings rose at the outbreak of the Ukrainian conflict and soared even higher in the wake the annexation of Crimea. According to a December 2014 survey conducted by the independent Russian public opinion research agency Levada, 85% of the Russian population highly approves of his policies compared to a mere 15% that does not (compared to a ratio of 65 to 35 percent in December 2013). Another December Levada poll revealed that 55% of survey subjects would like to see Putin re-elected as president in 2018 and another 10% would prefer the race to go to other candidate who would nevertheless pursue similar policies (compared to 26% and 14% respectively in April 2013). Only 18% would prefer a candidate with different approach to win office in 2018.

What the Russian people lack in terms of a tradition of democracy they make up for in nationalist sentiment that explains their appreciation for a strong leader in the Kremlin who has boosted national pride by restoring the country's high-profile role in international politics. Although the combined effects of sanctions and plummeting oil prices are bound to lower Russian standards of living, spark protests and erode both Putin's popularity and national stability, no alternative political forces appear to have a solid footing or, in fact, to be particularly desirable. An unforeseen catastrophe notwithstanding, it is most likely that Putin will continue to be the EU's interlocutor in Moscow for many years to come.

## EU-Russian relations

Some Europeans, whose opinions have only been sharpened by the Ukrainian conflict, continue to see the Russian Federation as a superpower that could one day harbour grand ambitions to

dominate Europe. Nevertheless, this perception does not square with Russia's relative position in the world today. In order to gain an accurate picture of Russia's position relative to that of the EU, one needs to take into account that Russia's population is only 28.2% as large as the EU's<sup>3</sup> and its nominal GDP is lower than Italy's and barely 11.6% of that of the UE<sup>4</sup>. Even its defence budget, despite a hike of 50% between 2010 and 2013, is only 31.5% of the combined defence budgets of the EU's 28 Member States<sup>5</sup>. Although Russia's vast nuclear potential must be taken into account, it is very unlikely to be used in conventional warfare. These comparisons are based on aggregate figures for the EU. If one compares Russia with individual Member States, the picture changes dramatically, a fact that should serve as a constant reminder that European unity is the key to pursuing foreign relations with Russian under favourable conditions.

Russia's economy depends greatly upon that of the European Union, which is its leading trading partner in terms of both imports and exports. In 2013, the last year before sanctions were imposed, European goods made up 43.6% of its total imports. In comparison, only 16.6% of its total imports came from its second largest trading partner China. On the other side of the coin, 51.8% of Russia's total exports that year went to EU countries, generating a trade surplus in that country's favour of over 86 billion euros<sup>6</sup> – a figure almost equivalent to its 2013

<sup>3</sup> World Bank population figures for 2013: Russia: 143 million; UE: 506.7 million.

<sup>4</sup> World Bank GDP figures for 2013 in US dollars: Russia: 2.097 trillion; UE: 17.96 trillion.

<sup>5</sup> Stockholm Internal Peace Research Institute (SPRI) figures in US dollars for 2013: Russia: 87.8 billion; EU: 278.8 billion.

<sup>6</sup> [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113440.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113440.pdf)

defence budget. In comparison, exports to China represented a mere 6.9% of its total export trade in 2013. The EU is also Russia's most important foreign investor. It is estimated that 75% of the direct foreign investment stocks in Russia come from EU Member States. In 2012, outward FDI stocks from European countries to Russia reached a level of 19 billion euros<sup>7</sup>. In the light of these numbers, it would not be feasible for Russia to contemplate a rupture with the EU any time soon – a fact that the EU should keep in mind and have no qualms about using as a bargaining chip should Moscow resort to any direct or indirect form of coercion.

Although trade with Russia is not as crucial to the EU as trade with the EU is to Russia, the Federation is nevertheless an important trading partner. In 2013, it was the EU's second largest trading partner in terms of imports (206.1 billion euros in trade that represented 12.3% of total EU imports) and its fourth largest partner in terms of exports, receiving 119.8 billion euros in goods from the EU Member States that made up 6.9% of total EU exports. It is worth pointing out that 77.7% of Russia's exports to the EU fall into the category of mineral fuels and derivatives. The Union's dependence on Russian petroleum and gas is a serious issue: 33.7% of the crude oil and 32% of the natural gas imported by the EU in 2012 came from Russia<sup>8</sup>. Although the percentage of mineral fuels imported by EU countries from Russia is steadily declining and a concerted effort is being made to diversify Europe's energy sources, given that the reserves of Norway, its second largest supplier, are diminishing and

Libya and Nigeria, two of its other important suppliers, are becoming increasingly unstable, it is currently impossible for the EU to wean itself completely off Russian energy supplies. Nevertheless, while Putin may be tempted to use energy as a political weapon as he did with Ukraine in 2006 and 2009, the fact is that Russia is under more pressures to sell than Europe is to buy.

Russia is looking to the East in an attempt to diversify its foreign trade. In 2014 it signed a 323 billion euro, thirty-year gas supply contract with China for which pipeline construction is already underway. It has also entered into an agreement to build 12 nuclear reactors over the next two decades in India, a country with which it has signed a number of defence supply contracts. Nevertheless, Russia cannot do without the EU for any extended period of time. Despite their differences, their interdependence obliges them to seek some kind of working understanding.

The legal linchpin of relations between the EU and Russia is a Partnership and Cooperation Agreement that covers a wide range of policy areas including political dialogue, trade, finance and culture. This accord established a new tradition of organising twice-yearly summit meetings between Russian and EU heads of state or government as well as a Permanent Partnership Council that facilitates interaction at the ministerial level. This ten-year agreement entered into force in December 1997. Since it expired in December 2007, it has been renewed annually pending the negotiation of a new agreement, a process that has been repeatedly hindered by a variety of diplomatic obstacles and suspended since the outbreak of the Ukrainian crisis. At the EU-Russia summit held in Saint Petersburg in May 2003, both countries agreed to set up four "common spaces" to facilitate deeper mutual cooperation: A Common Economic Space; A Common Space on Freedom, Security and

<sup>7</sup> <http://ec.europa.eu/trade/policy/countries-and-regions/countries/russia/>

<sup>8</sup> [http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Main\\_origin\\_of\\_primary\\_energy\\_imports,\\_EU-28,\\_2002%E2%80%9312\\_\(%25\\_of\\_extra\\_EU-28\\_imports\)\\_YB14.png](http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Main_origin_of_primary_energy_imports,_EU-28,_2002%E2%80%9312_(%25_of_extra_EU-28_imports)_YB14.png)

Justice; A Common Space on External Security; and a Common Space on Research, Education and Culture. The most recent initiative related to this agreement was the Partnership for Modernisation launched at the 2010 Rostov summit, which was intended to provide a flexible framework for dialogue on reform, growth and the rule of law.

The EU launched an Eastern Partnership programme in May 2009 in the framework of its European Neighbourhood policy. The main purpose of this initiative is to strengthen bilateral relations between Belarus, Moldova, Ukraine, Armenia, Azerbaijan and Georgia and the EU by helping them meet and implement EU standards in a wide range of areas. When the EU signed Association and Free Trade Agreements with Georgia and Moldova on 27 June 2014, a Russian government spokesman immediately issued a warning regarding the negative consequences that entering into such an agreement could have for the economies of these two former Soviet republics. There are “frozen conflicts” in both of these countries provoked by Moscow-backed pro-Russian enclaves that have declared independence (Transnistria in Moldova and Abkhazia and South Ossetia in Georgia). Whereas Belarus and Armenia have become members of the Russian-led Eurasian Economic Union, Azerbaijan is moving closer to the EU. Experience has shown that attempting to forge a policy directed towards any of these states without taking Russia into account is unrealistic and can give rise to conflicts such as the present crisis in Ukraine.

### **Looking towards the future**

The EU has no desire to enter into a confrontation with Russia, a new cold war or, most of all,

an armed conflict. Nor does it wish for the Russian economy to collapse, an eventuality that could have a negative impact on European economic recovery barely underway, or that it enter a period of destabilisation that could have unknown consequences. The possibility of Russia turning its sights to the East and forging closer ties with China is equally unattractive, in that it would provoke a geopolitical imbalance harmful to European interests. Europe and Russia need each other in equal measure –not only in view of their economic and energy interdependence, but also because the security and stability of Eastern Partnership countries, including Ukraine, cannot be achieved without Russia or against its will. It must also be remembered that Russia’s nuclear potential and permanent seat on the UN Security Council makes that country an essential partner in the resolution of international security problems. Without its cooperation, it would be impossible to meet the challenges of Jihadist terrorism (currently Europe’s greatest security threat), the proliferation of weapons of mass destruction and organised crime or conflicts such as those in Iran and Syria.

Nevertheless, understandings reached at any price or from a position of weakness are unacceptable. The EU cannot submit to coercion and must draw its own red lines in regard to its relations with Russia. Most importantly, it cannot allow Russia to meddle in the internal affairs of its neighbours or seek to overturn political decisions taken by these countries as it tried to in the case of Ukraine. The use of sanctions as means of applying political and economic pressure on Moscow to change its posture on the Ukrainian conflict is essential, although such a tactic is not a per se solution and such sanctions must be lifted as soon as the crisis is resolved. The resolution of the Ukrainian conflict is a non-

negotiable condition for renewing a dialogue that must be oriented towards a more comprehensive agreement that benefits the EU, Russia and the border countries that lie between them.

The main objective is to ensure that the ceasefire in the Donbas outlined in the Minsk II agreement is thoroughly and permanently respected so as to end the current humanitarian crisis, attend the needs of the civil population and lay the basic foundations for the next step forward. Should there be violations of the ceasefire, it will be necessary to up the pressure on Kyiv and Moscow until both sides respect it. Supplying arms to Ukraine would be not be best way to achieve this goal, given that Russia would most likely react by sending arms to the rebels, unleashing an escalation of the conflict that must be avoided in view of the severe consequences it could entail. Our mission is not to stoke the crisis, but rather to defuse it.

Whatever solution is finally agreed upon, it must guarantee respect for the territorial integrity of Ukraine, which theoretically should be understood to include Crimea and Sevastopol, both of which should revert to Ukraine in line with international laws and treaties. Nevertheless, as it would require a major political turn of events in Moscow, it is not realistic to hope for such an outcome. No proposal contingent upon the reintegration of Crimea and Sevastopol into Ukraine could ever succeed. However, there is no reason for either Kyiv or the EU to recognise their annexation to Russia. Both can continue to defend their positions on territorial integrity, but must be prepared to keep working towards a peaceful solution even though this objective is not achieved.

On the other hand, the reestablishment of Kyiv's control over the Donbass and the border with Russia must be non-negotiable bargaining

points. Occupied zones cannot be allowed to become frozen conflict points like Transnistria, South Ossetia, Abkhazia and Nagorno-Karabakh. Reunification and the disarmament of secessionist militias must include guarantees that the populations of rebel areas will not be subject to reprisals and that special statutes accommodating local identities will be negotiated for these zones. Although both of these conditions have been enshrined in the Minsk II agreements, convincing the Ukrainian Parliament to approve them will not be easy. It is clear that some kind of federal system would be the best solution for a country with a divided identity. However, for such an arrangement to work, the Donetsk and Luhansk oblasts as well as others such as Kharkiv and Odessa would need to have a significant degree of autonomy and the possibility of maintaining economic and cultural ties with Russia without jeopardising the political unity of the country.

The stabilisation of Ukraine and the normalisation of relations with Russia hinge on an additional key condition: the renunciation of Ukraine's plans to join NATO. Putin has probably already assimilated the idea that he cannot count on Ukraine to become a member of the Eurasian Union and that this country's alignment with the EU is irreversible. He has no option other than to accept these facts. However, Ukraine's integration into the Atlantic Alliance would be perceived in Moscow as a major threat to Russian security and provoke tensions that could lead to new cold war. Non-NATO EU states such as Finland that do not have security problems serve as precedents. Neutrality is the best stance for a border country with a divided identity like Ukraine to take. Its security, like that of other Eastern Partnership countries, must be guaranteed within the framework of a definitive

agreement with Russia in which the EU would have much a greater voice and more compensations to offer than NATO.

The EU must provide Ukraine with financial and technical aid firmly pegged to deep political and structural reforms that will reduce corruption, modernise government operations, the judiciary system and security forces, and transform the country's oligarchic and corporatist economy.

The resolution of the Ukrainian conflict (even if the Crimean question is put aside) should serve as a springboard for renewing an EU–Russia dialogue towards an ambitious successor agreement to the Partnership and Cooperation Agreement that guarantees oil and gas supplies to the EU and serves as a forum for addressing other issues of international importance, especially the fight against Jihadist terrorism and the pursuit of stability in the Middle East.

During a speech delivered in Berlin in July 2008, Russian Federation president Medvedev proposed a pan-European security treaty to include Russia and possibly even Central Asian republics, but the EU turned a deaf ear. Once a

solution to the Ukrainian conflict has been reached, the time may be ripe to consider the possibility of including arrangements for common security in the new agreement with Russia.

At the 23 January session of the World Economic Forum in Davos, Angela Merkel offered to open negotiations between the European Union and the Eurasian Economic Union towards the creation of the free trade area from “Lisbon to Vladivostok” that Vladimir Putin had called for in 2010, if a resolution to the Ukrainian crisis could be found. Such a project would free Eastern Partnership countries from the burden of “choosing camps” and create a climate of confidence and cooperation that could help prevent the outbreak of future conflicts. The road towards such an agreement, which will be long and difficult, begins in the Donbass. Nonetheless, it must be travelled with patience and firmness from the unwavering perspective of EU unity, for the outcome could prove to be tremendously positive in terms of the peace and prosperity of all European countries, including Russia.



# Assessment of the jihadi threat and the response strategies

Jesús A. Núñez Villaverde

The first condition for devising an appropriate strategy in response to jihadi terrorism is to have set of solid concepts and foundations common to all those who feel affected by the threat that it poses. In this respect, we are found wanting. Still today, despite the thousands of terrorist acts that take place each year and the considerable number of organisations classified in this way, we simply do not have a single and agreed concept in the international community on what we should understand by terrorism.

If we go back to the tragic attacks of 11 September 2001 in New York and Washington (9/11), we will remember that when the UN General Assembly finally got underway its members assigned themselves the task of reaching an agreement on the matter in the belief that it was an essential component of the necessary multilateral response strategy in the face of a threat that we all felt. However, neither on that occasion nor throughout the years in which the Executive Directorate of the Security Council's Counter-Terrorism Committee has been dealing with the issue has it been possible to bridge the deep differences that exist. To this day, that

deficiency continues to obstruct the adoption of multilateral, multidimensional and prolonged response strategies that address both the most visible effects of the problem and the structural causes that serve as a breeding ground.

## **Catalogue of intentional errors**

In no way has that stopped terrorism from capturing the obsessive attention of the most prominent international players (with the United States during the George W. Bush era as the chief instigator), to the extent that many today try to single it out as the biggest threat to international security. Those who have been acting in this way, with a rhetoric that is as mistaken as it is self-interested, use the vagueness of the term to their advantage to interpret it as they please, simply selectively classifying as terrorists those who are their enemies. They would rather forget that terrorism is just one form of violent action, to which many very different players turn as another instrument of violence to achieve their ultimate goals. In other words, the

term terrorist does not always define a specific player, whose elimination it is possible to plan and execute, but a way of acting that is elusive by definition and, though it may pain us to admit it openly, impossible to eradicate in the medium term.

Alongside the distorted use of the term, and since the appearance of the “clash of civilisations” model promoted by Samuel P. Huntington in 1993, a powerful line of argument has also sprung up, pointing to Islam as the new enemy to be defeated. With the aim of reinforcing the most negative aspects of what had already been dubbed “the green threat” (green being the colour of Islam), nor did the promoters of the idea have any qualms about manipulating the concepts. A self-interested view has been built up that lumps together Islamism –the mark of identity of all Muslim believers–, radical or reformist political Islamism –which adds a political component to define the groups, such as the Muslim Brotherhood, which mean to win power imposing Islamic law in all aspects of domestic life– and jihadi terrorism, which is the term used to describe the individuals or groups –such as Al-Qaeda– that choose terrorist violence to achieve their goals, trying to justify their acts with a twisted view of jihad. And all too often we also find that, disregarding the diverse reality and erring once again, the use of the term “Islamic terrorism” has caught on. It is as inappropriate as it was to use “Basque terrorism” when referring to ETA. Obviously, the Basques are not terrorists and nor are the vast majority of the some 1.6 billion Muslims on the planet.

None of that means that jihadi terrorism is an imaginary or inconsiderable threat. Unfortunately, it is only too real and as the Global Terrorism Index 2014 (drawn up by the Institute for Economics and Peace) reminds us, in 2013 there were some 10,000 terrorist attacks throughout

the world that claimed the lives of 17,958 people (bearing in mind that in half of them there were no fatalities). It is worth highlighting –in order to consider its important appropriately– that more than 80% of those terrorist acts were reported in just five countries (Iraq, Afghanistan, Pakistan, Nigeria and Syria), which reinforces the idea that the chief victims of violent jihadism are Muslims. In fact, if we take into consideration the data for the period 2000-2013, during which time some 107,000 terrorist acts were reported, only 5% of them took place in OECD countries. Lastly, of the 13 countries that the document listed as those in which it was possible to foresee an increase in terrorist violence in the near term, only Israel and Mexico can be described as Western.

It is, then, a global threat (out of the total of 162 countries surveyed in the above mentioned analysis, 60 reported at least one death because of a terrorist attack last year), chiefly carried out by jihadi groups (DAESH, Boko Haram, the different groups identified as Taliban and Al-Qaeda and its associated franchises were responsible for 66% of the total) that basically afflicts Muslims and which is responsible for 40 times fewer dead than homicides (11,133 in 2012, compared with 437,000 murders).

### **We are not at war**

These preliminary considerations and data enable us to draw some immediate conclusions that go against the tide of opinion expressed in various circles again in the wake of the reprehensible Paris attacks. Contrary to what the French prime minister said following the impact of the 17 dead in the attacks on 7 to 9 January, we have to insist that we are not at war. It is worth recalling on this point that Bush too chose to



describe the international scene in this way following 9/11, as the grounds for undertaking the invasion of Afghanistan (October 2001) and Iraq (March 2003). There is no doubt that we have to fight the threat, but war –which by definition means handing the military the lead role in the response– is not the best strategy.

Basically, it is a matter of understanding that in general terms the armed forces are not equipped, trained and even motivated to perform in these circumstances. Without getting carried away by the academic arguments and critical theories regarding the prevailing militaristic approach of the last decade, we have the cases of Afghanistan and Iraq to remind us that the Taliban have not been eliminated and nor has Al-Qaeda in Iraq (now DAESH). On the contrary, as a result of the application of a militarized agenda in every dimension (in which there has barely been room for other necessary social, political and economic instruments) and after an accumulation of considerable political and military errors, both countries still remain very active theatres for jihadi groups today.

### **It is not the greatest challenge for European security**

If the experience of the Cold War had not been enough, at the beginning of the 1990s we came to realise that security is a concept that goes way beyond the field of military defence. We learned then, once the bipolar confrontation had been overcome, that the threats affecting our security were not limited to a devastating nuclear holocaust or the dreaded invasion of Western Europe by Warsaw Pact troops. We finally learned that pandemics, climate change, uncontrolled population flows, organised crime, the destabilizing potential of illicit trade, failed

states, exclusion and poverty, the proliferation of weapons of mass destruction and, of course, international terrorism were high on the list of threats facing us in the globalised world in which we happen to live.

Similarly, we also learned that they were transnational threats and risks that no country could tackle on its own with any real prospect of success and that they were rooted much more in social, political and economic issues than in purely military considerations. As a result, we concluded that it was necessary to reformulate the concept of security to take in many dimensions that had been neglected before then –food, energy, economic, political, health security and so on–; that multilateralism had ceased to be an option and become an obligation and that the answers would have to be essentially non-militarist, ceding centre stage to social, political, diplomatic and economic instruments, while the military featured only as the last resort.

Despite the new analysis, which stressed the importance of human security as the ambitious paradigm towards which efforts had to be geared, it was not possible to change the prevailing course that led NATO (an essentially military organisation) to include international terrorism in its strategic concept of 1999, assigning itself the task of responding to the threat that it posed. The 9/11 attacks prompted a definitive return to mindsets that had seemingly been superseded, with unilateralism and militarism as the standards and the US intention (which fortunately failed) to make preventive war a third rule of the game to legitimise the use of force (along with legitimate defence and an explicit mandate from the UN Security Council).

As a result of a process in which there has been no hesitation to resort to spreading fear among the population, the fine balance between

freedom and security has been tipping in an increasingly visible manner towards a cut in the framework of fundamental rights that define us as open societies with the promise (a false one, as it is impossible) of complete security for all. It is an old method, but, unfortunately, no less effective for that; in such a way that under the paralysing effect of the fear of suffering a terrorist attack that is presented to us as imminent, we tend to lose sight of reality—a reality that insists on reminding us, we who have the privilege of forming part of the European Union (EU) as members of the most exclusive club on the planet in terms of welfare and security, that there are many other security challenges to which we are not providing an adequate response.

Therefore, if we take human life as the yardstick to gauge the seriousness of the threats afflicting us and as an asset of incalculable value that must be preserved above all other considerations, we can come to the conclusion that we are not prioritising the issues that really concern us appropriately. Looking within the EU itself, the growing inequality gap in our societies is by far such a top-tier problem that it may upset our much-envied model of economic and socio-political organisation. Looking beyond the EU, we can immediately see that none of the threats and risks that we had identified over 20 years ago now has disappeared; on the contrary, they are growing stronger by the day because of glaring neglect.

We do not live in a safer, more just and more sustainable world today than when we were subject to the balance of power between the two contenders for world leadership and nobody can consider themselves satisfied with the level of effort made to remedy the ills that afflict us. Without the slightest hint of demagoguery or populism, one only need remember that there are 2.6 billion people in the world who do not

have access to a basic toilet and we know only too well that it means that every year more than 800,000 children under five die because of something as simple as diarrhoea. Hundreds of thousands of women are raped every year without any consequence. Are those lives any less valuable than those lost in a terrorist attack? Are they more difficult to preserve than those that the violent jihadis put at risk? We face constant dangers and we must consider what resources we allocate to tackle each one of them, without giving way to self-interested and selective hysteria that ignores implementing solutions that are within our reach (such as those already mentioned, or the elimination of hunger in the world) and which leads us to obsessively channel resources and time into one problem alone, which, as has already been said, is not the one that causes most human suffering.

In short, as a result of that disturbing approach, which is still in good health today, security has once again acquired a clear militaristic bent and the spectrum of threats has once again been reduced to one: terrorism. If at the beginning of the last decade everything appeared to boil down to Al-Qaeda, today it is DAESH that serves the same purpose.

## Threats and responses

Despite the insistence on rhetoric that magnifies violent jihadism, portraying it as the embodiment of the only threat worthy of being taken into consideration and as a hierarchical network united in a common cause, it is useful to recall that, on the contrary, there is a multiple reality. There are many groups that could be described with the term, but there is nothing to confirm the existence of a cohesive and homogenous jihadi international, other than that many of

them follow a similar *modus operandi* and that some of their leaders have global delusions. In fact, and under the impact that DAESH's violent return to the stage is having today, what is being detected is a growing internal fragmentation, with individuals and splinter groups that break away from their original organisations (affiliated in varying degrees to Al-Qaeda or the Taliban) and which are quick to publicly declare their loyalty to the group that currently appears to be the most active and, though it may sicken us, most attractive in the eyes of those who have radicalised to the extent that they believe violence to be the only means of achieving their goals.

Neither Ayman al-Zawahiri, at the head of Al-Qaeda, nor Abu Bakr al-Baghdadi (who has now become the self-styled Caliph Ibrahim), in charge of DAESH, have the capacity to coordinate the efforts of so many jihadi groups that only symbolically consider themselves to be part of one of them. Neither of them is at the top of an operational chain of command capable of mobilising all the combatants enlisted in the jihadi ranks. In most cases, while there is evidence of ties among groups, each one acts independently, though they feel inspired by the same or similar ideas - ideas with which, it is also worth highlighting, not all of them identify ideologically, but which very often only serve as a mere front for bandits, criminals and mercenaries of all kinds (Libya today is a very good example, as was Afghanistan before it).

## **DAESH**

DAESH has been around for quite some time in the Middle East. One only need recall that it was already operating in Iraq a decade ago as the local franchise of Al-Qaeda, under the leadership of the Jordanian Abu Musad al-Zarqawi

(who was eliminated by Washington in 2006). Even then, despite its limited means, it stood out on account of its jihadi activism in both Iraqi and Jordanian territory. Its limited importance kept it from controlling a territory of its own effectively yet, but, in keeping with the ever ambitious aspirations of Al-Qaeda, it already aimed to establish an emirate, which would serve as springboard for creating a caliphate that would take in the entire Islamic world.

Further depleted following the US "surge" that began in 2007, the group did not rise to any sort of prominence again until the end of 2011, as one of the violent groups immersed in the conflict that had engulfed Syria for some months. In its participation in the Syrian conflict –under the name Islamic State of Iraq and Syria (ISIS) at the time and still as part of Al-Qaeda– it did not dutifully follow the guidelines laid down by Al-Zawahiri, Bin Laden's successor at the head of Al-Qaeda. In fact, disobeying his orders –which required Al-Baghdadi, the new leader, to leave the Syrian battlefield in the hands of the local branch of the terrorist network, Al-Nusra Front–, ISIS expanded its radius of action not only to the Syrian provinces in the east, but also to Aleppo, even carrying out isolated action on the Mediterranean coast.

With a reputation as a highly disciplined and operative group, ISIS enlisted combatants from diverse backgrounds (including radicalized Westerners), rising to an estimated volume of 15,000 armed militants at the beginning of the offensive launched on Iraqi soil in early 2014 (in Fallujah and Ramadi, in the western province of Al-Anbar, chiefly). This remarkable recovery was not unrelated to Saudi Arabia's interest in funding Sunni jihadi groups in both Syria and Iraq that it aims to use as a spearhead to reverse the advantage that Iran is slowly gaining in its bid to become the regional leader.

Following the proclamation of the caliphate on 29 June, and now under its current name, DAESH has tried to make the most of the power vacuum in Baghdad and win over a good part of those who Nouri al-Maliki (now ousted from the post of prime minister) had gradually disappointed for various reasons. DAESH, then, has been able to add several Sunni militias - such as Jamaat Ansar al-Sunnah, Jaish al-Mujahiden and Naqshbandiyya Way - to its own forces. It also enjoyed the initial calculated passiveness of the Kurdish Peshmerga, who were waiting for Al-Maliki to be more generous with his economic offers (increasing the percentage of national oil revenues agreed between Baghdad and Erbil, set at 17% of the total until then) and political concessions (guaranteeing the election of a Kurd to replace the head of state and more clout in the new government led by Haider al-Abadi). Lastly, another factor that explains the apparent success of the first phase of its offensive was that it benefited from the considerable lack of motivation on the part of the Iraqi military units located in the middle ground between Baghdad and Iraqi Kurdistan. A large percentage of them were Sunni soldiers who had no desire to face enemies from their own doctrinal branch. In fact, there were no real battles for control of places and zones of strategic value, rather a widespread and hasty withdrawal on the part of the government forces (action that the government in Erbil immediately made the most of to increase its dominions by 40%, including the important oil zone of Kirkuk, thanks to the rapid deployment of its Peshmerga).

Yet in the face of the evident threat, and as if we had failed to learn hardly anything over the last few years, the response once again has been the activation of an international coalition led by Washington, which since 8 August has been carrying out a campaign of air strikes

against DAESH on Syrian and Iraqi soil. At the same time, the training of Iraqi soldiers and Kurdish Peshmerga is now under way in order to launch a ground offensive within a matter of months.

The problem is not the repeated use of military instruments at this stage. It is clear that at present there is not the slightest possibility of negotiating with DAESH (all the more so following the farce with Jordan that followed the capture of one of its pilots last December) and the basic goal today is its elimination. However, that cannot conceal the fact that, on the one hand, what has happened is largely the result of past mistakes, both those made by the local governments and by the Western powers by backing partners who are hardly renowned for their democratic leanings and who use their power to subjugate populations they do not like, believing that they always had them under control; and on the other, that without a parallel effort (and one that is more important than the purely military one) in the social, political and economic field, it is only possible, at best, to buy some time before the problem flares up again even more seriously.

At this point, and despite the uncertainty that currently characterises the state of war in which DAESH and its makeshift allies, on the one hand, face the United States at the head of a coalition that even Panama has just joined, on the other, it is feasible to predict the outcome in the medium term. Under the impact of the US military machinery (with the occasional contribution from Arab countries such as Jordan, the United Arab Emirates, Bahrain, Saudi Arabia and Qatar) DAESH has seen its offensive in both Syria and Iraq held back, forcing it to cling to the ground conquered up to last summer and admitting defeat in places that it had defined as emblematic (Kobani and Deir ez-Zor, both of

which are in Syria). However, as military history has shown us so many times before, air strikes have a limited effect against combatants dug in on the ground who also make very imaginative use of their capacity to concentrate and disperse forces without offering worthwhile targets in the majority of cases, combining terrorist action with action of an insurgent nature, but also entering into conventional combat when they consider it necessary. In this way they have managed to control a territory of some 55,000km<sup>2</sup> straddling Syria and Iraq and which is home to around 6 million people.

With the added factor of the foreseeable phase of ground combat –which has no guarantee of success–, it is possible to imagine that the structure of DAESH will be seriously damaged. While in the medium term it may be possible to imagine that there will be an overall weakening, it is also very possible to anticipate that it will reappear under a different name and on another stage - without forgetting that in the near term it is still in a condition to continue causing a great deal of problems for its enemies (both local and international).

### ***And the rest***

While DAESH practically monopolizes media attention at present, the jihadi threat is not confined to the misnamed Islamic State. We should not forget that Al-Qaeda remains an established force, in terms of both its central core - located in an area straddling Afghanistan and Pakistan, though considerably weakened following more than a decade of pounding on the part of Washington –and its main franchises– with the Yemeni and Maghreb branches occupying a prominent position, along with the myriad small local groups that adhere to its ideological line

and even the so-called “lone wolves,” inspired by the jihadi creed. This terrorist conglomerate retains the capacity to strike indiscriminately in many places and it will certainly try to make the most of any window of opportunity that arises (for instance, a concentration of effort against DAESH that eases the pressure on its forces) to return to the fore.

For their part, the violent groups that come under the generic term of Taliban continue to show clear signs of activism, in both Afghanistan and Pakistan, though there is nothing to suggest that they appear to be planning to extend their sphere of action beyond those territories. The same can be said of Boko Haram, which is chiefly concentrated in the northern states of Nigeria, though it carries out violent action in neighbouring countries (such as Chad or Niger) from time to time. In both cases, they must be taken into consideration, given their capacity to destabilize the countries where they operate, but they lack the transnational dimension that DAESH and Al-Qaeda have today.

### **Notes on an alternative response**

Seen from the West, the data mentioned above discredit those, like the Spanish foreign minister, who in the wake of the Paris attacks would like to convince us that jihadi terrorism is the biggest challenge to the security of the European Union. No matter how distressing its effects, it is not - not in terms of the number of dead it causes compared with so many other war-related factors, and certainly not in terms of its capacity to cause the collapse of our states. We must be clear on this point, in the understanding that terrorism is a scourge that is going to be with us for a very long time, accepting that there are no short cuts to eliminating it and,

being realistic, acknowledging that the goal is to reduce it to a level that is tolerable for our societies. Instead of frightening the population, cultivating a culture of fear that paralyzes us and keeps us quiet while fundamental rights and freedoms that define us as open societies are cut, it would be a good idea to devote more effort to devising strategies that are not limited to mobilising military resources against an enemy that it is impossible to defeat by those means.

An exercise of this type should consider it necessary to simultaneously address the most visible effects of the problem – thwarting terrorist plans where possible and pursuing, arresting and trying those who perpetrate this kind of action, if the former is not possible – and its structural causes – focused on the radicalisation of individuals who, for multiple reasons, feel discriminated in their communities of reference. On the first level of response it seems clear that the leading roles should go to the police and intelligence services, as well as the economic authorities (to short-circuit the channels that they use to fund their criminal activity) and the courts (to ensure effective and common treatment of the problem). All this should rest on a foundation of close international coordination, since we are facing a common threat. The armed forces can play only a supporting role here, complementing security tasks in the service of the global fight against terrorism.

On the second level, which should address the structural causes that fuel terrorism, it is clear that military means have virtually nothing to contribute. The fundamental issue in this case is to take a preventive approach, geared to averting the radicalisation of individuals who for various reasons are tempted to enlist in violent jihadism. Instead, what takes a prominent role at this stage is, from a domestic viewpoint, the appliance of a sustained effort that places the

emphasis on the educational field and moves physical and human resources in the social, political and economic fields to ensure the full integration of all those who make up each national community. That means developing a preventive approach that encourages policies geared towards narrowing the gaps of inequality to acceptable levels, reinforcing the framework of rights and freedoms for all its members, without exclusion. We are talking about the need to reinforce inclusive education systems and promoting media that are determined to stop the spread of xenophobia and racism, but also about policies focused on ensuring true equal opportunities.

On the foreign front, the list of tasks is equally long. While it is by no means exhaustive, it includes:

- Demanding of ourselves greater consistency between the values and principles that we say we uphold and the type of relations we maintain with Arab Muslim governments that are hardly sensitive to the demands of their own populations (Saudi Arabia stands out in this respect as the most striking case). Trapped over the last few decades in a mindset in which the stability of our neighbours has taken precedence over all other considerations, our governments do not appear willing to offer their decisive support to the citizens' movements of our neighbours, in fear of encountering undesirable interlocutors who may jeopardise our energy security. This is one of the main reasons behind the anti-Western feeling present in broad circles of opinion in those countries.
- Making a more determined contribution to eliminating the international double standard that has been applied for too long when it comes to judging the conduct of certain countries (a prominent example being Israel

when it has invaded sovereign territory on different occasions without consequence; compared with examples such as Operation Desert Storm in 1991 to force Iraq to leave Kuwait). We know only too well that the reality, along with the persistence of the Palestinian-Israeli conflict, is used constantly by the jihadis to try to justify their violent action, presenting it as the only possible response in the face of what they interpret as discrimination against Arabs.

- **Avoiding the demonisation of Islam and radical Islamism**, not only because this type of political movement has amply demonstrated that they have the broad support of the local populations –which means that they are here to stay and that there is no way out of the tunnel that these societies are in without their participation–, but also because the most basic strategy requires drawing a clear line between those who choose violence and those who reject it. In the same vein, it is highly advisable to establish permanent channels of dialogue with authorized representatives of Islam who are accepted and

respected in those societies as preferred partners in order to isolate those who use violence.

- Employing the many powerful national and community tools –which are especially significant in the commercial and financial fields, but also in the sphere of the peaceful resolution of conflicts– to close the gaps of inequality that characterise the Mediterranean Basin. None of the formulas applied so far by Brussels has managed to even narrow the gap, let alone improve the chances of the majority of our neighbours to the south and east of being able to aspire to a decent life, subjugated as they are by failed, ineffective and authoritarian governments.

Granted, none of this guarantees the success of the venture and nor does it protect us completely from possible violent outbursts. There is no magic formula that is valid for every case, nor will it have an immediate visible effect. Yet in the face of militarist misadventures that have clearly demonstrated their limitations, it is high time to set the wheels in motion. Or will we never learn from our mistakes?





# Towards a federal Europe

Francisco Aldecoa, José Candela, Carlos Carnero

## **The European Union is on the move**

There have been numerous demonstrations during 2014 and 2015 that have shown that Europe is still full of life. As an example, we could cite the demonstrations in Paris and other major cities on 11 January 2015, in which millions of citizens marched in defence of the European model of freedom, democracy and coexistence, in one of the clearest assertions of European identity in recent years.

One of the major challenges facing the EU is how to give political and constitutional expression to this maturing European identity in the current legislature. This would reduce the feeling of disaffection that some sectors of society have towards the Union, it would encourage greater participation and, above all, it would bolster the belief that through the construction of a federal European Union it is possible to reconquer the rights lost during the last six years of crisis.

The aim of this chapter is to analyse progress in the European Union with respect to democratic legitimacy since the European elections of May 2014, and the effect this is having on the configuration of its fundamental institutions: not only the Parliament and the Commission, but also the Council, which should be configured as a second chamber or Senate. We also consider the demand from citizens for more visible, more effective participation in the European

political system, taking into account the shortcomings of this system and seeking to develop its potential, which would justify far-reaching reform of a federal nature through a 3rd European Convention, with full citizens' participation and with an explicitly federalist logic that would embody the dual legitimacy of a union of citizens and a union of states.

Our aim is to examine the capacity of a reformed European political system to satisfy the demands raised by European citizens in response to the crisis that began in 2008 and which has threatened the European social model, a model based on striking a balance between the market, society and the state, a model that has differentiated European capitalism from capitalist systems elsewhere in the world. To do this, it will be necessary to strengthen European democracy, to promote policies for growth, to develop and consolidate the social model, and to strengthen the role of the Union as a global actor striving to transform global governance in order to defend human rights and fight poverty and inequality through policies that are increasingly subject to mandatory international regulation.

We also consider the need for the capacity to reform the Treaties through the European Convention, avoiding the requirement for unanimity among member states, perhaps by means of a European referendum. Given the publicly stated decision not to expand the Union

during this legislature (that is, until 2019) this opportunity should be grasped before the admission of new members further complicates the process of reaching agreement at the heart of the institutions of the European Union.

### **New progress towards federalism: the European elections of May 2014**

The elections to the European Parliament in 2014 were the first held since the Lisbon Treaty came into force, article 17.7 of which states: "Taking into account the elections to the European Parliament and after having held the appropriate consultations, the European Council, acting by a qualified majority, shall propose to the European Parliament a candidate for President of the Commission. This candidate shall be elected by the European Parliament by a majority of its component members."

These elections achieved something that the majority of observers doubted was possible, namely the election of the President of the Commission and the Commission itself as a consequence of results at the polls. It is therefore important to stress the continuing relevance of the drive towards federalism, and to ensure that this development is to the benefit of citizens.

This should be linked to the major federal achievements of the past 35 years, such as elections to the European Parliament by universal suffrage in 1979, the disappearance of borders since 1992, the insertion of the concepts of "European citizenship" and "social and economic cohesion" into the Treaties since 1993, the birth of economic and monetary union and the creation of the euro as a single currency since 1999 for eleven states (today, fifteen years later, the number has grown to nineteen), the creation of a shared space for issues such as freedom,

security and justice, the development of a joint foreign policy and the creation of joint diplomacy since 2009, and the recognition of the legal value of the Charter of Fundamental Rights.

It is important to note that this federalist progress has not been the result of technocratic concessions but has, rather, been delivered by pressure from citizens' representatives through the European Parliament since it was elected by universal suffrage in 1979 and, in particular, following approval of the Proposal for the Treaty on European Union in 1984. In fact, the need for a federal European Union has been evident in all subsequent constitutional reforms.

In any event, it is important to note that the European Union today is different from the European Community of the 1960s and that while, for the Community, the key innovation was the new concept of sovereignty (that of shared sovereignty, something that until then was unheard of), the Union has continued to develop from that starting point and is increasingly characterized by what can be termed "intergovernmental federalism". In other words, federalism is already a reality, but one influenced by the power of states that refuse to complete the work of constructing the European edifice.

### **The 8th Legislature (2014–2019): a new beginning for Europe**

We can think of this legislature as the start of a new European political cycle, because it offers an opportunity to strengthen the legitimacy of institutions, especially the Commission (which is increasingly coming to resemble a fully-fledged government) but also the Parliament, which has grown in power with respect to the European Council and the Commission, which are likely to see a reduction in their influence on the Union's

decisions if there is a full and much-needed return to a shared method of operating.

This new cycle has begun with the development of an ambitious programme, sustained by the three major pro-European political forces (People's Party, Party of European Socialists, and Alliance of Liberals and Democrats for Europe), set out in President Juncker's inauguration speech on 15 July 2014, supported by approximately 60 per cent of the European Parliament, a clear majority that reflects strong support for the implementation of these commitments by the Commission.

This programme is innovative in some areas, such as the Plan for Investment for Growth or the establishment of a "more powerful player" in world politics. However, it is insufficient in other areas, such as defence of the European social model or the need for constitutional reforms in a federal direction, in which regard the programme rules nothing in or out, although there was, to a greater or lesser degree, a clear commitment to such reforms in the election manifestos of the main political forces mentioned above and during the campaign itself.

As a result, this legislature differs from those that preceded it: firstly, because the President of the Commission has been appointed taking into account the results of the elections, as seen in the vote in favour by the majority of the Chamber; and secondly, because the European Parliament will henceforth more closely resemble national parliaments in the way it operates, with some groups supporting the government and others opposing it.

### **A Parliament with more legitimacy and more political power**

The results of the European elections (despite the fears of a Eurosceptic victory) produced a Parliament with a clear commitment to the European project, which will provide political stability and majorities in favour of the reforms needed. At the same time, these results show that governability is easier in the Europe-wide context than in some member states, with clearly anti-European parties, whose commitment to democracy is questionable, winning in France and the United Kingdom, for example, although in other countries these populist and anti-European forces, while making progress, failed to achieve victory at the polls.

The new European Parliament differs in its composition from the preceding legislature. The People's Party, together with the Alliance of Liberals and Democrats for Europe, no longer have an absolute majority. The gap between left and right has shrunk, and for the first time a single president (German social democrat, Martin Schulz) will remain in office for the full five years of the legislature. Previously, this position was shared between the People's Party and a member of the Party of European Socialists, with each party nominating a candidate for two and a half years.

Within the European Parliament, none of the six largest parliamentary groups contain any of the anti-European parties, which have either established weak and insignificant political groupings of their own or have ended up in the Non-Attached Members group. In other words, they have almost no influence over the European political decision-making process, and only use the Parliament to publicize their own existence.

As a result, the European Parliament is already very close to functioning according to the

same logic as the national legislatures of the member states (government and opposition) although it is possible that it will have more power than these. What it lacks is the power to initiate legislation, although this shortcoming may be remedied through inter-institutional agreements. In addition, its budget-setting powers need to be extended to include some areas that are not currently covered by co-legislation.

The European Parliament is becoming the most important legislature in the world, of relevance not only to European internal politics but also to the development of global policy, as a voice that expresses the wishes of European citizens in the world in a way that is quite different from other international parliaments.

In addition to using its legislative powers to deepen the federal progress already achieved, the European Parliament should propose a comprehensive alternative with the objective of completing the European political system by providing a new constitutional framework, and should have a strategy for achieving this during the 8th Legislature, as was the case during the 1st, which gave rise to the Draft Treaty of 1984, and in driving forward the 2nd European Convention (2002-2003), which produced the first Constitution of the European Union.

### **The European Commission: towards a democratic European government**

Due to the fact that, for the first time in its history, the European Commission derives its mandate to a large degree from the results of elections, its democratic legitimacy and inter-institutional political influence have increased. This means that, with the necessary political will, the executive of the European Union can change the direction of European policies, replacing the strict adherence to

austerity with public spending policies designed to promote growth and employment. This is the only way in which European citizens can feel fully involved in the construction of Europe.

However, while this increased legitimacy means that the Commission more closely resembles a democratic government, it still suffers from a degree of deficit. Under the Treaties (as interpreted by the member states) it has been necessary to incorporate commissioners proposed by national governments. As a result, the dual legitimacy of the Union (citizens and states) continues to be tilted in favour of the interests of states in terms of who exercises executive power during the five-year legislature. By way of compensation, the political actions of the Commission will increasingly be influenced by the majority within the European Parliament that has appointed it, and such actions will have to be consistent with the programme democratically endorsed by the chamber.

While it is true that the new Commission is more legitimate than those that preceded it, the effectiveness of the Commission depends on its structure, an area in which there is plenty of scope for improvement. For example, an excessive number of Commissioners makes collective decision-making difficult and reduces the results of government action. Although the Juncker Commission has developed a new system based on team-working (referred to as “clusters”), it is possible that this will be insufficient as there are still too many Commissioners to whom competencies need to be attributed. The maximum ideal number of Commissioners – which, fortunately, the treaties continue to establish as being two thirds of the number of member states – will only be implemented with effect from 2019.

As a result, while the legitimacy of the Juncker Commission is greater than that of any of its predecessors, it is unclear that it will be

fully effective, given both its composition and the basis on which it must operate.

The Commission, as the driver of the European project, should use its monopoly on legislative initiative to move beyond the period of austerity that European citizens have suffered. Following the first months of the new Commission's existence, it is clear that there has been a significant change with respect to the past, with this Commission generating significant political initiatives. The impact of the new political balance—reflecting a Parliament that is more progressive, more federalist and thus more ambitious—is also clear, although it is still too early to reach any definitive evaluation of how it is operating. However, the limitations of its mandate will need to be addressed when reform of the Treaties is considered at the next European Convention.

### **A “union of citizens and states”**

The response to the current economic crisis, which began in 2008, has been conservative, applying inappropriate policies of rigid austerity that have produced no positive results, have endangered the basis of the European social model and have paralysed growth, particularly in southern Europe. Many of these policies should be corrected as a result of the application of the “New start for Europe” programme, referred to above.

In addition, there is both the need and the opportunity to undertake the constitutional reform that would deepen the European Union, strengthening its political system along federal lines in order, in the words of Leo Tindemans in 1975, to “put the political roof on the building”, so that storms do not wash the whole edifice away, as has nearly occurred during this crisis.

Citizens demand the adoption of policies that reflect their needs and aspirations, particularly

with respect to social issues, the economy and the restoration of the basic rights that the crisis has weakened or threatened. It is important to note that in the two latest Eurobarometers of 2014, disillusionment with the European project has fallen, something which is not true with respect to national political institutions, particularly in the case of Spain. It is also interesting to note that, while the media stress the lack of support for European institutions, they ignore the far greater lack of support for national institutions, particularly parliament and the government. Moreover, this lack of national support is on the rise, while in the case of Europe it is declining. However, there has also been a shift in this trend since the European elections in spring 2014.

### **The constitutional logic of Treaty reform**

For all of the above reasons, we believe that, in order to address the problems of the EU, it is not enough simply to apply the Treaty provisions by developing new policies of a progressive, federal nature. Instead, we must recognize that the Treaties themselves contain limitations that need to be corrected, and this means that Treaty reform is essential.

There are at least six underlying factors that limit the democratic and progressive operation of the European Union and require federalist reform to:

- Improving democratic legitimacy. We need to bring the institutions and treaties closer to the citizens, so that the latter have ownership of the European construction process. And this means not just reforming them, but simplifying them and giving them the form of a Constitution. The Lisbon Treaty could be seen as a constitution in all but name, as it contains some of the key elements of such a

document, including a charter of fundamental rights, a division of powers or functions, and a legal framework for the authorities. However, this message has not reached citizens and they are therefore unaware of it. In its current wording, it is practically impossible to understand it. To do this, it will be necessary to change the form of the treaties, simplifying them and setting them out as a constitution.

- Developing the rights implicit in the category of European citizenship and, in particular, protecting the social model and improving participatory democracy. To do this, a new legal framework must be incorporated into the new Constitutional Treaty.
- Addressing the reform of common institutions, particularly the European Parliament, giving it greater legislative power, and also the Council of Ministers, which should be transformed into a second chamber. It may also be necessary to reform the Economic and Social Committee and the Committee of the Regions.
- The reforms affecting the economic governance of the Union adopted in the previous legislature should be incorporated into the primary law of the Union, as should the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, which only lasts for five years, is due to expire in 2017, and has only been signed by 26 states within the framework of international public law.
- Reform some elements of the Treaties, particularly those relating to the link between European diplomacy and the diplomacy of member states, and develop a joint defence and security policy, with the aim of making the European Union a leading player in global politics.
- Incorporate into the Treaties the possibility of reforming them without the need for

unanimity among member states, with the aim of enabling the major political progress that the Union needs.

At the same time, there are some basic political demands, such as a minimum salary, basic income or minimum pension provisions that require a reform of the legal basis of the Treaties.

There are also numerous technical issues that require Treaty reform, particularly with respect to the need to provide a solid legal basis in areas such as social rights, economic governance, energy, climate change, migration policy or border control, among others.

Some federalist reform of the Parliament, the Commission and the European Council will also be necessary, while we should be careful not to neglect issues relating to the European Central Bank and possibly to the Committee of the Regions and the Economic and Social Committee.

### **Towards the 3rd European Convention**

These reforms cannot be implemented through the abbreviated procedure of working through Treaties, as they are not just technical reforms but also reflect the necessary and essential development of the federal political model that has been under construction for 60 years and in particular during the last 30 years, and this is something that must be done with the full participation of European citizens, with the aim of making them aware of the project so that they can take full ownership of it. This means explaining the real meaning of the federal logic of the project, which is nothing less than the dual legitimacy of citizens and states, the keystone of the European Union.

To do this, the ordinary revision procedure established in Article 48, paragraphs 1 to 5 of

the Treaty on European Union, should be applied, using the appropriate mechanisms to ensure the maximum participation of civil society in this reform process.

We can be confident that a 3rd European Convention would propose more progressive measures than the second, because its composition will reflect the advance of federalism that is beginning to be seen at the level of parliaments and national governments in various member states. The economic crisis has shown that we cannot leave our work half done, and that democratic institutions need to be granted the powers they need to fully exercise the responsibility deriving from the dual legitimacy of the Union, conferred upon them by citizens and by states.

The progress towards a European federation is something that must be undertaken during this legislature, given that from 2019 it is possible that new states will join the Union. If it is difficult with 28 members, with more it will be almost impossible. This is why now is the time to undertake reform to move away from the current requirement for unanimity, towards a system requiring, for example, acceptance by two thirds of states, representing two thirds of the Union's population. This would be similar to article 82 of the Draft Treaty on European Union approved by the European Parliament in 1984.

For all of these reasons, the 8th Legislature, as has been noted, starts with the aspiration to achieve major progress towards federalism, enabling institutions to exercise their powers thanks to increased democratic legitimacy which, in turn, should drive a change in EU policies, endorsing the commitment to the welfare state. To achieve this aim, it is necessary to reform the Union along federalist lines through the vehicle of a 3rd European Convention with the participation of citizens.

## **Recommendations for a federal Europe**

We propose that the EU reform the Treaties, through the 3rd Convention and the corresponding Intergovernmental Conference, by means of the following actions:

### ***Constitutional form, symbols and citizenship***

1. Convert the EU Treaty into a European Constitution that is clear, concise and comprehensible.
2. Explicitly recognize the dual legitimacy of the EU: deriving both from citizens and member states.
3. Make the EU symbols, including the flag and the anthem, official.
4. Expand recognition of European citizenship to nationals of third countries who have been legally resident in a member state for a continuous period of ten years.

### ***The European Parliament***

5. Introduce the possibility of presenting a transnational list of candidates for the European Parliament, representing at least 10 per cent of seats, as a means of strengthening the role of European political parties.
6. Reform the Uniform Electoral Procedure for the European Parliament to harmonize national systems for elections to the European Parliament, maximizing proportionality.
7. Establish gender parity and open lists as obligatory features of lists of candidates to the European Parliament.
8. Attribute new powers to the European Parliament, including:
  - Legislative initiative.

- Exclusive power to approve the European Citizens' Initiative.
- Motion of no confidence.
- Ratification of modifications to the Constitution (or the Treaties) of the EU.
- Authorization to call a European referendum.
- Legislative capacity in all spheres, without exceptions.
- Ratification of the President of the European Council.
- Decision about its own location (which we hope would be on a single site).
- Deliberation and adoption of decisions in European format.

### ***The European Commission***

9. Reform the structure of the European Commission, so that:
  - The maximum number of members is equivalent to two-thirds of the member states, reducing the role of national governments in the process of proposing commissioners.
  - There is gender parity.
  - The President is chosen from among the members of the European Parliament, having stood for election as a candidate on a national or transnational list.

### ***The ECB***

10. Expand the functions of the European Central Bank so that it can intervene without restrictions both in the management of the euro and in economic governance in general, so that its three essential functions would be: to guarantee financial and monetary stability, to prevent asset inflation, and to promote

growth and employment. Its President and the members of its Board of Directors should be ratified by the European Parliament.

11. Create a European Credit Risk Rating Agency.

### ***Participatory democracy***

12. Within the Constitution (or in the Treaties), strengthen the role of organized, European civil society, introducing the concept of participatory democracy and improving the operation of the current European Citizens' Initiative, in particular by removing the filtering role currently played by the Commission.

### ***Decision-making procedures***

13. Establish the obligation to adopt European legislation, without exceptions, through the joint legislative procedure (of the European Parliament and the Council) and by double majority.
14. Simplify the current definition of double majority, both in terms of percentages and forms.
15. Restrict the use of unanimity in the Council of Ministers and the European Council to the admission of new member states.
16. Make it compulsory for the European Commission to present an Annual Political Programme for the EU to the European Parliament and the Council for debate.

### ***Treaty reform***

17. Establish that reform of the Constitution (or of the Treaties) will be by qualified majority, not unanimous.



18. Establish that any substantial reform of the Constitution (or of the Treaties) will require a European Convention to be held.
19. Create a new European Referendum system to apply initially to substantial reforms to the Constitution (or the Treaties) and to be called with the authorization of the European Parliament and the European Council, at the proposal of the Commission.

### ***Competencies and resources***

20. Attribute new competencies to the EU in economic and social affairs, including issues such as the creation of a European Treasury Department and the issue of eurobonds, fiscal harmonization, establishing employment rules with the same status as the rules governing the single market, establishing a European minimum salary, and supplementary provisions for unemployment, health and education.
21. Include in the Constitution (or in the Treaties) the Treaty on Stability that expires in 2017, together with the reforms adopted in the sphere of economic governance.
22. Modify the Multiannual Financial Framework, reducing its duration to five years so that it coincides with the term of the European Parliament and the mandate of the Commission.
23. Attribute competencies to the EU to introduce, in the secondary education curriculum of member states, topics covering the history and operation of the Union drawing on a shared, compulsory curriculum.



# Recommendations



# Recommendations

European Affairs Council of the Fundación Alternativas

To conclude this 2014 Report on the State of the European Union we offer a number of recommendations, as discussed by the European Affairs Council of the Fundación Alternativas.<sup>1</sup>

## **1. Promoting the growth, employment and investment we need to escape from the crisis**

- The Union must refocus its economic policy on investment, abandoning the failed obsession with austerity that has been pursued so relentlessly since 2010. The Juncker plan is a positive step but is not enough, and it should be expanded with both public and private capital.
- The European Parliament should consider the social consequences of radical austerity, with Juncker already having recognized that this policy was adopted without taking account of its impact on the rights of European citizens.
- Public investment in education, alternative energy and R&D+i should not be included when calculating the deficit the EU permits member states to run.
- These policies should lead to the growth of employment so that, by the end of the European legislature, the level of unemployment would be close to half of the current level.

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<sup>1</sup> The European Affairs Council of the Fundación Alternativas is composed as follows: Diego López Garrido (Director), Nicolás Sartorius, Juan Moscoso, Carlos Carnero, Vicente Palacio, Manuel de la Rocha Vázquez, José Candela, Jesús Ruiz-Huerta, Enrique Ayala, Carlos Closa, José Manuel Albares, José Luis Escario, María Muñoz, Emilio Ontiveros, María Joao Rodrigues, Francisco Aldecoa, Soledad Gallego, Irune Aguirrezábal, Josep Borrell, Doménec Ruiz and Xavier Vidal-Folch. Permanent guests at meetings of the Council are Michale Ehrke, Delegate to Spain of the Friedrich-Ebert-Stiftung, and María Pallares, programme coordinator, also of the Friedrich-Ebert-Stiftung.

## **2. Fighting inequality and revitalizing the Welfare State**

- European employment conditions should be established with respect to: minimum salary, taking into account the level of prices in each country, and minimum standards in other employment and social conditions, particularly health, education and pensions, including complementary European unemployment insurance.
- We need a policy to promote a rise in the purchasing power of workers (and thus of demand) in line with increases in productivity.
- Social integration can no longer be achieved solely through high salaries and full employment, and we therefore need the sustained redistribution of income through a progressive direct tax system (corporate, income and wealth tax), harmonized at the European level.

## **3. Energy Union and the fight against climate change**

- The 20-20-20 targets for 2020 have set the tone for the first decade of a transformation of energy and climate change policy. However, we need to review these policies to analyse both the successes and the failures in detail, with a view to the next decade.
- Given the confused nature of public policy in this area, the Energy Union represents a real challenge for the EU, one that is yet to be addressed.
- Without a clear pro-European perspective in the 28 member states, any common approach will be hampered by rising tension and greater obstacles in the coming years.

## **4. Development of the Digital Single Market**

- Consolidate a regulatory framework at the European level and make progress towards the unification of different national frameworks for an open internet with unrestricted access. We need to avoid users being blocked and restrictions placed on their demands, and to establish mechanisms to ensure greater transparency on the part of telecommunications providers. EU regulation should also apply to the mobile internet.
- Make progress in consolidating a balanced fiscal framework with respect to economic transactions within the European market, starting with a single VAT rate for e-commerce.
- Strengthen Europe's position in the internet economy, facilitating the support of the European Commission and member states for the creation of a 'digital Airbus' international consortium, with public and private backing, to generate a European search engine able to compete both at the European and the global level with the major content and information providers.

## 5. The EU-USA Free Trade Treaty (TTIP)

- This agreement is an opportunity for Europe if it is balanced and based on respect for Europe's political and social characteristics. The final formulation should contribute to economic growth and the creation of jobs, and should be favourable to all companies, particularly SMEs, not just large corporations.
- The TTIP should preserve European standards on food safety and data protection and should not have a negative impact on social protection, consumer protection, environmental protection, employment rights and cultural diversity.
- In so far as it is also an investment treaty, the TTIP should include a chapter on financial cooperation with an express commitment by both parties to eliminate banking malpractice and to prevent future crises. Alternatively, the USA and the EU should sign a separate agreement to address this shortcoming.
- It should respect regular legal procedures in the resolution of disagreements between investors and states, incorporating safeguards and mechanisms such as a Trade and Investment Tribunal, along the lines of the EU–Canada Treaty.
- We need to make the negotiation process more transparent, as promised by Commissioner Cecilia Mällstrom, and argue for the requirement for the Treaty to be ratified by the European Parliament. This would require an extensive round of consultation with governments, national parliaments and other affected sectors.

## 6. Reform of the financial system

- The European Union needs to develop an integrated financial system, one that addresses the problem of financial fragmentation and, above all, that clarifies the different rates of interest offered to retail customers in different member states.
- The European financial system must be stable and should contribute to the growth of per capita income and of employment. This requires the strict regulation of banks to reduce specialization and minimize systemic risk. There are still some major unresolved issues regarding Banking Union, such as the separation of investment banking from high street and business banking. It is important that this separation should be objective and based on a clear threshold, one that measures the ratio of loans to the real economy as a proportion of the total portfolio.

- The stability of the financial system depends on reducing the number of institutions that are too large or too interconnected to fail.
- The EU should issue public debt denominated in euros to increase the stability and liquidity of the eurozone. This requires repeal of article 17.2 of Regulation 976/2012.

### **7. Tax evasion and tax avoidance. Tax harmonization**

- The EU and its member states need to increase corporate fiscal transparency, obliging multinationals in all sectors to publish a breakdown of key financial information (employees, value of assets, sales, profits and taxes due and paid) to determine whether the multinational pays tax in each country in proportion to its economic capacity.
- The EU should compile a European blacklist of tax havens based on objective, exhaustive criteria, to stigmatize those territories that do not cooperate. It should also establish a multilateral sanctions system to apply both to those territories that operate as tax havens and companies that use them for the purposes of tax avoidance or tax evasion.
- Member states of the EU should revive and improve the BICIS proposal on the harmonization of corporation tax, under which multinationals would be taxed for their activity within the EU as a single unit, and the tax collected would be distributed between member states according to a predetermined formula. This harmonization must be compulsory and cover both the calculation of taxable income and the rates applied.
- The EU should support the nationalization of financial institutions that engage in money laundering.
- The Financial Transactions Tax should be introduced without further delay or restrictions on its scope.

### **8. Economic and political immigration**

- The EU should promote joint development with African countries, including those that are not part of the Mediterranean region but are generators of emigration. The aim should be to offer alternatives of work and subsistence to a growing population of young people. Development aid with a focus on job creation should be strengthened.
- The EU must implement a migration strategy that is designed to respond to the new strategy of people-trafficking networks of setting boats full of irregular migrants adrift on the Mediterranean. This will require a special maritime surveillance programme, with particular emphasis on routes with their origin in Libya.



- The EU should design a plan to welcome refugees and asylum seekers that shares them fairly between all member states. This plan should further standardize the criteria for granting refugee and asylum status.
- The EU should promote immigration agreements with countries of origin to help ensure the future of pensions in Europe. These agreements should include clauses to prevent the economic and professional outflows from developing countries.

### **9. Peace and stability in Eastern Europe**

- Solution of the conflict in the Ukraine depends on strict observance of the Minsk II accords by all parties, including both military and political aspects. The monitoring mission of the Organization for Security and Cooperation in Europe in the Donbass region should be provided with the means, the authority and the freedom of movement needed to effectively conduct its verification duties.
- Sanctions against Russia should gradually be reduced if the successive phases of the Minsk II accord are observed by Moscow. Sanctions would be increased or extended if the peace process fails as a result of Moscow's actions.
- When the Ukraine crisis has been resolved, the EU should seek to relaunch economic and political relations with Russia, with the aim of reaching an ambitious, long-term strategic association agreement, which could lead to the establishment of a free trade area and include security issues. It should also provide a framework for guaranteeing the territorial integrity and sovereignty of the countries of the Eastern Association, and the resolution of frozen conflicts that threaten the stability of the region and of the whole continent.
- Within the framework of these agreements, and based on respect for Ukraine's sovereignty, the EU should support the adoption in this country of a federal system that would recognize its ethnic diversity and its neutrality with respect to military alliances in order to defuse tension now and in the future. In addition, the Ukraine must be provided with economic support in coordination with the International Monetary Fund, to enable it to overcome its economic crisis, subject to a programme of administrative and political reform.

### **10. The threat of radical jihadism from the Sahel to the Middle East**

- While using all available defence and security measures to combat this phenomenon, it is also essential to take a preventive approach,

one that seeks to forestall the radicalization of individuals who, for various reasons, are tempted to join violent jihadism. This approach should emphasize educational work and should mobilize physical and human resources in the social, political and economic sphere, in order to ensure the full integration of all members of each national community.

- We need to avoid demonizing Islam and non-violent Islamism. Partly because such movements have clearly shown that they have the support of local populations – which means that there is no solution to this situation without their participation – and also because any strategy must start by establishing a clear boundary between those who opt for violence and those who reject it. For the same reasons, it is important to establish permanent channels of dialogue with authorized representatives of Islam who are accepted and respected in these societies, as partners to isolate the advocates of violence.
- We need to use every possible instrument at both the national and the EU level – particularly in the fields of trade and finance, but also with regard to peaceful conflict resolution – to narrow the inequality gaps that define the Mediterranean basin.
- We need to staunch the financial flows that fund jihadi terrorism and to make progress in coordinating the struggle against this threat, something that requires a genuine Common Security and Defence Policy.
- The EU should develop a strategy to address return trips to jihadist destinations around the Mediterranean (Syria, Yemen, Libya, and the Sahel). To do this, we will need selective criteria and filters to detect trips by potential jihadists from or to the EU. These criteria and filters must respect fundamental rights and freedoms, and not be discriminatory or abusive. The aim is to guarantee security without harming freedom.

### **11. Political Union and progress towards the democratic legitimacy of the EU**

- We need to reform the Treaties through a Convention and the corresponding Intergovernmental Conference to complete political, economic and social union, and convert the EU Treaty into a European Constitution that is clear, concise and comprehensible.
- This Constitution needs to grant new powers to the European Parliament, so that it is able to assume political leadership in response to the challenges of the current European legislature.

- We need to further strengthen Europe-wide political parties.
- Political Union must continue to progress across all spheres, with particular attention to the creation of a political and budget-making structure for the Eurozone within European institutions, enabling the development of a coordinated economic policy, a European Treasury issuing eurobonds, and a social dimension for Europe.
- EU budgets should be approved by a qualified majority in Congress and in the European Parliament, and reduced to a period of five years.



# Biographies

**José Manuel Albares.** Career diplomat, he is currently the Deputy Director for Sub-Saharan Africa at the Spanish Ministry of Foreign Affairs and Cooperation. He has also served as Spanish Consul in Colombia and member of the Permanent Delegation of Spain to the OECD in Paris, during which time he filled the position of Vice-Chairman of the organisation's Development Assistance Committee (DAC). José Manuel Albares has also held the positions of Acting Director General for Africa and Director of the Department for Cooperation with Sub-Saharan Africa in the AECID. He is the author of various studies on foreign policy and external action, as well as numerous press articles on these topics. He has been visiting professor at several universities, as well as the Institut d'Études Politiques in Paris (Sciences-Po) has led and participated in several summer courses at the Complutense and Menéndez Pelayo Universities. He holds a Bachelor of Laws and a Diploma in Business Studies from the University of Deusto. He holds as well a diploma of National Defence Course (CESEDEN).

**Francisco Aldecoa.** Professor of International Relations at the Complutense University of Madrid (2000) and formerly professor at the University of the Basque Country (1990). He has held the Jean Monnet chair, conferred by the European Commission, since 1994 and was awarded an honorary doctorate by the University

of Bucharest in 2009. Aldecoa is a disciple of Antonio Truyol y Serra, a distinguished professor and theorist on the process of European construction. From May 2002 to May 2010, he served as Dean of the Political Science and Sociology Faculty of the Complutense University of Madrid. He was president of the Spanish Association of Professors of International Law and International Relations from 2005 to 2009. He is the current Director of the Centre for Studies in Management, Analysis and Evaluation at the Complutense University of Madrid.

**José Enrique de Ayala.** Brigadier General of the Army, retired. Ayala holds a degree in Staff and Joint Staffs as well as in International Relations from the Centre for International Studies. He has served as military attaché to the Spanish Embassy in Germany, and as Chief of Staff of the Eurocorps. An international policy analyst specialized in the European Union, he collaborates with numerous media both written and audiovisual. He is a member of the European Affairs Advisory Committee of Fundación Alternativas.

**José Candela Castillo.** Doctor in Law, Complutense University of Madrid. He has been working for the European Commission since the accession of Spain to the EC. He was Member of the Cabinet of Vice-President of the European Commission. Head of the Units Governance and

Application of Community Law at the Secretariat-General of the European Commission. Co-author of the European Commission's White Paper on European Governance. Counsellor at the Secretariat-General, European Commission and Advisor to the Spanish Secretary of State for the European Union. He is Professor of Philosophy of Law, Moral and Politics at the Complutense University of Madrid.

**Carlos Carnero.** Managing Director, Fundación Alternativas. Carnero has served as a member of the European Parliament (1994-2009), Spanish ambassador-at-large for European integration 2009-2012), and Vice-President of the Party of European Socialists (2006-2009). He was also a member of the Convention that drafted the European Constitution. He has collaborated on several books, including *Construyendo la Constitución Europea. Crónica política de la Convención*, *Manual de Instrucciones de la Constitución Europea*, *Europa en la encrucijada* and *La diplomacia común europea: el servicio europeo de acción exterior*, *Gobernanza económica de la Unión Europea y salidad de la crisis*. Carnero holds a degree in Tourism. He is a visiting professor in the master's programme of the Institute of European Studies at the University CEU-San Pablo and has led several summer courses at the Complutense University of Madrid on the EU. Carnero is member of the Scientific Council of Real Instituto Elcano. The Spanish government awarded him the Order of Constitutional Merit and the Order of Civil Merit for his work related to the European Union and foreign affairs, and the European Parliament with its Medal.

**Manuel Carvalho da Silva** was born in 1948 in Viatodos, Barcelos, in a family of small farmers. He was trained as electrician (1965) and in the first years of his professional career he

worked as blue-collar electrician in several companies. Soon he became unionist, first as a member of a workers council and later holding responsibilities in a trade union. He was elected coordinator of CGTP-IN (General Confederation of Portuguese Workers - National Trades Union) in June 1986 and held office as Secretary General between December 1999 and January 2012. He graduated in Sociology in 2000 and concluded a PhD in Sociology in 2007 at ISCTE-IUL (Higher Institute of Business and Labour Sciences-University Institute of Lisbon). He became researcher at the Centre for Social Studies (CES) of the Coimbra University in 2009. Currently he coordinates the Observatory on Crises and Alternatives and CES delegation at Lisbon. Since 2011 he teaches as invited Cathedric Professor at Lusófona University, Lisbon.

**José Castro Caldas** is a researcher at the Centre for Social Studies (CES) of the Coimbra University, Portugal. Is a member of CES's Observatory on Crises and Alternatives. He was previously assistant professor at the Economics Department of ISCTE. He graduated in Economics and concluded a Master in Mathematics Applied to Economics and Management at ISEG and a PhD in Economics at ISCTE-IUL (Higher Institute of Business and Labour Sciences-University Institute of Lisbon). His present main research interests include: personal and collective deliberation, institutional economics and the history of economics.

**José Luis Escario Díaz-Berrio** graduated in law and is Master of International and Community Law from the University of Leuven. He has worked in the European Commission, European Parliament, the Spanish Administration. He has been Policy Advisor for Taxation in Oxfam Intermón. Currently he is Advisor to the Spanish Socialist Party Delegation in the European

Parliament (Special Committee on Tax Rulings). He is also Coordinator for European Union Affairs at Fundación Alternativas (FA), as well as member of the FA Council of European Affairs. He is the author of books and numerous scientific articles on European and taxation issues. He has been coordinator of the “State of the European Union Report”.

**Severin Fischer** is an associate at Stiftung Wissenschaft und Politik (SWP, German Institute for International and Security Affairs) in Berlin which he joined in 2011. He has six years of working experience in the field of energy and climate policy. Between 2008 and 2011, he worked as project coordinator at the Institut für Europäische Politik (IEP) in Berlin. During 2009 and 2010, he joined the office of the Chairman of the Environment Committee in the European Parliament as a policy advisor. He earned his PhD for a dissertation on the Europeanization of German Energy and Climate Policies. He is currently working on topics such as the creation of an Energy Union in the EU and new models of governance for energy and climate policies in the EU.

**Oliver Geden** is Head of the EU/Europe Division at Stiftung Wissenschaft und Politik (German Institute for International and Security Affairs) in Berlin which he joined in 2006. He has been a visiting scholar at the University of California, Berkeley and the Swiss Federal Institute of Technology (ETH), Zurich. He also worked for the Federal Foreign Office’s Policy Planning Unit and, most recently, for the Federal Ministry for Economic Affairs and Energy, Directorate General Political Staff and Policy Planning. His main area of expertise is the EU’s energy and climate policy.

**Carlos González-Valderrama** gained his M.Sc. degree in telecommunications engineering

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**Diego López Garrido.** Chairman of the Council on European Affairs at Fundación Alternativas and member of the Scientific Committee of the Foundation for European Progressive Studies (FEPS). He is MP for Madrid and spokesperson for the Socialist Group in the Parliamentary Defence Committee and member of the Parliamentary Assembly of NATO (Vice-Chair of the Mediterranean and Middle East Special Group and Vice-Chair of the Subcommittee on Transatlantic Economic Relations). He has also assumed the role of spokesperson for the Socialist group in the Spanish Parliament (2006–2008). From April 2008 to December 2011, he was Secretary of State for the European Union and coordinated the Spanish Presidency of the EU in 2010. López Garrido was a member of the Convention that drafted the European Constitutional Treaty, the accord that paved the way for the Lisbon Treaty, as a representative of the Spanish Parliament (2002–2003). He is an economist and professor of Constitutional law. Author of various books on human rights, economics, politics, contemporary history and European law; he is also a regular contributor to the Spanish daily *El País*. His last book: *The Ice Age. Europe and USA vs. the Great Crisis: bailing-out the Welfare State* (RBA, 2014).

**Jesús A. Núñez Villaverde** is economist and military officer (reserve force). He is specialised in security, peace building and conflict prevention, with a particular attention to the Arab-Muslim world. He is currently codirector of the Institute of Studies on Conflicts and Humanitarian Action (*Instituto de Estudios sobre Conflictos y Acción Humanitaria*, IECAH) and professor of International Relations at the Comillas Pontifical University. He is also president for the office in Spain of the United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA) and works as a consultant for different agencies such as the Spanish Agency for International Development Cooperation (*Agencia Española de Cooperación Internacional para el Desarrollo*, AECID) and the United Nations Development Programme (UNDP). Member of the International Institute for Strategic Studies (IISS), he collaborates with numerous media both written and audiovisual.

**Vicente Palacio** is Deputy Director of the Fundación Alternativa's Observatory of Spanish Foreign Policy and professor at the School of International Relations of the Instituto de Empresa. He has directed and coordinated research for the Socialist group in the Spanish Parliament, the Cabinet of the Spanish President and the Ministry of Foreign Affairs and Cooperation. Palacio has been Associate Professor of Internal Relations at Syracuse University and a visiting fellow and researcher at Harvard University's Department of Government. He is author of dozens of analyses and articles for the specialised press on the subjects of Spanish and EU foreign policy, transatlantic relations and EU–Latin American relations. He is a frequent contributor to *El País* and CNN's Spanish language news channel.

**Jorge Pérez Martínez** gained his Ph.D. in Telecommunications Engineering from the Universidad Politécnica de Madrid and his M.Sc. in Political Science and Sociology from the Universidad Complutense. He has been a Professor at the Higher Technical School of Telecommunications Engineering of Universidad Politécnica de Madrid since 1990 and his research topics relates to socio-economic aspects of Information and Communication Technologies and telecommunications policy. In addition to his distinguished academic career, he has held several positions in public and private institutions including dean of the Official College of Telecommunications Engineers and Director General for the Development of Information Society at the Science and Culture Ministry of Spain. Nowadays he is director of the Information and Communications Technologies Group of Universidad Politécnica de Madrid and manages the Red.es chair, through which he advises the Secretary of State for Telecommunications and Information Society at the Industry, Energy and Tourism Ministry. Moreover, he leads the Spanish Internet Governance Forum in Spain (IGF-Spain).

**Alfred Pfaller** works as a free-lance consultant and analyst on issues of political economy. Before he was an editor, analyst, researcher and program coordinator with the Friedrich Ebert Foundation (FES) in Bonn, Germany. From 2004 to 2007 he was director of the FES Bucharest office, developing programs of political education, civic mobilization, consulting and international exchange for Romania, Moldova and South East European region. In the 1970s he worked with the FES offices in Chile and Ecuador. Alfred Pfaller studied sociology and economics. He holds a Ph.D from the University of Pittsburgh, USA.



**João Ramos de Almeida** was born in 1960 in Lisbon, graduated in Economics at the Instituto Superior de Economia, was a journalist from 1986 to 2012 in several Portuguese newspapers as *Diário de Lisboa*, *Europeu*, *Semanário Económico*, *Expresso* and *Público* and is currently working as consultant at the Observatory on Crises and Alternatives. He is the author of two animated films, a documentary and a book about elections fraud in Portugal.

**Domènec Ruiz Devesa** is a specialist in European economic policy and the international monetary system. Devesa holds degrees in Law and Economics from the University Carlos III, a degree in Political Science and Sociology from the UNED and a Master in International Relations

with a concentration in European Studies from Johns Hopkins University. He has provided consulting services for international organisations such as the World Bank, the Inter-American Development Bank and the Union for the Mediterranean, international consulting firms including Oxford Policy Management and Family Health International and think tanks such as the Fundación Alternativas, where he is a member of the Council for European Affairs, and Fundación Sistema, in which he serves as a member of the editorial board of the journal *Temas para el Debate*. Domènec is currently an Advisor to the Spanish Socialist Delegation in the European Parliament and Vice President of the Union of European Federalists of Spain.



# Acronyms

- ACER:** Agency for the Cooperation of Energy Regulators  
**ACP:** African, Caribbean and Pacific Group of States  
**AEAT:** Spanish National Tax Agency  
**AECID:** *Agencia Española de Cooperación Internacional para el Desarrollo* (in English, Spanish Agency for International Development Cooperation)  
**AEOI:** Automatic exchange of information  
**AUC:** African Union Commission  
**BEPS:** Base Erosion and Profit Shifting  
**BRICS:** Brazil, Russia, India, China and South Africa  
**CAE-FA:** Committee for European Affairs of *Fundación Alternativas*  
**CBCR:** Country-by-Country Reporting  
**CCCTB:** Common Consolidated Corporate Tax Base  
**CEAS:** Common European Asylum System  
**CEPR:** Centre for Economic Policy Research  
**CES:** Centre for Social Studies  
**CESEDEN:** *Centro Superior de Estudios de la Defensa Nacional* (in English, Spanish Centre for National Defence Studies)  
**CETA:** Canada-EU Comprehensive Economic Trade Agreement  
**CGTP-IN:** General Confederation of Portuguese Workers - National Trades Union  
**DAC:** Development Assistance Committee  
**DAESH:** *ad-Dawlah al-Islāmiyah fīl-‘Irāq wash-Shām* (in English, Islamic State of Iraq and the Levant)  
**DPR:** Donetsk People’s Republic  
**DTA:** Double taxation agreements  
**DTT:** Digital terrestrial television  
**ECB:** European Central Bank  
**ECOFIN:** Economic and Financial Affairs Council  
**ECOWAS:** Economic Community of West African States  
**EFSF:** European Financial Stability Facility  
**EFSI:** European Fund for Strategic Investments  
**EHT:** *Eidgenössische Technische Hochschule Zürich* (in English, Swiss Federal Institute of Technology)  
**EIB:** European Investment Bank  
**ENTSO-E:** European Network of Transmission System Operators for Electricity  
**ENTSO-G:** European Network of Transmission System Operators for Gas  
**ENVI:** Committee on the Environment, Public Health and Food Safety  
**ESM:** European Stability Mechanism  
**ETA:** *Euskadi Ta Askatasuna* (in English, Basque Country and Freedom)  
**ETS:** Emissions trading scheme  
**ETSI:** *Escuela Técnica Superior de Ingenieros* (in English, School of Telecommunications Engineering)  
**EU-ETS:** EU emissions trading scheme  
**EU:** European Union  
**Euribor:** Euro Interbank Offered Rate  
**EUSTD:** EU Savings Tax Directive  
**FA:** *Fundación Alternativas*  
**FATCA:** Foreign Account Tax Compliance Act  
**FCC:** Federal Communications Commission  
**FEPS:** Foundation for European Progressive Studies  
**FES:** *Friedrich-Ebert-Stiftung* (in English, Friedrich Ebert Foundation)  
**FIIAPP:** *Fundación Internacional y para Iberoamérica de Administración y Políticas Públicas* (in English, International and Ibero-American Foundation for Administration and Public Policies)  
**Frontex:** European Agency for the Management of Operational Cooperation at the External Borders of the Member States of the European Union  
**G20:** Group of Twenty (Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia,

- Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom and the United States—along with the European Union)
- G5:** Group of Five (France, Germany, Italy, the United Kingdom and Spain)
- G8:** Group of Eight (Canada, France, Germany, Italy, Japan, Russia, United Kingdom and the United States)
- GAMM:** Global Approach to Migration and Mobility
- GATT:** General Agreement on Tariffs and Trade
- GDP:** Gross domestic product
- GTIC:** Group on Information and Communications Technologies
- ICMPD:** International Centre for Migration Policy Development
- ICO:** *Instituto de Crédito Oficial* (in English, Official Credit Institute)
- IEB:** *Instituto de Economía de Barcelona* (in English, Barcelona Institute of Economics)
- IECAH:** *Instituto de Estudios sobre Conflictos y Acción Humanitaria* (in English, Institute of Studies on Conflicts and Humanitarian Action)
- IEP:** *Institut für Europäische Politik* (in English, Institute for European Politics)
- IGF-Spain:** Internet Governance Forum in Spain
- IISS:** International Institute for Strategic Studies
- IMF:** International Monetary Fund
- INE:** Instituto Nacional de Estatística (Portugal)
- INTA:** Committee on International Trade
- IOM:** International Organization for Migration
- IPCC:** Intergovernmental Panel on Climate Change
- ISCTE-IUL:** Higher Institute of Business and Labour Sciences-University Institute of Lisbon
- ISDS:** Investor State Dispute Settlement
- ISEG:** *Instituto Superior Economia e Gestão* (in English, Lisboa School of Economics and Management)
- ISIL:** Islamic State of Iraq and the Levant
- Libor:** London InterBank Offered Rate
- LPR:** Luhansk People's Republic
- MAEC:** *Ministerio de Asuntos Exteriores y de Cooperación* (in English, Ministry of Foreign Affairs and Cooperation of Spain)
- MERCOSUR:** *Mercado Común del Sur* (in English, Southern Common Market)
- MMS:** Multimedia Messaging Service
- MNC:** Multinational Corporation
- NATO:** North Atlantic Treaty Organization
- NGO:** Non-governmental organization
- OCDE:** Organisation for Economic Co-operation
- OSCE:** Organization for Security and Co-operation in Europe
- PNR:** Passenger Name Record
- PPP:** Public-private partnership
- RSPP:** Radio Spectrum Policy Programme
- SIPRI:** Stockholm International Peace Research Institute
- SME:** Small and medium-sized enterprise
- SMS:** Short Message Service
- SRF:** Single resolution fund
- SRM:** Single Resolution Mechanism
- SSM:** Single Supervisory Mechanism
- SWP:** *Stiftung Wissenschaft und Politik* (in English, German Institute for International and Security Affairs)
- TEN-E:** Trans-European energy networks
- TEU:** Treaty on European Union
- TFEU:** Treaty on the Functioning of the European Union
- TIEA:** Tax information exchange agreements (s)
- TPA:** Trade Promotion Authority
- TPP:** Trans-Pacific Partnership
- TTIP:** Transatlantic Trade and Investment Partnership
- UHF:** Ultra High Frequency
- UK:** United Kingdom
- UN:** United Nations
- UNASUR:** *Unión de Naciones Suramericanas* (in English, Union of South American Nations)
- UNDP:** United Nations Development Programme
- UNED:** *Universidad Nacional de Educación a Distancia* (in English, National University of Distance Education)
- UNHCR:** United Nations High Commissioner for Refugees
- UNICEF:** United Nations Children's Fund
- UNRWA:** United Nations Relief and Works Agency for Palestine Refugees in the Near East
- USA:** United States of America
- USD:** United States dollar
- USSR:** Union of Soviet Socialist Republics
- VAT:** Value-added tax
- WTO:** World Trade Organization



Seven years after the onset of the crisis, 2014 only confirmed the deep division in the Western world when it came to how to tackle it. The mixed results in the Union and in the United States are a clear sign that, more than ever, politics matters. In the Union, the doctrine of the creditor countries continued to predominate (with increasing difficulty), unbending in the commitment to cutting public spending as the priority. In the United States, another viewpoint prevailed: bolstering a recession-stricken economy by means of fiscal and monetary stimuli for growth.

The figures we saw at the beginning of 2015 are irrefutable. The United States enjoys virtually full employment. In Europe, however, joblessness still stands at around 11%, that is to say, 24 million people are out of work.

The political response is the right one in the face of two major but different problems. The first problem is the productive system's difficulties in providing goods and services. There is not enough manpower, among other reasons because the working population, those who are seeking employment, plummeted in Europe between 2007 and 2014 and in the United States too.

The other major issue arising from the crisis—actually the quintessential European challenge—is the deterioration of the welfare state. It can be seen in salary devaluation, precarious employment, inequality and poverty. It can also be seen in especially painful effects on young people and children, with the resulting generation gap that divides Europe.

The challenge facing the Union, then, is very clear. It must spend more on social and labour rights, it has to invest much more in research, innovation and education and it must raise more cash by broadening tax bases along progressive taxation lines.

This is surely the best way of ensuring that the incipient growth in Europe remains on an upward trend and is capable of creating worthwhile employment.

The other challenges facing the EU, which are set out in the following report and its recommendations, will only be met adequately under the umbrella of an economy based firmly on production, jobs and demand.