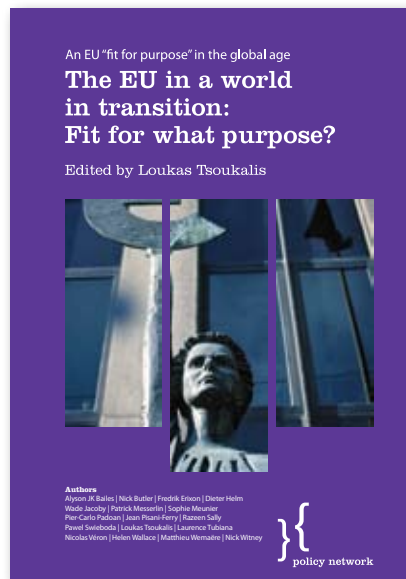
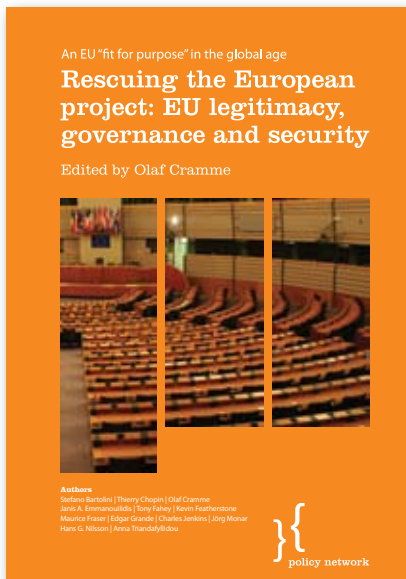


An EU “fit for purpose” in the global age

Can we rise to the challenge?

Loukas Tsoukalis | Olaf Cramme | Roger Liddle



Published at a crucial moment for EU integration and combining 35 original contributions from leading thinkers and experts in EU politics, these three volumes offer detailed analyses and fresh proposals on a wide range of key internal and external challenges which the European Union is confronted with in its quest for relevance and influence in the global age.

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About the project

Organised by Policy Network, in partnership with the European Institute of the London School of Economics and ELIAMEP (Hellenic Foundation for European and Foreign Policy), the EU “fit for purpose” project was initiated in May 2008 when Professor Loukas Tsoukalis presented to a workshop in London a substantial critique of the challenges and choices facing the EU in the 21st century.

Subsequently, a programme of study and events, co-directed by Olaf Cramme, Maurice Fraser, Roger Liddle and Loukas Tsoukalis, was organised around the central theme of this initiative: what the role of the European Union is as a political entity in a rapidly changing world and how it should reform itself, both internally and externally, in order to overcome and respond to the multifaceted challenges of the global age we now live in.

Over a period of 12 months, the project has sought to engage with a wide-ranging group of distinguished academics, policymakers and government advisers from across Europe, looking at the key clusters of policy choices facing the EU post-2009. High-level symposia and public events took place in Hydra, Paris and London.

Three publications mark the climax of this project:

- *Rescuing the European project: EU legitimacy, governance and security* (edited by Olaf Cramme)
- *The EU in a world in transition: Fit for what purpose?* (edited by Loukas Tsoukalis)
- *After the crisis: A new socio-economic settlement for the EU* (edited by Roger Liddle)

In addition, this synthesis report, inspired by the individual contributions to the three volumes, provides a compact analysis of how the EU needs to evolve and operate if it is to live up to the expectations and hopes of many of its citizens.

All of the publications are available in hard copy and online. Further information about the project and the organisers is available at:

Policy Network www.policy-network.net

LSE European Institute www.lse.ac.uk/europeaninstitute

ELIAMEP www.eliamep.gr

About the authors*

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The world we're in

European integration started as an inward-looking venture: the fathers of Europe (there were no mothers at the time) began, in the wake of the destruction of the Second World War, by laying the foundations for peace and reconciliation in a new Europe. Global order was taken as a given and shaped by external actors. As progress ensued, greater prosperity, through the elimination of economic borders, became a key objective, soon to be joined by democracy as new members with fragile institutions and troubled political records later joined in. Thus, over time, Europeanisation acquired a much broader dimension.

Ending the period of introspection

The record is quite impressive. Integration began with six countries and two sectors of the economy and developed over a period of almost sixty years into a complex system of governance covering a wide range of policy areas, from trade and money all the way to immigration and foreign policy, for the now 27 member countries of the EU. The European system is about the joint management of ever increasing interdependence between countries and peoples of Europe. It provides rules and regulations for the single market and the euro, whilst offering a framework for cooperation. Successive rounds of enlargement, in turn, have been the most effective foreign policy of the EU. They have also acted as a convergence machine for the economic periphery.

Europe is not a power in the traditional sense of the term, nor is it, of course, a typical international organisation. It continues to defy classification. While the role of the EU as an international actor has steadily expanded, the focus has always been on the utilisation of different forms of soft power. Civilian power was the

As we now approach the end of the painful ratification process of the Lisbon Treaty, this period of introspection is hopefully approaching its end

term coined for Europe many years back; normative power is another term used now to denote an emphasis on values and rules as opposed to narrowly defined interests. In other words, the EU constitutes an attempt to move away from the old world of power politics.

All this happened on the assumption that a broad basis of permissive, if not passive, consensus for ever-deepening European integration continued to exist. Riding on a wave of Euro-enthusiasm and encouraged by its past progress, the EU embarked on three highly ambitious projects at the beginning of the 21st century: the introduction of the euro, the biggest ever enlargement and the adoption of a European constitution to replace the existing treaties. The first shock came with the French and Dutch referendums on the constitutional treaty, when it became clear that European citizens were no longer prepared to give their leaders a *carte blanche*.

The negative results were an expression of a deeper problem concerning the legitimacy of the process of integration and the direction the Union was taking. A major political crisis ensued, causing the EU to turn inwards at a time when major new challenges were sweeping the rapidly changing international scene. As we now approach the end of the long and painful ratification process of the Lisbon Treaty, a successor to the stillborn constitutional treaty, this period of introspection is hopefully approaching its end.

Coping with the pace of a rapidly changing world...

It has indeed been a rapidly changing world. The fall of the Berlin Wall twenty years ago marked the end of the bipolar world system established after the Second World War, giving rise to an era of unipolarity. Yet, this period looks likely to be short lived, as China and the other emerging economic powers begin to flex their political muscles, and the United States, although still more equal than others, is forced to negotiate on an ever more level playing field with other countries. Thus, power has become more diffuse in an increasingly multi-polar world. At the same time, the world is still very much unstable, with unresolved conflicts, failed states, nuclear proliferation, messianic ideologies, terrorism and organised crime, abject poverty and new waves of international migration, fierce competition for access to raw materials and a time bomb under the name of global warming. On top of this worryingly long list of challenges, history also tells us that the transition from one political order to the next is rarely peaceful.

Europe no longer occupies centre stage. Power has gravitated elsewhere and mainly eastwards. The relative weight of individual European countries, measured in terms of population, income and trade,

Lack of unity usually comes with a price tag: a divided, ageing and shrinking Europe can only court with strategic irrelevance and decline

has been steadily declining for more than two decades; it can only go further down in the foreseeable future. On their own, European countries no longer hold much sway when in the company of big powers, and they will count even less tomorrow. This is a hard reality to reconcile oneself with, especially when it concerns the old great powers of Europe.

In the next few years, the key challenge for Europeans will be to identify and collectively defend common interests and values in a world where size still matters a great deal. Europe's comparative advantage may indeed lie in soft or normative power, although in many cases action still falls short of rhetoric, of which there is plenty. But soft power may not be enough in a world in which martial arts are still widely practiced. Europeans will have some hard decisions to make, not least whether they make them together or separately. They have a model, at least a collective experience, worth exporting to the rest of the world, which is now grappling with new ways of managing global interdependence. And they also have a neighbourhood that includes several countries where poverty and instability combine to form an explosive mix. This is another challenge for Europe as a regional power.

Will unity prevail over diversity? The answer will surely vary from one policy area to the other, even from one case to the next. But we should not be under an illusion. Lack of unity usually comes with a price tag: a divided, ageing and shrinking Europe can only court with strategic irrelevance and decline.

...exacerbated by the economic crisis

If anything, the economic crisis has reinforced the trend towards multipolarity. China and others have become indispensable partners in the attempt to manage a crisis, the scale of which has not been seen since the Great Depression, a crisis that was made in the west and quickly turned global. It surely marks the end of an era. The globalisation model that relied on the liberalisation of financial markets to spearhead global economic integration is in deep crisis. Protectionism is on the rise together with rates of unemployment. International coordination has so far averted the worst case scenarios, but looking beyond the crisis, many people now realise that a global economy requires new

forms of global governance and effective international institutions.

The economic crisis also marks a watershed in the evolution of Europe. Closer coordination will be required to exit from it. Europe will need a new socio-economic settlement and a new grand bargain to sustain the single market and the euro. For years, market integration ran faster than policy integration; the latter will now have to catch up. In the search for a new capitalist order with rules – some would call it the taming of capitalism – the EU will have to provide the overall framework. We are talking about no less than a paradigm shift. The alternative could be a process of disintegration as growing state intervention, if uncoordinated, erodes the *acquis*: this is a real danger.

In short, the world has changed around us, and we need to adjust. Strengthening the role of the EU as a global actor, while seeking a new internal mix between liberalisation, rules and solidarity, is a tall order at a time when nationalism appears to be on the rise and the legitimacy deficit of common institutions is growing. New European initiatives will require broad support from member states and citizens. Complex package deals achieved through the tortuous, yet consensual, processes of the EU are one thing; popular acceptance of the results is another, and can no longer be taken for granted. We should have learned something from the experience of recent years. While the stakes are higher, the political processes in the EU have become so much more complicated.

The quest for external influence

There is a less benign reading of Europe's collective role in the world. Europeans are trying to make virtue out of necessity, old style realists would argue. Europe continues to depend on the security umbrella of the United States provided through NATO. Many European countries are at best thinking of a European role in global affairs on the model of Switzerland writ large. And there are those who confuse soft power with talking power. Indeed, Europe does a great deal of talking, often as a substitute for policy. Arguably, only the big countries are capable of thinking global and strategic – but they do not always think European.

What kind of power?

The description of Europe as a different kind of power offering an alternative model of governance in the global age does not necessarily exclude that of a still divided

and often powerless entity resembling an NGO in a world where power politics (and martial arts) remains a popular game. Both descriptions contain elements of truth in a complex and increasingly interdependent world. They are not mutually exclusive. In fact, they should not be treated as such by those who aspire to a greater European influence in a rapidly changing world.

Europeans will need to address politically awkward (and often divisive) questions, including Europe's relations with the big powers and, most important of all, the United States. Relations with Washington still go through London, Paris, Stockholm, Athens and Riga rather than Brussels. The Obama Administration may be ready for a strong and reliable European partner (not partners). But how many Europeans are ready for it? Illusions of different kinds of special relationships die hard – as do old habits of free riding. Admittedly, eastern enlargement has complicated matters further.

Europe's hard power is lagging far behind its soft power. As defence merges increasingly with security, many Europeans are still reluctant to invest in European unity in this sensitive area. Some even think that the European is somehow incompatible with the Atlantic. The learning process is taking a long time: arguably, too long.

Can European security and defence policy go beyond a collection of haphazard peacekeeping missions? And if so, what kind of place will be reserved for the big countries – at least those ready to invest in a common European defence effort? Pooling resources in the defence industry, adjusting military capabilities to the new security threats and deploying more troops in joint operations abroad would be a good way to start.

Collectively defending common interests and values means investing in European unity in terms of money and institutions. Intergovernmental cooperation on its own can only deliver so much: we should have learned something from the experience of Europe's common foreign and security policy, with or without defence. There are political choices to be made with respect to common instruments and policies, as well as methods of reaching decisions internally and ways of being represented internationally. There is also the possibility of opt-out, even temporarily.

The new Treaty of Lisbon creates the conditions for a more effective European presence on the international scene. After all, this has been one of its main *raison d'être*, though poorly communicated to those directly concerned, namely Europe's citizens. "Lisbon" is far from perfect; and it is only a framework. But this is what treaties are for. The contents of policies can only be decided later, and of course much will depend on those who will occupy the new posts created by the treaty, most notably the President of the Council and

the High Representative, in cooperation with the President of the European Commission.

Coming to terms with the neighbourhood

Foreign policy begins with the neighbours, and Europe's neighbourhood is mostly poor and unstable. The record of successive enlargements of the EU is one that Europeans should be proud of. The big bang enlargement of 2004 and 2007, with the accession of twelve new members, has been the most daring, and also the most difficult. Successful transitions to democracy and the market are now going through a harsh test in some of the new members hit hard by the economic crisis. European solidarity is also being tested in the process.

At present, the appetite for further enlargement is limited: arguably, a sign of indigestion, which is certainly not helped by the economic downturn. Many people believe that the criteria for accession have been applied loosely in some cases. A strict application of those criteria in the future, coupled with a manifest lack of enthusiasm for further enlargement, at least in some members, will mean that most countries of the western Balkans as well as Turkey, not to mention possible future candidates, including Ukraine and Georgia, will have to exercise their patience in the waiting room for several years to come.

The process of further enlargement will be long – it also appears to be highly unpredictable. It will require strategic decisions, which the EU is not always best equipped to take. Hiding behind the technical aspects of the *acquis* is politically more convenient; it is also a much more natural reaction for bureaucrats. On the other hand, enlargement raises uncomfortable questions about internal cohesion, identity and borders, not to mention the budget and institutions. They are uncomfortable questions precisely because there is no agreement as to the answers to be given. Not surprisingly, many people try to avoid them. Yet, whether we like it or not, enlargement has become politicised, and there is no way back.

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Whether we like it or not, enlargement has become politicised, and there is no way back

We know that all previous attempts to offer substitutes for full membership have not convinced any of the candidates. It is unlikely to be any different in the future. But if further enlargement proves to be a long drawn process at best, the EU will be forced to devise intermediate stages, and link them with concrete benefits, for countries in the waiting room. We need to do much more in this area, starting with visas and measures affecting the younger generations.

The emphasis on the adoption of EU regulations, as a pre-condition for improved access to the European internal market, inevitably carries with it an economic cost for countries with lower levels of development. This applies to other associated countries with no prospect of membership, only more so. Exporting rules and regulations to neighbours and others is not always cost-free. It also sometimes verges on the surreal when Brussels pretends that some (privileged?) partners have either the political will or the institutional capacity to apply those rules and regulations. Going beyond the technical or the strictly economic, do we honestly believe there are many “shared values” between Europe and various kinds of authoritarian regimes in the neighbourhood? And how far are we prepared to push “conditionality” in our relations with countries that may not be candidates for membership in the near or even distant future?

The EU often behaves as a regional power with global rhetoric. Its neighbourhood is highly diverse: a common policy applying to all countries should recognise this diversity, and hence allow for much needed flexibility in relations with individual countries. The Union for

Do we honestly believe there are many “shared values” between Europe and various kinds of authoritarian regimes in the neighbourhood?

the Mediterranean and the new Eastern Partnership are recent attempts to revitalise neighbourhood policies addressed to the south and to the east. The EU would prefer a multilateral approach. Geopolitical realities though are likely to impose their own logic and limitations. Rhetoric sometimes runs out of control. There is a big risk that the gap between ambition and delivery will be once again uncomfortably wide. In the meantime, it would help if the EU were to make better use of its economic aid to neighbours and more distant partners in the developing world.

European soft power has repeatedly hit against the hard rock of power politics in relations with the neighbours. The EU now has a shared neighbourhood with Russia; it should not necessarily be treated as a zero-sum game. But how does post-modern Europe deal with post-imperial Russia? Does a common European foreign policy precede a common energy policy? In relation to Russia, the European answer so far seems to be neither. What kind of incentives should be offered to Germany (and others) in order to persuade it to integrate its bilateral relations with Russia within a common European policy? Preaching will simply not do. And what kind of assurances should be given to the new members who bring with them a long and painful experience of what virtual sovereignty feels like? A package deal should not be beyond the capacity of European institutions and politicians. Europe needs to handle more seriously, and in a more united fashion, its relation with the big neighbour to the east: it will be a real test of Europe’s power in the making.

On the other hand, turning the Mediterranean into an area of peace and prosperity depends crucially on the resolution of the Israeli-Palestinian conflict. The EU has for long been reduced to the status of a frustrated observer, making the odd token gesture, hoping that the United States will drive the two sides to a peaceful settlement, even when it was blatantly obvious they were driving in the wrong direction, while the carnage went on in the Middle East and the Europeans paid for the buildings that were repeatedly destroyed and rebuilt. Europe is directly affected in many different ways. After all, it is all happening in its immediate neighbourhood. Europeans tend to underestimate the policy instruments at their disposal, including those that come under the category of soft power, perhaps because they are afraid of dirtying their hands and taking risks. Such may be the limitations of a timid (and often divided) civilian power. But those limitations come with a big price.

Importing security and managing migration

What happens outside Europe can of course directly affect it inside – all the more, as international criminality and terrorism are essentially cross-border

challenges. And with its open economies and frontiers, the EU undoubtedly adds its own important dimension not only to security, but also to wider questions of immigration and asylum. In all these domains, EU policies and measures are so far of a “cooperative” rather than an “integrative” nature – unsurprisingly, one might say, given that providing security and residence or work permits for those coming from outside the EU belong to the litany of most sensitive political issues for member states. But how long will it manage to balance the resulting tensions between calls imposed from outside for joint responses and the highly resilient role of national systems?

Sure, a centralised European policing system – a kind of European FBI – cannot be a plausible objective (at least for the foreseeable future). But a further deepening of internal security operations as well as further convergence of the juridical systems seem well within the realms of possibility, in particular when putting the emphasis on a more decisive and ambitious development of already existing measures, such as Eurojust and Europol, which are clearly under-utilised at present. Not least, this strengthened internal dimension can only produce satisfactory results if coupled to an external dimension of law enforcement cooperation – with neighbouring countries and as part of the wider foreign, security and defence policy agendas. The calls for a truly integrated strategy for internal security, modelled for instance on the “European Security Strategy”, must therefore be taken more seriously.

Likewise, attempts to devise effective policies for managing migration and asylum have been suffering from piece-meal approaches, yielding, so far, relatively little. Yet while some EU countries are naturally more exposed than others, the challenges and implications are increasingly common: strong migration pressures from the global south to the global north, an ageing EU population, a contest for global talent and in many EU countries a labour shortage especially in low-skill, low-paid jobs. Europe’s geopolitical position makes the matter clearly more pressing, not less. True, the line between ensuring solidarity and effective burden sharing in the EU on the one hand, and respecting the needs and sensitivities of individual member states on the other, is a thin one. But if the EU is to accept these common challenges, adjustments in favour of more competence-pooling may well be required.

Exporting the European model

Trade policy, financial services, energy and climate are four areas in which the role of the EU will be crucial in the years to come. They combine the old and the new as Europe’s fields of competence go on expanding, often in response to a rapidly changing external environment. These are all policy areas in which European soft power has a concrete meaning;

How long will the EU manage to balance the resulting tensions between calls imposed from outside for joint responses and the highly resilient role of national systems?

and it is more familiar ground for European collective action.

Trade: between preferences and multilateralism

The EU is already big and influential in trade matters. Influence is indeed commensurate with its size, being the biggest trading bloc in the world. The Commission negotiates on behalf of the Union on the basis of mandates agreed by the Council through qualified majority voting. Material conditions differ widely inside the Union and so do political preferences on national or ideological grounds. Yet, the European legal and institutional system succeeds in delivering common positions in international trade negotiations, admittedly through intense bargaining and complex package deals, which are the trademark of the EU.

Liberal principles are not easy to reconcile with domestic interests and pressures, from agriculture all the way to shoes, cars and financial services. In times of economic crisis, with unemployment rising and national governments spending large amounts of money to save financial institutions and other lesser mortals from bankruptcy, the task will become exceedingly difficult. It will not only affect European trade policy vis-à-vis the rest of the world: the survival of the internal market will also be at stake. Preserving a liberal stance and avoiding beggar-thy-neighbour policies will require political courage and strong coordination at EU level. More effective compensation measures internally for the losers would also help.

Europe has been an advocate for multilateral management and rules for the international trading system, albeit not always in a consistent manner. For a long time, the EU tried to do a difficult balancing act between multilateralism and preferences. In more recent years, it has been tempted back to negotiating bilateral agreements, albeit with unspectacular results. In order to be able to lead, if anything by example, in a world trading system in which power is becoming more diffuse, the EU needs to be seen as complying with existing rules, including decisions that go against

it in the dispute settlement procedures of the WTO, which it has played a key role in setting up.

The EU has repeatedly tried to promote regional integration in other parts of the world, notwithstanding its limited success. The European model may indeed become more attractive, although still difficult to emulate, in a world where small is no longer so beautiful. On the other hand, Europe still runs a fragmented trade policy: EU competencies remain limited in the so-called new areas – most notably in services. Such fragmentation does not help Europe's negotiating stance in international forums, and it is high time that we try to glue the different pieces together.

The trade deficit with China is dangerously large in a time of rising protectionism. Should Europeans follow the US example of directly linking this trade deficit to currency manipulation by China? In any case, they should avoid speaking with 27 different voices, and thus risk not being heard at all in the vast land of this rapidly emerging Asian power.

Financial markets: spearheading global governance?

The illusions held by so many people for so long concerning the efficiency and self-regulating capacity of financial markets have come crashing down, causing a real disaster for the global economy in the process. The need for new standards, more effective financial supervision and global economic governance more generally are now almost universally recognised, although the devil surely lies in the specifics. And we are only at the beginning. For a globally integrated market, nothing short of global solutions will make much sense. The credibility of the United States and the west more generally has suffered a big blow. Emerging economic powers will have a much greater say in the setting up of the new order. And free riding, through regulatory or tax havens, has at long last reached the top of the international agenda.

Europe is a major player in the negotiation for a new global financial architecture, sometimes represented through the big countries, sometimes through the

Should Europeans follow the US example of directly linking its trade deficit to currency manipulation by China?

eurozone, and less so through the common institutions of EU27. A European common front makes a real difference in those negotiations. The form of external representation, in turn, largely depends on what happens internally. The crisis is most likely to act as a major catalyst for further integration in Europe: the economic governance of the eurozone and common financial regulation are prime candidates.

Will attempts at strengthening global economic governance concentrate on existing financial institutions, albeit reformed, or will they instead be canalised through more loose intergovernmental structures along the lines of a revamped G20? Whichever direction we go (probably both), the IMF seems to have been resurrected from the dead with an important mission in times of crisis and thereafter. A real reform of the IMF, unlike what was achieved last time round, can only go hand in hand with a major redistribution of power in its governance structure.

Europe has been a keen supporter of strong international institutions and common rules, trying to project its own positive experience to the global level. Europe is also grossly over-represented at the IMF executive board, as it is also at the World Bank equivalent as well as in other international organisations. Those calling for a single representation of EU countries, or perhaps more realistically the eurozone, coupled with a substantial reduction of the overall European weight of votes in those two financial institutions, have been steadily growing in numbers. Such a move would have a strong symbolic value, while also providing an effective lever for the reform of international financial institutions. Is Europe ready to turn rhetoric into action, or not yet?

Energy: navigating through high politics

Energy is not new on the European agenda, although the record of concrete achievements remains feeble. Coal went quickly into decline in the founding countries, while nuclear energy never took off as a collective European project. The EU is highly dependent on imported energy, especially oil and gas. This dependence will grow further in the future. It certainly does not help that the main suppliers are Russia and countries in the Middle East. On the other hand, import dependencies vary significantly from one member country to the other, and so does the energy mix, including the role of nuclear energy, in each country. There is as yet no European market for energy: just a juxtaposition of national markets with different forms of state intervention and limited links within them.

Pure market solutions in the energy sector are a dangerous illusion, and so are independent national solutions. Energy is a prime example of how Europe

could make a real difference combining the depth of a large internal market, solidarity among members and strong negotiating power vis-à-vis foreign suppliers. True, it is not an easily achievable target: it requires careful and patient building of a complex package deal.

We are not there yet. The Commission has been pursuing a policy of “unbundling” in electricity and gas, as a way of strengthening competition and creating a true European market for energy. This policy remains controversial. Instead, do we need large companies in an inherently oligopolistic market, in which so much of the world production is in the hands of large state controlled companies? And would the establishment of European grids in electricity and gas be a surer and more direct way of creating an integrated market?

In other words, energy policy is inextricably linked with high politics: the European component has been, until now, weak in both. The stakes are high and member countries have been reluctant to entrust the Commission with representing their interests in the context of a common European policy. Oil and gas pipelines have tended to divide European countries. Russia has been only too keen to exploit those divisions, while US pressures have not always helped much either. Strategic reserves and mutual support among members will have to be key elements of a common European energy policy. And so should greater energy efficiency, coupled with diversification of supply sources and a more realistic policy vis-à-vis Russia.

Climate change: from targets to action

Energy is directly linked to climate change. Europe is turning “green”; at least, it is aspiring to be. And it has also become a world leader in the fight against climate change, consistent with its ambition to act as a normative power defending global public goods. With the early adoption of post-Kyoto targets, Europe is trying to lead by example and thus help to shape the international agenda.

Scientific opinion suggests that this is the biggest threat facing mankind. We are told that dealing with it will

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Pure market solutions in the energy sector are a dangerous illusion, and so are independent national solutions

require a radical shift in production and consumption patterns. Few are as yet ready for it. The economic crisis could provide the opportunity to think out of the box. Alas, for the majority of policymakers climate change action risks being seen as an unaffordable luxury in times of hardship. It may prove necessary to implement an EU-wide carbon tax to supplement the operation of the European emissions trading in order to ensure that the correct market signals are in place to promote a new wave of low-carbon investment. But there is also the risk that carbon taxes may serve as an excuse for protectionism.

There are big costs involved – and the politics of distributing those costs within member countries and within the EU is both difficult and painful. The negotiation on the Climate Energy Package provides clear illustration. Intra-European negotiations require consensus, which in turn raises the risk of agreements being reached on the basis of the lowest common denominator. The shift from coal to gas in some of the new members also raises awkward questions and trade-offs between security of supply and clean energy: one among several difficult trade-offs facing policymakers.

Are the targets achievable? The 20:20:20 targets agreed by the EU for global emissions reduction, the share of renewable sources and energy efficiency improvement by 2020 may be good as a sound bite. Many people doubt whether they are realistic. It would not be the first time that rhetoric runs ahead of the capacity to deliver. Even if achievable, already a highly optimistic assumption, will the targets be enough to deal with the problem? Scientific predictions about the effects of global warming are only getting worse: the stakes will be higher. And what will Europe do, if other countries, with a large share of carbon emissions, do not follow suit with ambitious and binding targets? Hopefully, we will know better after the Copenhagen conference in December 2009: a very important, though surely not the final, stage of a long, difficult and pretty unusual process of international negotiation.

A new socio-economic settlement

The economic crisis is very likely to mark a defining moment in the process of European economic integration. Some think that it will provide a new impetus for stunted integration. Others fear (some may indeed hope) that the crisis will lead to a sustained upsurge in economic nationalism and demands for greater state autonomy that will eventually undermine the achievements of the single market. It will also surely affect the climate of intellectual and policy thinking in the EU. Is the Anglo-Saxon model of capitalism morally wounded? And will the long running debate about the future of the “European social model” prove to be too weak as a governing idea?

Before the crash: a partial success story?

These issues cannot be satisfactorily addressed without an appreciation of what EU economic and social policies had achieved before the crisis broke out. Following a period of fiscal consolidation, low growth and rising unemployment in Europe in the 1990s, the EU increasingly bought into an agenda of “economic reform”, by which bodies such as the OECD meant labour market reforms to create more flexibility and weaken trade union resistance to change; further opening of product markets, especially those traditionally dominated by publicly owned monopolies; and the liberalisation of financial services. In 2000, the Lisbon strategy added a more social democratic emphasis on both new forms of public investment in growth through research and innovation and the idea that social inclusion policies could be designed to have a positive impact on economic performance.

Sure, there is considerable debate as to whether or not policymakers’ continued emphasis on the “Lisbon Agenda” of economic reform contributed much to timely and effective outcomes. But the first decade of the twenty-first century turned out to be a period of relative success for the European economy. A central feature of the upturn was the remarkably smooth transition to the euro. That the euro was a success became clear when the financial crisis struck. Its existence prevented currency turbulence and the rounds of competitive devaluation that would have occurred without it, which, in turn, would in all likelihood have led to more pressures on the integrity of the single market.

Is the Anglo-Saxon model of capitalism morally wounded? And will the long running debate about the future of the “European social model” prove to be too weak as a governing idea?

One other area of conspicuous policy success was employment. This reflected in part the success of piecemeal labour market reforms in member states. These on the whole embedded a policy shift from work sharing, early retirement and limitations on working time towards employment activation, “flexicurity” and greater flexibility.

Compared with the US record, R&D and innovation in Europe continued to lag behind. On the other hand, the success of Germany in re-establishing itself as the world’s leading exporting nation demonstrated the pay off from difficult structural reforms, above all at company level. Rather than globalisation signalling the end of Europe’s ability to compete in rapidly growing world markets, it demonstrated the scale of the huge new commercial opportunities that existed for European businesses that reorganised their global supply chains, focused their European activities on high value added and exploited new market niches. Admittedly, this road may not be open to everybody.

Economic integration...

Economic integration, meanwhile, proceeded apace. Cross border mergers increased. In particular, cross border financial integration deepened as a result of EU policy decisions on the creation of the euro and on financial liberalisation. The City of London strengthened its dominance as Europe’s major financial centre, apparently unaffected by the UK decision not to join the eurozone though benefiting greatly from the increased momentum of European economic integration. At the same time, strong catch up growth took off in the new member states, particularly the Baltics, Slovakia and Poland, suggesting that the central and eastern enlargement would lead to rapid convergence, as it had earlier in the case of the Cohesion Four (Greece, Ireland, Portugal and Spain). EU budgetary transfers and the freeing of labour movements across borders also contributed.

Enlargement has greatly increased economic and social diversity in the EU, without much serious analysis of the implications thereof. The wage share in national income declined in many of the old member states and measures of inequality and child poverty grew. But Europe saw nothing like the increase in inequality that occurred in the United States. Instead, increases in inequality in Europe appeared member state specific and episodic rather than part of a general trend. At the same time, divergence in terms of fiscal deficits and current account balances grew within the eurozone.

...with little appetite for policy reform

Policy integration continued at a slow pace. Only modest progress was made in strengthening eurozone governance. True, the rules of the Growth and Stability Pact underwent pragmatic revision and were made more flexible and intelligent, but the institutional architecture remained both weak and unbalanced: the difference between the economic and the monetary dimension of EMU is absolutely huge.

The Lisbon process was in part conceived as an alternative to classical integration. Yet though it was re-launched with a flourish at the start of the Barroso Commission in 2004, it failed to engage political attention or deliver high-profile results. In terms of market liberalisation, the remaining area with the most economic potential is the service economy. The broad based approach adopted by the Commission came up against strong resistance. This demonstrated the limits of political will to drive the extension of the single market beyond goods. There was also sparse legislative achievement in harmonising internal rules and standards, not to mention questions of taxation, with only few notable exceptions, namely the REACH directive and limited progress with respect to financial services. The dominant spirit of the time was anti-regulatory.

There also appeared to be a lack of radical ambition for budget reform. Over 70% of the funds are still devoted to the Common Agricultural Policy and Structural Funds, despite the emergence of major new EU policy priorities such as the need to facilitate the transition to a low-carbon economy; strengthening controls on migration at the common EU border; research and higher education in light of Europe clearly falling behind the US; and a more active and effective EU neighbourhood and external policy.

True, agricultural subsidies have largely been decoupled from production and more funds switched to rural economic development. The Structural Funds are now also supposed to be aligned with “Lisbon” policy objectives. Yet, even within fields covered by the EU budget, the Commission still has little ability to direct spending towards its agreed policy priorities. To put it bluntly, the Commission’s political accountability

The Commission’s political accountability is centred on bureaucratic processes and financial procedures rather than better policy outcomes

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Partly as a result, “Social Europe” remained largely a rhetorical construct. Debate was polarised between those who interpreted anything labelled “social” as a burden on business and those who advocated a traditional social agenda centred on labour market regulation. However, some political space for future European action was created through the establishment of the Globalisation Adjustment Fund, albeit with very limited resources, and the advancing debate on “flexicurity”.

In short, until the crisis broke in the autumn of 2008, the prospects for major policy change were poor. This reflected an intellectual consensus that the single market in legislative terms was near complete; that the euro had become quickly embedded in its early years without a degree of turbulence that fundamentally called its governance into question; and that social and budgetary questions were in the classically “all too difficult” redistributive category that member states had no appetite to grapple with. Given the dominance of this view, it was more or less taken for granted that the internal development of the EU would proceed benignly as a result of market dynamics, supplemented by the full exercise of the Commission’s powers of implementation of existing legislation and the powerful liberalising instincts of the European Court’s jurisprudence.

Scattered responses to the crisis

Against this background, it is not surprising that Europe’s initial reaction to the global financial crisis was somewhat complacent. Its impact was deemed to be containable. The crisis was seen as a problem of “Anglo-Saxon” financial capitalism, conceived in the US, with the implication that spillovers to the continental economy would be limited. Clearly, some member states were more exposed than others. In the UK and Ireland, where financial services had grown (too) rapidly as a share of economic activity and had (together with Spain) seen an unsustainable boom in bank lending, house price rises and consumer spending growth had been in excess of GDP growth.

But the initial conventional wisdom was that the EU would be able to batten down the hatches and ride the storm. This complacency did not, however, survive long as the seizing up of the world financial system shook the banking system to its foundations in Europe as much as the United States. The spread of the crisis from Wall Street to Main Street triggered a sudden collapse both in consumer confidence and world trade, to which Germany as the world's leading exporter, has been particularly exposed.

The crisis found the European Union ill prepared. Few experts had predicted what could go wrong. In fairness, some had foreseen a looming problem in that financial market integration in Europe had proceeded apace without an adequate parallel development in the effectiveness of financial regulation at EU level. But even if better cross border supervision had been in place, there is legitimate doubt as to how much it would have mitigated the scale of the crisis. The problem for supervision may have been an inability to understand the nature of systemic risk as much as a failing of normal regulatory processes. And when the problem became one of bank solvency, the absence of any European fiscal authority with the power to tax meant that member states had to take responsibility for bank rescues and recapitalisation. In eurosceptic eyes, the essential role of the nation-state was confirmed.

The good news is that the coordination reflex developed after so many years of working together finally prevailed as Europeans began to realise what was really at stake. A broadly pitched framework for national financial rescues was adopted, followed by a fiscal stimulus plan, the implementation of which has been both imperfect and uneven. The bad news is that the EU coordination mechanism is clearly not up to the task, while European solidarity is still shown to have narrow limits.

There can be no substantive economic recovery without a cohesive EU approach to banking sector recapitalisation, regulation and supervision. In many respects, what Europe requires is a kind of "Treuhand agency", which famously privatised many East German

enterprises during the process of the country's re-unification. Such an agency at EU level would take on the overall responsibility of guiding the banking sector in Europe through the difficult phase of restructuring.

The wider pattern of responses to the crisis has largely been national and the consequences for the EU policy framework treated as second order issues. Governments have sought both properly and legitimately to protect their citizens against the impact of the crisis: the unprecedented risks of loss of savings due to potential bank collapse; more mortgage defaults and housing repossessions; and business bankruptcies. Emergency measures have been taken to mitigate the impact of the crisis on particularly vulnerable sectors, for example the motor industry, where orders have collapsed as new car purchases have been deferred. The handling of the disposal of General Motors' European interests was notoriously left to member states to fend for themselves rather than a cohesive European view taken with accusations that Germany had designed a deal to protect domestic jobs at the expense of GM jobs in other member states.

Emergency actions taken at national level will inevitably lead to distortions in the single market. The scale of these will remain relatively uncertain until the crisis has completed its trajectory. But we know already that in banking and motor manufacturing, the provision of new state aids has been extensive. There is no certainty that these distortions will be easily unwound in the near future, unless there is a powerful Commission, with strong leadership from its president, willing to take recalcitrant companies and member states to task, with the political backing of the Council.

And there is another, very important aspect to the economic crisis. Some of the new member states have been very badly hit; the loss of GDP in Latvia could be close to 20% in 2009, thus running the risk of undoing the remarkable progress achieved during the transition to democracy and the market economy. The IMF has come to the aid of Latvia, and also of Hungary and Romania so far. This speaks volumes about the maturity of the EU as an economic and political entity. True, European institutions, and most notably the ECB, have also been playing a significant role in assisting member countries in financial difficulty. Greater intra-European solidarity may be needed soon, together with more effective mechanisms of "conditionality".

A paradigm shift?

The crisis has cast doubt over the prevailing consensus that internal EU economic and social questions could take second place to the much bigger debate on the EU's global role. Its wider impact on the European economy is still uncertain. Even in autumn 2009, when there are some encouraging signs of recovery underway,

The good news is that the coordination reflex finally prevailed... the bad news is that the EU coordination mechanism is clearly not up to the task

The era and rhetoric of tax competition is likely to be at an end

many experts question whether “normality” is about to be restored and, even if it were, whether European policy could conceivably return to “business as usual” as in the period up to mid-2008. Could a paradigm shift be occurring that will have profoundly deep and long-term effects? And what will the consequences for the EU be?

In one sense, this question is already answering itself – at least in part. European leaders have already committed themselves to a programme of reinforced financial regulation to buttress a “more responsible capitalism” that could have profound consequences, particularly for the UK, which historically has been allergic to entangling its financial markets in European red tape. Financial services re-regulation will be at the heart of the reconstruction of the single market once the worst of the crisis is over and the proposals contained in the de Larosière report translate into binding legislation.

Thereafter, a great deal will depend on the vigour of the Commission in tackling the market distortions that the crisis has introduced, which will probably be a long haul slog over at least a decade. In the process of rebuilding the single market, market liberals will probably have to give some ground to interventionists in the modernisation of, for example, the motor manufacturing sector, alongside wider policies to promote the transition to a low-carbon economy. This could be the early twenty-first century equivalent of the structural policies for reshaping the coal and steel sectors in earlier periods. Yet, for all the undoubted difficulties and compromises ahead, the key conclusion is that the single market has survived.

Fiscal coordination and the role of the Eurogroup

The ratification of the Lisbon Treaty is likely to result in greater formalisation and the further strengthening of the role of the Eurogroup. The management of the euro needs stronger and more effective institutions. On the other hand, an enhanced eurogroup does not mean that the role of ECOFIN will disappear: it is strongly in the interests of the eurozone that the necessary strengthening of financial regulation is agreed on an EU-wide basis, involving the UK. As the City of London is the de facto financial centre of the euro area, despite being outside it, this still gives the UK significant leverage in designing the detailed shape of this new regulatory regime, as long as the UK agrees

to play the European game. The present pressure to be serious in tackling tax havens and abuses by the rich may result in greater tacit tax coordination, including eventually the adoption of minimum rates. The era and rhetoric of tax competition is likely to be at an end. But there will be inevitable rows and tensions between different views of how all this should be done, laced naturally enough with vested national interests.

At present, however, there is no sign that the crisis will result in a centralisation of fiscal authority in the euro area. The EU therefore needs to establish a new consensus on what should be the sound principles of public finance for the period ahead. To say that there is no need for fundamental change in the Growth and Stability Pact is to argue that the EU should take no effective position at all. Meaningful targets for each member state could be framed on the basis of a sustainable long term debt to GDP position with much greater transparency on whether current fiscal policies are consistent with achievement of the long term target. The key requirement is to agree on rules whereby an adequate portion of the proceeds of growth is steadily devoted to reducing national debt, without attempting a fiscal consolidation at such speed that growth itself is stifled.

In judging progress towards member state compliance with a revised set of fiscal rules, the question of the quality as well as the quantum of public expenditure needs to become a guiding principle. This raises the issue of whether it would be possible to arrive at an operational definition of what constitutes “social investment” on which member state policies could be compared and judged. The EU has gone a long way in developing statistically robust measurements of social inclusion that allow meaningful comparison between member states. A similar exercise should now be undertaken to measure member state performance on indicators of social investment.

Macroeconomic management

In terms of macroeconomic policy coordination, the position of Germany is absolutely crucial. With its strong balance of payments and dominant position as the motor of the European economy, Germany needs to be persuaded that a prudent decision to expand

The question of the quality as well as the quantum of public expenditure needs to become a guiding principle

its own economy without significant inflationary risk will not lead to profligacy elsewhere or increase the chances that the German taxpayer will be expected to bail out others' mistakes.

Berating the Germans about their failure to take the expansionary steps that they could afford is unlikely to yield much success. However, a grand bargain at EU level is possible whereby other member states agree reforms that Germany is arguing for. This package would certainly include tougher common rules for financial regulation. It might also include greater tax coordination, including the adoption of minimum tax rates. In order to bring down fiscal deficits and public debt, member states need to protect and restore their tax base. In a situation where public finances are generally weak, it does not make sense to allow business to play off one member state against another or allow blatant tax competition. It may also be necessary to implement an EU-wide carbon tax.

Another possible reform is to make payments under the EU budget conditional on benchmarks of progress that would need to be agreed individually with member states: these benchmarks could include quality of governance as well as progress towards Lisbon-type reforms. Germany as the largest contributor to the EU budget stands to gain from such an approach.

Labour market reform and social inclusion

A big political uncertainty is whether the recession will be long-lasting and parts of Europe engulfed by a serious social crisis. Much of Europe's impressive employment growth has been in the second tier labour market of insecure jobs with inadequate protections and employment rights. The privileged position of the labour market "inner core" is likely to seem even more indefensible. This should sharpen the debate in favour of more balanced "flexicurity", giving greater consideration to the security dimension without reverting to a work-sharing psychology.

A social crisis – combined with populist opposition to labour migration – may also lead to a new look at EU social policy. Europe is faced with manifold social challenges: the ever-present threat of protectionism and

fear of globalisation; rising unemployment, especially among youths and graduates, and the polarisation of labour markets between "lovely and lousy" jobs; citizens in new member states struggling to service debt as their ailing national currencies depreciate.

It is clear that member states as a whole need to invest more in their social future. Priority must be given to policies that improve life chances for children and young people to tackle emerging problems of generational inequity. New "social bridges" need to be constructed to create access to new ladders of opportunity at different stages of the life cycle. The potential risks of polarisation between winners and losers from economic change and globalisation need to be narrowed: a new focus is needed on better labour market transitions, particularly for the low skilled. Emerging social problems, such as the social exclusion of disadvantaged and child poverty, can only be tackled through sustained social investment. Member states have the main responsibility for the social policy changes that are necessary. But this does not preclude a framework of objectives, targets, incentives and mutual learning that could be set at EU level.

An opportunity to strengthen social policy is offered by the forthcoming review of the EU budget. One possibility is that if the crisis is prolonged, demand may grow for a Europe-wide recovery plan based on investment in low-carbon transition, research and skills among others. This recovery plan could be financed through the issuing of Eurobonds. One important dimension of the EU budget will continue to be about redistribution and cohesion policies. They now constitute integral parts of the European internal bargain. However, difficult decisions will need to be taken about how much money should be spent and on the basis of what criteria. Ideally, the discussion about overall net balances among member states should be dissociated from that of individual policies. We need better and more efficient use of every euro spent. And it goes without saying that the reform process of the common agricultural policy will have to be accelerated.

On the other hand, EU budget reform should place particular emphasis on the expansion of common policies where the EU can genuinely make a difference beyond the remit of national policy instruments and what they can realistically achieve at the national level alone – research and innovation; mobility within higher education; cross-border energy infrastructure necessary for energy security and low-carbon transition, alongside flagship social policy initiatives. EU budget funds could be used to realise some form of minimum income or anti-child poverty guarantee across the Union. This could be agreed as a "side-payment" to the new member states for a tightening of the Posted Workers Directive.

One important dimension of the EU budget will continue to be about redistribution and cohesion policies

Towards a new political economy of the EU

At one level, the discourse on the future of Europe will take the shape of a reversion to a familiar pro- or anti-European debate. Lining up on one side are those who feel that in some way the EU offers a shield against the disruptive forces of global capitalism, potentially far wider and thicker than the diminished role that the nation state can now offer: the logic that persuaded the Irish to vote a second time in favour of the Lisbon Treaty and Iceland to apply for EU membership.

Ranged against this position are mostly populists on both the right and left, who see European integration as part of the problem, not the solution. They will almost certainly see a stronger nation-state as a consequence of the crisis, whether in protecting jobs at home, controlling migrant labour, or supporting national businesses in trouble. In addition, there is the possibility that some of the newer member states may feel “let down” by the EU – if they are left to themselves and denied the possibility of early entry to the euro. This could strengthen anti-EU feeling in some member states, unless the EU acts with greater boldness and vision.

Reconciling different economic approaches

Among those who see Europe as an essential part of the solution, the lessons of the crisis may be interpreted quite differently. For ease of understanding, they can be placed into four distinct camps.

First, “integrationist interventionists” will see the crisis as an opportunity and find support for their instincts in the argument, popular on the left, that the crisis brings back the case for a wide range of public intervention in the economy, not just a need for tighter financial regulation but Euro-Keynesianism and more interventionist industrial policies.

In contrast, “economic liberals” who regard the single market as a central EU achievement, will only be “market-conditional integrationists”. They will want to consider whether and how EU institutions need to

be strengthened as an agency of liberalisation, both internally and in the wider world, in order to better defend, or indeed re-impose, what they regard as essential commitments to the “four freedoms” of the Rome Treaty and the centrality of the EU’s espousal of the single market to its work.

There will also be some “market redistributionists” who would count themselves in the market liberal camp, but would be more prepared to embrace social measures aimed at strengthening political support for open markets, as long as they cause no significant damage to competition, efficiency and dynamism. Prominent Europeans have called for a new balance to be struck between market liberalism and redistribution.

Finally, there will be “better market orderers” who in the classic German social market tradition place heavy emphasis on closer social regulation of how financial markets operate and how business conducts its affairs and exercises its wider social responsibilities. This view gives priority to getting frameworks right and frowns on day to day public interventionism: it is fundamentally about shaping behaviours in the market place not altering market outcomes.

How will these different perspectives play out in their impact on future policy? The fundamental concern that will unite all strands of pro-European thinking is the survival of the euro. For “market orderers”, the euro is what binds together the social market they seek to build. For “market liberals” and “redistributionists”, it is the cornerstone of liberalisation without which the risk of fragmentation in the single market would grow as member states sought to protect their economies against the consequences of exchange rate instability. For “interventionist integrationists”, the existence of the euro holds out the hope of stronger European economic government.

This is not to say that the future of the euro will be without crisis or fierce political rows. No one can tell whether the eurozone will one day be confronted with a credibility crisis if the markets refuse to fund the borrowings of an over-indebted member state. Germany (with the support of other richer member states) may be prepared as a last resort to bail other countries out – but this emergency support will not be for free. For instance, Ireland could come under pressure to phase out the tax rules that are seen to give them an unfairly favourable advantage in attracting US investment. The central and eastern European states could be forced to follow a disciplined path to euro membership and curb “social dumping”. But Germany and others would have the sense to recognise that all this would have to be done within the limits of political acceptability for the member states concerned.

A major uncertainty concerns the speedy enlargement of the euro to those member states who see it as a safe

The fundamental concern that will unite all strands of pro-European thinking is the survival of the euro

haven of stability. “Market liberals” will tend to argue that “politics” should not determine “the economics”, though the question of what makes for sensible entry criteria has been thrown wide open by the crisis. “Market orderers” may take a longer term view of Europe’s essential interests.

Avoiding “beggar-thy-neighbour” policies

The crisis has strengthened the importance of the role of government at both nation state and EU level. The nation state gains in importance because of the added urgency to reform welfare states and hasten low-carbon transition. Countries like the UK and Ireland need to develop a new growth model as an alternative to their previous dependence on financial services. These are tasks that, given the division of competences within the Union, only the nation-state can reasonably fulfil.

Yet, at the same time, the necessity of greater nation-state activism requires a stronger framework at EU level, both to make nation-state activism effective and to prevent it resulting in “beggar-thy-neighbour” policies. Nation-state efforts to combat unemployment will be most effective within a framework of EU policy coordination given the scale of the economic spillovers created by European economic integration and the single market. Similarly, an effective EU framework for carbon pricing is essential if large scale low-carbon investment is to take place. And when it comes to events to promote economic development, nation-states and regions must operate within a clear framework of EU rules for state aids and incentives.

Similarly, the debate about regulation of bankers’ bonuses is symptomatic of a wider concern that the crisis has intensified: that our economies need to be governed by “fair rules”. This implies that in the years ahead there will be a continuing bias on issues of corporate governance and responsibility. The striking change is how far in the UK the mood has shifted against the “light touch” mentality of Anglo-Saxon capitalism. There is an acceptance of the need for “market ordering” across the political spectrum that simply did not exist before; and this opens up new possibilities of EU consensus.

The post-Lisbon policy framework

The overall conclusion, therefore, is that the impact of the crisis will be that “market liberalism” loses out and “market orderers” gain the upper hand. This should not lead to a retreat from the promotion of competitive markets or indeed globalisation as a tool of efficiency and a driver of innovation. But it does mean a new framework of “markets with rules” for the future.

There is an acceptance of the need for “market ordering” across the political spectrum that simply did not exist before

There can be no return to business as usual after the global recession runs its course: public policy cannot and will, in any case, be unable to return to status quo ante. Instead, the EU needs to focus with even more urgency on the new economic paradigms of the twenty-first century: economic globalisation, low-carbon transition and the ageing society. Overcoming these immense challenges, in tandem with coping with the long-term impact of the current recession, will require a greater steering role for government. At the same time, this must happen within a strong and credible EU framework.

Therefore, the EU needs a new overarching internal policy framework to replace Lisbon – a new socio-economic settlement for the future. This should be based on seven pillars:

- A Euro-area that is consolidated as a zone of economic security open to all member states willing and able to abide by clearly defined rules.
- A stronger framework for macroeconomic coordination which promotes growth and facilitates strictly defined social investments that offer high economic and social returns.
- A new determination to rebuild and strengthen the Single Market with structural reforms to strengthen competition.
- Moves to single EU external representation in the economic field.
- New EU-wide “fairness” rules for financial regulation, tax coordination and corporate governance.
- A consistent emphasis throughout on sustainability and the promotion of low-carbon transition.
- New and more effective forms of solidarity and redistribution, coupled with a comprehensive EU budget reform that makes EU aid conditional on policy reforms by member states and addresses the twin challenges of demography and globalisation.

This framework should, of course, acknowledge the need for differentiated approaches toward common goals given the increased diversity of the EU. Yet this is the moment in the history of Europe as a political project that will test the mettle of the European leaders and challenge the principle of its *raison d'être*.

How politics can deliver

The big question then is: will Europe's political system actually be able to deliver? When European voters were asked in June 2009 to cast their ballot for the election of the European Parliament, the political circumstances could not have been more agitated. The world had just suffered one of its worst economic crises, marking the end of an era in economic, political and ideological terms. Governments across Europe were intensely debating costly rescue operations for their respective financial systems, while political parties of all colours were attempting to interpret the looming paradigm shift in their favour and to their tastes. And on top of all this, the EU itself was confronted with the weighty challenge – unprecedented in scale and scope – of navigating its member states through these times of crisis. In short, the perfect menu for a mature political contest with clear policy choices, strong personalisation and greater visibility for the EU institutions was all but arranged. Indeed, the stakes of the elections seemed to be exceptionally high.

Why we need to be concerned about EU legitimacy

However, instead of a feast for European democracy we witnessed yet another political low point which was characterised by a further decrease in the turnout (to just 43%) and little to no interest in the manifestos and campaigns of the EU-wide political parties; and this despite hard-fought, yet successful, attempts by many politicians to equip the European Parliament with real power in EU policymaking. Moreover, the subsequent manoeuvring surrounding the re-election of Commission President José Manuel Barroso did not change any of this assessment – quite the contrary given the absence of an alternative candidate for his position and thus real competition for political direction. For those who were hoping for the emergence of a more democratic and expedient “political Europe” the June elections and their aftermath were nothing but a disappointment.

Some people choose complacency. They point out that, over the last fifty years or so, the European Union

has suffered a number of low points and setbacks – only to emerge fitter and stronger afterwards. This is particularly true for those defeats inflicted by European citizens when directly consulted on important EU questions. They do not believe in a popular rejection of a project perceived as select and top-down in its approach. Instead, they point to the constitutional and institutional complexities of the EU integration process, which require diligent and time-consuming explanations before European citizens are ready to give their blessing to major decisions reached at the EU level. Has the positive outcome of the second Irish referendum in October 2009 proved them right once again?

At the same time, attitudes towards and opinions on specific aspects of European integration provide an ambivalent picture. National support for membership of the EU, as measured by the Eurobarometer (Sept 2009), has stabilised at a level just over 50%, even though only a minority of EU citizens maintain that their overall image of the EU is positive. True, those with a negative image of the EU are much fewer in most member countries, with a significant number of “don't knows”.

The economic crisis, in turn, does not seem to have directly affected (positively or negatively) citizens' attitudes as far as the perceived benefits of membership are concerned – the situation is exactly the same as that recorded in August 2008 – while expectations for the EU to deliver in sensitive policy areas such as internal security, energy and climate change, as well as foreign policy, remain very high. On the other hand, there are still slightly more who think that the EU is “going in the wrong direction” than those who see the EU as “on the right track”. And even more worryingly, just over a third of the EU population believes that their voice actually counts in the EU, while a majority believe that this is not the case.

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Manifestations of unease

All this should not come as a surprise. Despite its spectacular past successes, ranging from the single market and the euro to the consolidation of democracy and peace on the European continent, there is evidently something discomfiting about the EU in 2009. This unease is manifested in the inward-looking mood of Europe, the resurgence of nationalistic tendencies and the faintness of the European idea. It is not only that the relative weakness of the popular mandate granted, either directly or indirectly, at various points in the recent EU integration process has slowed down or severely disrupted this very process, but also that seasoned observers of the European scene now broadly agree that the EU's legitimacy has indeed been eroded – a problem that will not be resolved by the adoption of the Lisbon Treaty alone.

Some may still dispute the existence of such a legitimacy problem or “democratic deficit”. But they misjudge at least one central point in relation to the dynamics of European integration: it may be correct to point out that until relatively recently the EU had mostly dealt with issues that were of little interest to citizens, or at least perceived to be so, from trade liberalisation and economic regulation to peacekeeping in Kosovo. From this standpoint, the low level of political participation was justified by the low degree of importance people attached to such issues.

However, precisely because this is already changing, as the EU begins to deal with more salient issues, such as macroeconomic management, immigration, the environment and possibly, tomorrow, taxation, the “passive consensus” has come under considerable strain in recent years and could be further weakened in the future. In other words, legitimacy is likely to become even more of a problem as the EU expands into new areas under the pressure of both internal and external factors.

The populist and elitist revolts

Two important developments epitomise this tension. First, more and more political parties in Europe, mostly populist but no longer exclusively so, cultivate (and exploit) anti-EU feelings among those citizens who have been negatively affected by societal and economic changes in recent years. While the causes of anti-Europeanism are of course manifold, there is increased evidence that the losers from change, in particular those with low-income and insecure jobs, are turning against the EU, which is perceived as an important vehicle of change. Therefore, in today's world a major challenge for mainstream politicians lies in how they rebut the, often unfounded, accusations of a growing number of people, who blame the EU for prejudicial and unwanted developments.

Legitimacy is likely to become even more of a problem as the EU expands into new areas under the pressure of both internal and external factors

Secondly, current reform processes and institutional arrangements are increasingly coming under attack from parts of the European elite itself – both on the left and the right. Germany, the biggest member state of the EU, offers two revealing examples in this context. On the one hand, it is argued that recent decisions by the European Court of Justice constitute a violation of salient national interests, raising serious questions about the attribution of competences when it comes to defining and ensuring common EU rules. At the core of this criticism lies the concern that the non-political actors of EU policymaking have developed a degree of activism and autonomy, which tend to weaken the political legitimacy of member states, ultimately jeopardising the voluntary compliance of governments to implement EU norms and directives. The functioning of labour markets and the welfare state are cases in point.

On the other hand, the German Constitutional Court, in an unprecedented ruling on the institutional arrangement of the EU, has put a big and bold question mark behind any form of closer European cooperation in sensitive national policy areas, let alone deeper integration. Karlsruhe has not only denied the European Parliament its role as a genuine democratic representation of EU citizens' interests, but has also drawn sharp new dividing lines on questions of legitimacy and sovereignty which are bound to complicate EU decision-making on future big questions.

Essentially, the ruling attempts to cement the EU *status quo* despite the fact that the dynamics of the single market and the monetary union demand further adjustments, for example on fiscal policy, if Brussels is to deal with crises like the current one in a more effective manner. While it was always unlikely that Germany would be the country to bury the Lisbon Treaty, this damning verdict by the senior counsels has already startled those European federalists who tend to consider the German system as a potential role model for deeper integration.

Expanding the base of legitimacy

Needless to say, major discrepancies are evident vis-à-vis the next steps required to work through this conundrum of relatively weak popular support, the rise of “intelligent Euroscepticism” and growing nationalistic reflexes on the one hand, and high expectations and demands placed on the EU by large sections of the European elites and those outside, on the other. This is really the crux of the matter.

Some believe that the way out would be through a more rigorous application of the concept of “subsidiarity”. The disentanglement of competences would not only create a better understanding on the part of EU citizens, it would also help streamline the EU policymaking process as a whole, so they argue. The underlying assumption seems to be that the EU may at present be attempting too much rather than too little. But could this be reconciled with the continuous expansion of an EU agenda that appears to be driven by a variety of factors linked to the internal dynamics of economic integration and the global age?

On the other end, there are those who point to growing inequalities and a powerless and effectively disenfranchised under-class, which has bred a hitherto unknown degree of alienation and cynicism that seems to rock the very foundations of our liberal democracies. According to this view, the most difficult challenge for the EU as a political entity is providing a stable framework for the peaceful coexistence and continuous compatibility of capitalism and democracy in Europe under the conditions of the 21st century.

Indeed, historians remind us that during the *Trente Glorieuses* European integration was successfully married with a “European Social Model” in its different national versions, which in turn managed to tame capitalism in the interests of justice and cohesion. Capitalism was by no means dispelled or even dissipated; on the contrary, it was strengthened and, most importantly, legitimised in the eyes of the vast majority of our society. Nowadays, however, widespread feelings exist which deem our capitalist systems to be beyond reasonable control, overwhelmed by the unprecedented level of global interdependence

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and capital flows around the world. As such, is it realistic to believe that the EU should act as a political project to re-tame capitalism without reversing globalisation and cutting back on the benefits of openness?

Leadership and a new narrative

There are high expectations and big challenges that will prove difficult to meet given the constraints of EU governance and the weakness of its base of legitimacy. Hence, what could possibly be done to enable the Union to again take bold decisions in the name and best interests of the large majority of its citizens? The most crucial factor in this equation may be political leadership, but this can prove difficult to influence. After all, major advances in European history were initiated by outstanding personalities and visionary politicians; a quality leadership that seems to be in short supply in Europe in this age. And the EU does not and will never resemble the United States of America, where the president accumulates a range of powers which not even the supporters of a “United States of Europe” can dream of. As a consequence, the task is to find other ways in which the EU can gradually expand its basis of legitimacy; only this will allow EU policymakers to act more decisively, coherently and consensually.

To begin with, European integration needs a new narrative and a new normative foundation. While this insight has now become commonplace, efforts to act on it have yielded very little. In fact, these efforts have primarily been hampered by the Union’s increased diversity, reflected in its varying ideological, cultural and political preferences. Any attempt to construct such a foundation or narrative in antagonism to others (the US, Islam, etc) or in view of a narrowly defined political goal (“Europe as a protector against globalisation”) is therefore bound to fail.

Instead, besides its indispensable roots in history and emphasis on common values, Europe needs to identify itself through widely held principles such as “openness” and “competition” coupled with “inclusion” and “solidarity”, which can transcend their abstract meaning in real life European integration and be applied in a variety of political contexts, both internally and externally. Negotiations and the rule of law have successfully replaced power politics in intra-European relations. This is a remarkable achievement and something that Europe could try to export to the rest of the world: a soft kind of export that could really help to mobilise the younger generations of Europeans. There are both interests and values to defend collectively: “strength in unity” could be a powerful driving force in the years to come.

The emptiness of European identity might therefore be a real obstacle when seeking different forms of popular support for further integration

A shared sense of identity

Any configuration of representative democracy, whether national or trans-national, must reflect a shared sense of identity to achieve legitimacy. Despite the EU being a *sui generis* political entity and the recognised constraints of direct representation in Europe, there are now strong indications that the Union’s “identity deficit” has begun to undermine the integration process as a whole. In particular, the gulf between elite and popular perceptions of what the EU is actually all about and what it is capable of achieving remains wide open. While some want to rectify this problem through better communication strategies, others judge that what may be needed is a stronger collective sense of “we” among European peoples.

Indeed, the weaker the shared identity, the less likely Europeans will give their consent to developments in Europe, which they cannot always fully appreciate. At best, the problem of “understanding” refers to the technical details of the issue at stake. Yet, it is equally possible that EU citizens actually do want to comprehend and control the broader context in which the EU is supposed to progress. Or, at the very least, how it relates to “others” in the equation. The emptiness of European identity might therefore be a real obstacle when seeking different forms of popular support for further integration.

Of course, sceptics argue that there is no such thing as a European identity: nothing, in any case, that we can build upon. However, identities are always plural and full of uncertainties and internal divisions. What matters here though is substance and familiarity. Many inveterate optimists therefore believe that renewing our efforts to build a “common European house” through the creation of truly European spaces of education, research and sport, or the establishment of more pan-European networks and institutions, with higher degrees of visibility, will ultimately pay off.

Taking output legitimacy seriously

But should we waste time, resources and energy in ensuring broad-based support for nearly every aspect

of the EU project, when important commonalities and preferences already exist? There are those who believe that Europe primarily needs a big idea which, in turn, can ultimately succeed in overcoming the worrying mismatch between promises and results that has so far thwarted any attempt to increase EU legitimacy. According to this reading, the self-inflicted crisis of an inward-looking EU can best be cured by a renewed focus on “output legitimacy”; in other words, the kind of legitimacy founded on the ability of institutions to deliver the goods and hence meet the expectations of European citizens.

Correspondingly, the idea has to be in line with the concerns expressed by citizens; for instance, in public surveys over an extended period of time. Tackling climate change, energy security and a more effective common foreign policy appear to be among the top favourites in this context. In fact, they might even be the last available *cartes blanches*; the last of a series which has essentially carried the EU forward in previous decades. Brussels should therefore make the most out of them, by devising, if necessary, new *ad hoc* mechanisms that help to ensure successful delivery and implementation. Indeed, it is not uncommon to believe that if the EU fails to act on these fronts, any question of legitimacy will sooner or later become obsolete.

Constructing a new narrative, facilitating a stronger sense of identity and renewing the focus on output legitimacy are all factors which may well make a positive difference to EU legitimacy. Yet in the case of identity, it seems at best a long-term prospect and ultimately a case of “gardening” rather than “engineering”. Increasing legitimacy through effective output, on the other hand, is certainly feasible in the mid-term and also uncontroversial as long as its focus remains on common problems where decisive action at the EU level is supported by a clear majority of member states and peoples. However, will it also deliver on those ambitions and policy aspirations, which tend to be more divisive, in particular in the socio-economic realm?

A positive strategy for differentiated integration

Given the scope of the political challenge, it is now time for the European Union and national policymakers to

The task must be to unite behind a more positive understanding and strategy of flexible integration

look much more seriously at two of the more contested approaches. One of them is flexible or differentiated integration. Here, the core assumption is that a Union of 27, that will continue to grow, simply cannot function in the same way as the EU12 or EU15 did. Despite the fact that voting records and the number of adopted rules and directives do not suggest a slowdown in EU policymaking processes after the big bang enlargement, the successive widening of diversities and interests has inevitably led to questions of how politics at the lowest common denominator can be avoided.

Proponents of flexible integration draw attention to the previously successful use of flexibility and differentiation, listing the euro, Schengen and the Treaty of Prüm as prime examples. Indeed, all the major advances and important acts of integration since the Single European Act have been based upon some form of flexibility, allowing those who opted out, to sidestep or postpone the tricky question of popular legitimacy. Several models are therefore being discussed: multi-speed, hard-core, *avant-garde*, or *Europe à la carte*. The core emphasis of the Lisbon Treaty on “enhanced cooperation” seems somehow to be a compromise between all of these slightly diverging options. Yet, should it also become a core norm of European integration?

The crux of the debate about flexible or differentiated integration is that its supporters have often little or nothing in common, ranging from those who look for practical ways of surmounting EU deadlock, all the way to those who use it as leverage against stubborn partners, or simply those who yearn for “the good old days” when EU affairs were decided by a handful of like-minded Europeans over an expanded lunch break. High politics in the EU has so far been essentially a matter of intergovernmentalism, potentially leading to the accentuation of national prerogatives and unsatisfied demands. But the mission we seek is fundamentally a common one.

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Hence, the task must be to unite behind a more positive understanding and strategy of flexible integration by using it as a functional tool for clearly defined purposes as opposed to an ideological stick. This applies in particular to those issues, such as macroeconomic coordination, where the practical need for more firm decision-making structures, especially in times of crisis, coincides with individual interests in a particular form of economic governance. Otherwise, risks may well outweigh the opportunities.

Managing greater politicisation

A second powerful approach put forward for tackling the legitimacy deficit is the politicisation of the EU. If you want to raise awareness and improve understanding of the EU, make the debates and ballots more interesting and worthwhile at the European level. If you want a strong mandate for reform and policy change, ask and involve the European people. Needless to say, democracy cannot simply be shifted from the nation state onto this singular EU design. And there are, of course, difficult questions around the use of referendums *per se*. However, advocates of the politicisation agenda have tried to show how some form of democratic politics in the EU could work, even without further institutional change. A “winner-takes-more” model for the European Parliament, increased transparency in the EU legislative process, or a genuine contest for the high places in the European Commission are only some of the many proposals.

While this approach appears attractive – and there is growing approval at least for its rationale – it remains an equally controversial one. Compelling arguments have been made for why a mediated emphasis on partisanship and the injection of “majoritarianism” in the essentially consensual processes of the EU carry considerable risks, or at the very least, require a number of tough preconditions. Moreover, it remains uncertain whether an EU which is politicised along the lines suggested above will actually pave the way for more effective and positive action.

Meanwhile, a third group of pro-Europeans have adopted the middle ground: while they recognise the political void and its damaging implications for European integration, they believe that only by restoring the direct link between national political classes and EU policymaking can the legitimacy gap actually be closed. From this point of view, the European Parliament may be part of the problem, and not the solution. Reforms should consequently facilitate the European role of national legislators in order to empower citizens on EU issues. Greater polarisation is welcome – but not necessarily in the Brussels bubble. Yet, could such an approach really be reconciled with the desire for building a common European house?

As a matter-of-fact, European affairs have already become much more political over the last years and this trend is likely to intensify, both in the EU and especially in its capitals. While this development should be welcome, the task must now be to channel greater confrontation and polarisation in a meaningful and constructive way. Difficult choices have to be made in adjusting the national and European systems (e.g. by following the Danish example of strengthening the EU parliamentary committee on the one hand and facilitating the formation of real European political parties on the other), since the prospects for re-opening the Pandora's Box of further institutional restructuring in the EU are small, at least for the foreseeable future.

Can we rise to the challenge?

The EU needs to redefine its role in a rapidly changing world. Shaping globalisation, defending common interests and values, exporting its model of governance and adding more substance and elements of hardware to its soft power, indeed combine for a very tall order. The global age has been forcing the European Union to turn increasingly outwards. There are, however, many forces of inertia and a multiplicity of interests that have to be reconciled. When it comes to the crunch, the most powerful driving force may, in fact, prove to be a negative one, namely the fear of being marginalised in a world in which power becomes more diffuse but still very much unequally distributed.

The economic crisis, in turn, is challenging some of the fundamentals of the European *acquis*. It has caused many people to reflect on both the tremendous value and the fragility of the single market and the euro, achievements that tended to be taken for granted. In a different and more adverse economic environment, governance mechanisms and the overall internal bargain need to adjust. There is no way back to a pre-crisis world.

The more robust the foundation becomes, the more decisive EU action will be in the future

European integration is clearly at a crossroads. There is a vicious circle that needs to be broken

The economic crisis erupted as the EU was entering the final phase of the long and painful Lisbon Treaty ratification process. European integration is clearly at a crossroads. There is a vicious circle that needs to be broken: the legitimacy foundation of the integration process has been weakened and this, in turn, acts as a constraint on the ability of European institutions to take big and bold decisions. The EU will need to be re-justified in order to sustain its relevance. It will need a new narrative and concrete measures in order to regain the confidence of European citizens and thus secure, renew and expand the foundation upon which European policymaking is legitimised. The more robust the foundation becomes, the more decisive EU action will be in the future.

For some, Europe is already doing too much and needs to be reigned in. Although there is surely room for more subsidiarity in specific areas, those trying to turn the European and world clock backwards simply refuse to recognise the reality of interdependence and the many benefits associated with it. However, in managing interdependence the EU should also address more effectively the sensitivities and concerns of those negatively affected.

When it rains, it makes more sense to look for an umbrella rather than pointing your finger menacingly at the clouds. For the large majority of its citizens, the European Union provides such an umbrella, and much more: it is part of the answer to the numerous policy challenges Europe's proud nations are confronted with. This is the message that European institutions and national political leaders should get across: with deeds more than with words. We can rise to the challenge!



The EU “fit for purpose” initiative is organised by Policy Network, in partnership with the European Institute, LSE and ELIAMEP.

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