

New Pact *for* Europe

TOWARDS A NEW PACT FOR EUROPE



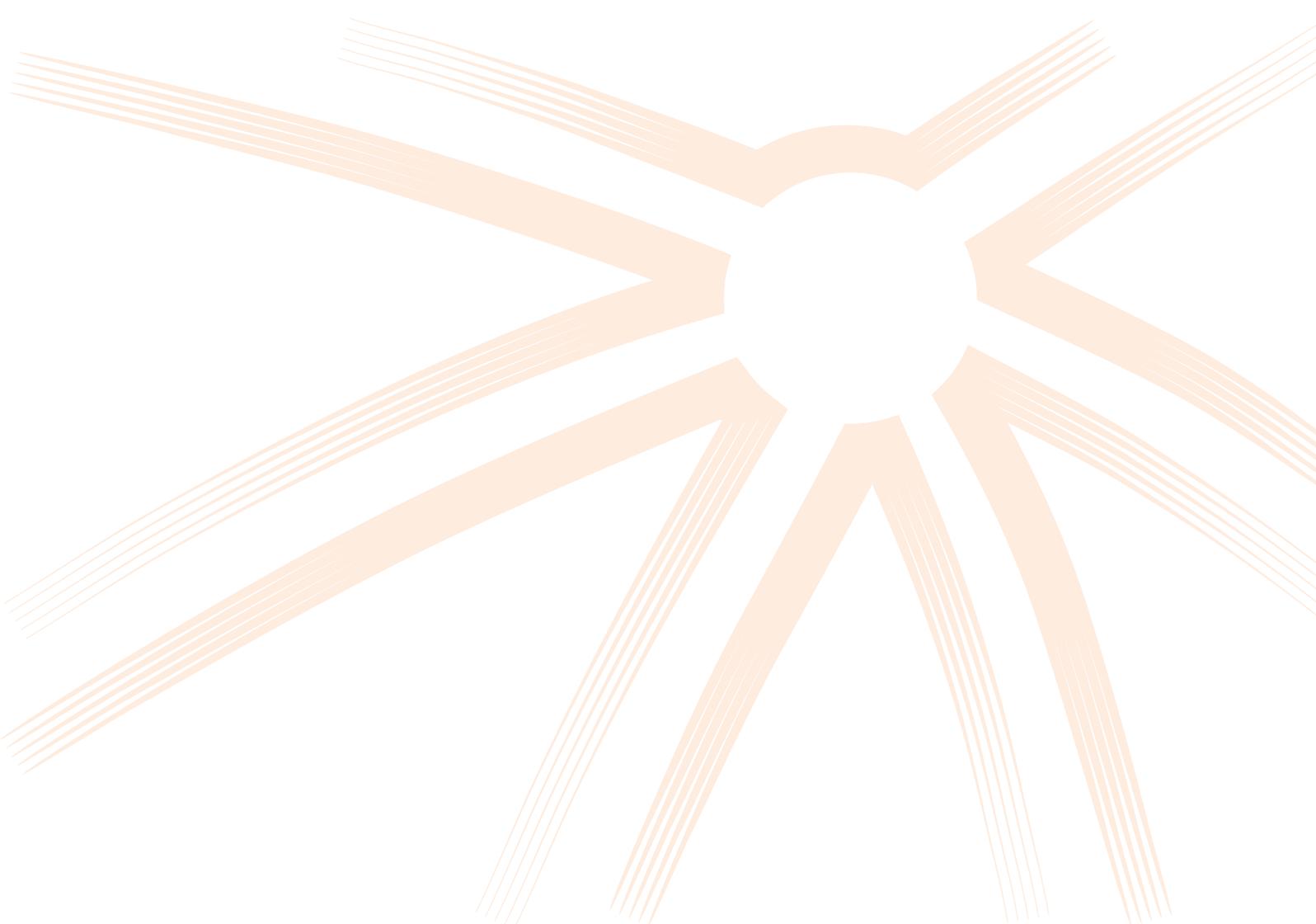
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Promoting
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Debate**

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TOWARDS A NEW PACT FOR EUROPE



SECOND REPORT
October 2014

NEW PACT FOR EUROPE: SECOND REPORT
TOWARDS A NEW PACT FOR EUROPE

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NEW PACT FOR EUROPE – PROJECT DESCRIPTION

In 2012, a consortium of 11 European foundations initiated by the King Baudouin Foundation and Bertelsmann Stiftung, and supported by the European Policy Centre, decided to launch a project to promote a Europe-wide debate on the future of the European Union (EU): an ambitious participatory initiative whose ultimate goal is to develop realistic reform proposals to shore up an EU hit by multiple storms in recent years which have left many people questioning its capacity to respond effectively to the manifold internal and external challenges Europeans are and will be confronted with.

A first report outlining five strategic options for the future of the EU was drafted by a Reflection Group of eminent EU experts from different Member States, enriched by input from an Advisory Group made up of prominent Europeans from the worlds of politics, business, academia and civil society (Phase I). This report was published in November 2013 and served as an input for almost 50 debates which took place in 17 EU Member States targeting different groups: randomly selected citizens, policy-makers, young Europeans, stakeholders and media representatives (Phase II). In all, several thousand people were given the opportunity to discuss the strategic options outlined in the report.

The feedback from these events provided the basis for further discussions in the Reflection Group and the Advisory Group. Those discussions led to a second report that you now hold in your hands, which calls for a 'New Pact for Europe' – between EU Member States and between the EU and its citizens – to enhance the Union's capacity to deliver effective solutions to the many challenges facing Europe and to do so in a way that benefits all EU countries and groups within society (Phase III).

This second report is designed to feed into the on-going discussions about the Union's future as the new EU leadership team takes charge. It aspires to contribute to the debate on how to introduce ambitious while at the same time workable and realistic reforms to make the EU more effective in responding to the challenges Europeans are facing. The report will be discussed again in a majority of Member States with policy-makers, EU experts, stakeholders and citizens (Phase IV), and the outcome of this process will impact the future progress of the New Pact for Europe initiative.

For more details about the project see www.newpactforeurope.eu

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LIST OF ABBREVIATIONS

CSRs	Country-specific recommendations
EC	European Community
ECB	European Central Bank
EFSF	European Financial Stability Facility
EIB	European Investment Bank
EIGS	European Investment Guarantee Scheme
EMU	Economic and Monetary Union
EPU	Economic and Political Union
ESM	European Stability Mechanism
EU	European Union
GEMU	Genuine Economic and Monetary Union
IMF	International Monetary Fund
MEP	Member of European Parliament
SGP	Stability and Growth Pact
SME	Small and medium-sized enterprise
SSM	Single Supervisory Mechanism
SRF	Single Resolution Fund
SRM	Single Resolution Mechanism
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TSCG	Treaty on Stability, Cooperation and Governance

FOREWORD

As the new EU leadership takes office, Europe faces a complex web of economic, political, social and global challenges which require new responses – above all, the need to restore the public’s faith and trust after the years of crisis which have prompted growing dissatisfaction with the Union, with many people now seeing it as part of the problem rather than part of the solution to those challenges.

In 2012, a consortium of 11 European foundations initiated by the King Baudouin Foundation and Bertelsmann Stiftung, and supported by the European Policy Centre, decided to launch a project to promote a Europe-wide debate on the future of EU integration: an ambitious participatory initiative whose ultimate goal is to develop realistic reform proposals to shore up a Union hit by multiple storms in recent years, which have left many people questioning its capacity to respond effectively to those challenges.

Two years later, we are proud to be able to present the outcome of this endeavour: the result of a joint reflection process involving the public, politicians, policy-makers, business leaders, trade unionists, EU experts, opinion-formers and other civil society representatives in many EU Member States. Obviously, not all the ideas and proposals generated by this process could be included in this report, but we hope that it faithfully reflects the feedback we received in all the debates.

The discussions we have had led to the report that you now hold in your hands, which calls for a New Pact for Europe – between EU Member States and between the EU and its citizens – to enhance the Union’s capacity to deliver effective solutions to the many challenges facing Europe, and to do so in a way that benefits all EU countries and groups within society.

This report is designed to feed into the on-going discussions about the EU’s future as the new leadership team takes charge, providing what we hope will be seen as a valuable contribution to the debate on how to introduce ambitious while at the same time workable and realistic reforms to make the EU more effective in responding to the challenges we face. We hope that it will be taken up for discussion by the new European Parliament, the new leadership of the European Commission, European Council and European External Action Service, and also by policy-makers in the Member States. And it does not by any means mark the end of the process. The report will be discussed again with policy-makers and stakeholders in a majority of Member States. Their feedback is important to us and will impact the future progress of the initiative.

This report would not have been possible without the tremendous commitment of Janis A. Emmanouilidis, Paul Ivan and Corina Stratulat from the European Policy Centre, Jacki Davis and the members of the Reflection Group and Advisory Group, to whom we would like to express our immense gratitude. Finally, we would like to thank all 11 partner foundations from all over Europe for their crucial involvement and financial support over the past two years which enabled us to make this initiative happen.

King Baudouin Foundation and Bertelsmann Stiftung
Brussels and Gütersloh, October 2014

EXECUTIVE SUMMARY

Over the past decade, European integration has been tested as never before, buffeted by storms that have exposed and exacerbated significant shortcomings in its economic and political construction. As a new leadership team takes office after years of deep crisis, the **EU faces key strategic decisions** about its future.

The history of European integration is littered with crises. In the past, the EU has always bounced back and emerged stronger than before, but the current state of the Union has cast doubt on whether history will repeat itself this time. The crisis that has rocked Europe since 2008 has raised serious questions about whether the EU and its members can deal effectively not only with the immediate problems they face, but also with the many socio-economic, political-institutional, societal and global challenges the 'old continent' will be confronted with in future – and all of this at a time when the world is in the middle of a great transformation, putting pressure on Europeans to respond to fundamental changes 'out there' and get their act together if the Union is to remain a pivotal player on the international stage.

The EU and its members have, individually and collectively, made some remarkable progress in recent years and **fears of the worst-case scenario** – that the euro would implode – **have receded**. But if Europeans want to overcome the lingering effects of the crisis and provide a solid basis from which to exploit their combined potential both within and beyond the EU, they will have to address **two interlinked strategic challenges**: those posed by economic, social and political divisions within and between countries, leading to **increased fragmentation**; and the growing perception in many EU countries that **European integration is no longer a 'win-win' for everyone**, that it has ceased to be a 'positive-sum game'. This has exposed severe cracks in the 'old bargain' between Member States, and between the EU and its citizens, making this a moment of both risk and opportunity for the EU: on the one hand, this fragmentation could complicate the search for compromises and thus undermine the Union's ability to provide adequate policy responses; on the other, the scale of the challenges facing Europe and the success of populist anti-EU forces increase the pressure on national capitals and EU institutions to do so.

Tackling these issues is not an end in itself. Citizens want the EU to provide answers to the problems they are facing; they want it to **provide added value in the drive for prosperity, peace and democracy**; they want it to help **protect and safeguard the 'European way of life'** in a massively changing global environment – and a **disunited Union would struggle to deliver adequately on these objectives**. The challenge for the EU now is to find a way to restore unity, heal the wounds of the crisis, develop effective responses to multiple challenges and articulate a new vision of the future, and thereby restore the public and elites' faith in the European project as part of the solution rather than part of the problem.

So, what options are open to the Union to respond to citizens' expectations, restore its image as a 'win-win' for all its members and confront the new realities of a changing global environment?

'Going back to the basics' – putting the EU into reverse gear and abandoning any moves towards an 'ever closer union' – would not help tackle the many challenges facing Europe. The quest to (massively) scale back European integration would, in most cases, weaken rather than strengthen countries' ability to deliver effective policy responses. At the other end of the spectrum, **'leaping forward'** – putting the EU into the highest possible gear and moving towards a fully-fledged economic, fiscal, social and political union – does not seem viable either, at least not now, given the reluctance of most national political elites and European citizens to pool core elements of national sovereignty at European level.

Another option, much favoured by policy-makers in national capitals and in Brussels at the moment, is **consolidation** – putting the gearbox in neutral while the ‘EU vehicle’ continues to move. According to this logic, the structural reforms and governance innovations of recent years should be given more time to work. This, say supporters of this approach, is the only realistic option in the current economic and political climate: the EU needs to catch its breath rather than being over-ambitious. **‘Doing less, but doing it better’ has become the predominant mantra in Brussels and in many national capitals** as immediate crisis threats and market pressures have receded, with a loss of ambition and some complacency as reform fatigue is omnipresent.

There are **many rational and understandable arguments supporting the logic of consolidation. But would this be enough to reverse the trend towards fragmentation, prevent similar or worse crises in future and avoid the risk of repeating past mistakes?** When the euro was launched, its architects knew its construction was by no means perfect, but the political realities of the time stopped governments going further. Ten years later, when the euro sailed into stormy waters, the EU, its Member States and citizens were hit by the consequences of these imperfections. The overall situation may look better today than in 2012, but the state of affairs remains volatile, and there is a risk that Europeans will be left asking themselves – five, ten or 20 years down the road – why they stopped the reform process halfway when they should have been aware of the potential dangers.

A New Pact for Europe

Simply **consolidating past achievements will not be enough**: to turn the tide, the EU must go beyond a lowest common denominator approach. Closer cooperation will be indispensable if Europe wants not only to overcome the immediate crisis, but also to create fresh momentum that will allow it to exploit more of its potential and meet citizens’ needs and expectations. This will require a pragmatic but ambitious approach to create a new win-win situation in which the EU is once again perceived as a positive-sum game for all its members, within the framework of a ‘New Pact for Europe’ between Member States and between the EU and its citizens.

The reforms of recent years have been driven first and foremost by fear – fear of an implosion or involuntary exit from the euro. To generate active support, **future developments must be driven instead by confidence and renewed ambition**. That is why elaborating a **New Pact** should be a key strategic task for the new EU leadership: a Pact **based on three main pillars** – an **‘Enabling Union’**, a **‘Supportive Union’** and a **‘Participatory Union’** – and a **new ‘grand project’** as part of a package deal balancing the interests of different Member States and different groups within them.

An **Enabling Union** should **foster sustainable economic growth and job creation** by stimulating (public and private) investment at both European and national level, promoting social investment and enhancing Europe’s overall competitiveness by supporting structural reforms, especially in countries that are lagging behind, while remaining on the path towards fiscal consolidation. Measures to strengthen and transform national economies – implemented by Member States but supported by EU instruments – will enable Europe to realise its combined growth potential, which is in the interest of all EU countries irrespective of how well or badly they have weathered the crisis storm. ‘Smart’ investments will provide them with better tools to enhance their human capital through an active agenda focused on knowledge and skills.

A **Supportive Union** should **enhance the EU’s ‘caring dimension’** to address concerns that the crisis has hit some countries and social groups exceptionally hard, fuelling a sense of social injustice within and between Member

States. The potential measures foreseen under this pillar would send a clear signal to European citizens that efforts to reform national economies and social systems will always have to respect minimum social standards and will not lead to a 'race to the bottom'. Instead, a social compact including social convergence criteria and more specific measures to support those suffering most from the crisis – including, for example, a complementary European unemployment scheme, an obligatory minimum support scheme or a European Mobility Fund – would flank efforts to promote Europe's economic competitiveness.

A **Participatory Union** should **strengthen the ties between the EU and its citizens** by increasing its democratic legitimacy. The focus should not only be on traditional issues such as the powers and role of the European Commission and Parliament, but also on expanding the opportunities for frank discussion within Member States and between citizens from different EU countries; on mechanisms to strengthen the public's direct involvement in the EU policy debates; on ways to enhance the role of national parliaments in European policy-making at Member State level; and on expanding schemes that enable people to experience the direct benefits of EU membership and foster greater understanding of the Union.

These three pillars are designed to provide the foundations for the New Pact, a set of guiding principles to underpin the development of a **new bargain to replace the old permissive consensus** which has long been under strain and has now cracked under the pressure of the crisis. Taken together, the measures envisaged under **each pillar could help meet the concerns of different countries** and different groups within them. Taken together, they are 'game changers' that could help to restore confidence in the Union by enhancing its capacity to deliver effective solutions that benefit all EU countries and groups within society, thereby addressing the causes of fragmentation and helping to restore the EU's image as a win-win project for all its members.

Besides these three main pillars, the EU should heed the lessons of history and seek to **identify and implement a new 'grand project'**. In the current political and economic climate, **an Energy Union appears to offer the greatest potential** to demonstrate the EU's added value and deliver genuine benefits for many different groups of Member States and stakeholders. It could be a perfect illustration of the type of 'grand bargain' that is required, with the potential to deliver beneficial spillover effects in a range of policy areas (economic, industrial and environmental, as well as foreign and security policy) and to act as a unifying factor, a political catalyst by addressing the concerns of all Member States, including non-euro countries that may feel there is too much focus on the common currency while other important challenges are being neglected.

The **measures proposed** within the framework of this New Pact for Europe **are ambitious but not overly so**: almost all could be implemented on the basis of the current EU Treaties, although some might require additional intergovernmental treaties/agreements. However, this is not a long-term solution, and the **EU and its members need to start preparing for the process of treaty change**. A New Pact could lay the foundations for this by helping to reverse the tide of public opinion towards the EU, which will be essential before any attempt can realistically be made to reach agreement on substantial changes to the EU Treaties and get them ratified in all Member States.

The pragmatically ambitious approach necessary for the New Pact for Europe to deliver requires that EU leaders demonstrate the political will to help restore confidence in the Union by equipping it with the means to meet future challenges. Only in this way can future progress be built on solid foundations, by basing it not just on addressing fears about what might happen if Europe fails to act, but also (and more importantly) on offering hopes – as well as tangible prospects – of a better future for the citizens of Europe.

PART 1



STATE OF THE UNION

Uncertainty has been one of Europe's most loyal companions. Over the last decade, the European Union has resembled a sedate tanker with a glorious history but without a unified command bridge able to navigate it through rough waters towards a clear destination. At the start of a new institutional-political cycle (2014-2019) and after years of deep crisis which have exposed and exacerbated some of the EU's biggest deficiencies, the Union and its members **need to take strategic decisions** about its future and consider what further steps are needed to remedy those deficiencies and achieve their strategic objectives.

Since the 1950s, **European integration has been the product of grand aspiration** born of the horrific experience of two devastating world wars. Inspired by the imagination of pragmatic visionaries like Robert Schuman, Jean Monnet, Altiero Spinelli and Winston Churchill, and guided by the political courage of political leaders such as Konrad Adenauer, Charles de Gaulle and Alcide De Gasperi, the founding six Member States embarked on a journey without a clear destination, but with hopes of breaking Europe's century-old vicious cycle of violence and vengeance.

This was an experiment aimed at securing peace, freedom, stability and security, and providing a solid basis for economic and social prosperity throughout the continent. Six decades later, it has **reached a level the founding fathers might have aspired to but were not sure Europeans could ever accomplish**: multiple rounds of enlargement to the west, south, north, and east of the continent which have taken it from the six to 28 members; the launch of the Single Market with its four freedoms; the abolition of border controls; the creation of a common currency; and, most significantly, the absence of military conflict between EU countries. European integration has provided an institutional framework for elaborating and implementing policy solutions, which have enabled its members to provide adequate responses to challenges within the context of increasing interdependence.

This project is not – and never was – perfect, and has not been without major ups and downs. In fact, the history of European integration is littered with crises – from the failure to establish a European Defence Community and European Political Community in the 1950s and an extended period of Eurosclerosis in the 1970s and early 1980s, to a series of reform crises in the last 20 years marked by repeated rejections of EU Treaties, resulting in part from a growing gap between the EU and its citizens and the end of the 'permissive consensus' on deepening integration.

Despite a series of heavy blows, the **European project has always bounced back and emerged stronger** than before. The founding of the European Economic Community in the 1950s (starting with functional economic, rather than political, integration), the 1985 Single European Act and the Europe '92 project to establish a Single Market, the creation of a borderless Europe in the Schengen Area, the launch of joint policies and institutions in the field of foreign, security and defence policy, and the Lisbon Treaty's entry into force in 2009 all demonstrated that although European integration was not crisis-free, it had proved itself to be crisis-proof. This reflected a belief among citizens and elites that while European integration might not be perfect, it probably represented the best option to secure a better future. Today, the EU and its members need to demonstrate once again that they are able to respond effectively to current challenges and provide an adequate framework for realising Europe's full potential.

However, the deep crisis that has rocked the EU since 2008 exacerbated problems that have been evident for at least a decade. **Deep cracks have appeared in the European project.** The euro-zone crisis triggered by a severe global financial and economic crisis has put European integration to the sternest test in its history. The individual and collective experience of recent years has exposed and aggravated significant deficiencies in the EU's economic

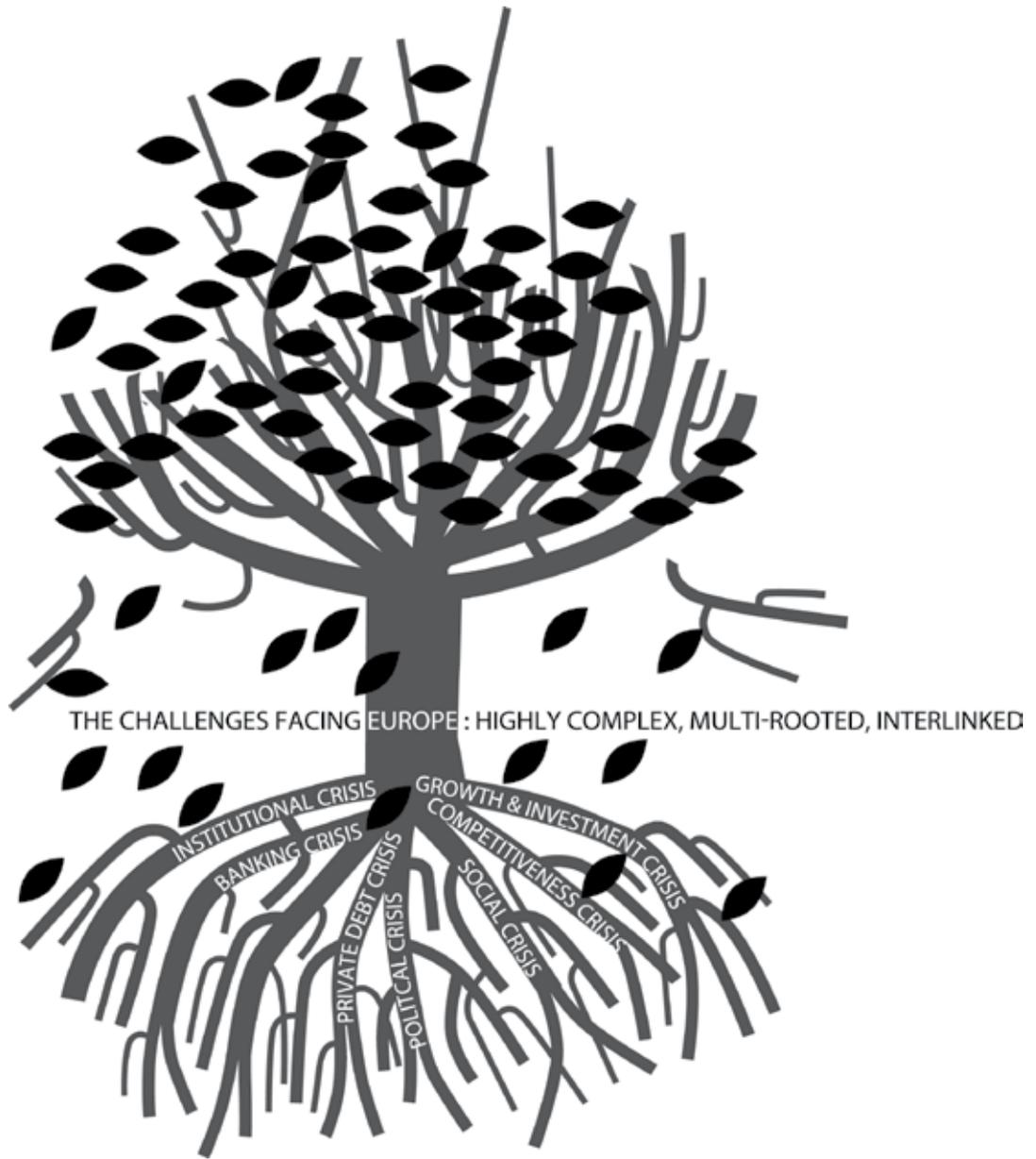
and political construction. The **crisis cast doubt on the fundamentals of the European project**, raised questions about whether Europe could deal effectively with the immediate crisis, and demonstrated that it is ill-prepared to meet the many other serious socio-economic, political-institutional, societal and global challenges it faces.

In 2010, the unthinkable became eminently possible: that one or more countries could leave the euro; that the euro zone could implode; or even that the EU could disintegrate. As a result, there were – and still are – concerns and doubts among the public and increasingly also among elites as to whether the EU will be able to provide added value in effectively addressing the challenges of a deep and long-term transformation provoked by the combined effects of globalisation as well as fundamental demographic, technological, environmental and foreign policy changes. Past achievements of European integration, such as the Schengen area or the free movement of labour in the Single Market, have come under pressure and potential reversals cannot be ruled out.

Two years after the collapse of Lehman Brothers in 2008, **Europe became the epicentre of the biggest financial and economic crisis** since the Great Depression in the 1930s. What began as a government debt crisis in one of the smallest economies on its periphery soon exposed the fundamental flaws of a fully-fledged monetary union without an equally strong economic and political pillar. As the Greek crisis escalated in early 2010, many European leaders insisted the country's problems were unique, but the markets followed their own logic and the crisis quickly spread to other EU countries. As the dominos began to fall, it became obvious that the EU – and especially the euro area – was insufficiently equipped to weather the storm; that Economic and Monetary Union (EMU) lacked the necessary institutional structures, procedures, rules and instruments to prevent such a crisis from beginning, spreading and deepening.

To make matters worse, Europe was facing not just one but a number of **highly complex, multi-rooted and highly interlinked crises**, which together produced a crisis of confidence, undermining the trust of markets, citizens, elites, and global partners in the future of the euro and the EU itself:

- a *banking crisis* in a highly interwoven European financial system which includes illiquid or even insolvent financial institutions burdened by high levels of debt;
- a *public debt crisis* which at times blocked or endangered over-indebted governments' access to capital markets;
- a *private debt crisis* putting additional strains on households and the banking sector in many EU countries;
- a *competitiveness crisis* illustrated by large current account deficits at the outset of the crisis and by a limited ability to adapt individual European economies to the challenges of a more competitive global environment, underlined by the failure to create the necessary consensus to implement long overdue reforms;
- a *growth and investment crisis* involving structurally low levels of GDP growth and a lack of private and public investment, especially on Europe's periphery, fostered by high levels of economic and political insecurity and the negative effects of a persistent credit crunch;
- an *institutional crisis* characterised by the increasing dominance of national governments in EU policy-making, while responsibilities have been shifted to the Union without a parallel delegation of actual powers and sufficient resources to Brussels;
- a *social crisis* caused by a deep, long-lasting recession and intolerable levels of long-term structural unemployment in a number of Member States and by more fundamental and unresolved demographic challenges, with ageing societies across the EU; and,
- a *political crisis* characterised by high levels of political volatility and instability and the rise of populist anti-establishment/elitist, anti-EU/euro and anti-immigration parties and movements.



BANKING CRISIS	PUBLIC DEBT CRISIS	PRIVATE DEBT CRISIS
in a highly interwoven European financial system	blocking/jeopardizing some governments' access to borrowing	putting extra strains on households and the banking sector
COMPETITIVENESS CRISIS	GROWTH AND INVESTMENT CRISIS	INSTITUTIONAL CRISIS
with some countries struggling to adapt to a more competitive global environment	fostered by economic and political insecurity and a persistent credit crunch	with national governments increasingly dominating EU policy-making without a shift of more responsibilities to the Union
SOCIAL CRISIS	POLITICAL CRISIS	
caused by deep recession and high unemployment and unresolved demographic challenges	with high levels of political volatility and the rise of populist anti-establishment/elitist, anti-EU/euro and anti-immigration parties	

In this unprecedented situation, there was no textbook that European and national decisions-makers could turn to for guidance on how to react to these interlinked crises. **Responses have often been slow, insufficient and sometimes ill-advised, and the results sometimes meagre and disappointing.** There are strong grounds for arguing that a more pro-active, bolder approach – along the lines of that taken by the US – might have cushioned some of the negative economic and financial consequences of the crisis.

However, the **EU and its members have individually and collectively made some remarkable progress** in recent years. The pressures generated by fears of a euro implosion or an involuntary exit from the common currency have made many things that seemed impossible some years ago a reality since the crisis began, at both European and national level. We have witnessed huge bailout programmes for Greece, Ireland, Portugal, and Cyprus, with strong conditions attached and supervised by the Troika of the European Commission, International Monetary Fund (IMF) and European Central Bank (ECB). We have seen the creation of two multi-hundred-billion-euro rescue mechanisms (firewalls), including the ad hoc European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM). We have observed unprecedented fiscal consolidation efforts in the deficit countries, accompanied by deep and painful structural reforms. We have seen the ECB engaging in unprecedented action to support the sovereign debt market and provide liquidity lifelines to banking systems under stress. We have witnessed a strengthening of the governance of EMU, especially within the euro area, with numerous innovations including a tougher Stability and Growth Pact (through the so-called ‘Six-Pack’ and ‘Two-Pack’); the introduction of stronger and new instruments of economic governance to enhance coordination of key economic and fiscal priorities (including the European Semester); the creation of an annual system of macroeconomic surveillance to assess the risks of macro-economic imbalances and vulnerabilities; and the entry into force of an intergovernmental fiscal compact treaty (the Treaty on Stability, Cooperation and Governance (TSCG)) which includes the introduction of binding ‘debt brakes’ at national level. Finally, we have seen the creation of a limited banking union with a Single Supervisory Mechanism (SSM) for all major European banks and a Single Resolution Mechanism (SRM) backed by a Single Resolution Fund to be built up in the upcoming years.

Despite these exceptional efforts and achievements, the EU and its members struggled for a long time to get ahead of the curve and persuade markets and citizens that they were capable of meeting the multifaceted challenges posed by the crisis. At times, it seemed the ‘crisis snowball’ might spiral out of control and trigger an avalanche with the potential to bury the euro and the European project beneath it.

Today, the situation remains volatile, and it will be the task of future historians to assess the impact of the crisis and ultimately judge how significant this period was for European integration. However, at the time of writing (October 2014), **fears of the worst-case scenario have receded** for two main reasons: the ECB’s promise to do ‘whatever it takes’ to guarantee the euro’s stability; and the economic adjustment efforts undertaken by governments on the periphery of the euro area, which have eradicated large imbalances, though at a huge cost in terms of incomes and jobs. As a result, there is now a significantly lower risk of a country leaving the common currency, which has boosted confidence and substantially reduced the danger of a euro meltdown.

Although the **situation has improved in systemic terms**, this is not reflected in the day-to-day reality for people in many Member States. The **crisis is by no means over** and there is **no room for complacency** either at European or national level, given the continuing fragility of the economic, financial, fiscal, social, and political situation: unemployment remains (exceptionally) high in some countries and economic growth elusive, with growing fears of a triple-dip recession; the European banking system is still highly fragmented and vulnerable; government debt levels

remain (very) high or even rising; the social and political situation in some Member States is tense, and the rise of populist forces on both the left and right in the 2014 European elections and political apathy among large parts of the electorate raise grave concerns about the state of democracy both at national and European level. Last but not least, collective efforts to overcome the EMU's remaining structural shortfalls have lost momentum since late 2012, with the decreasing threat of a euro meltdown limiting governments' readiness to take bold decisions at EU level.

All this is happening at a time when the world around us is in the middle of a **'great transformation'**. Global political, economic and societal affairs are in a major state of flux, putting pressure on the EU and its members to respond to fundamental changes 'out there'. Those who 20 years ago predicted the 'end of history' have been proved wrong. History is very much in the making – even if we, watching from within, do not always seem to grasp the complexity, magnitude and speed of developments as well as the extent of the changes taking place.

It is impossible to predict with any certainty what the future global political and economic order will look like, which powers will prevail and whether the new system will ultimately be characterised by 'confrontational rivalry' or 'co-operative interdependence' between major players. The chances are high that it will feature a mix of both for the foreseeable future, which will require a flexible approach to foreign affairs to prevent crises, respond to geopolitical competition, build partnerships and reinforce struggling multilateral structures.

Despite different patterns of relative rise or decline, all the major international players display a considerable degree of domestic fragility. Overall, however, we are witnessing a **shift towards a less transatlantic and Eurocentric world**. The ability of the 'West' to influence international political, financial and economic affairs is being put to the test as the US and the EU struggle to cope with intersecting crises while Europe's share of the world population and global economy continue to shrink. Increased economic competition poses challenges that require both individual and collective responses, coupled with a recognition of the extent to which Europeans – and indeed people all around the world – are interdependent.

In the new global landscape, **Europe is no longer a centre of gravity in international affairs**. Global developments are increasingly shaped in other parts of the world while the 'old continent' remains preoccupied with itself. This has prompted serious doubts as to whether the EU and its members will be able to shape and manage the process of growing global interdependence and connectivity. Globalisation remains the overarching framework for international political and economic relations, but fissures are emerging in its fabric under the pressure of geopolitical tensions and instability in fragile regions and countries.

Europe – as in 1945 and 1989 – finds itself once again at a **crossroads**, faced with two paths leading in very different directions: **creeping decline and gradual marginalisation; or resurgent influence** and a key role in shaping the future rules of global governance.

But while the changing distribution of power is undermining Europe's clout on the global stage, the EU is still a pivotal international actor, whose combined economic and political resources can make a positive difference to international cooperation, if mobilised for the pursuit of clearly defined goals. Whether Europeans will be willing and able to act strategically to advance their values and interests in a changing world will very much depend on whether they can master the key strategic challenges they face at home in the years to come.

PART 2



TWO STRATEGIC CHALLENGES: combating fragmentation and restoring 'win-win'

Given the current state of the Union and the challenges posed by the 'great transformation' now underway, it remains questionable whether the 'iron law' of European integration history will prove itself again – whether the EU will, once again, emerge stronger and more mature from the crisis, as it has in the past. But one thing seems certain: if Europeans want to overcome the lingering effects of the crisis and provide a solid basis from which to pass complex internal and external tests and exploit their combined potential, they will **have to address two interlinked strategic challenges**: they must confront the economic, social and political divisions within and between Member States resulting in **increased fragmentation**; and counter the **growing perception** in many EU countries **that European integration is no longer a 'win-win' for everyone**.

STRATEGIC CHALLENGE 1: combating fragmentation

In the new institutional-political cycle, the EU and the Member States face a number of **different sources and dimensions of fragmentation** which are shaping a new political reality and have the potential to undermine Europe's unity and thus its ability to master current and future challenges:

Fragmentation between the EU and its citizens:

A growing number of **people** have **turned their back on Europe** in recent years because of **dissatisfaction with the Union as it stands**. There is a widespread perception that the EU has not been 'part of the solution' to the challenges we have faced, but rather 'part of the problem', poisoning national debates and public attitudes towards the Union, especially among young people. There are growing doubts among 'ordinary' citizens – and increasingly also among elites – about the added value of European integration. This is raising new questions about what unites Europeans, making it harder to foster the shared sense of identity and common destiny needed to generate active support (and not just passive consent) for integration. At the same time, people are increasingly aware of the growing impact on their lives of decisions taken in Brussels and Strasbourg, and the high degree of interdependence between Member States, especially in the euro area. But citizens feel they cannot influence the formulation of policies because of the EU's complex, inefficient and often incomprehensible decision-making system – an impression enhanced by national politicians' tendency to blame 'Brussels' for some of their own failings and reluctance to give the Union credit for its successes.

Economic fragmentation between Member States:

There is a growing economic gap between EU countries. While some Member States have managed (more or less) to weather the storm, many European economies, especially in the continent's periphery, are characterised by persistently low growth rates, a lack of competitiveness *vis-à-vis* other EU countries and the outside world, the negative effects of a continuing credit crunch undermining investment, persistently high public and/or private debt levels, extreme levels of unemployment (particularly among young people), and an intensifying brain drain as the 'brightest and best' feel obliged to leave their country to seek a better future in other Member States or outside Europe.

Fragmentation between states and national societies:

In recent years, Europe has witnessed a **resurgence of national stereotypes, nationalistic chauvinism, historical resentments, increasing levels of distrust**, and a **damaging 'blame game'** between national governments and even between 'ordinary' people in different EU countries. European citizens are living in very diverse economic

and social conditions, and evaluate the 'state of the Union' and the root causes, nature and complexity of the crisis in very different ways. At times, it seems as if they are 'living on different planets', making it much harder for them to understand each other and to find the political compromises needed to make progress at EU level. The consequences of this are likely to haunt Europeans for years to come, as the crisis experience is likely to remain in the public's collective memory, with a potentially negative impact on attitudes towards deeper cooperation at European level for the foreseeable future.

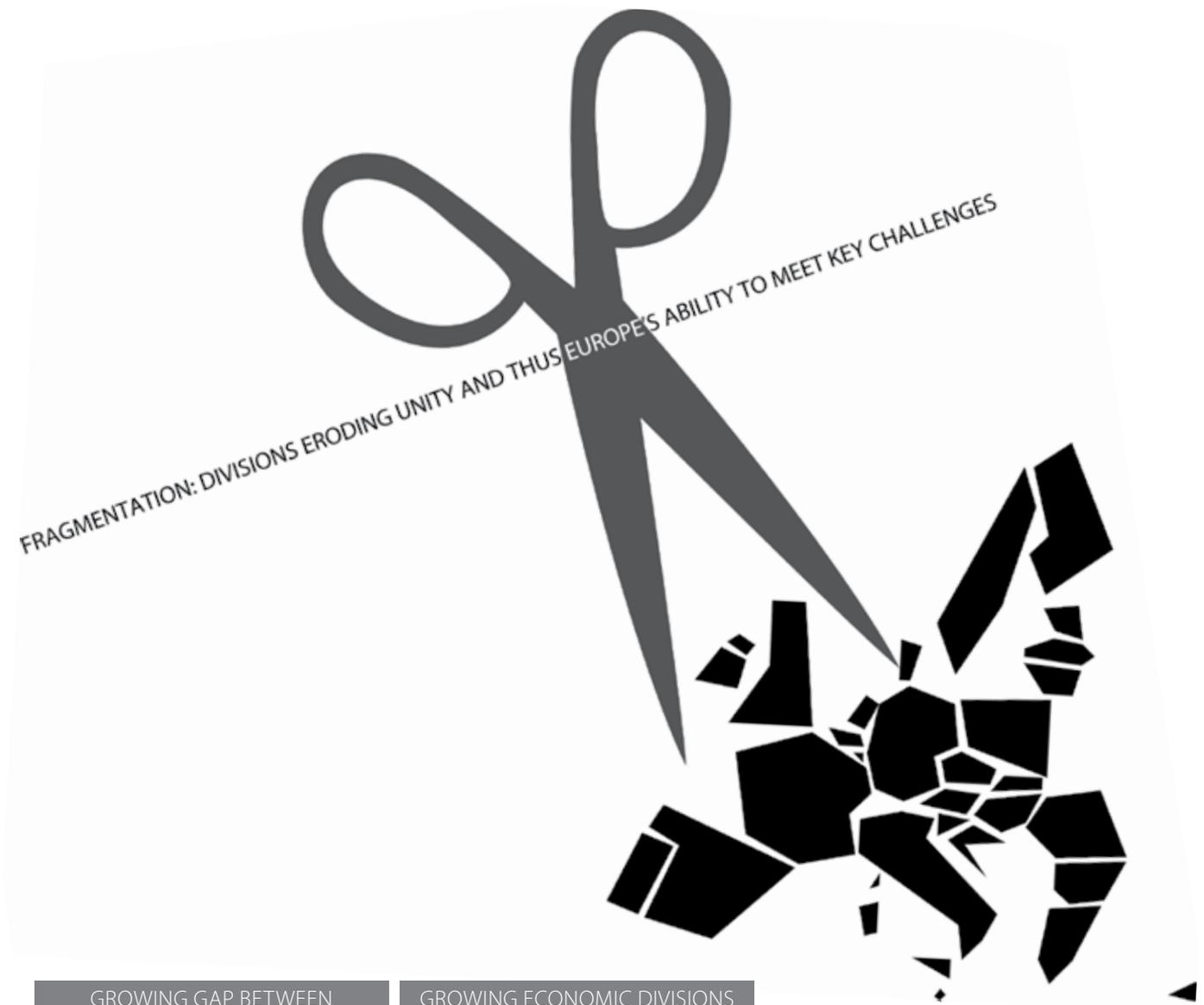
Social and political fragmentation within Member States:

There is not only increasing fragmentation between EU countries, but also within them. **Social cleavages** are **growing** between the 'haves' and the 'have-less' both in countries hit hardest by the crisis and those less affected. This is fostering a **growing sense of social injustice**; fuelling indignation, despair and anger in many sections of societies; and undermining national social contracts and social peace within Member States and between generations ('intergenerational divide'). Alongside this is an increased **loss of trust in traditional political elites** ('the establishment') and their ability to provide timely and adequate policy responses to master the complex challenges of today's world. Although the resulting pressures on traditional models of political representation are a wider phenomenon, they have particularly drastic consequences for the EU, which is still perceived as an elitist project and thus is questioned more quickly and fundamentally than traditional political entities. The loss of trust in traditional parties also leads to a more fragmented political scene, with citizens' movements and new parties entering the political arena, which in turn complicates the formation of stable governments in some Member States. Last but not least, there is the challenge of secessionism in some countries and increasing doubts about the future relationship between the UK and the EU, to which answers will have to be found in the years to come.

Geopolitical fragmentation:

Europe is also facing geopolitical fragmentation in much of its neighbourhood and beyond. The political stand-off between the 'West' and Russia over Ukraine has cast serious doubt on the future relationship with Moscow and on prospects for stability in Eastern Europe. Some believe we are witnessing a **'paradigm shift' away from the post-Cold war order** in the region and that this will require a more assertive stance from Europeans. To the South, the short-lived democratic aspirations of the Arab uprisings have given way to the restoration of authoritarianism, political violence and civil wars, while sectarian divides threaten to unravel the Middle East. In East Asia and the Pacific, creeping geopolitical competition between the US and China risks polarising an already volatile region, punctuated by territorial disputes in an area where nationalist sentiments are on the rise. As a foreign policy actor, Europe will be called upon to make a strategic assessment of the roots and implications of these multiple challenges with a view to pooling political capital and resources in tackling them. However, from energy security to migratory pressures, these challenges are also exposing **different perceptions and interests among Member States, which risk compounding the fragmentation of the Union.**

Looking back in history, there have always been uniting and dividing forces at work simultaneously, and many of the dimensions of fragmentation outlined above, some of which began at national level, have been evident for some time. However, the crisis has acted as a catalyst, aggravating existing sources of division and creating new ones, which in turn have **provided fertile ground for 'anti-forces'** – anti-EU, anti-euro, anti-migration, anti-establishment – on both the left and right of the political spectrum. The success of anti-EU populist parties and movements, demonstrated most visibly in the 2014 European Parliament elections, is putting mainstream parties under severe pressure, which risks further complicating the search for compromises between Member States.



<p>GROWING GAP BETWEEN THE EU AND ITS CITIZENS</p>	<p>GROWING ECONOMIC DIVISIONS BETWEEN EU COUNTRIES</p>	
<p>with more people turning their back on the Union because they see the EU as part of the problem, not part of the solution.</p>	<p>while some have weathered the storm relatively well, others have been hit very hard.</p>	
<p>GROWING DIVISIONS BETWEEN STATES AND NATIONAL SOCIETIES</p>	<p>SOCIAL AND POLITICAL DIVISIONS WITHIN COUNTRIES</p>	<p>GEOPOLITICAL DIVISIONS</p>
<p>the crisis has prompted a resurgence of national stereotypes, chauvinism, historical resentments and distrust.</p>	<p>between the 'haves' and 'have-less' in many countries, fuelling indignation, despair and a loss of trust in traditional political elites.</p>	<p>in the EU's neighbourhood and beyond, illustrated most starkly by the Ukraine crisis, exposing differences in countries' perceptions and interests.</p>

However, the negative effects of political, economic and social fragmentation between and within Member States and the success of these anti-forces also increase the **pressure on national capitals and EU institutions to identify and implement adequate responses at both national and EU level**. Europeans will have to find ways – individually and collectively – to cope with the new realities they face now and in the years to come, while preserving the diversity which is, and will remain, one of Europe's major assets.

STRATEGIC CHALLENGE 2: restoring the 'win-win' character of European integration

The EU and its members will not only have to identify ways to respond to the effects of fragmentation, but are also confronted with another related phenomenon that is undermining European unity: the widespread perception that European cooperation is no longer a 'win-win' for all its members and citizens. This **sense that EU integration is no longer a 'positive-sum game'** between Member States and between different groups in society is tangible in many EU countries and in different parts of the Union – euro/non-euro; north/south; east/west; old/young Member States; core/periphery; creditor/debtor – for different reasons. In each case, one can question whether these perceptions are objectively valid – but valid or not, they are nevertheless key as they shape individual and collective realities. Five examples reveal the increasing sense that the EU is no longer beneficial for everyone:

No fair distribution of crisis costs:

There is a widespread perception that the 'costs of the crisis' have not been fairly distributed among Member States and their citizens. Those in **creditor countries feel that they have been forced to pay for the mistakes of others** without gaining any benefits from their show of solidarity – and, worse still, have actually been criticised by those they were helping for 'telling them what to do'. Meanwhile, the debtor **countries feel that those on Europe's periphery have suffered disproportionately from the crisis**, with their 'punishment' for past mistakes resulting in deep economic recession, severe income losses, reduced social security benefits, higher indirect and direct taxes, intolerable levels of unemployment and a loss of political autonomy, especially in the countries that received emergency help. The coexistence of (very) high unemployment levels in the periphery or debtor countries with (very) low levels at the core, of high borrowing costs in the periphery with (very) low costs at the core, has contributed to impressions of EMU as a zero-sum game.

No economic catch-up process:

There is a **feeling that the promise of economic prosperity** and convergence through the creation of the Single Market and the launch of the euro **has not materialised**. On the contrary, seen from the countries most affected by the crisis – both within and outside the euro area – **economic divergence** between Member States is in fact **growing** and the **common currency has widened rather than closed the gap**. Seen from the perspective of those countries that have weathered the crisis storm better than others, most of those who have found themselves in difficulties in recent years have, in many ways, only themselves to blame for failing to make best use of the economic opportunities provided by EU budget support and a strong and stable common currency to strengthen the fundamentals of their economies.

Doubts about the benefits of mobility:

There are growing doubts in a number of EU countries regarding the benefits of intra-EU mobility, which in the past was widely perceived as one of the major and uncontested achievements of European integration. In some Member States, especially in those that have experienced an inflow of people from other EU countries, mobility is seen by some as a **threat to their social systems** ("welfare tourism") and national labour markets. For others, especially those that have suffered from a notable outflow of people, mobility has become a problem as the **'brightest and best'** have felt they had little option but to **leave their home countries**, undermining the future economic potential of the Member States concerned.

No suitable EU governance structures able to balance national interests:

There is a widespread sense that the **Union has become more intergovernmental** and **dominated by the views and interests of particular Member States** in recent years. As a result, its governance structures are not perceived

as being able to balance national interests so that all Member States feel they profit from decisions taken in Brussels and Strasbourg. Since the Lisbon Treaty entered into force and over the course of the crisis, the powers and political weight of heads of state and government – meeting in the European Council – have increased at the expense of the European Commission and European Parliament. This has boosted intergovernmentalism in the EU, at times undermining or even circumventing the traditional ‘community method’ through the introduction of a number of intergovernmental treaties/agreements outside the EU treaty framework. Today’s Union is also characterised by what might be called **‘unbalanced intergovernmentalism’**: a **new balance of power between Member States**, with Germany playing a much more dominant role than in the past, posing a challenge for both Berlin and its partners.

Increasing divisions between ‘core’ and ‘periphery’:

There is a perception of increasing divisions within the EU between those who are part of the euro zone or Schengen and those who have not (yet) joined. Those on the ‘political periphery’ fear that they may be left behind in an increasingly **‘two-tier Europe’**, and that the creation of new institutional and political barriers could make it more difficult for them to influence policy-making or join certain policy areas (such as the euro or Schengen). Conversely, some in the ‘core’ countries argue that more (temporary) differentiation between Member States has become necessary, especially in relation to the euro area, to avoid a potential implosion of the common currency.

The increasing fragmentation and the perception in many parts of the EU that European integration is no longer a ‘win-win’ and a positive-sum game for all has exposed severe **cracks in the ‘old bargain’** between Member States and between the EU and its citizens, which makes it difficult to convey a convincing ‘European narrative’ both at EU and national level.

In the worst-case scenario, these trends could split the Union apart, although this seems unlikely given the high degree of interdependence between Member States. However, the different sources of fragmentation could **undermine the Union’s ability to develop joint policy solutions** adequate to deal with the complex socio-economic, political, societal, and global challenges facing Europe, which no country – irrespective of its size – can cope with alone. The EU and its members (and political elites) would thus struggle to meet citizens’ expectations in terms of delivery, which would further damage not only the Union’s legitimacy but also the ‘output legitimacy’ of policymakers at both European and national level. As a result, the EU could stagnate and face increasing irrelevance.

Addressing the negative impact of fragmentation and the perceived loss of a win-win is not an end in itself. Citizens want the EU to provide answers to the concrete problems they face. They want the Union to **provide added value in delivering prosperity, peace and democracy**. They want the EU to **help protect and safeguard the ‘European way of life’ in a massively changing global environment** – and a disunited Union would struggle to deliver adequately on these objectives.

The priority now – with the EU at the crossroads facing very different futures depending on which path it chooses to go down – is to find a way to restore unity, heal the wounds of the crisis, develop effective responses to the challenges we face and articulate a new vision of the future, and thus restore confidence in what Europeans can achieve if they act together.

PART 3



THE NEED FOR A 'NEW PACT FOR EUROPE'

So, what needs to be done in the next institutional-political cycle (2014-2019) to address the challenges posed by increased fragmentation within the EU, the lost 'win-win' and the new realities of a changing global environment?

In light of the gravity and complexity of the situation, it is clear that **there is no 'silver bullet'; no easy option** to meet these challenges. That said, the Union does face some clear choices. So what are the potential strategic options open to it and which path should it choose?

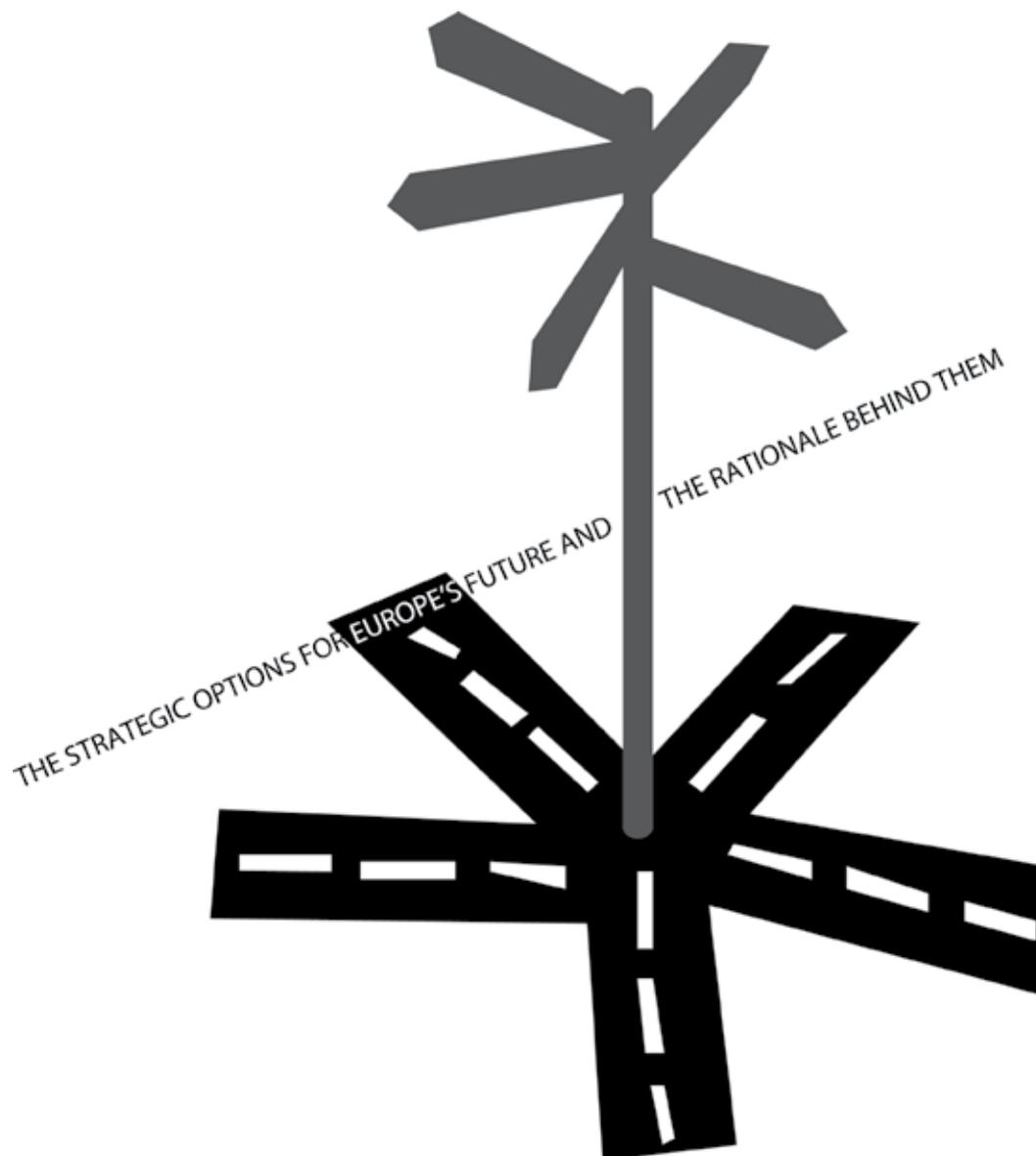
Strategic options for Europe's future

One radical option could be to **'go back to the basics' – put the EU into reverse gear and abandon any moves towards an 'ever closer union'**. This approach starts from the assumption that recent experience has shown that European integration has gone too far and that the EU should never become an 'economic and political union'. On the contrary, performing a U-turn and undoing mistakes of the past – by, for example, dismantling the euro area in its current form or 'renationalising' certain policy areas – is the most promising way forward to ultimately rescue the most worthwhile result of European integration: the Single Market. 'Going back to the basics' would not – according to this logic – lead to the collapse of the EU, but rather herald the start of a more pragmatic, effective approach to European integration instead of fruitless attempts to 'fix the unfixable' or chase the unattainable and undesirable.

However, **moving backwards would not help tackle the many current and future challenges** ahead. Dismantling the euro area is not a viable option as it would not solve but rather exacerbate Europe's economic and social problems. The costs of 'undoing' the common currency would outweigh the benefits and entail incalculable risks and uncertainties for both stronger and weaker Member States. Those forced to abandon the euro would face (very) high levels of inflation, massive and repeated currency devaluations, unsustainable levels of public debt and limited access to capital markets, which could lead to both government and corporate defaults and, ultimately, to political instability in the respective countries.

Nor could the euro area be dismantled in an 'orderly fashion', as this would have incalculable economic, legal and political costs. The departure of individual countries could have unforeseeable domino effects, challenging the notion that the euro is irreversible and sparking renewed bouts of market speculation about which country would be next, resulting in a negative spiral which could eventually force more countries to leave the euro. Scaling back or abolishing the common currency could also have serious negative knock-on effects on other policy areas, including the Single Market, prompting protectionist reflexes, a competitive race to the bottom, pressures on the free movement of labour or the imposition of capital controls. **'Going back to the basics' would reverse the European integration process without any clear guarantee of where this might end, which would create many uncertainties** inside and outside Europe.

The quest to abandon the euro or massively scale back the EU's powers is in many ways steered by a misguided nostalgia for the past, as **most pressing internal and external challenges cannot be dealt with effectively at national level** at a time of increasing regional and global interdependence. 'Retrieving' national sovereignty would, in most cases, not strengthen but rather weaken the ability of Member States (including the biggest ones) to deliver effective policy responses.



GOING BACK TO THE BASICS

The crisis has shown that integration has gone too far. The EU should abandon moves towards 'ever closer union' and take a more pragmatic approach to preserve the most worthwhile result of integration: the Single Market.

CONSOLIDATING PAST ACHIEVEMENTS

The EU has introduced most of the reforms needed to overcome the crisis. It should steer clear of overambitious attempts to deepen integration and focus instead on delivering results, especially on growth and jobs.

MOVING AHEAD AMBITIOUSLY

Consolidating past achievements will not be enough. The crisis is not over, much more needs to be done to tackle its root causes, and the EU must be more ambitious if it is to meet current and future challenges.

LEAPING FORWARD

The crisis has provided ample proof that the EU does not have the tools to face current and future challenges, and that it needs to take a major qualitative leap towards a fully-fledged economic, fiscal, financial, social and political union.

CHANGING THE MORE/LESS EUROPE LOGIC

The traditional debate over 'more' or 'less' Europe has been exhausted. The complex challenges facing the EU require a fundamental rethink, to make it more accountable and inclusive.

The **second potential option**, at the other end of the spectrum, would be to **'leap forward' – put the EU into the highest possible gear**, even if this might mean that some countries move ahead faster and leave others (temporarily) behind. Advocates of this option argue that the euro crisis has provided ample evidence that the EU does not have the tools it needs to face the internal and external challenges confronting Europe. There is thus a need to take a **major qualitative leap towards a fully-fledged economic, fiscal, financial, social and political union** worthy of the name, governed by a strong politically partisan executive (European government) and legislature (parliament) armed with ample discretionary powers, able to collect taxes and take autonomous decisions reflecting European interests. According to this line of thinking, the creation of a federal union is the only way to overcome the contradiction between having a post-national currency while defending narrow national interests. If some Member States are reluctant to take the plunge, this should not prevent the 'willing and able', especially those who share a common currency, from making a qualitative leap, even if this leads to the creation of a 'core Europe'; that is, a 'new Union' with a separate institutional structure and treaty base.

However, leaping towards some sort of **federal entity does not seem to be a viable option either, at least not in the current political climate**. The vast majority of national political elites and European citizens – in countries both inside and outside the euro area – are very reluctant to increase the powers of supranational institutions by pooling core elements of national sovereignty (including taxation, labour, fiscal and social, or foreign, security and defence policies) at European level. Transposing national democratic structures to the European level – with a much higher level of politicisation, parliamentarisation and personalisation – is also unrealistic given the absence of a genuine European public space, a sufficiently developed European *demos* or a common European language (*lingua franca*). Finally, the establishment of a two-tier Europe could divide Europe into two camps permanently, especially if a group of core countries leave others behind by creating new parallel institutional structures governed by a separate treaty.

If 'going back to the basics' or 'leaping forward' are not viable options, **one possible way** forward would be to follow the logic of **'consolidation' – put the gearbox in neutral while the 'EU vehicle' continues to move**. Proponents of this option argue that the EU and its members have introduced substantial reforms to overcome the euro crisis, many of them unthinkable some years ago, and the worst of the crisis is now behind us. National budgets are being consolidated, the EU's system of economic governance has been significantly enhanced, bail-out countries are able to access the markets again, and the first signs of economic stabilisation and recovery are appearing.

According to this logic, while the situation remains volatile, **structural reforms** and **governance innovations** should be **given more time to work** at both national and European level. Any attempt to go much further in deepening European integration now could backfire, given current negative attitudes towards the EU and the euro in many countries. Member States are not willing to go much further by pooling sovereignty in core areas. Instead of institutional reforms, the EU and its members should **concentrate on delivery**, and especially on **boosting growth and creating jobs**.

'Doing less, but doing it better' seems to be the **predominant mantra** in Brussels and the Member States today. The consolidation option finds particular support among policy-makers, who argue that the EU needs to catch its breath and now is not the time to move ahead more ambitiously, especially if this would require substantial changes to the EU Treaties in the near future.

Take EMU as an example: the political appetite to go much further in creating a ‘Genuine Economic and Monetary’ (GEMU) has receded significantly, with EU governments backtracking from earlier, more ambitious plans. Many of the proposals in the European Commission’s November 2012 “Blueprint for a deep and genuine economic and monetary union” or the December 2012 four presidents report led by European Council President Herman Van Rompuy – such as a single European deposit guarantee scheme, automatic stabilisers, some form of debt mutualisation, transfer of economic competences, or institutional reforms aimed at strengthening democratic accountability and legitimacy – are simply not on the table any more.

To be clear, the EU is still advancing, as shown by the agreement on the next leg of the banking union, the Single Resolution Mechanism (SRM). But there has been a **loss of ambition** and **growing complacency** as reform fatigue has spread. ‘Consolidation’ – or **‘reactive muddling through’**, as it might more accurately be described – have become the **order of the day as immediate crisis threats and market pressures recede**. Multiple fears are blocking bolder steps: the fear that another round of treaty change would open up a Pandora’s box, possibly leading to a further transfer of power away from the national level; governments’ fear of ‘losing control’ of the reform process in another Convention exercise; the fear of high ‘consensus costs’ among 28 Member States who will each ask for something in return for their readiness to amend EU primary law; and the fear that any new treaty might once again fall at the ratification hurdle in one or more Member States, with the ‘constitutional trauma’ of 2005 – when the ‘no’ in France and the Netherlands marked the end of the Constitutional Treaty – still haunting the collective memory.

There are many rational and understandable arguments supporting the logic of consolidation. But would this be enough to avoid the risk of repeating past mistakes? Would it be sufficient to kick-start economic growth and provide new political momentum for European integration? When the euro was devised and introduced, its architects knew that its construction was by no means perfect, but the political realities of the time did not allow governments to go further. Ten years later, when the euro left calm waters and began being buffeted by storms, the EU, its Member States and citizens collectively and individually were hit by the consequences of these imperfections.

Experience shows that European cooperation advances most when the immediate pressures are strongest. But even if the overall situation looks better today than in 2012, growth is still elusive and the public’s disaffection with the EU is exceptionally high. There is a **risk that Europeans will be left asking themselves** – five, ten or 20 years down the road – **why they stopped halfway** when they should have been aware of the potential dangers of failing to finish the job.

A New Pact for Europe...

Simply consolidating past achievements will not be enough: the crisis is by no means over and the EU and its members **need to be more ambitious at both European and national level**. The inherent weaknesses and gaps in the Union’s construction require more far-reaching initiatives and reforms than the (undeniably important) changes that have been introduced so far. Without a further strengthening of its economic pillar, there is a serious risk that EMU will remain fragile and unable to weather potential future storms. An **imperfect and deficient Union** would not only fail to deliver a ‘win-win’ for all its countries and citizens, but **could also eventually become a negative-sum game of progressive disintegration from which every Member State would lose**. Thus, further steps to foster cooperation between Member States are indispensable if Europe wants not only to overcome the immediate crisis but also to prepare itself for future challenges.

EU countries and institutions will have to **identify ways to restore the trust of citizens and elites** in the European integration process. To do this, they will have to **create a new win-win situation** in which the EU is once again perceived as a positive-sum game for all its members, in the framework of a **'New Pact for Europe' between Member States and between the EU and its citizens**. This **new bargain** should aim to close the gap between EU countries and between the Union and its people by **enabling the EU to exploit Europe's potential** and meet the needs and expectations of citizens. The reforms and developments of recent years have been driven first and foremost by fear – fear of a euro implosion or an involuntary exit from the common currency. To generate active support from citizens and elites, **future developments need to be driven** instead **by confidence and renewed ambition**. That is why the elaboration of a new pact should be a key strategic task for the new EU leadership.

... based on three main pillars and a 'grand project'

If EU institutions and Member States want to turn the tide, they will have to **go beyond a lowest common denominator** approach and **avoid the temptation to resort to 'gesture politics'** that capture headlines but ultimately fail to deliver tangible results. There is a need to **identify key game changers** that, taken together, can demonstrate the EU's added value, restore the public's faith by showing that the Union benefits all its members, and give it a new sense of direction while respecting today's political reality. There is a need to integrate these measures into the basic pillars and elements of a new pact between Member States, and between the EU and its citizens. This **new bargain must be 'ambitiously pragmatic'** or 'pragmatically ambitious' enough to cut the Gordian Knots which currently prevent the EU from going beyond 'reactive muddling through'.

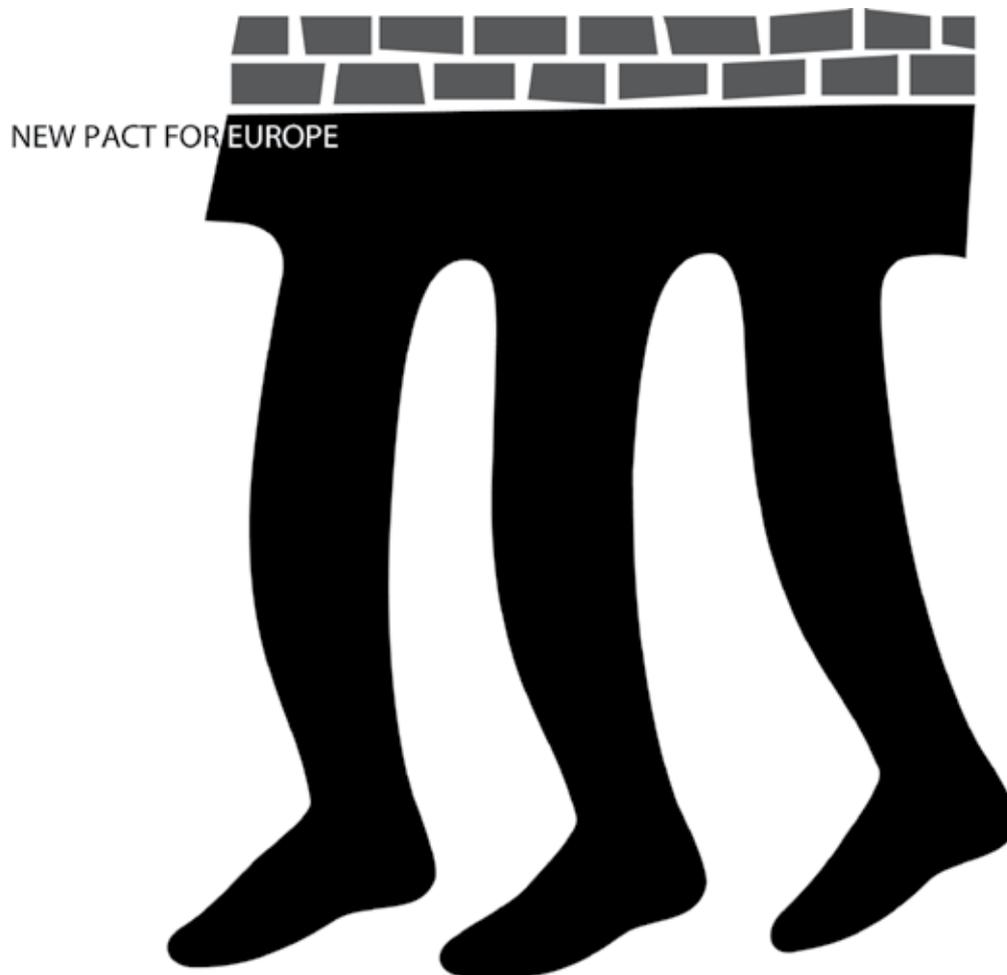
Following this logic, the **New Pact should include** the following **three main pillars** – an 'Enabling Union', a 'Supportive Union' and a 'Participatory Union' – **and a new 'grand project'**:

PILLAR 1: Enabling Union

If the EU is to convince citizens that it can provide solutions to today's challenges, it must start by **demonstrating its capacity to help maximise Europe's potential for sustainable growth and jobs**, which is in the self-interest of all Member States, irrespective of how well they have weathered the crisis storm. Without higher levels of growth throughout the Union, the EU and its members will in times of increasing interdependence not be able to collectively exit from the crisis and withstand future storms. Low growth and high unemployment rates are key concerns throughout the Union and a major source of discontent and fragmentation. To tackle this, the EU and its members should focus on **three key areas: (i) stimulating public and private investment; (ii) extending and implementing the European social investment agenda; and (iii) promoting structural reforms by introducing a new fiscal capacity**. In doing so, they would be investing not only in the European economy, but also in their citizens and the EU's overall future.

(i) Stimulating public and private investments

One of the legacies of the crisis has been a **large investment gap** resulting from public spending cuts, private sector deleveraging, and a deep and long credit crunch in a fragmented European capital market, which has hit small- and medium-sized enterprises that desperately require capital particularly hard. It is therefore essential to **identify ways to foster investment and improve the investment climate** to boost Europe's medium- and long-term growth potential. This is in the interest of all EU countries irrespective of how well they have weathered the crisis individually.



PILLAR 1: ENABLING UNION	PILLAR 2: SUPPORTIVE UNION	PILLAR 3: PARTICIPATORY UNION
<p>The EU must demonstrate its capacity to maximise Europe's potential for sustainable growth and jobs by focusing on three key areas:</p> <ul style="list-style-type: none"> • stimulating public and private investment • promoting and safeguarding social investment • structural reforms supported by a new fiscal capacity. 	<p>Economic consolidation and social cohesion must be balanced to ensure better protection of social, human and civil rights to strengthen the EU's 'caring dimension' by focusing on two key areas:</p> <ul style="list-style-type: none"> • elaborating and introducing a social compact • enhancing the EU's capacity to act as 'democratic watchdog' in safeguarding civil rights and fundamental values and freedoms. 	<p>The ties between the EU and its citizens must be strengthened by identifying ways to increase the Union's democratic legitimacy and accountability, focusing on two key areas:</p> <ul style="list-style-type: none"> • measures to boost accountability through a stronger involvement of citizens in EU policy-making • activities aimed at enhancing citizens' experience and understanding of Europe.

A European investment stimulus package could take the form of a **combination of measures and instruments aimed at boosting both public and private investment** in Member States and at EU level.

At EU level, and going beyond the monetary measures taken by the ECB, investments could be stimulated by increasing the capital base of the **European Investment Bank (EIB)**; expanding the **Project Bonds initiative** implemented by the Commission and the EIB; and establishing a **European investment fund with a borrowing capacity**, either within the EU budget or as a separate intergovernmental fund (similar to the European Development Fund) managed by the Commission and scrutinised by the European Parliament.

To **allocate more money from the EU budget** to growth-enhancing measures, the mid-term review of the multi-annual financial framework (MFF) in 2016 could be used to redirect spending to areas such as energy security and efficiency, the completion of the single digital market, additional and targeted backing for structural reforms in individual EU countries, support for applied research activities at university level, or investments aimed at improving the links between regional and European infrastructure projects. In terms of concrete projects, priority should be given to **investing in key enabling technologies**, which have a high growth potential, require large amounts of funding and would benefit from economies of scale. Special emphasis should be given to areas such as digital manufacturing and the digital economy and society more broadly, smart grids, the bio-economy and 'green energy' (see below the section on an Energy Union).

In this context, **innovation** has been, and will remain, a **key to greater productivity and growth** in the European economy. The EU needs to capitalise on its many advantages such as the size of its market, an educated labour force, a strong research base and vibrant SMEs. Europe should be characterised by its use of innovation as a vehicle to address societal challenges such as ageing, climate change and the provision of education. Innovation policy instruments should aim to shape new markets and develop a 'high risk-high reward' culture, combined with the freedom to experiment. Innovation also needs to be spread more widely to ensure its up-take and commercialisation. The new ecosystem for innovation has to bring together stakeholders from across policy areas and sectors, capture new cross-sectoral value chains and create a new culture of collaboration between the public, private and third sector. The creation of European Innovation Partnerships and Knowledge and Innovation Communities has already delivered some tangible results, but needs to be scaled up and better coordinated.

Private investments and growth could also be stimulated by intensified efforts to **complete the Single Market**, filling the gaps in areas such as services, the digital economy, research and energy. Open and interconnected product and services market could have positive spill-over effects across sectors and drive economic growth.

Despite historically low ECB interest rates, the high cost of credit in a number of EU countries shows how a lack of confidence and a high degree of uncertainty are preventing private investors from investing in these economies. This will continue to prevent private capital from reaching some Member States unless action is taken at EU level. To improve the climate for private investment on Europe's periphery, the EU could launch a **European Investment Guarantee Scheme (EIGS)** to provide a form of insurance for excessive risks incurred when investing in crisis countries. To be credible, this would require some financial underpinning, but it would only pay out if the downside risks materialise. It would, in essence, replicate a tried-and-tested method of supporting trade and investment through similar instruments such as export guarantees for companies facing significant market and political uncertainties.

Last but not least, there is a need to **speed up the completion and implementation of the banking union** by introducing an adequate fiscal backstop for the Single Resolution Mechanism, repairing bank balance sheets on the

basis of credible and continuous stress tests and restructuring financial institutions where necessary. Addressing the financial sector's remaining weaknesses is important for the euro's stability and for the recovery of crisis-hit countries, and thus to halt and reverse economic fragmentation within the EU. Without a single capital market providing access to finance – through equity funding, peer-to-peer lending or access to venture capital – many EU countries could find themselves trapped in a permanent cycle of low investment, high capital costs, savings flight, wage deflation, low growth and persistently high unemployment, with a negative impact not only on these countries but also on the prospects for growth in the EU as a whole.

At Member State level, **countries with relatively low public debt and deficit levels should use the fiscal space available to lead the investment drive** required for Europe's economy to recover. Germany and others should increase domestic demand by, for example, allowing higher wage increases and more public investment, which is overdue in areas such as education or infrastructure modernisation.

(ii) Promoting and safeguarding social investment

In the past, the European social agenda has tended to focus on social protection, with the bulk of legislation aimed at ensuring binding minimum standards. Although the arguments for ensuring social protection at both European and national level remain valid (see below), what is needed are **targeted social investments that concentrate on strengthening people's current and future capacities**, which is also a basic requisite for more flexibility in the labour market.

Human capital plays a key role in generating economic growth, with investments in people ultimately producing substantial increases in GDP. Experience shows that EU countries that have pursued a growth model with a strong social investment element have outperformed others both in terms of GDP and inclusive growth. All Member States face structural, social and demographic challenges, and the modernisation of social policies is a matter of common concern, especially in times of increasing economic interdependence. The crisis has shown that policies that hamper competitiveness and limit the potential for growth in some EU countries have a negative impact on the entire Union, especially within the euro area, where poor education and skills in some Member States have led to a lower-quality and less productive workforce, with adverse effects on their competitiveness and negative repercussions for Europe's economy as a whole.

In more concrete terms, **social investment** should be **focused** on the following key areas: **human capital development through education, training and lifelong learning**, with a focus on equipping people with the skills they need to realise their full potential; **childcare; health services**; promoting a **new spirit of innovation and entrepreneurship**; and active labour market policies. The latter could include a strengthening of cooperation between national labour agencies or even the creation of a **'European Labour Agency'** with branches in all Member States, which would foster labour mobility throughout the Union by helping people to find jobs in other countries and helping companies to identify qualified potential employees beyond their national borders.

When it comes to fiscal consolidation, **social investments** financed by Member States **could be treated differently from other types of public spending** when it can be shown that they are a cost-effective investment in the future. Education, training and life-long learning should remain priorities and shielded from spending cuts. One radical option might be to take the positive effects of social investments into account when assessing whether countries have exceeded the 3% deficit ceiling, which would significantly transform countries' capacity to invest in the European welfare model (see also the next section).

(iii) Structural reforms supported by a new fiscal capacity

Few would dispute that structural reforms need to continue at national level, but the EU must also **identify innovative ways to promote and support change in individual countries**. Recent experience has revealed **low levels of implementation of national reform programmes** in line with the country-specific recommendations prepared in the framework of the European Semester in almost all EU countries. Member States are all too often reluctant to risk a domestic political backlash by translating recommendations they have agreed to at European level into practice, and a number of governments have publicly criticised the European Commission for telling them what to do. Moreover, some structural reforms, when implemented during an economic downturn, tend to increase economic hardship in the short run, which in return undermines the readiness to support change.

The main advantage of the European Semester exercise is that it reveals structural macroeconomic weaknesses in Member States and so, at least in some instances, helps to trigger or foster debate about what needs to be done at national level. However, in most cases, the recommendations attract little attention and end up in the desk drawers of officials in national public administrations, despite all the time and energy invested in this at both national and European level.

Since Member States ultimately cannot be forced to implement reforms against their will – unless they have received bail-outs and are thus subject to supervised adjustment programmes – more innovative ways must be found to encourage implementation of recommendations agreed at EU level. Past experience shows that **neither a simple reliance on peer pressure nor fines and sanctions will 'do the trick'**. The two most promising options are to link the implementation of structural reforms to greater flexibility in applying the Stability and Growth Pact (SGP), and to provide additional 'carrots' by offering targeted financial incentives to countries ready to undertake reforms.

On the first, the Commission could **exploit the fiscal flexibility provided by the Pact** and the rules enshrined in the 'Six-Pack' and 'Two-Pack', **while respecting the basic spirit of the SGP** and the need to maintain a strict course towards fiscal consolidation. While the total public deficit is important, the quality of public spending is equally significant (**'smart spending'**). If spending enhances long-term growth – for example through public infrastructure or social investment in areas such as skills, education, health services and the like – it is important that this kind of investment is maintained, even in times of fiscal constraint. It must also be recognised that public funding is crucial to carry out sustainable structural reforms which go beyond simple spending cuts. Besides a more flexible implementation of the current SGP, there will be need for a more fundamental reform of the Pact in the longer term in the framework of efforts to deepen EMU, including (ultimately) changes to the EU Treaties.

On the second there is a need to **increase the incentives for national reform programmes by introducing a new fiscal capacity**. The current architecture of the euro area does not allow for an adequate response to large country-specific shocks when individual Member States do not have the means to address them and when a centralised monetary policy cannot offset the impact of localised shocks. The crisis has shown that, when national fiscal buffers are too low, Member States cannot stabilise the situation on their own. Although lengthy discussions between EU governments have failed to deliver tangible results so far, it makes sense to **restart the debate about** some sort of **'competitiveness pact'** or **'contractual arrangements'** between individual countries and the EU institutions, supervised and administered by the Commission and **adequately supported by funds from a new fiscal capacity** (a euro budget or 'Convergence and Competitiveness Instrument'). Governments and EU institutions (including the Commission, the Eurogroup President and the Parliament) should step up efforts to agree the conditions, roadmap and features of this new fiscal capacity.

To avoid discrimination between ‘ins’ and ‘pre-ins’, participation in the fiscal capacity and in arrangements linked to it would be mandatory for euro members and voluntary for non-euro countries. **Support** could, for example, be **focused on those suffering from exceptionally high levels of unemployment**, which is a waste of human capital and undermines the EU’s productive capacity and future growth potential. In any case, contractual arrangements need to be designed carefully to ensure that projects receiving support can be implemented in practice, otherwise the process could become too slow, cumbersome and bureaucratic. There would also have to be a **strong commitment to longer-term distributional neutrality** – that is, to **avoiding permanent transfers** – in order to generate support for the fiscal capacity. Without this, political backing from surplus countries is unlikely. In institutional terms, the new fiscal capacity would require strong central oversight at EU level and should be subject to scrutiny by the European Parliament and, more concretely, by a special committee consisting of MEPs from the countries contributing to the fiscal capacity and participating in contractual arrangements.

PILLAR 2: Supportive Union

Beyond the objective of stimulating growth, investment and structural reforms, there is a need to **balance economic consolidation and social cohesion** to allow for better protection of social, human and civil rights. This pillar of the New Pact should aim to address concerns that the crisis has hit some countries and EU citizens particularly hard, fostering an increasing sense of social injustice within and between Member States. It should send a clear signal that **attempts to reform national economies must always respect minimum social standards** and fundamental rights. To strengthen the EU’s ‘caring dimension’, the Union should focus on **two key areas: (i) elaborating and introducing a social compact; and (ii) enhancing the EU’s capacity to act as ‘democratic watchdog’** in safeguarding and promoting civil rights and fundamental values and freedoms.

(i) Social compact

The transformation of the global economy poses a major competitive challenge for the EU. The challenge is not only to slow down or reverse the long-term contraction in Europe’s share of global GDP, but also to do so while **preserving the European model of a social market economy**, by balancing efforts to promote growth and competitiveness with social cohesion. To achieve this goal, **without seeking to harmonise national social policies**, the EU and its members (who will be responsible for implementing most of the measures) should **adopt a social compact**, which could include a number of potential elements:

- Measures to strengthen the **social dimension of EMU** by identifying and agreeing on **binding common social convergence benchmarks/criteria** matching the quality of the convergence criteria laid down in the Stability and Growth Pact or the fiscal criteria included in the Stability Treaty. Introducing such benchmarks within the framework of a social compact (if necessary via an intergovernmental treaty/agreement) would guarantee minimum social standards and guide EU spending priorities. To make the social dimension an integral part of economic and fiscal governance, these criteria could also be used as the basis for mechanisms to trigger preventive and corrective actions if social indicator targets are not met (‘excessive social imbalances’), similar to the excessive deficit procedure in the Stability and Growth Pact.
- A **complementary European unemployment insurance scheme** supporting national efforts to deal with excessively high levels of cyclical and structural unemployment above a certain threshold, by providing supplementary benefits to individuals set at a minimum level linked to their country’s average wages. Funding for this complementary scheme could be provided through a fiscal capacity (see also above).

- A **bill of social rights**, which could be a binding document going beyond the European Charter of Fundamental Rights in practical terms, setting out EU citizens' basic social rights and minimum standards of public service provision agreed on by the EU institutions and ratified by all (participating) Member States. To inject life into the concept, the adoption of such a **bill would have to be linked to concrete measures**. One potential example could be a joint decision by Member States to introduce an **obligatory minimum support scheme** at national level, defined and financed individually by each EU country and operating as a basic guaranteed social safety net for those most in need of public financial support, just as euro-zone members are obliged to respect certain fiscal targets. Mechanisms should be put in place to guarantee that this support scheme will always be sustained, even when national budgets come under pressure in times of crisis. In relation to minimum standards of public services, particular emphasis could be given to **setting standards in healthcare**, which citizens point to as a key determinant of their quality of life and has been severely buffeted by the economic storms of recent years in many Member States.
- The creation of a **European Mobility Fund** to mitigate the negative impacts of mobility in both the countries people leave and those they go to while exercising their right to free movement. The Fund could, for example, help local communities to meet the costs of providing basic public services to cope with influxes of newly-arrived workers until their contributions to the local economy via taxation feed through into public budgets.

(ii) Safeguarding civil rights, fundamental rights and freedoms

Beyond protecting basic social rights, Member States should **enhance the Union's capacity to ensure respect for, and the protection and promotion of civil rights, fundamental values and freedoms** when they are encroached upon at national level, by giving it new tools to act as **'democratic watchdog'** in response to serious breaches of its common values, including respect for democratic principles, the rule of law, media freedom, human rights and dignity, freedom, equality, and non-discrimination.

Recent experience has demonstrated the need for a **new system to monitor Member States' compliance** with basic EU values and to enforce compliance when those values are breached. To guarantee a higher level of independence, this system could include – alongside the roles already given to the European Commission, European Parliament and Fundamental Rights Agency – the **creation of a high-level group of independent experts** tasked with monitoring and ensuring that all EU countries abide by the values enshrined in the EU Treaties and the Charter of Fundamental Rights, and advising and regularly reporting on fundamental rights issues to identify any serious breaches.

In addition and in more concrete terms, the EU should: (i) complete the process of acceding to the **European Convention on Human Rights**; (ii) streamline existing mechanisms for monitoring fundamental rights' violations and **strengthening the European Court of Justice's role** in fundamental rights matters; (iii) carry out **regular peer reviews** of Member States based on a set of clear indicators including, for example, the introduction of a **'rule of law' scoreboard**; (iv) ensure better coordination between the Parliament and Council working groups/committees; and (v) elaborate a **clearer set of recommendations and procedures** for dealing with violations of civil rights and fundamental values and freedoms that go beyond the current EU Treaties, which already allow for a temporary suspension of voting rights in the Council or of funds from the EU budget.

PILLAR 3: Participatory Union

Beyond measures to foster sustainable economic growth and job creation and to enhance the Union's caring dimension, there is a need to **strengthen the ties between the EU and its citizens** by identifying ways to increase the Union's democratic legitimacy. There are **two key areas** where action can be taken: **(i) measures to boost accountability** through a stronger involvement of citizens and stakeholders in EU policy-making, reinforcing its 'input legitimacy'; and **(ii) activities aimed at enhancing citizens' experience and understanding of Europe**.

(i) Enhancing accountability

To foster **more active involvement of citizens and stakeholders** in EU policy-making, the Union should provide additional channels at European, national and regional/local level for citizens to give continuous input and feedback, going beyond the right to vote in European elections every five years.

In this context, EU institutions and Member States should support the provision of **fora for a frank national and transnational dialogue** with citizens about the goals and future of European integration and the direction of EU policies. These initiatives should not be limited to mere information campaigns, but rather involve content-oriented debates that give the public the chance to deliberate EU issues and mechanisms to ensure that the key conclusions they reach are fed into policy-making processes in Brussels and national capitals. These debates should not only be held in individual EU countries, but also include a transnational dimension, involving citizens from different Member States, to foster greater mutual understanding and counter the growing fragmentation between national societies of recent years. They could, for example, be organised in the framework of transnational 'people's meetings', bringing together citizens, policy-makers, stakeholders and others from all over Europe to discuss key issues of common concern.

The EU should also consider creating **European platforms** to discuss and develop proposals on specific topics of particular importance. These platforms could bring together different networks of scientific expertise, stakeholders, civil society representatives, NGOs, and European and national policy-makers, as well as representatives of regional and local entities, to identify long-term policy goals, priorities and responses to complex challenges, drawing on relevant expertise to help inform decision-making at EU level. They could include groups dealing with issues related, for example, to the use of biotechnology, big data, Internet privacy, energy, ageing societies, or migration/mobility.

Finally, to intensify the involvement of citizens, ways should be found to enhance the efficiency, responsiveness, transparency and quality of European policy-making by improving the planning, monitoring, evaluation, auditing and control of EU spending. In line with the subsidiarity principle, this could, for example, include **giving regional/local authorities more autonomy in setting spending priorities and finding ways to involve citizens** in the process. Achieving a higher level of horizontal social accountability – by involving relevant stakeholders who are aware of regional/local needs and circumstances in the planning, control and evaluation of EU spending – could facilitate more targeted actions, improve the use of available European funds, provide a sense of ownership and establish the basis for a more swift and direct monitoring of EU-funded projects.

With a view to further **increasing the Union's 'input legitimacy'**, the EU and its members could pursue a number of measures at both the European and national level.

At EU level, the 2014 European Parliament elections demonstrated the need to further **improve the procedure linking the results of European elections to the (s)election of the Commission president**. The political link

between the nomination of lead candidates (*Spitzenkandidaten*), the outcome of Euro-elections and the impact of both on the (s)election of the Commission president has now been established and should not be reversed. The EU should not go back to the days of secretive horse-trading behind closed doors in the European Council. However, the procedure was by no means perfect, which is hardly surprising given that it was the product of an uncoordinated and conceptually half-baked process; a political experiment which should not be judged prematurely. The nomination of lead candidates and the consequences of this for the Union's political system – and especially for the role of a more politicized European Commission and the future of European political parties – are part of a dynamic process. All those involved (European and national political parties, the European Parliament, the Commission, national governments, and parliaments) will have to individually and collectively **evaluate the results of this 'first experiment' and find ways to improve and clarify the procedure.**

To increase voters' interest in future European elections, a limited number of additional MEPs should be elected in a single constituency – the whole territory of the EU – based on a **transnational EU-wide list of candidates.** Each citizen would be able to cast one vote for the EU-wide list and another for the national or regional list in his/her country, and this EU-wide list could also generate candidates for 'top' EU jobs. This would, however, require a change to the EU Treaties.

At national level, the role of national parliaments in European policy-making should be enhanced, not by creating new institutional arrangements but rather by **strengthening the ability of national assemblies to scrutinise and shape their governments' positions** before they head off to meetings in Brussels. At present, the capacity of national parliaments to control and influence their governments' actions in the EU is far from uniform or satisfactory. Denmark and Finland remain the partial exceptions to this rule, and others should seek inspiration from these models to make their parliamentary oversight procedures more robust.

National parliaments could also be given a **stronger role in translating decisions and recommendations made in the framework of the European Semester into action** on the ground. They should hold their national governments to account on the implementation of EU macroeconomic policies and country-specific recommendations. To foster better implementation of national reform programmes, the way the recommendations are drawn up needs to be reviewed, specifically to focus the process on a smaller number of key priorities for each country.

(ii) Experiencing Europe

The Union and its members should **expand existing schemes that enable people to 'experience Europe' and identify new opportunities** for more citizens (especially young people and those who have not already been exposed to the benefits of European integration) to do so. Extending the possibilities for mobility, especially for the under-18s, is very effective in developing intercultural skills and open-mindedness, the capacity to integrate with others, language skills and a greater appreciation of the benefits of European integration.

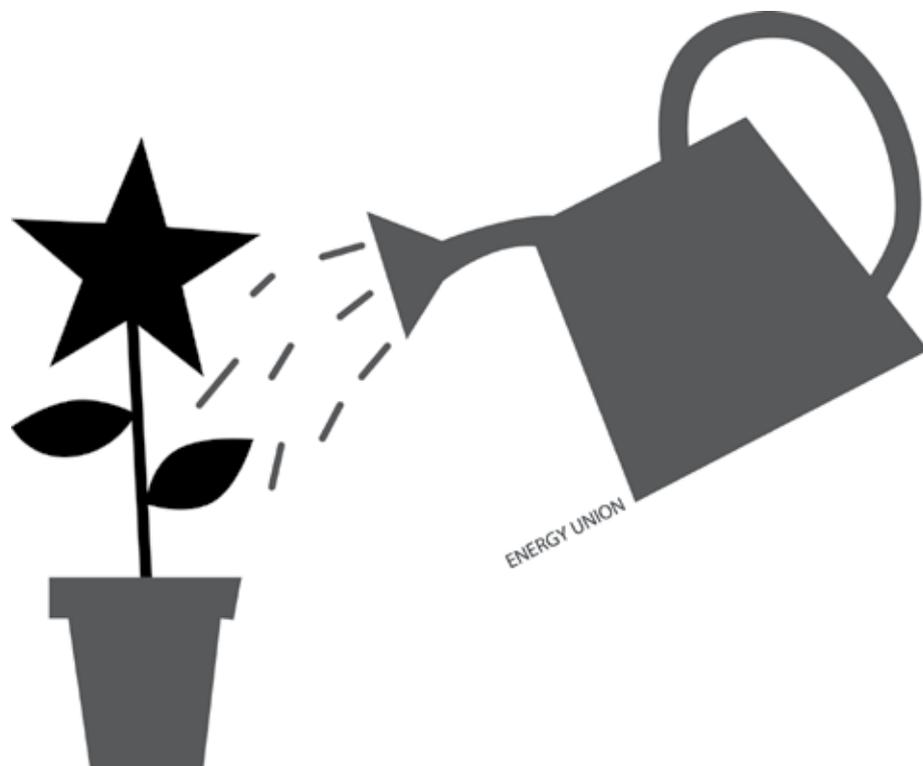
Concrete initiatives could include expanding existing programmes to reach out to people who up until now have not had the chance to study and work in other Member States. Greater efforts should be made in this context to find ways to enable people to 'experience Europe' for themselves by, for example, building on the progress to date in using the Erasmus or Leonardo programmes as models for more schemes to **encourage exchanges between people in different professions and different phases of their professional career** etc. Efforts should also be intensified both at EU and national level to provide pupils in schools with more opportunities to study in other Member States.

Opportunities to ‘experience Europe’ could also be widened by extending the **European Voluntary Service**, which allows young people (18–30 years) to do voluntary work in another country for a specified period (up to 12 months), for example, in the field of environment, arts and culture, activities with children, young people or the elderly, or sports and leisure activities.

A NEW GRAND PROJECT: **Energy Union**

Next to the three main pillars of a New Pact for Europe, the EU should heed the lessons of history and seek to **identify and implement a new ‘grand project’** with potential knock-on effects in numerous policy areas and clear benefits for all EU countries – just as it did with the Europe ‘92 Single Market initiative – in order to break the current impasse and provide new momentum for European integration.

In the current political and economic climate, an **Energy Union seems to offer the greatest potential to demonstrate the EU’s added value** and deliver genuine benefits for many different groups of Member States and stakeholders. It could be a perfect illustration of the type of grand bargain or package deal that is needed for two main reasons. First, it could have knock-on effects on many different policy areas: energy security, the economy, the environment, sustainable development, as well as foreign and security policy. Second, it would provide a vehicle to address the different priorities and interests of individual Member States, meeting the concerns of those, particularly in Central and Eastern Europe, who feel that there is too much focus on EMU-related issues while other important challenges are being overlooked.



Recent developments in Ukraine have highlighted the **need to reduce Europe's dependence on energy imports**, given the challenges this poses to Europe's energy security and its economy. Russia provides around 30% of the EU's natural gas and is its main supplier of crude oil (around 35%). Within the Union, Germany is the largest importer of Russian gas and some EU countries import almost all their gas from Russia.

In recent years, the EU and its members have taken a number of steps to promote energy security and reduce dependence on individual suppliers. The Union's gas network has become more integrated, the installation of interconnectors has progressed and the use of reverse-flow technology, which allows gas to be transported in the other direction, has been extended. But progress has been slow and much more needs to be done since, despite all these efforts, EU energy imports increased from 63.4% in 2009 to 65.8% in 2012 and its dependence on imports is predicted to grow still further because of the expected decline in European gas resources. All this is happening at a time when Europe is facing much higher energy costs than major economic competitors such as the United States.

To move towards a comprehensive Energy Union, Member States need to **intensify efforts to save energy and natural resources** as part of efforts to build a **more sustainable and more circular economy**; create a **genuine internal energy market** with a European regulator alongside national ones; increase indigenous energy production; **diversify external energy supplies** by seeking ties to new partner countries (including the US) and **extending supply routes**; **invest in Europe's energy infrastructure** by adding critical links; **strengthen emergency and solidarity mechanisms** between EU countries, especially for those Member States in Central and Eastern Europe that are almost exclusively dependent on Russian energy supplies; and, last but not least, improve the Union's ability to **speak, negotiate and bargain with one voice in external energy matters**.

The way forward

The three pillars and new grand project outlined above are designed to provide a framework for a New Pact for Europe – a set of guiding principles and key measures that should underpin the development of a new bargain to replace the old permissive consensus which has long been under strain and has now cracked under the pressure of the great crisis whose aftershocks are still buffeting Europe.

There is no silver bullet and the EU alone will not be able to solve all of Europe's problems, but taken together and coupled with the many things that need to be done at national level, these are potential game changers that could help to reverse the tide of public opinion and restore trust in the Union, by enhancing its capacity to deliver effective solutions to the many challenges facing Europe and to do so in a way that benefits all EU countries and groups within society. This would go a long way towards addressing the multiple causes of fragmentation and restoring the public's confidence that the EU remains a 'win-win' project for all its members.

Each pillar seeks to contribute to this in different ways:

- The **Enabling Union** aims to foster sustainable economic growth and job creation by stimulating (public, private and social) investment, and enhancing Europe's overall competitiveness by supporting structural reform processes, especially in those Member States lagging behind, while remaining on the path towards fiscal consolidation. Measures to strengthen and transform Europe's economies – implemented by Member States but supported by the EU through, for example, a new fiscal capacity – would enable the Union to realise its combined growth potential, which is in the interests of all countries, irrespective of how badly or well they have weathered the crisis

storm. So too is focusing support on countries and regions suffering from intolerably high levels of unemployment, to avoid a waste of human capital that undermines the EU's productive capacity and growth potential. All this would address growing economic and social divisions within the Union by relaunching the convergence process to narrow the gap between its richest and poorest countries and regions, extending the benefits of integration and thus helping to win back public support for the common European project.

- The **Supportive Union** aims to enhance the EU's 'caring dimension', to address the social costs of the crisis and concerns that it has hit some countries and social groups exceptionally hard, fostering an increasing sense of social injustice within and between Member States. The measures foreseen under this pillar would send a clear signal to European citizens that efforts to reform national economies and social systems will always have to respect minimum social standards and will not lead to a 'race to the bottom'. Instead, a social compact including social convergence criteria and more specific measures to support those suffering most from the crisis would flank efforts to promote Europe's economic competitiveness. It would provide the EU with better tools to enhance its human capital through an active agenda focused on knowledge and skills. All this would help to address growing social fragmentation within the Union and thus help to restore a sense of the EU as a positive-sum game.
- The **Participatory Union** aims to strengthen the ties between the EU and its citizens by increasing its democratic legitimacy and accountability. This should be done by focusing not just on traditional areas such as the powers of the European Parliament or the increasingly political role of the European Commission, but also on extending schemes to enable more people to experience the direct benefits of EU membership and foster greater understanding of the Union; on mechanisms for strengthening the public's direct involvement in the EU policy debate; and on ways to enhance the role of national parliaments in European policy-making at Member State level, especially when it comes to translating country-specific recommendations made in the framework of the European Semester into reality on the ground. All of this could contribute to a common understanding of the situation in other EU countries and a shared perception of the common challenges and benefits – but also the limits – of the Union.

Taken together, these three pillars could help to meet the concerns of different groups in different countries. Their combined effects could contribute to restoring the public's faith in the EU by boosting its ability to deliver, especially in terms of growth, jobs and social cohesion, demonstrating that European integration is not an end in itself, but rather the means to bring about greater prosperity and security.

All three pillars contain elements designed to **move further down the road towards a 'Genuine Economic and Monetary Union'** (GEMU), which is essential if the EU – and especially the countries of the euro area – ultimately want to master the crisis and secure the long-term stability of the common currency. Many of these measures target, first and foremost, euro-zone countries. This might prompt some **criticism in those Member States** that have not yet joined the common currency and **feel that other significant policy issues are being neglected**. It therefore makes sense to try to **identify a new 'grand project' which could function as a unifying factor**, a political catalyst providing significant benefits for all EU countries and different groups within Member States and potential spill-over effects in a range of internal and external policy areas.

As reflected in the set-up of the Juncker Commission and given the current political circumstances and challenges, an **Energy Union could play this role**. The countries of Central and Eastern Europe, many of whom have not yet joined the euro area, have a particular interest in measures to secure their energy supply and strengthen the EU's foreign policy dimension, especially *vis-à-vis* Russia. An Energy Union is also particularly interesting for non-euro

countries such as the UK, where there is a strong belief that the EU should, above all, be about the Single Market and should therefore focus on its completion.

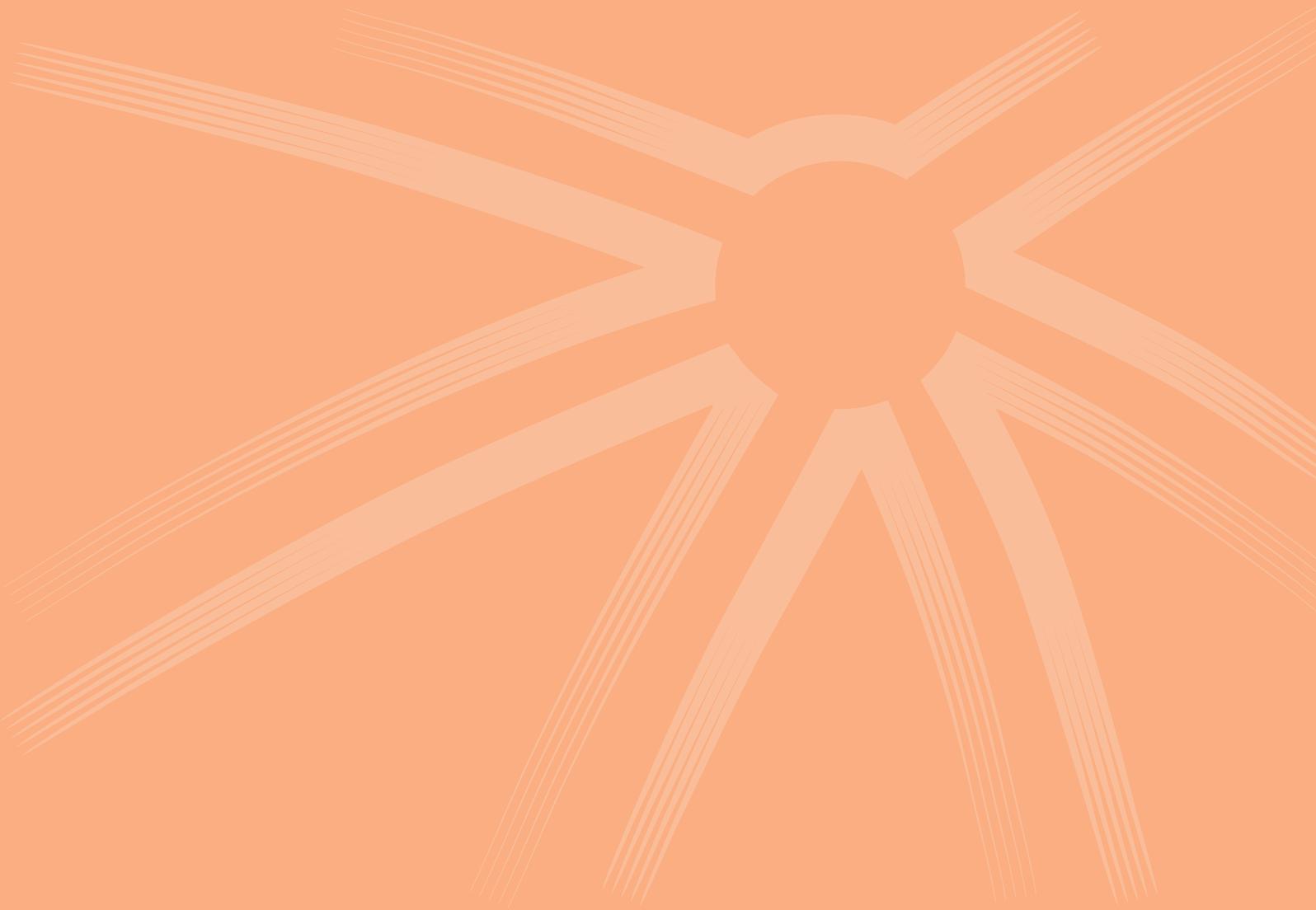
The **measures outlined** in this report are designed to illustrate the types of action that could be included in a New Pact for Europe. They **are ambitious but not overly so: almost all could be implemented on the basis of the current EU Treaties**, although some might require additional intergovernmental treaties/agreements. However, this cannot be a long-term solution. To foster institutional and legal coherence, the **content of the many inter-governmental agreements** of recent years should, at some point in the not-too-distant future, be **integrated into the EU's treaty framework**.

To do this, the EU and its members **need to start preparing for the process of treaty change**. The implementation of a **New Pact** along the lines described above **could lay the foundations** for this **by helping to reverse the tide of public opinion and attitudes** towards the EU in the Member States, which will be essential before any attempt can realistically be made to launch a process aimed at getting agreement on substantial amendments to the EU Treaties and getting those changes approved in all EU countries.

The Union should **use the time between now and then to prepare the ground for this process**. Besides integrating the content of intergovernmental agreements into the EU Treaties, there is a need to reflect on and identify: (i) the key issues and questions which should be addressed; (ii) the potential treaty provisions which should be amended in light of existing and future economic, financial, political and global challenges; and (iii) the concrete details of the procedure for treaty change, including the timing, mandate and organisational set-up of a new Convention. This reflection process could be launched in 2015, with the aim of reforming the EU Treaties in the next decade.

The pragmatically ambitious approach necessary for the New Pact for Europe to deliver requires that EU leaders demonstrate the political will and commitment to help restore confidence in the Union by equipping it with the means to meet future internal and external challenges for the common good. Only in this way can future progress be built on solid foundations by ensuring that it is based not just on addressing fears about what might happen if Europe fails to act, but also (and more importantly) on offering hopes – as well as tangible prospects – of a better future for the citizens of the European Union.

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ANNEX 2: FOUR DIMENSIONS OF KEY CHALLENGES

The socio-economic dimension

Threats to social peace resulting from indignation and despair caused by high levels of (youth) unemployment in most Member States; pressures on the welfare state stemming not only from the crisis but also from ageing populations and other structural challenges related to demographic change; growing pressures on, and a gradual erosion of, the middle classes; widespread perceptions of (increasing) social injustice; and a lack of upward social mobility, especially among young people (the ‘intergenerational divide’).

Increasing economic divergence between EU countries due to a lack of competitiveness of certain EU economies; ‘beggar thy neighbour’ policies because of insufficient economic coordination between Member States; persistently high public and/or private debt levels in some EU/euro countries; and the lack of mechanisms between weaker and stronger euro countries to cushion economic and social shocks that hit some harder than others.

The structural deficits of a fragmented euro area due to an incomplete and unbalanced Economic and Monetary Union that still lacks adequate fiscal, financial and economic integration.

The political-institutional dimension

Insufficient public support for the EU because of a widespread and growing feeling among citizens in both weaker and stronger Member States that they are directly affected by decisions taken in Brussels/Strasbourg which they cannot influence and which do not (always) reflect their interests and point of view; national elites acting as ‘gatekeepers’ and looking for ‘scapegoats’ when talking about the EU to national electorates; a complex and often incomprehensible EU decision-making system, which, at a time of crisis, relies heavily on decisions taken behind closed doors and often driven by powerful national governments..

Multiple leadership crises at national and European level due to the failure of political elites to provide timely, effective and adequate policy responses; the inability of politicians to effectively reconcile their various roles at different levels (EU, national and regional); the lack of a coherent and politically accepted ‘integration engine’ commensurate with the role previously played by the Franco-German tandem; the inability of the European Commission to provide strategic guidance at supranational level along the lines of a ‘common European interest’ as it lacks political might, sufficient means/tools and – at times – support from key Member States.

Growing challenges to the traditional concept of political representation, leaving room for new forms of opposition, often from the fringes of the political system and characterised by radical/populist rhetoric; the empowerment of individuals through higher levels of education and the availability of new technologies; the multiplication of different and potentially conflicting sources of identity at local, regional, national and transnational level; challenges linked to openness, diversity, plurality and multiculturalism which spur immigration-related problems; the delegation of decision-making powers to beyond the national level and to institutions without a popular mandate; the impact of non-traditional means of communication and interaction via social media.

The societal dimension

The lack of a common understanding and vision of European integration (narrative; 'leitmotiv') – of what Europe is for and what is in it for 'me' – due to a lack of awareness or relative neglect among citizens, including elites, of the EU's core added value (peace, prosperity and well-being, collective global influence) and the nature of its identity (i.e. distinct historical experience, rule of law, collective rules, the European social model, protection of individual rights). All this creates ambiguity about what unites Europeans, making it harder to foster the shared sense of identity and common destiny needed to generate active support (and not just passive consent) for European integration. There is also a growing perception that 'Europe' is not 'part of the solution' but 'part of the problem', souring national debates and younger generations' attitudes towards the Union.

Increasing divisions between Member States leading to a (re-)surfacing of national stereotypes, nationalistic chauvinism and historical resentments, and an ever-louder, over-simplistic and harmful blame game between Member States because of differing interpretations of the root causes, nature and complexity of the crisis; disagreements over how to respond to the crisis at national and European level; conflicting visions of the future of European integration; and a reluctance to address sensitive questions openly because of 'political correctness' and fears that the debate might degenerate and become counter-productive.

Lack of knowledge about the EU and simplistic perceptions of national sovereignty in a globalised world due to ignorance about the functioning, powers and limits of the EU and of individual EU institutions; insufficient awareness of the consequences of the high level of interdependence between EU countries; idealistic views of national sovereignty and the 'power' of nation states in a globalised world.

The external-global dimension

Danger of gradual marginalisation, loss of attractiveness and credibility on the global level and in the EU's neighbourhood as influence shifts globally and economic, political, sociological and ideological competition increases; inadequate attention paid to regional and global affairs because of an enduring preoccupation with internal affairs and crisis-related 'navel-gazing'; the damage done to the EU/euro's image outside its borders by the crisis; and the persistent inability of the EU to act jointly and speak with one voice in the global arena because of the lack of a shared 'strategic vision' of Europe's role and core interests and insufficient support from Member States.

Pressure to adapt the multilateral system of global governance to the new realities of international relations (weakening the EU's role) and risk of gridlock, given the limited ability of individual countries to respond effectively to global challenges (e.g. climate change; resource scarcity/security; economic imbalances; migration; nuclear proliferation; international terrorism) in a highly interdependent and competitive world; the lack of effective global rules and mechanisms to enforce them; growing question marks over the legitimacy of existing global institutions because they fail to reflect the emergence of 'new' powers demanding a stronger, more equal say; the prospect for a downsizing of the weight of EU Member States in key global bodies to meet the demands of others; and an increasing risk of stand-offs between major powers (e.g. competition over scarce natural resources; 'currency wars').

ANNEX 3: GENERAL OBSERVATIONS AND MAIN CONCLUSIONS OF NPE EVENTS

This document lists a number general observations and provides a short overview of main conclusions regarding the state of the Union, future key challenges and option preferences related to the five strategic options presented and discussed in the first report of the New Pact for Europe project (available at www.newpactforeurope.eu). It is based on national reports of almost 50 public and non-public events, which took place in 17 Member States (MS) between December 2013 and April 2014.

General observations

- The method applied and the **five strategic options** elaborated were generally **considered a suitable and productive framework** and fruitful starting point for stimulating discussions between 'ordinary citizens' in the so-called Citizens' Advisory Groups (CAGs) and also between more informed policy-makers, stakeholders and experts. Participants were stimulated to put themselves into the role of decision-makers asking themselves which of the options should be or should not be pursued.
- Citizens appreciated the fact that they were **given a chance to debate** issues related to European integration and valued the fact that they were given the **opportunity to make themselves heard**. Many citizens were very opinionated about the EU, while their knowledge about the Union was rather limited. Following their participation in the CAG citizens held that this experience had increased their knowledge and understanding of the EU (learning effect).
- Some participants in the events, especially in countries hit less by the crisis or in non-euro MS, said that options developed in first NPE report put **too much emphasis on the euro crisis**.

State of the Union

- Independent of the situation in individual EU countries and although a **vast majority** was (rather) **positive about the European integration process**, there was a widespread negative sentiment regarding the current state of affairs in the European Union.
- However, despite the experience of the last years and the gravity of the situation there was **no (strong) sense of alarmism** regarding the present state of affairs. On the contrary: those who spoke of a "great crisis" or "dramatic situation" and those who warned of "bigger crises" yet to come were in minority.
- A broad majority of participants felt that the **situation regarding the euro crisis had improved** since 2012. However, there was a widespread feeling that the EU **and its members are not 'out of the woods'** and that the situation is not back to normal as the overall crisis situation remains volatile ("danger of backlash") and as the economic and social situation in many EU countries remains (very) difficult.
- Evaluating the current state of the Union, many participants – especially in events with policy-makers – argued that although there still is some progress (e.g. on banking union) there is compared to 2012 a **loss of momentum** regarding further (substantial) reforms and that the EU is currently moving (more or less) along the lines of Strategic Option 2 (consolidating past achievements). MS seem exhausted after many years of crisis and are now less ready to move further as crisis pressures have decreased (complacency) and eurosceptic attitudes increased.

Key challenges

- There was a broad agreement that the four dimensions of challenges – socio-economic, political-institutional, societal, and external-global – listed in the framework of the first NPE report are actually the most pressing challenges (see Annex 2).
- However, **some issues were missed from the list of challenges:** (i) environment/ecological concerns/climate change; (ii) future of enlargement (mentioned especially in the MS in Central and Eastern Europe (CEE); scepticism in other MS (e.g. in the Netherlands)); (iii) corruption; (iv) tax evasion & tax fraud; (v) need to secure the EU's external borders (especially mentioned in southern MS); (vi) negative effects of brain drain; (vii) external immigration and integration of migrants; and (viii) issues related to the free movement of labour which are associated to recent debates about the 'abuse' of social benefits in some MS ("social tourism").
- In terms of significance the **following challenges** were **mentioned more often** than others (no hierarchy as there was no clear preference for certain challenges!):
 - (1) (youth) unemployment seen as a structural problem;
 - (2) increasing social (welfare) crisis within some MS and lack of a strong EU social dimension;
 - (3) low growth and erosion of Europe's competitiveness ("crisis of current concept of development");
 - (4) growing economic heterogeneity between MS and very slow process of catching up (mentioned especially in CEE);
 - (5) need to overcome euro crisis and structural limitations of EMU;
 - (6) lack of legitimacy of EU and democratic deficit;
 - (7) non-transparent & informal decision-making process ("decisions behind closed doors");
 - (8) lack of (common) vision/*raison d'être* of European integration ("need for emotional link");
 - (9) poor knowledge and insufficient media coverage about EU;
 - (10) increased support for populist, radical, Eurosceptic parties who are driving the debate ("crisis of national European narratives");
 - (11) lack of leadership at national and European level;
 - (12) scapegoating by national politicians;
 - (13) unclear distribution of competences between EU and MS;
 - (14) foreign policy & security concerns (increased mentioning following events in Ukraine; source of concern especially in CEE; "peaceful Europe is fragile");
 - (15) increasing cleavages & dividing lines between MS (centre/periphery; euro/non-euro; north/south; east/west; net-recipients/net-payers);
 - (16) asymmetric division of crisis costs (feeling both in 'stronger' & 'weaker' MS);
 - (17) new (im-)balance of power between MS.

Option preferences

- There was **no clear preference for any of the five strategic options**. Many participants in the national events called for a mixture of options ("hybrid options") and mixture of measures presented in the framework of the five strategic options. There was also a call to link individual options to specific policy areas, i.e. to further deepen cooperation in some areas while having less centralisation ("less Europe") in other policy fields.
- At the **epicentre of many debates** were the following two questions: **(i)** Is Option 2 ("consolidating past achievements") enough or not enough in light of current & future challenges? **(ii)** How to keep up European unity while experiencing high levels of divergence between MS?

- Many participants argued that **Option 5** (“changing the ‘more/less Europe’ logic” going beyond simplistic and unrealistic attempts to copy the national model at the European level) was **not as clear and understandable as other options** (“vague”; “no fully-fledged option”; “philosophical”; “irrelevant”). It was perceived by many as being more of a horizontal option that could be added to or enlighten/inspire the other options. Option 5 was welcomed as it has the strongest citizens’ dimension and inserts the notion of a “radical/fundamental rethink” into the debate. This explains also to some extent why Option 5 was most popular option in 5 out of 9 CAGs. Other elements of Option 5 – more sophisticated growth indicators, introduction of 3rd chamber or ‘technocratic orientation’ – found less attraction or support.
- As a whole, **Option 1** (“going back to the basics” by putting the EU into reverse gear and abandoning any moves towards an ‘ever closer union’) **found less support** than the other four options. Main reasons mentioned: ‘going back’ would not help tackle the manifold current/future challenges, and Single Market and single currency cannot be seen in isolation from each other. However, the **notion of decentralisation** and a stricter application of the subsidiarity principle in certain policy areas, which is included in Option 1, **found some support**, while the **idea to dismantle the euro area** or to abolish the common currency altogether was **not supported**.
- **Option 4** (“leaping forward” towards a fully-fledged economic, fiscal, social and political union, even if this might mean that some countries move ahead faster and leave others (temporarily) behind) **found some support** in a number of MS. Those advocating a ‘federal leap’ argued that it was the only way to tackle Europe’s challenges (“monetary union will ultimately require a political union”). At the same time, Option 4 was considered by many to be a **long-term vision/ultimate objective** rather than a practical option that could be pursued at this point in time. Others again held that Option 4 is impossible (“utopia”; “people do not want to live in a United States of Europe”; “economy is no sufficient base for a European state”) and that attempts to move in this direction might overstretch the Union and its citizens and could thus result in disaster (“danger of EU implosion”). For others, also among those advocating in favour of this option, Option 4 carried the **danger of excluding some MS**, who are not able to ‘jump into the deep’.
- **Option 2** (“consolidating past achievements” by giving reforms more time to work both at the European and national level while accepting that Member States are not ready to further pool sovereignty in key areas) was perceived by many as being **maybe not the best but the most realistic option**. This option found particular support from policy makers, who argued that there is a need to “catch breath” and that time was not ripe to move ahead more ambitiously, especially if this requires substantial treaty change (reasons: negative mood/euroscepticism in many MS; citizens not ready to further deepen integration (at this point in time); hesitation regarding a further loss of national sovereignty; fear of opening up a Pandora’s box; fear of another Convention; fear of ‘consensus costs’; fear of ratification failures etc.). Some argued in favour of an “option 2 plus”, i.e. that the EU and its members should progress as ambitiously as possible in certain policy areas, but within the limits of the current Treaties by using *inter alia* the instrument of enhanced cooperation. In general terms, although there was a widespread appreciation that Option 2 seemed the most realistic avenue, there was also a feeling among many participants that the **EU cannot afford to stay where it is**, that there is a need to move ahead (at some point in time) as mere consolidation will be insufficient taking into account the current state of affairs in the EU and in many MS.
- **Option 3** (“moving ahead ambitiously” by going beyond mere consolidation while not moving towards an economic and political and avoiding the creation of a multi-tier Europe) seemed for many a **realistic while at the same time also ambitious alternative** following a step-by-step approach (“need to find an ambitious and balanced approach”). This option could be the basis for a compromise, which incorporates certain ingredients from other options (“mix between Option 2 and 3”; “Option 3 minus”/“moving ahead”; “Option 3 plus” (including the insertion of some Option 4 elements); “inclusion of Option 5 ingredients”). A good number of participants from euro and non-euro countries argued that there is a particular need for countries of the euro zone to further

integrate in order to stabilise the common currency (and the EU in general) – without closing the doors to other who are not (yet) in the euro area.

- **Voting results:** When calculating the votes in the ten CAGs, **Option 5 proved to be the most popular option, followed by Option 2 and 3. Option 1** was the one that registered the **fewest votes** in the CAGs. In the policy-makers events Options 2 and 3 were the options chosen most often, while numerous participants called for an inclusion of elements of Option 5 into these options. Options 2 and 3 were also mentioned most in the public stakeholders events, but there Option 4 also got more mentions than in the events with policy-makers.
- Alternative options mentioned: **(i)** “Option -1”: EU should be dismantled; **(ii)** “Option zero”: total withdrawal from the EU; **(iii)** “Option 7”: nothing should be done for a while and EU expansion should be frozen.

Some interesting thoughts from national events regarding the options:

- (1)** need to link options to individual policy areas by deepening cooperation in some areas while having less centralisation in other policy fields;
- (2)** independent of individual option preferences there was a more fundamental debate as to whether there should be more emphasis on growth or on the need for strict fiscal discipline;
- (3)** none of the options is suitable to overcome the current crisis as the options perceive diversity as an obstacle to unity;
- (4)** no treaty change now, but good time to start public debate about EU's future;
- (5)** efforts should not concentrate on “institutional engineering” but on concrete concerns and policies, i.e. on delivery;
- (6)** Option 4 seen as more favourable from the perspective of many less powerful/smaller MS, but stronger EU countries not ready to accept/support major leap;
- (7)** Option 3 would be an intermediate step as it would eventually lead to Option 4;
- (8)** only Options 1 and 4 would lead to a stable equilibrium – other options would lead to unstable equilibrium risking a repetition of the crisis in the future;
- (9)** countries hit most by the crisis (including e.g. Greece, Italy, Portugal or Spain) seem more inclined than others to further deepen EU integration.

Over the past decade, European integration has been challenged as never before, buffeted by storms that have exposed and exacerbated significant shortcomings in its economic and political construction. As a new leadership team takes office, the EU faces key strategic decisions about its future. To create fresh momentum that will allow Europe to exploit more of its potential and meet citizens' needs and expectations, there is a need to elaborate a New Pact for Europe between Member States and between the EU and its citizens: a Pact based on three main pillars – an 'Enabling Union', a 'Supportive Union' as well as a 'Participatory Union' – and a new grand project, which balances the interests of different EU countries and different groups within them and restores the perception that European integration is a 'win-win' for everyone.

The New Pact for Europe project was initiated by the King Baudouin Foundation (Belgium) and the Bertelsmann Stiftung (Germany) and is supported by a large transnational consortium of foundations, think tanks and civil society organisations. The initiative aims to promote a Europe-wide debate on the perspectives for European integration and this second project report, which will be discussed with policy-makers and stakeholders in a majority of Member States, is designed to feed into the ongoing discussions about the European Union's future.

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 "la Caixa"

