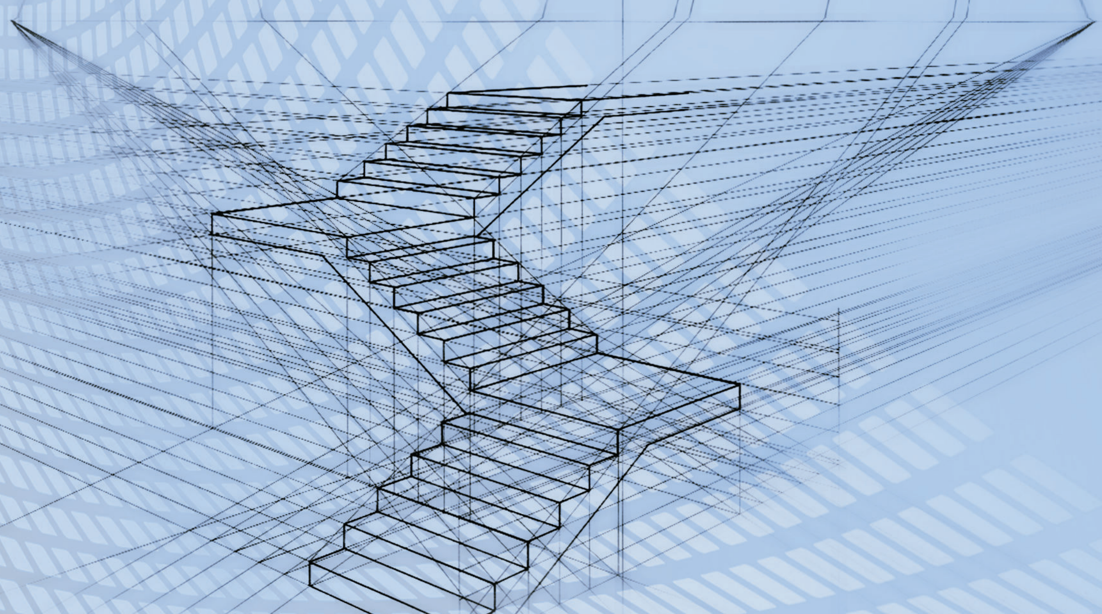
Joint study project of
Avenir Suisse - Zurich, Boğaziçi University - TÜSİAD Foreign Policy Forum - Istanbul and THINKTANK Centre - Warsaw
Supported by

economiesuisse LEWIATAN TÜSİAD

The Future of European Integration: A Reform Call



THE FUTURE OF EUROPEAN INTEGRATION:

A REFORM CALL

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This study is the result of a joint initiative from three European business federations: Economiesuisse (Business Federation of Switzerland), LEWIATAN (Polish Business Confederation) and TÜSİAD (Turkish Industry and Business Association).

Each chapter of the report was written by independent authors and does not necessarily reflect the views of neither the business federations nor the other authors.

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LEWIATAN

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Introduction

PROF. GÜNTER VERHEUGEN

With a new European Parliament and the Juncker Commission in place, there is an excellent opportunity to give the process of European integration a new momentum. This opportunity should not be missed, because the EU is in a critical stage. Due to the deep financial and economic crisis and the sluggish recovery, the risk of a lost decade in terms of growth and job creation remains high. Social inequality has become a burning issue. Moreover, the crisis has fuelled public mistrust in the European integration and for the first time in the history of the EU, the discussion about exiting the community is no longer a purely theoretical consideration. The crisis has also shed light on the deep inherent disparities within the EU, where catching up is going hand in hand with drifting apart from the EU economies. All the more, it is urgent to reassure its more than 500 million citizens that the European integration doesn't only mean to ensure peace and stability creation but also refers to driving prosperity and shared welfare. The European crisis strategy has undoubtedly created further bonds between the EU countries, notably the European Monetary Union (EMU) member states; however the concept of an ever-closer integration of the European nations is not only questioned from a political point of view. While the EU and especially the EMU stood together to rescue the Eurozone and to overcome the crisis, it became equally clear, that the member states are the owners of the integration and that the conflicts between European solidarity challenges and national interests still form a complex and very often tense relationship.

The crisis has hit the EU fully unprepared and the EU has entered new territory in dealing with the crisis. However, the EU's crisis reaction was largely concentrated on avoiding the worst case - the break up of the Eurozone and in so far rather a defensive approach. Such a defensive policy approach seems to prevail also in some other core EU policies, such as research and development or innovation, immigration or dealing with an aging population, industrial policy or energy policy. Still, the EU has an overall tendency to predominantly react to obvious threats instead of strategically using emerging opportunities. The recent debates around the Transatlantic Trade and Investment Partnership shed light on a profound EU dilemma: Different problems or fears may easily overshadow the undoubted overall stability and welfare gains and consequently may put a whole project at risk.

The dynamics of globalisation aggravate the substantial internal problems of the EU and any inward looking European policy will only lead to a further political and economic marginalization of the EU. The EU needs to tackle its weaknesses in a decisive manner, because the world will not wait for the EU to fix its problems, but puts expectations and hopes upon the EU and attributes responsibilities to it, which cannot be ignored. The situation in Eastern Europe or in the Middle East will have its impact on Europe, and the only question is, whether the EU is prepared to shoulder the tasks or whether the EU will have to deal with the consequences in a fully unprepared manner.

As the EU is at a critical junction, it must address its predominant weaknesses, by setting a positive reform agenda, which builds on its core strength: The potential of the internal market, the four freedoms, its commitment to open markets and fair trade and the political will to exit the crisis in a strengthened way. Apart from dedicated political leadership, it is the economy that will make the difference. With unsustainable high unemployment rates, and a youth unemployment rate, which prevents a whole generation from equal opportunities it will be difficult, if not impossible, to change the present mood in our societies, which is characterized by growing scepticism regarding the usefulness of European integration. Obviously, there is more than just disappointment with the economic conditions. A long list of complaints and critical questions finally comes down to one central weakness. All opinion polls suggest that Europeans across the EU are convinced that the EU has infringed the right balance between national responsibilities and supra-national decision-making, thus objecting any further deepening of the European integration. The call for "more Europe" does not meet an enthusiastic population in the EU but is rather perceived as a threat by many, feelings that are fuelled by nationalist or anti-European parties, which, representing still a minority, are on upswing across the EU.

Such a situation needs immediate action and the strongest possible concentration of policy makers at European and national level on political and economic reform. It is time for a change, time to overcome European deficiencies, time to correct wrong developments and to focus on improvements, on delivery in direct benefit of the citizens. Business as usual is not an option. Strong leadership and close cooperation between the political and economic actors is therefore indispensable.

While the EU has focussed on the financial sector during past years, without having sorted out the problems of this sector, the deficiencies of the real economy have not been properly addressed. The EU is faced with macroeconomic imbalances, unsustainable public finances and a lack of global competitiveness. Strengthening the competitiveness of the EU economy, while addressing internally the drifting apart, must be the top-priority for years to come.

This report has been initiated by three business organizations namely TÜSİAD, Turkish Industry and Business Association; Polish Confederation of Lewiatan and Economiesuisse. These organisations have always been strong advocates for European values and the European project and have been the drivers of the European economic integration for a long time. What is new however is, that, instead of agreeing among themselves they have asked leading European think tanks to reflect upon the future reform needs of the EU. Consequently this report has been prepared by three think tanks namely Boğaziçi University - TÜSİAD Foreign Policy Forum, THINKTANK Centre, Avenir Suisse and by Dr. Cornelius Adebahr, Associated Fellow of German Council on Foreign Relations (DGAP). Coming from different backgrounds and with different experiences they are all sharing the view that close cooperation, partnership and integration is the lesson European history tells us.

The first chapter, written by Alois Bischofberger, Dr. Samuel Rutz and Dr. Rudolf Walser (Avenir Suisse) provides an analysis of the challenges, which the shortcomings of the EMU and the macro-economic imbalances have created. The chapter also deals with eventual policy options. The second chapter, contributed by Dr. Małgorzata Bonikowska (THINKTANK Centre), focuses on reform needs the business environment and the completion of the internal market. The third chapter, authored by Prof. Hakan Yılmaz (Boğaziçi University - TÜSİAD Foreign Policy Forum) analyses the foreign policy needs of the EU by casting a light on the nature of globalisation and dealing in particular with enlargement and neighbourhood policy. The final chapter presented by Dr. Cornelius Adebahr (DGAP), addresses urgent institutional reform options.

All contributions are focused on a European reform agenda, which could be pursued without changing the European Treaty and consequently could be implemented without any delay to deliver immediate or mid-term results. Formally, the potential EU-exit of the UK has not been dealt with, however many of the recommendations have picked up current concerns of European citizens, which are echoed by the UK government and some other EU countries. Any substantial EU reform agenda may therefore have not only a positive impact on the public opinion in the EU at large but also on the UK discussion about its future European destiny.

What are the main lessons to be learned or recommendations to be followed?

All recommendations are of truly European nature. The authors do not present some academic thinking about more or less integration. Instead they concentrate on improvements based on the existing Treaty and are focussed on the achievable and the likely output of any suggested reform steps. Moreover, they make a strong point to set up positive reform agenda and unveil their commitment for change through reform steps. All authors point to the urgency of EU reforms, however, as the analyses of the contributing think tanks also unveil, there is no magic solution. Instead the authors understand the working agenda ahead as a pragmatic step-by-step approach, with not much political glamour, but far from a mere muddling through.

There is also no single solution to one of the most pressing issues the EU is facing in the years to come: How to manage diversity in a way that ensures sustained European competitiveness not just in average, but in a shared manner, without leaving some countries behind, neither within the Eurozone nor across the meanwhile 28 member states.

The first chapter authored by Alois Bischofberger, Dr. Samuel Rutz and Dr. Rudolf Walser (Avenir Suisse) concentrates on macroeconomic challenges and on particular needs of the EMU. Its main advantage, compared to reports written by the EU insiders is its sharp and neutral analysis of the achievements and weaknesses of the current EU. It makes a strong plea for a differentiated integration approach, finding the right balance between a common rule setting, which should be thoroughly followed through and preserving the free competition between member states, including about the best economic policy to be followed. This interpretation of the future economic governance needs of the EU and notably the EMU is clearly at the core of any EU policies in the years to come. This report also points to the need to further follow a clear consolidation policy, however rightly sheds a light to the limits of the application of the Stability and Growth Pact (SGP) in times of crisis. Whenever the forecasts do not match with realities, all assumptions about the needed consolidation paths turn out to be an illusion and are thus not politically deliverable. What is however even more important is that the consolidation need is not just seen as complying with the SGP targets but measured against the challenges of aging Europe. How to finance the demographic change in the EU remains an unanswered question. It will therefore have to be in the focus in the EU in the years to come. Authors also suggest the need to agree on an insolvency system within the EMU, not only for banks, but also for states. While being a legitimate consideration, shared by a number of economists, politically, the EU has already answered this question differently, when deciding to rescue the Eurozone as such, clearly being more concerned about uncontrollable developments in the case of any country (Greece) exiting the Eurozone than about the costs of the rescue actions. Since then the developments have backed this policy choice and it would be highly recommendable, if the leaders would start thinking about any EU exit in a comparable way and not let the development slip out of their hands.

Following the analysis of Dr. Małgorzata Bonikowska (THINKTANK Centre), the EU has generally found the right recipe for strengthening European competitiveness, as they are enshrined in the Europe 2020 strategy: Ensuring more convergence, a rational energy and climate change policy, promoting SMEs and entrepreneurship and boosting research and innovation are at the core of this chapter. It cannot answer however the question, how to ensure the full delivery.

As it stands now, the EU will miss many of the 2020 targets: On employment, on poverty and on research and development (R&D) spending. To change the situation the EU would have to pursue a double approach: While pushing the national reform agendas, it would also have to push the best performing member states to do much more than planned, to counterbalance weaknesses, which are not likely to be overcome in the medium term. Even with best efforts, and well targeted spending the unacceptable high youth unemployment will not substantially decline in some countries. All the more, it would be important that those countries with solid labour markets strengthen the job creation measures even further in order to promote more European labour mobility. The same strategy holds true for European R&D spending. There is not much hope for the EU to reach the agreed common goal of 3% in 2020, as long as countries such as Germany will limit themselves to just reaching the 3% target at national level, given the weak R&D performance of a number of member states in the medium term. On the longer run however, the substantial gap between the member states as regards to their R&D and innovation capacities will have to be closed. Achieving coherence between industrial policy, climate change policy and energy policy turns out to be another challenge for the years to come. The process of deindustrialisation in the EU needs to be reverted, and consequently appropriate framework conditions must drive entrepreneurship and investments accordingly. Better regulation both at European and the national level, including a substantial de-burdening of businesses, primarily of SMEs from regulatory and administrative burdens are since long on the European agenda, however the results so far are sobering. This situation will not change, even with the strongest political will, as long as substantial deregulation is not fully appreciated as a horizontal policy priority of the whole Commission. The announced re-launch of the better regulation program by the President of the Commission, Mr. Juncker, is a decisive move. If thoroughly implemented, the Juncker Commission may achieve a remarkable push for investment and competitiveness, with a much larger impact than any financial stimulus package - as needed as it is - would achieve. All depends however whether the new Commission will really be able to restrain its rule setting power as this is much easier said than done. It will not only require political courage but a cultural change inside the Commission, which still perceives harmonisation as the preferred integration option. The fact that a Vice-President is now overseeing better regulation can help mastering the challenge.

However the EU needs also to act more commonly in selected areas, such as energy. The energy community needs to be formed, both in terms of energy safety but more importantly in terms of ensuring affordable energy prices. Future reports will have to deal with the question, whether the EU is politically and mentally prepared to abandon its current focus on national energy security in favour of a community system of energy production and distribution, which is based on full competition of all available energy resources, including nuclear power and indigenous resources. The support of the European leaders from October 2014 will need to be translated in concrete actions, which may undoubtly face public resistance.

The contribution of Prof. Hakan Yılmaz (Boğaziçi University - TÜSİAD Foreign Policy Forum) takes a refreshing new look on the nature of globalisation, echoing the doubts about a one-size-fits-all approach and instead urges for flexible EU-solutions that may be picked up by different microeconomic environments. The "collective bargaining power" of the EU is seen as its biggest asset, on which must be capitalised, while lagging behind in the "smart, knowledge-based, innovative, higher value added, high technology economy" is being rightly described as the biggest weakness of the EU. Consequently it is recommended to follow a pro-active foreign affairs and foreign trade policy, instead of solely focussing on domestic issues. The EU should therefore exploit its strength as a value driven Community and soft rule setter to positively influence European and the global developments and also strengthen a global level playing field. A second set of recommendations may be summarized under the heading of partnering and networking across the world. Next to the transatlantic market place, the continental economic integrations should be seen as natural further integration step, thus creating more stability and prosperity across Europe. This chapter also deals with one of the most controversial policy issues - the enlargement of the EU. Current EU thinking, deeply influenced by enlargement fatigue and the shock of the EU crisis, does not consider dedicated enlargement policies of the EU as a "must" for the next years, not only in policy terms but also from a competitiveness angle. This applies not only for Turkey but also for any European country aspiring EU membership, such as Ukraine and other countries next to Russia, as they represent the major growth markets in Europe for the foreseeable future, provided that the process of political and economic reform continues.

The contribution from Dr. Cornelius Adebahr (DGAP) deals with institutional reforms and arrangements, which should help focussing the integration on the core European needs. It places a strong focus on the reform needs inside the European Commission. There were many discussions, whether the institutional power is been shifting away from the Commission towards the Council, or from the Community method towards a more intergovernmental approach. The author of the chapter is firmly convinced that the future shape of European integration stands and falls with finding a new balance of power between the Commission and member states, including Parliaments at national and European level. In any event, much depends on the policy choices the Commission will make.

At first sight, many of the institutional recommendations may look rather technical; however their implementations would profoundly change the Commission. Working with an external impact assessment board or publically consulting draft impact assessments would not only improve the political culture in European decision-making but also ensure that subsidiarity and proportionality are respected. The analysis of the European added value would be broadly shared. This would be one important step to accommodate concerns of national parliaments and the wider public. Generally, the Commission still lacks a proper follow up of concerns and desires of national parliament and the working relations with national parliaments require substantive improvement. Equally important will be a common understanding between the new Commission, the Council and the newly elected European Parliament, to fully back a European legislative approach that is self-restraint and based on the real needs.

Concluding remarks

The EU's recovery is still fragile and recent international developments, both the deterioration of the relationship with Russia and the developments in the Middle East put the EU under additional constraints. The risks of the EMU are still not fully overcome and the threats of deflation are looming. There is still no agreed European recipe how to ensure growth and job creation while maintaining and sustaining the indispensable fiscal consolidation. What is however undisputed is that competitiveness is key for ensuring medium and long-term growth. All European institutions are therefore challenged to scrutinise existing policies or intended new policies according to their capacity to foster competitiveness. The design of new policies with a clear focus: Adding value to competitiveness, both at national and at European level. To this end, the EU must set free the full potential of small and medium sized enterprises. This cannot be done without the substantial reduction of legislative burden. Furthermore the EU will have to deal with the transport sector and the logistics in general to make the internal market fully functioning. As the internal demand in the EU will remain relatively weak in the years to come, it shall be balanced by accelerating the internationalisation of the EU. The EU should therefore strive for the transatlantic market place with its huge investment and trade potential. As other economic blocks are forming, the EU needs to realise that time is running short. Equally the EU must foster its economic ties with catching up economies, and new economic "tiger" states such as Turkey or the BRICS. Finally, not least in the light of the crisis in Ukraine, the EU shall overcome its reluctance towards enlargement because all European experiences demonstrate that stability and growth are best preserved within a truly integrated European space. The recent Balkan Summit in Berlin has revealed that the process of rethinking the reluctance towards enlargement has already started.

Much will depend on the political authority and leadership of the European Commission as regards the challenges the EU is confronted with.

Mainstreaming differentiation as an opportunity, smart regulation as a mean to win back public support and enhanced participation to increase transparency, accountability and democratic scrutiny - this is by no means a wish list of European scientists - but an urgent policy agenda aiming at enhanced competitiveness. The EU patient has been sick for too long, and the suffering has been painful enough in some parts of the EU, however with political courage and the mobilisation of the economy, the therapy can be successful, and the remedy - as suggested by the authors - are by no way too bitter to swallow, but represent a smart and innovative medicine. Thanks to the social commitment and responsibility of three European business organisations, these recommendations are now public. May they serve as an inspiration and input for discussion and for European policy-making for the years ahead.

I

Subsidiarity Wherever Possible, Solidarity Where Needed

ALOIS BISCHOFBERGER, DR. SAMUEL RUTZ AND DR. RUDOLF WALSER (AVENIR SUISSE- ZURICH)

Summary of Recommendations

- Given the high degree of heterogeneity and the wide discrepancies in macroeconomic performance between EU member states, the most promising path for the EU to follow in the foreseeable future is a multi-speed variable-geometry concept.

- The reformed Stability and Growth Pact (SGP) - enshrined in the Fiscal Compact - and the EU scheme for a banking union are the central pillar of an institutionally strengthened Economic and Monetary Union (EMU) of Sovereign Member States (Maastricht 2.0).

- The "no-bail-out" clause in the treaty must henceforth be strictly adhered to since each member state is ultimately responsible for its own policy. Credibility can only be restored if treaties and rules are respected again. Eurobonds would be contrary to Maastricht 2.0 since they would introduce joint liability without sufficient control possibilities.

- To provide flexibility and facilitate economic adjustments in the peripheral countries, parallel currencies might be an effective interim solution to regain competitiveness, especially since the adjustment process via internal devaluation may be confronted with insurmountable social limits.

- The window of opportunity opened by the rescue funds and the emergency measures of the ECB should now be used for reform-oriented policies, in particular the removal of rigidities in the labour and product markets. If certain member countries of the EMU permanently lag in the development of productivity, the Euro area is confronted with a serious structural problem.

- The connection between banks and the public sector was a major driving force behind the crisis in the Euro area. To break the vicious circle between bank balance sheets and public debt, which is a result of mutual and implicit state guarantees, a restructuring and an insolvency regime for EU member states and a European banking union are unavoidable.

- The Single Banking Supervision (SBS) may, however, create a potential conflict between monetary and financial stability. The ECB could come under pressure to perform a quasi fiscal rule, which would undermine its ability to maintain price stability. One would worry less about these imperfections if there was a commitment to improve the new procedure at a later stage by transferring the task of supervising banks to an authority independent of the ECB.

- The Single Resolution Mechanism (SRM) is an important step in the direction of a robust banking union, irrespective of the fact that the resolution procedure is probably too complex, slow, and involves too many institutions. Therefore, practice will have to prove the effectiveness of the SRM.

- To restore competitiveness, the overarching goal of EU governance must be to emphasise the crucial role of market forces. This implies the rigorous implementation of structural reforms in all EU countries with the aim to make it easier to do business and to increase employment, thereby enhancing the growth potential of individual EU countries and reducing unemployment for the benefit of the EU as a whole.

1. Introduction

There is no doubt that the EU as a project for peace, open markets, fundamental freedoms, and eastward expansion has created conditions and initiated processes that should no longer be questioned. Europe has profited from this in legal, economic, political and cultural terms. So, we may properly describe the EU as "the most ambitious and successful example of voluntary international cooperation in world history" (Moravcsik, 2012).

At the same time it would be an act of self-deception to deny that the EU has failed to reach important targets. Ultimately, politics can be measured and judged only against the targets it sets itself. For this reason, it is important to begin with a brief assessment of the latest developments, in order to create a basis on which to set out possible paths to successful EU policies for the future. Today, the EU does not need sweeping visions or new strategies but consistent market-oriented policies, in accordance with the EU Treaty. In fact, Art. 3, par. 2 of the Treaty postulates that the Union shall work for "...the sustainable development of Europe, based on balanced economic growth and price stability, a highly competitive social market economy...".

In view of the global competition between countries, the thrust of the EU must be to offer highly mobile resources such as capital and qualified manpower conditions that grant these resources the best possibilities for unfolding optimal productivity, thereby fostering growth and employment. Therefore, the quality of the legal framework of the EU is an essential prerequisite for competitiveness, and the macroeconomic framework is an important part of it.

1.1 A Weakened European Union

The expectation that the European single market would gradually lead to better aligned economic development, and thus to a more homogeneous economic area with greater resistance to external economic shocks, has, sadly, only been partially fulfilled. The macroeconomic imbalances have not been evened out. Until the reforms of the last few years, the opposite was true. This was shown, for example, in the great discrepancy in unit wage costs, current accounts, and private and public debt. And accordingly, the various competitiveness indicators reveal a fairly disappointing picture. While a few of the more recent member countries have been able to make up ground economically, the past years have seen a loss of competitiveness in the southern peripheral countries and France. The latest global rankings of the International Institute for Management Development (IMD, 2013) and the World Economic Forum (WEF, 2013) includes only a few EU countries in the top group: According to the IMD's World Competitiveness Yearbook 2013 these are Sweden and Germany; according to the WEF's Global Competitiveness Index they are Finland, Germany, Sweden, the Netherlands and the United Kingdom.

The Stability and Growth Pact (SGP) is anchored in Treaty provisions and was intended to ensure budgetary discipline among member states. However, due to pressure from France and contrary to the original German proposal - which foresaw nearly automatic sanctions in case of non-compliance - the SGP also refers to extraordinary economic circumstances, which may prevent countries from playing by the rules. As a result the SGP entails an element of appreciation whether extraordinary economic circumstances are applicable. The SPG has been changed twice, yet the inherent dilemma between fiscal efforts and real economic developments is not solved. In particular, the SGP cannot deal with unexpected economic downturns, where the rules are overtaken by realities. Since the outbreak of the financial crisis in 2007 debt has risen sharply in almost all member countries and, with the exception of Finland, Luxembourg and Slovakia, is now well over the upper limit of 60% of GDP. If implicit state debt is also taken into consideration, the situation is alarming. According to calculations by the Generationenverträge research centre at the University of Freiburg, the unfunded pension benefits in Germany, Italy, France and Austria represent well over 300% of the relevant GDPs.

According to the 2000 Lisbon Strategy, the EU was to become the most dynamic and competitive economic area in the world by 2010 with an employment rate of 70%. The employment rate rose from 62,6% (2000) to 65,8% in 2008, but decreased in the wake of the financial crisis to 64,1% in 2010. The implementation of the strategy remained well below expectations. A further aim was establishing a research and development quota of 3% of GDP; however only 2% was allocated. Not only did the EU as a whole lose ground against other regions, but since 2000, industry's share of gross value-added has fallen in almost all EU countries, with detrimental effects on innovation (Deutsche Bank, 2013). The successor to the Lisbon Strategy is the Europe 2020 strategy, with the goal of creating "smart, sustainable and inclusive growth" in Europe, through research and development, higher education and life-long learning. The EU is well behind achieving this goal as well.

1.2 European Monetary Union - a Problem Child

The very start of the European Monetary Union (EMU) was problematic, as membership was not only determined by strict economic criteria but also based on predictions of future economic and fiscal developments. This approach allowed political considerations in decision-making. As so often, the politicians indulged in leniency, in the hope that the consolidation process would at least go in the right general direction. However, the "windfall gains" of interest-rate convergence in the so-called GIPSIC countries[1] were not used to strengthen their competitiveness; rather, the low interest rates above all encouraged credit-financed consumption and a real-estate boom. The flow of funds into these countries allowed wages to rise faster than productivity. With its low interest rates, the Euro as a single currency reduced rather than strengthened the pressure for reform.

The hope for disciplining states by financial markets also turned out to be illusory and inadequate. The markets were either too uncritical, and took too little account of the growing imbalances, or they were too clever, and did not believe that the "no bail-out" clause would actually be applied and that the other member countries would permit the default of any individual country. And developments proved them right. Finally, the Basle Committee on Banking Supervision took the decision, with far-reaching consequences for the Eurozone, to regard government bonds as risk-free investments, for which banks did not need to hold any equity. As a result, many banks inflated their balance-sheets with such paper. They thus reinforced the mutual escalation of bank balance sheets and public debt that proved so disastrous in the financial crisis.

The current crisis in the Eurozone is primarily a crisis of the European financial framework, and not of the Euro as a currency. It has, though, laid bare the design defects of the monetary union. These were revealed in a fragmentation of the financial markets,

1 *The GIPSIC countries are Greece, Ireland, Portugal, Spain, Italy and Cyprus.*

the problematic feedback effects between state debt and bank balance sheets and the serious macroeconomic imbalances between the core members and the peripheral countries, as the competitiveness levels of the members of the Eurozone drifted apart. Although real exchange rates diverged, the implicit national Euro exchange rate remained fixed at a nominal 1:1.

The crisis has shown that a monetary union is by no means a guarantee against problems caused by the persistent payment imbalances in member countries. Deficits still must be financed in a monetary union. However, the adjustment process is different as monetary policy and exchange rates are no longer at the disposal of member countries. In fact, the adjustment process is cushioned and protracted by the single monetary policy through harmonised interest rates and liquidity assistance measures of the Euro system. Empirical studies of the Deutsche Bundesbank have confirmed that current account adjustments therefore take longer in a monetary union than in fixed exchange rate regimes (Weidmann, 2014). While the current account surplus of the northern countries increased since the beginning of 2000, the deficit in the peripheral countries mounted accordingly (Deutsche Bundesbank, 2012). The much cited target balances of the Euro system reflect not only the serious divergences in the current accounts within the Eurozone, but also the fact that the countries with a deficit could no longer finance their deficits through private capital inflows. At the start of the monetary union the possibility of such a development was dismissed, so any correction mechanism was regarded as unnecessary. It was believed that individual countries within a monetary union would no longer experience funding shortages after the elimination of exchange rate risk. The Eurozone's GDP at the end of 2013 was 3% below the level of 2007, though with large differences between member countries. This can hardly be regarded as evidence of success.

However important healthy state finances may be, the lop-sided fixation of the monetary union on fiscal development may well have been a mistake. This approach loses sight of other potential undesirable developments, such as cross-infection between member countries, loss of competitiveness, and high levels of private debt. A deep divide runs through the Eurozone today. The crisis has revealed serious competitive weaknesses in the peripheral countries, which is by no means to say that all is well with the core countries of the Eurozone.

2. How Could This Ever Have Happened?

The Maastricht Treaty defined clearly, with the agreement of the governments and parliaments of all member countries, how Europe and its monetary union were supposed to function. It was to be a community based on individual responsibility, in which each state was responsible for its own finances. The aim was to take account of the differing perceptions of the role of the state, as primarily revealed in the relationship between states and their citizens.

It rapidly proved, however, that the rules for limiting public deficits were unable to achieve binding status. Either countries flouted the rules without fear of punishment, or the rules were temporarily bent, so that more and more holes were knocked in the "fiscal rules" (Weidmann, 2013). With only slight exaggeration, the treaty union turned into a breach-of-treaty union. This did serious damage to the rule of law. It is thus little surprise that in the well-known Economic Freedom Index of the Heritage Foundation the great majority of EU countries appear only in mid-field, because they "are generally plagued by an encroaching state and deterioration in the rule of law" (NZZ, 2013).

Today, we must conclude that the EMU has not served as the pacemaker for a political union. It started with illusions and has led to severe problems, which may not be overcome within a few years. The EMU has provided the EU with its own currency, which is globally respected; however, it has also eliminated a major instrument for dealing with competitive pressures and current account imbalances. The political debate about the distribution of the costs of the Euro-Stabilisation Policy, being conducted against the backdrop of the unequal distribution of assets in the Eurozone, serves as an example.

The development of the EU in recent years, broadly sketched out here, has resulted in the concept of "Europe" suffering serious loss of credibility and appeal among many citizens. Belief in a European policy has been shaken, and confidence in the project of European unification has been damaged. The EU appears no longer as the solution, but as the problem. In all probability, never since the foundation of the European Community have so many divisions opened up. The proposal in the United Kingdom to hold a referendum on continuing membership in the EU is the most striking outcome of these problems.

3. The Reaction to the Latest Crisis

In reaction to the global financial crisis, the heads of state and government of the G20 resolved on numerous programmes of action, with the aim of strengthening the resistance of the financial sector, and overcoming the weaknesses in international cooperation. Even if much remains patchwork, it has at least been possible to prevent the total collapse of the global financial system, and a slide into global depression.

In the EU, the global financial crisis transformed, from 2010 onwards, into a banking and state debt crisis. The starting point was May 10, when the ECB started with its purchases of sovereign bonds of peripheral countries. Numerous rescue plans for distressed states and reform packages were stitched together under enormous time pressure, not least to gain time for the development of a stable long-term framework. And it was possible to initiate some important reforms, and create preconditions for better crisis management. At the same time, a lack of clarity persisted as to what long-term strategy the EU would pursue, and what its structure should ultimately look like. The key decisions and measures of the most recent past are:

- Strengthening of the rule-based elements of fiscal policy (reform of the SGP; better monitoring of macroeconomic imbalances; review of the Euro-states' budgets in the context of the "European Semester") and, as an important innovation, Reverse Qualified Majority Voting, intended to complicate the formation of coalitions against the enactment of sanctions.
- The Fiscal Compact Treaty, under which the participating countries make a fundamental commitment to a balanced budget and an upper limit to structural deficit of 0.5% of GDP, either through a debt cap in their constitution, or by means of similarly binding national legislation.
- The transformation of the temporary European Financial Stability Facility (EFSF) into a permanent European Stability Mechanism (ESM) as a safety net and to relieve the crisis management of the central banks.
- The implementation of the Basle III framework in the "CRD IV" package.
- The creation of a banking union via the Europeanisation of material banking regulation law (Single Rule Book, Single Supervisory Mechanism, Single Resolution Mechanism).

The economic governance of the EU and the Eurozone has thus been subject to extensive revision, with the aim, firstly, of intensifying the monitoring of the member countries' financial policies and secondly, of enabling the early identification of any macroeconomic imbalances, in order to be able to take counter-measures swiftly. Associated with these are some potentially effective reforms that should lead to higher growth rates in the medium and long term, if they are implemented consistently. These measures and decisions also involve an increase in the European capacity for action, something that has been widely overlooked by the general public. It is only fair to mention that the reformed economic governance has some punch to it.

However, the whole regulatory structure for economic and financial-policy coordination and monitoring has become overly complex and allows for considerable political leeway. Moreover, many bodies are involved in decision making. This could lead to fragmentation of EU-policy and a loss of coherence and open new areas for interpretation offering opportunities for evasion and reciprocal indulgence. From the point of view of accountability the "new economic governance" is undoubtedly not optimal.

There have also been problematic decisions, such as the exercise of banking supervision by the ECB as this might result in a potential conflict between monetary and fiscal policy. Commissioning the ECB to provide financial as well as price stability might give rise to time-inconsistency problems. In such a setting the ECB could promise an inflation goal ex ante, but deviate from it ex post. With regard to crisis management, it is therefore essential to keep monetary and fiscal policy separate. And lastly, some hot topics have not been addressed at all yet. Most worthy of mention here is the concept of a well-functioning insolvency procedure for the member countries of the Eurozone that would at last give credibility to the "no bail-out" principle. Empirical research tells us that a state default usually entails the insolvency of the national banking systems and an economic recession. This underlines the necessity for an efficient regime for state insolvency and restructuring (Weder di Mauro, 2014).

4. The ECB as Sheet-Anchor

At the height of the financial and state-debt crisis, the ECB, as virtually the only properly functioning institution of the monetary union, played a key role. With its "unconventional" measures from 2010 onwards, in the form of the purchase of some €220 billion of state debt from the peripheral countries and a comprehensive credit line totalling one billion Euros, it poured massive liquidity into the banking system during the critical phase. This was successful in calming the financial markets and creating more attractive conditions for state financing. With the promise in July 2012 to begin, if need be, the unlimited purchase of government bonds of individual member states - provided that the countries concerned agreed on a reform programme with the EMS - the ECB effectively provided not only a guarantee for the Euro but also an implicit interest-rate guarantee for certain countries. Whether in doing so it exceeded its mandate, which forbids monetary state financing, is a matter of intense and controversial debate in political and economic circles. There is also a lack of clarity in this context concerning the Emergency Liquidity Assistance (ELA) for problem countries provided by the national central banks without sufficient involvement of the ECB.

There is little doubt that with its unconventional monetary policy, the ECB now finds itself in a quandary. This is most obvious in the substantial rise in its balance-sheet. Much more difficult, however, is the question of whether the ECB has not crossed "red lines" that may endanger its functionality, effectiveness and independence in the longer term. Lastly, it is unclear how the ECB will eventually be able to disengage from its "unconventional monetary policy" and its quasi-fiscal role (Deutsche Bundesbank, 2013).

This holds all the more true after the ECB's decision to purchase covered bonds and asset-backed securities and significantly increasing its balance sheet. In any event, it will have to break the expectation that it can be put at the service of state financing, and take account of the economic damage caused by its ultra-expansive monetary policy (e.g. misallocation of resources, penalisation of savers, financial-market bubbles and potential inflation). Not the least source of anxiety is the high level of private debt, resulting from extremely low interest rates, which significantly exceeds public-sector debt in some countries. The shift in power over economic policy to the ECB was justified in the crisis on stability grounds. Now, however, the political actors, which have happily taken refuge behind the central bank, must accept their responsibility. Economic and fiscal-policy conditions must be set by politicians.

Lastly, in light of the most recent turbulence in the Eurozone, the question arises of whether the ECB's mandate should be adjusted with regard to a more symmetrical alignment process. It can be argued that a higher rate of inflation in the stronger countries of the Eurozone would facilitate relative price adjustments, as the exclusive fixation on internal devaluation in the deficit countries is not only expensive, but probably also ineffective. Whether this would require a shift in monetary policy towards nominal GDP targeting, or even the "Evans rule" of the Federal Reserve System (federal funds rate dependant on a given unemployment and inflation rate), will need further analysis. We give preference to a return to the ECB's price-stability mandate over other monetary-policy approaches -especially since the ECB has acquired a fair amount of additional responsibilities, such as banking supervision.

5. Where from Here?

Essentially, there are three preconditions for a successful reform policy. Firstly, it needs consensus-based clarification of its objectives. Secondly, the policy must be simple (transparent, coherent mission statement), efficient (primarily market-based control processes) and effective (measurable achievement of targets). Thirdly, stable conditions are essential to give the different actors the necessary security for planning and investment. Every policy will ultimately be measured against these principles.

Basically, there are various possibilities for the economic and institutional strengthening of the EU:

- Greater integration into a European fiscal union and a European economic government.

- Consolidation and expansion of cooperation between EU member states on variable-geometry lines.

- Strengthening of the Maastricht Treaty in the sense of a version 2.0, based on the principle of individual national responsibility, and the completion of the monetary union by a banking union, for the institutional security of the Eurozone.

- Consistent implementation of the subsidiarity principle (strengthening of EU regulatory policy and reduction of interventionist policy).

Regardless of which route is chosen, the EU's political aims must be brought into better alignment with the preferences of its citizens, if EU policy is to regain credibility and trust. In this context, it is undoubtedly a disadvantage that the EU lacks an institutional safety-valve for the accumulated anxieties and anger of its citizens. For this reason too, EU policy should not run away from the people (Riecke, 2013).

5.1 Fiscal Union and a European Economic Government

Greater joint liability, in the form of a fiscal union with its own budget and tax competences, is often promoted as the solution to today's problems. Not only could this close off the open flanks of the EU and the monetary union, but it would also be an important stage on the route towards "ever closer cooperation between the people of Europe." A fiscal union appears to be an obvious move since individual crisis measures increased joint liability de facto, but without establishing effective controlling legislation. The relationship between liability and control has thus become unbalanced, and a fiscal union could restore the balance.

In principle, a fiscal union need not necessarily involve a uniform taxation system, as demonstrated by the USA and Switzerland. Comprehensive joint liability would, however, necessitate the cession of a large part of fiscal sovereignty on the part of member states. Such a comprehensive renunciation of sovereignty and transfer of competence to the EU-level, seems fairly unrealistic today and would require tedious and protracted changes to the EU treaty. The creation of only partial EU responsibilities, such as the generation of funds by the issue of long-term, jointly guaranteed state bonds - the so-called Eurobonds - would, absent corresponding rights of intervention in national budgets, rapidly result in a system of organised irresponsibility (Deutscher Sachverständigenrat). Eurobonds would not only be associated with the serious issue of moral hazard, but would also penalise all the member countries with good credit ratings. The joint, cross-border liability inevitably involved with Eurobonds would ultimately give rise to still more serious problems, as the incentives to budgetary discipline would be weakened. State expenditure would remain a national prerogative, while debt would be communitised. This fundamental problem would still remain if joint liability were limited to the part of national debt below 60% of GDP.

The notion that centralising economic competences with a European economic government would make it easier to solve the structural problems is equally fallacious. The German chancellor contributed such a proposal to the discussion in spring 2011, with the Pakt für Wettbewerbsfähigkeit (Competitiveness Pact). Analysis of where the structural problems of individual member countries lie, and whether their solution is to be found at national or supranational levels, rapidly produces a more differentiated picture. Differing problem areas require differentiated measures; some at the supranational level, others at the national level. Thus, the real-estate crisis, youth unemployment and state debt should be tackled predominantly at the national level, as there are great structural differences between the member countries in these areas. Furthermore, some of the political preferences of member countries are so varied that it would be impossible to find a common denominator. This is why there should be no attempt to iron out European variety by means of the enforced homogenisation of all country-specific areas of politics. Competition as a coordination process is based on the opposite approach.

A general transfer of national responsibility to EU level would not only undermine the responsibility of individual states, but necessarily also result in an ever more complex and unpredictable coordination of economic policy. Ultimately, it would further diminish institutional competition, in which governments offer varying economic-policy concepts, in favour of a bureaucratic coordination mechanism. This would contradict the European idea of competition between Europeans as the motor of prosperity. The great hymn to competition would thus finally degenerate into empty rhetoric. The EU will not survive global competition under the overall control of a command economy (Stezner, 2011).

For all these reasons, the creation of a fiscal union, with comprehensive cession of national sovereignty, does not appear to be a promising strategy for the EU. Political theory teaches that heterogeneous constructs tend not to be stable. "A European Federation would be quite heterogeneous by most measures (ethnic, linguistic, cultural) and likely to face significant political costs when choosing common public goods and policies at the federal level" (Spolaore, 2013).

5.2 Greater Cooperation on Variable Geometry Lines

The variable-geometry strategy is nothing new for the EU. It is based on the concept of enhanced cooperation between member states. This provision has been integrated for the first time in the Treaty of Amsterdam in 1997 and is today enshrined in the primary law of the EU (Art. 20 EU-Treaty respectively Art. 326-334 of The Treaty on the Functioning of the European Union). Akin to this concept of enhanced cooperation is the notion of "core Europe" that originated from the German debate about Europe. It refers to those member states that are prepared to go further in the political and economic integration process than others. The variable-geometry strategy has already been applied in the Schengen-Dublin agreement, in the social protocol to the EU-Treaty, in the EMU and now also with the Fiscal Pact. Nevertheless, it seems that there is no clear policy behind this instrument, so that the variable-geometry concept resulted in ad-hoc measures.

However, the concept of variable geometry achieved a new respectability through a speech by the British prime minister at the beginning of 2013, on Britain and Europe (Cameron, 2013). In the speech, Prime Minister David Cameron advocated abandoning the idea of the EU as a political bloc in favour of a structure better suited to the variety of its members than is now the case. In concrete terms, what is needed is fewer "one-size-fits-all" majority decisions, and more flexible options for integration.

The Confederation of British Industry (CBI, 2013) also calls for an EU that is much more "outward-looking", rather than being preoccupied with itself: "A competitive EU is also one which ensures that its regulatory environment is globally competitive and not unduly burdensome". There is a direct link here to the reinforcement of the subsidiarity principle. The EU should exercise self-restraint in taking on further tasks, particularly in social and labour-market policy and the ever more favoured area of "lifestyle regulation". And the member countries must be granted greater freedom of action in the achievement of objectives. A statement by the Dutch government indicates a similar point of view: "The time of an ever closer union in every possible policy area is behind us". These considerations are also partly reflected in the history of the EU itself: "The European project has been much more successful when fostering economic exchanges and a common market, while it has stalled when attempting to pool 'federal' public goods, such as defence and security" (Spolaore, 2013). It might well be that the present crisis paves the way to more enhanced cooperation.

Particularly in the case of the United Kingdom, however, the question of the potential limits of variable geometry arises with some urgency. The island kingdom is the most important financial centre in Europe, and its participation in regulation and monitoring within a European banking union would be needed. If the UK stands to one side, the banking union might be revealed as a paper tiger.

5. 3 Institutional Frameworks and Individual National Responsibility

Behind the catchword "Euro-crisis" lie three major problem areas:

- The state debt crisis characterised by sharply rising debt ratios in many member countries and some high risk premiums against German government bonds as a reference point.

- The macroeconomic crisis, revealed in the recessionary economic development in an increasing number of member countries, and particularly in the loss of competitiveness in the peripheral countries.

- The banking crisis, reflected in investors' loss of confidence in the financial institutions of the problem countries, and the renationalisation of credit relationships.

EU policy has been focused on these trouble spots. Its aim is to keep the Euro as the common currency, and it is deploying an impressive range of instruments to achieve this desirable goal. It has succeeded in strengthening the institutional framework, by means of a series of packages that would previously have been regarded as inconceivable. Particularly remarkable are the envisaged disciplining of fiscal policy, closer control of economic policy, and the creation of a European banking union for supervision, restructuring and settlement.

It remains to be seen whether the toughened Stability and Growth Pact and the Fiscal Pact will strengthen the statics of the EU structure in a sustainable manner. Previous experience teaches that the mere existence of rules is not of itself sufficient; they must also actually be applied, and non-compliance punished. But compliance with rules remains difficult as long as decision-makers are confronted with contradictory objectives, which is why clear objective-setting at the top level of the EU is important. And there is still a lack of tough correction and sanction mechanisms; ultimately judgement on sinners is pronounced by those who are themselves potential sinners. For this reason, the EU Commission has a special responsibility, for it has substantial discretionary scope in interpreting the fairly imprecisely formulated rules. As the German Bundesbank warns: "If the rules are rendered too flexible, through exceptions and latitude in decision-making, there is a danger that their disciplinary effect will be lost" (Deutsche Bundesbank, 2013).

It may be that the strengthened institutional framework will suffice in a fair-weather economy. Not least, in that it cannot be ruled out that greater coordination and more monitoring may have some disciplinary influence on the national financial policy of member countries. But whether the new rules will be adequate when the structure is exposed to a new endurance test is difficult to say. An additional complication is that bringing the debt ratios back to the reference figure of 60% of GDP may take some countries over 20 years, which may give rise to domestic political tensions. What will ultimately be decisive is how the member countries assume their responsibilities, and how the markets exercise their function of disciplining national financial policies.

The economic and financial-policy coordination at the EU-level, being implemented in parallel with the restructuring and reform policies in the programme countries (Greece and Portugal), and Italy and Spain, are beginning to show some results. These countries are now at the top of the OECD's "reform responsiveness" indicator, which measures the reaction to the OECD's previous recommendations in the "Going for Growth" project. There have been structural improvements to the balance of trade in Ireland, Spain and Portugal, even if this may in part be due to falling imports. And improvements are also visible in the current budgets. Nevertheless, debt levels will continue to rise, so that the cost of servicing debt represents a critical factor. The situation remains difficult in Greece, Cyprus and Slovenia. In general, in these countries an overdimensioned state sector and rigorously regulated factor and product markets hinder the development of a free, innovative market economy.

The Eurozone appears to have come through the worst of the economic crisis, and the North-South divide has been somewhat reduced. However, the medium and long-term outlook for growth remains bleak. Despite reforms, the labour markets remain divided, as shown in the youth unemployment rates in some of the southern countries - nearly twice the average unemployment rate. The high youth unemployment rate is not only a tragedy for all those affected, but also has an explosive social component. If unemployment remains high for a long period of time, the related social problems will affect an entire generation. The debt ratio is - with few exceptions - high, not only measured against the Maastricht quota of 60%, but also with regard to the consequences of an aging population for state finances and growth.

Although basic conditions have to some extent improved, political will appears strong, and reforms are gaining acceptance, the situation remains vulnerable. The EMU must therefore take action in four areas to become sustainably resistant to crises.

First, the EMU must address the problem of competitiveness. As exiting the EMU is no viable political option, the EU must concentrate on the problem of enhanced diversity within an EU where the exchange rate is no longer available to address competitiveness issues. The standard recipe so far was that countries had to undertake an "internal devaluation", which essentially means substantial reduction of prices, to be achieved notably through the reduction of wages and social spending. This is happening in varying degrees in all crisis countries and has led to social unrest. Structural reforms, although important for sustaining competitiveness, will not improve the situation overnight. Furthermore, the massive European support measures have not yet led to the envisaged stronger coherence in the EU. Therefore, the EU needs to consider further reforms, which would also buy time and reduce costs for countries with a weak economic performance (flexible transitional periods or opt-ins for lower income countries with severe competitiveness problems; impact assessments that distinguish more closely between countries and regions with stronger and weaker economic performance).

Secondly, there is a need for the introduction of an insolvency regime for EU states. There is no other way to break the potential unholy alliance between politics, the banks and the financial system. This alliance results from the situation that states regard themselves a priori as good debtors, whose debt the banks do not need to back with equity. Insolvency regimes create incentives for sustainable national fiscal policy, and enhance the credibility of the "no-bail-out" clause (Sachverständigenrat, 2013/14).

Thirdly, the currency union's regulatory framework was blind to a crisis in the financial markets (Sachverständigenrat). And today, many questions are still open. The "too big to fail" problem remains unsolved. There is still the risk that tax-payers, businesses, and national economies could suffer damage in the event of insolvency problems. The monetary transmission mechanism still functions inadequately. Furthermore, for historical reasons, the monitoring of the financial institutions is still too nationally focused. Many banks are still carrying too much distressed credit, and many bank balance sheets are still inflated and backed by too little equity. For this reason, given the close interrelationships between the banking systems, it is appropriate and correct for the European monetary union to be complemented by a European banking union, providing uniform financial supervision, with comprehensive competences and intervention rights. What is important is that in the winding up of a bank, there is a clear cascade of liability that ensures that shareholders and creditors incur liability before tax-payers do.

The responsibility of banking supervision will undoubtedly put further pressure on the role and the independence of the ECB, due to conflicts of interest between decisions on monetary policy and financial stability. These are not easily resolvable. Some economists fear that this could cause price stability to suffer, in that preference would be given to overall financial stability, or even to the stability of a systemically important financial institution (Stark, 2013). Others think that central banks need to keep their eye not only on monetary stability, but also on the stability of the financial system (Blanchard, 2013). This discussion is still in full swing. An additional difficulty for the ECB is that it is inheriting hidden legacy burdens, and could therefore be drawn into the emergency financing of equity gaps. The banking union would be off to a poor start if legacy burdens were not cleared up beforehand. Now that the decision has been taken in favour of supervision by the ECB, the focus should be on drawing the appropriate conclusions from the most recent asset quality review without paying heed to national susceptibilities or the desire of national authorities for regulatory unilateralism. Also necessary is clear institutional and personal separation of the two mandates, monetary policy and supervision, in order not to endanger the independence of monetary policy.

The political independence of central banks, a prerequisite for price stability, is always in danger. This holds true even for the ECB. Empirical research shows that between 1999 and 2007 government officials have advocated in 82% of all public statements lower interest rates (Ehrmann/Fratscher, 2011). Likewise, the level of government debt had an important influence on the monetary thinking of politicians. This can be interpreted as a neuralgic point of the monetary union (Sorbeck, 2010). With the new mandate for banking supervision in place, the situation is getting even more difficult for the ECB. It is therefore advisable to transfer this task in the medium term to a new independent European authority or the existing European Banking Authority.

Despite these qualifications, the establishment of the banking union is well on track. However, potential pitfalls must be avoided. Four points are important:

- The supervisory authority must guarantee that false incentives are eliminated, credits with the potential to default cannot be concealed, interventions in business strategy do not occur, and the higher equity requirements are implemented consistently.

- Given the global character of banking today, the European authorities should campaign for an international resolution process, to avoid competitive distortions, the fragmentation of the financial system, and regulatory arbitrage. The key to insolvency law for banks is the "bail-in" of shareholders and creditors. They, and not tax-payers, should foot the bill if banks become distressed.

- Depositor protection, whose realisation at European level is contested, should - if implemented - primarily be financed by the banks themselves, but not ensured by means of the introduction of a tax on financial transactions. Such a tax risks deteriorating the financial conditions for European companies and compromising the international competitiveness of the European financial industry.

- As long as it remains unnecessary for government bonds to be backed with equity, a banking union will fail to achieve one important goal - the breaking of the vicious circle between bank balance sheets and public debt.

Fourthly, and this concerns not only the EMU, but the EU as a whole, there is need for economic-policy reform in the areas of public finance, labour-market policy, competition policy, tax policy and social policy. This does not mean that all these policy areas should be harmonised across the whole EU. It is a task for national governments to find the optimum mix of reforms for their country, and to be inspired by progress in partner countries. The EU institutions can serve as providers of impulse and support here. If, however, they undermine the decision-making autonomy of national politics, they will arouse resistance, strengthen the centrifugal forces, and do a disservice to the community spirit.

- *Public finances:* When public subsidies for particular economic sectors and interest groups are abolished, it benefits public finances, and puts an end to the preservation of obsolete and uncompetitive economic structures. The privatisation of unprofitable and often over-dimensioned state enterprises has the same effect. Additionally, it releases funds for the financing of education and basic research - and the reduction of debt.

- *Labour-market policy:* The abolition of obstacles to the free movement of persons between states, one of the four fundamental freedoms of the single market, increases the flexibility of the whole community, as knowledge and expertise can flow freely from country to country, and increases its resistance to external shocks. Flexible working hours and free collective bargaining between the social partners contribute to 'European businesses' ability to react rapidly to economic fluctuations and structural changes. Relaxations to employment protection facilitate access to employment for young people, increase the mobility of the labour market, and reduce the danger of ossification. Need-based social benefits, that do not make employment unattractive, create incentives for entry, or re-entry, into employment.

- *Competition Policy:* Competition policy is viewed as a public policy to promote competition or more specifically to ensure that competition is not restricted by private players. In this sense, competition policy should contribute to achieving economic efficiency and maximising social welfare. To reach this goal it is essential that the approach to competition policy is effect-based rather than form-based, where an effect-based approach focuses on the presence of anti-competitive effects, and rests on sound economic analysis of each specific case. The "more economic approach" to Article 101 TFEU (formerly Article 81 of the EC Treaty) and merger control introduced a decade earlier was therefore a step in the right direction. However, the "more economic approach" was not pursued consistently, particularly with regard to vertical restraints.

  Furthermore, although widely debated some years ago, a "more economic approach" to Article 102 TFEU (abuse of dominance) was also never consistently implemented - the recommendations by the Economic Advisory Group on Competition Policy (EAGCP) were largely ignored. A more economics-based approach would also be advisable in the control of state aid. Although the Commission seems to have recognised this lack, the underdevelopment of economics-based analysis in the control of state aid is still prevalent.

- *Tax policy:* Favourable taxation conditions, not least a transparent, simplified and non-discriminatory tax regime, are important for businesses facing increasing competitive pressure. Tax competition between EU member states should not be hindered, though it is necessary to find a fair solution for the problem of tax evasion and to close off unacceptable bolt-holes within the system.

- *Social policy:* The financing of social security is reaching its limits almost everywhere, and is unsustainable, given the ageing of the population. This is indicated by the high implicit state debt already mentioned. It points to the danger that current prosperity is being maintained on the backs of the future generations. To put old-age pensions on a sound basis, aligned with demographic developments, will take a shift of emphasis from the currently prevailing pay-as-you-go system to a fully-funded system. This will be a long and hard road, as reforms in this area demonstrate. But it should be embarked on.

The EU has succeeded, under difficult conditions, in strengthening its institutional framework, under the keyword of "Maastricht 2.0". There are still, however, some weaknesses and false incentives, which promoted the development of the crisis, to be addressed. Given the circumstances though, this approach still seems the most promising way to put the EU on track for greater stability, more growth and more competitiveness. But it should always be kept in mind that ultimately - in what remains a highly heterogeneous society - every economic system will fail once responsibility and liability cease to apply.

5.4 Implementation of a Consistent Subsidiarity Policy

The criteria for an efficient distribution of competences between the EU level and the member countries are known, and can be easily derived from the economic theory of federalism. Essentially, there are four good reasons for locating competences at the EU level:

- The existence of cross-border impact from measures taken by individual states (e.g. in environmental and climate policy).
- The existence of advantages of scale, i.e. if a task can be carried out more cost-effectively by a larger political unit (e.g. the centralisation of defence policy).
- Commitment problems on the part of national decision-makers, i.e. when, on account of conflicts between interest groups, it is impossible to take appropriate economic measures (e.g. state-aid control).
- "Ruinous" regulatory competition.

There are equally good reasons against the centralisation of policy at the EU level:

- Significant differences in preferences between member countries.
- Information deficits at the central level.
- Aggravation of the "principal-agent" problem, because the distance between the central and national level is too great.
- Maintenance of inter-system competition, to gather experience with various regulatory approaches, and thus trigger a learning process.

With increasing integration, the EU's advantages and disadvantages of scale have also grown. Accordingly, the importance of the subsidiarity policy has increased. The EU could undoubtedly have spared itself some inconvenience on its journey so far, had it given more attention to the implementation of a consistent subsidiarity policy right from the start. Developments were, however, in the opposite direction, in that the EU Commission cleverly broke down major issues into individual acts, and thus depoliticised them. In this way, it not only avoided conflicts with the EU Council, but also expanded its own room for manoeuvre. The subsidiarity principle was thus effectively turned upside down, so that "regulation by Brussels" gradually took over. Consequently, the politicians would be well advised to give thought to a readjustment of the distribution of competences between the community and national levels.

In this context it is also noteworthy that the EU Commission comprises a portfolio of 27 areas of activity, with a Commissioner, with his or her own legislative agenda, for each. There is, though, no subsidiarity policy as such, although such a policy would not only facilitate priority-setting, but also simplify horizontal coordination.

6. Conclusions and Recommendations

Variable geometry: The most promising concept

The EU is far from being a homogeneous entity. Aspirations of individual member states and opinions about the desirable future shape of the Union diverge widely. In some countries, there are even centrifugal forces at work. Furthermore, the EMU is not an optimum currency area. There are wide discrepancies in macroeconomic performance and international competitiveness. Therefore, the most promising path to follow is the multi-speed variable-geometry concept. It does not prevent individual EU countries from going farther in the integration process, while at the same time allowing other members to proceed at a slower pace. It requires opt-in clauses to provide more flexibility as well as less emphasis on the principles of unanimity and qualified majority voting.

Governance under Maastricht 2.0: less complicated, more efficient and transparent

A single monetary policy and a fiscal union are often seen as basic requirements for a well-functioning monetary union. However, hurdles for establishing a fiscal union encompassing either all EU or Eurozone member states appear insurmountable for the time being. Changing the treaties is difficult because unanimity is required, and the principle of "no taxation without representation" is violated as long as the EU is not a genuine political union. A more realistic approach comprises three elements: 1) the consistent application of the principle of subsidiarity, 2) strictly and transparently monitored cooperation, including the imposition of sanctions in the event of non-compliance, and 3) effective fiscal rules. Especially promising are the strengthening of the Stability and Growth Pact (SGP) and the introduction of debt brakes in national legislations or constitutions, as envisaged in the Fiscal Compact Treaty.

However, effective coordination in fiscal governance, essential as it is, should not end up in a bureaucratic overload of coordination and monitoring instruments. Otherwise, there is a risk of failing to see the wood for the trees, and the door to excuses and overindulgence is wide open. In the interest of clarity, efficiency and effectiveness, this should be avoided. A good example of overload is the Macroeconomic Imbalances Procedure Scoreboard, with its abundance of indicators to be monitored and assessed. The reforms to the SGP have also increased its complexity and lack of transparency.

EMU remains under stress

In all likelihood, the Euro will not cease to exist. Breaking up EMU would carry high political and economic costs, and the political will to keep the common currency is strong. Monetary policy will therefore continue to be conducted in a centralised way, while fiscal policy remains for the foreseeable future the prerogative of national fiscal authorities. This increases the danger of high budget deficits and rising state debt levels. Therefore, given the risk of non-compliance with the tougher rules and the possibility of an increasing gap in competitiveness, parallel currencies in the peripheral countries might be a promising interim solution that provides flexibility and facilitates adjustments without compelling those countries to leave the Eurozone (Mayer, 2012; Vogelsang, 2013).

In such a setting, a national currency would be introduced alongside the Euro. The national central bank would tie the national currency to the Euro at a fixed rate. This would allow the country to execute the exchange rate devaluation that is necessary to regain international competitiveness. At the same time however, there would still be a reliable form of participation without formally leaving the Euro system. In retrospect, the same regime would again be put into place as during the introduction of the Euro between 1999 -2001. At that time, the national currencies served as transaction currencies, while the Euro was reserved for banking transactions. A parallel currency would of course not be a magic solution but a tool for economic self-help and for facilitating the internal adjustment process in order to restore competitiveness.

Finding the right balance between subsidiarity and solidarity

In the absence of a fiscal union, and in view of persistent huge gaps in competitiveness and economic performance, the "no-bail-out" clause in the treaty should again be strictly adhered to. In our view, European policy-makers are well advised to refrain from advocating the creation of Eurobonds. Eurobonds have the ostensibly attractive advantage of deleting interest rate differentials between bonds issued by individual EMU countries. However, they would ultimately facilitate bail-outs and thus invite indebted countries to free-load on the discipline of other member states. Efforts at implementing structural reforms would be undermined, and countries pursuing relatively sound fiscal policies would be penalised by an increase in interest rates.

Fundamental reforms to replace emergency measures

The emergency measures taken by the ECB - not least the abundant supply of liquidity - have reduced the risk of a breakdown of EMU and provided short-term relief. However, the more fundamental problem of diverging competitiveness and economic performance has not been solved and indeed cannot be solved by such measures. Accordingly, fiscal and economic policy reforms in all EMU countries, but particularly in the most indebted and less competitive ones, remain extremely important. The fundamental mistake made during the first years of EMU must not be repeated. At that time, former high-interest-rate countries benefited from a sharp decline in yields and reaped windfall profits, but neglected structural reforms. The increasing divergences between unit labour costs and current-account balances bear witness to this undesirable development. This time round, EMU countries should utilize the window of opportunity provided by the emergency measures and embark on reform-oriented policies aimed at improving competitiveness. Flexible, mobile labour markets and decentralised wage-setting, deregulated product markets and cutbacks in subsidies serve this purpose. Not only must public finances be consolidated, but it is also important to remove incentives for ever-increasing private debt. In a medium-term perspective, and against the background of high implicit public debt levels, social security reforms are particularly urgent (e.g. the transition from the traditional pay-as-you-go (PAYG) and notional defined contribution (NDC) and funded systems).

State debt restructuring and banking union: two cornerstones of a more stable EMU

To break the vicious circle between bank balance sheets and public debt (the "bank-state loop"), clear and predictable mechanisms for restructuring Eurozone state debt, an insolvency regime for EU member states and the European banking union are unavoidable. The disorderly default of a member country would jeopardise the stability of the entire monetary union. Whether it is appropriate to allocate the task of supervising systemically important European banks to the ECB is debatable. However, as the decision has been taken, emphasis should now be drawing rigorously the conclusions from the most recent asset quality review, tackling the problem of non-performing loans without succumbing to national sensitivities, and erecting a firewall within the ECB in order to avoid conflicts of interest between the objectives of monetary policy and banking regulation.

The agreement on the Single Resolution Mechanism (SRM) is an important step in the direction of a robust banking union: It has been deliberately designed to ensure that no government needs to bail out its domestic banking system ever again. Whether the resolution procedure - a fairly complex mechanism - will allow speedy decision-making in a crisis situation is, however, an open question.

Since the outbreak of the financial crisis, the ECB has been burdened with tasks that are not part of its mission of providing price stability. The ECB should as soon as possible exit from unconventional monetary policies that must not become a permanent monetary policy instrument. This is all the more important as the double mandate of guaranteeing price stability and supervising systemically important banks is challenging enough.

Banking union: sound, binding regulation

The establishment of a banking union is well on the way, but important issues remain. Single Banking Supervision (SBS) raises questions about the extent of regulation. In our view, SBS must refrain from supervising business models and financial products. An important issue is the regulation of the shadow banking system and OTC derivatives. Distortions in national banking systems, among them the existence of government-sponsored banks, need to be abolished. Compensation incentives that may generate excessive balance-sheet growth should be avoided. Furthermore, the financing of the controversial single deposit insurance scheme is unclear. The various proposals have to be carefully evaluated in order to avoid new distortions and competitive disadvantages. Finally, it is important that the EU is vocal in the international regulatory debate, and supports sound, binding regulatory arrangements between the main financial centres, ideally within the framework of the Financial Stability Board (FSB). Participation of non-EMU EU countries in the Single Supervisory Mechanism (SSM) would strengthen that voice.

Competitive advantages thanks to market-oriented policies

Finally, an overarching goal of EU governance must be to emphasise the crucial role of market forces. During the financial crisis, trust in market forces and the benefits of competition has been undermined. Markets have been distorted by interventions. Yield curves and sovereign spreads have been manipulated; signals by the financial markets have been suppressed. This trend must be reversed. Otherwise, Europe will increasingly lag behind the more market-oriented parts of the world in competitive terms.

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II

Competitiveness of Europe - Economy First!

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Summary of Recommendations

OECD defines international competitiveness as the ability and motivation for long-term growth and development under free market conditions. The EU, including former powers that are now in relative decline individually, can be an important global player in shaping the networked international order, on the condition that member states work out a European competitiveness strategy which looks towards competing globally. **This report proposes to build such a strategic approach around 5 key areas, where EU action at the community level is needed:**

1. **convergence:** Enhance strong cooperation and exchange of knowledge among all the 28 EU member states, especially in innovation and new technologies;
2. **single market:** Fully implement services directive all over the EU, stimulate further integration of all sectors and enhance e-commerce;
3. **growth and environment:** Establish a European Energy Union and common energy market as well as implement measures to keep energy costs low;
4. **friendly business environment:** Reduce EU regulations for SMEs by 25%, implement a legal framework to provide easier access for SMEs to public procurement and financial instruments, both public and private;
5. **bridge between research and industry:** Stimulate commercialisation of research, create a legal and financial framework to attract the best minds to work in Europe and for Europe.

Europe has always been strategically flexible and adaptable and should remain so in the new millennium. Changes in the world economy are pushing the Old Continent to reassess itself. If it wants to remain a success story - which it has been for the last few decades - it should look for new opportunities for growth. Paradoxically, the economic and political crisis in Europe as well as instability at the EU's Eastern border might lead it to the right approach and mobilize the best resources to find practical solutions for the whole European Community.

If Europe is to remain a global economic leader and boost growth and jobs, it should focus not only on an "industrial renaissance" led by the biggest, but rather look to an innovative business spirit and creative potential of individuals and SMEs. This will be one of the main challenges for the new commission, especially for its new Vice-President responsible for Jobs, Growth, Investments and Competitiveness. While leading the commissioners' team for a special project: A boost for Jobs, Growth and Investment, it would be useful to remember that the debate about the European Union's competitiveness too often has concentrated on generalities. The main challenges faced by the EU institutions are about changing both their approach and mindset. "More Europe" should not lead to more regulations, but more interaction with people. The EU needs today not so much new ideas but successful leadership and effective management to implement practical and pragmatic recommendations from the experience and expertise of European business, for which competitiveness is a must.

1. Introduction

It is argued that ageing Europeans find it difficult to compete with innovative Americans and efficient Asians. Although the situation is far from dire, a loss of confidence could be dangerous. In rushing to restart by all means, Europe may throw out the attractive attributes of its development model. The truth is that **its economy has many strong elements and that Europe might again be innovative and efficient if only it would use its shared potential.**

First, the EU has been growing steadily over the last 60 years and has become an absolute and unique success story of regional integration free from domination of any single country. In constructing the new, networked international order and moving from the rule of power to the power of rules, the European project is invaluable as a source of inspiration. The process of integrating markets and institutions resulted in remarkable convergence, which was the major driving force of European economic growth until the present crisis.

Thanks to its strong and efficient institutions, in 50 years, the EU was able to create and operate the European single market based on free movement of capital, goods, services and employees. Unlimited internal trade resulted in quicker convergence not only in incomes but also in living standards. The EU became a lifestyle role model, highly attractive for outsiders. Real democracy and human rights, good work-life balance, healthcare and social security have been developed.

At the same time, European business and industry grew. All together, the EU remains the strongest economy: In 2011 the GDP of 27 member states reached $17,577 trillion, compared with the US at $15,094 trillion. The GDP of the Eurozone is $13,115 trillion.[2] Furthermore, European business has been growing wisely, but is limited by strong national governments and the institutions of the emerging European Union. A sustainable and inclusive approach to its growth ensured the Old Continent the protection of its natural resources and controlled enlargement of its metropolis.

On the other hand, European human capital became highly skilled and effective, where 1/10 of the world's population has been producing 1/3 of the world's GDP. European secondary school students have been well placed in the PISA scores and European universities generally enjoy good academic rankings, although Europe is not leading the scores. Together with a strong economy and trade domination (almost 50% of the global trade in goods involves Europe), Europe has truly become a recognized global brand. European soft power is seen as its greatest competitive advantage, which is why enlargement has been such a success story, further stimulating European politics and economy.

However, the last few years have shown that the European dream is over. It is not only because of the internal situation but also because of the radical changes in the external environment. The world driven by globalization, urbanization and digitalization has become different and smaller. The emerging global powers in Asia, Latin America, and Africa have awakened. Over the last few years, major weaknesses of the European project have emerged. First, being an incomplete union of 28 countries, permanently under construction, the EU lost its convergence skills. The number of member states is more than double the original 12, which signed the Maastricht Treaty in 1991. The enlargements in 2004 and 2007 not only doubled participants in the single market, but also incorporated a number of much poorer countries, which widened differences between member states in development and innovation. The global economic and financial crisis has deeply impacted the EU and shed a light on the weaknesses of competitiveness. The budgetary crisis has further aggravated the situation.

At the end of 2013, The European Commission and International Monetary Fund expected average global economic growth to be 3.3% and 4% the following year, largely as a result of growth in developing countries.[3] By the end of 2013, the GDP of the EU remained the same as the year before, while the US grew by 1.9%. The forecast for 2014 indicated slow growth in Europe at 1.4% (3 % in the US) and by 1.9% in 2015. Compared with Turkey's 5% and China's 8% growth rate, European growth has been far from impressive. How can European economies perform better to close the gap between ambition and reality?

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[2] *International Monetary Fund, World Economic Outlook Database, April 2012: Nominal GDP list of countries. Data for the year 2011*
[3] *World Economic Outlook, 10.2013, www.imf.org/external/pubs/ft/weo/2013/02/*

There is no lack of strategic thinking in the EU but unfortunately its objectives remain largely on paper. Some of the Lisbon Strategy's general objectives for European competitiveness remain valid (especially prioritizing a knowledge based economy, liberalization of the domains left behind the single market regulations, deregulation, new stimulations for entrepreneurship and labor market flexibility) but there is a need for practical solutions. The Europe 2020 strategy rightly focuses on re-modelling the EU cohesion and competitiveness policies to face the new global powers (mainly China, ASEAN countries and BRICS) but its performance in seven flagship initiatives (enterprise environment, digital agenda, innovative Europe, education and training, labor market and employment, social inclusion and environmental sustainability) differs in member states. The 2013 European Competitiveness Report by European Commission makes the case for a re-industrialization of the EU economy, building on existing strengths in terms of its knowledge base, sophistication and specialization; however it underestimates the huge potential of SMEs in a new era of e-commerce and globalization.

Therefore, the present report states that the Commission's current actions and future plans in order to ensure European competitiveness should concentrate on few actions and be implemented in all member states with a high level of determination. New leaders of the European Union should remodel its competitiveness strategy on the base of 5 major ideas, which can be transformed into 5 major community programs:

1. **"Convergence 28":** Restart the convergence machine which was one of the major drivers of the Europe's successes for decades;
2. **"Single Market really single":** Unlock the full potential of the EU 28 by implementing EU directive on services in all member states, liberalising all sectors, enhancing mobility and harmonising some elements of tax systems;
3. **"Smart E-G balance" (between Environment and Growth):** Correct the EU policy towards a realistic energy mix and adopt a more pragmatic approach for climate change;
4. **"Business-friendly Europe":** Deregulation and liberalisation of private sector with clear rules for common European standards: lower barriers for business, lower costs of running enterprises and introduce innovative financial instruments for SMEs; introduce early education training for entrepreneurial skills and business approach, improve the climate for businesses in all member states; attract more people with business experience into the EU institutions, remodel private and public financial instruments,
5. **"Science - Business Bridge":** Attract the best minds to work in Europe, for Europe, stimulate cooperation among EU member states in commercialisation of research results and building bridges between science and business.

2. Recommendations

1. Convergence 28

In the Global Competitiveness ranking by the World Economic Forum, some European countries are excellent, while others are severely lacking behind. The US, having topped the list in the past, now ranks fifth. Today the leading countries are Switzerland and Singapore and there are five EU member states in top 10 (Finland is 3^{rd}, Germany is 4^{th}, Sweden is 6^{th}, the Netherlands is 8^{th}, and the UK ranks 10^{th}). The problem is, however, that some EU member states rank fairly low (Hungary is 63^{rd}, Croatia 73^{rd}, Romania 76^{th}, Slovakia - 78^{th} and Greece - 91^{st}). Such wide interregional differences are one of the reasons of Europe's problem with competitiveness today.[4]

The gap between the richest, innovative member states and the poorest ones is widening further, as the cohesion policy has not been fulfilling its objectives. In trade and manufacturing all member states do well, **but in innovation and R&D - key factors to add value to products and services - the countries at the bottom of the list do much worse,** as they are seen as sales markets or subcontractors. The new EU leaders have to look at these differences and implement instruments to minimalize these gaps. The EU should encourage the leading countries in competitiveness to guide the rest by engaging them in large-scale common European projects in ICT infrastructure (such as cloud and fast internet availability), R&D or exchange of knowledge, instruments, research and training, instead of distributing funds by countries and regions.

The EU convergence does not only have internal implications. In the global dimension, European Union member states must speak with one voice and have a common economic agenda towards the emerging powers, especially BRICS. **Companies from different member states will always compete but their governments should not.** The new leaders should lead the EU 28 towards a serious political debate about global strategy and form a new pragmatic approach that takes into consideration economic weaknesses and strengths of all the community members. **The common trade and industrial policies in free trade negotiations, including TTIP, should reflect the positions and interests of all 28 countries to ensure that the companies from weaker member states will have equal changes at other markets.**

Deeper internal convergence of EU 28 is a great opportunity for each and every member state: for richer ones to enlarge their markets, for poorer ones - to modernise their economies and generate wealth. This mechanism - which worked well for enlargement - might also work well in an international scale if the EU opens up to other

[4] *World Economic Forum, www.weforum.org*

markets. The "more trade not aid" approach would be the best for Europe's southern and eastern neighbours. Turkey, which has a Customs Union with the EU, is a good test.

2. Single Market Really Single

The fact is that the European Union does not benefit fully from its Single Market of over 500 million consumers and 20 million entrepreneurs. Legally, it operates well, but in practice it is not fully integrated and the EU convergence is weak. Therefore, the new EU leaders should concentrate on tapping into the full potential of the EU 28, firstly by reducing burdens in services, which account for 75% of its GDP. Both legal and practical solutions are needed here: From consequent monitoring of the implementation of the EU directive on services in all member states to the creation of a single information point which would reduce confusion and bring the legislations closer. Moreover, further integration and synergies stimulated by EU institutions are needed in transport, railways, telecommunication, post, finance, energy and gas, ITC and defence sectors. Elimination of roaming within the EU, liberalization of its internal markets to avoid national monopolies, enhancement of interconnections of same sectors in different EU member states, creation of a friendly legal EU framework for e-commerce and digital economy will reduce the cost of doing business for both the European businesses and foreign companies operating in Europe.

The Single Market will not be complete without easy mobility of workers, requiring wider compatibility of health insurance systems and transferability of social security benefits. This should apply not only to fixed contracts but temporary employees as well. Common migration policy and regulations will have to be finalised in order to attract foreigners with necessary skills to fulfil the gaps in the EU labour market.

Tax differences within the EU are an important obstacle to the integration of the Single Market. The full harmonization of tax systems in Europe may never happen but their simplification and wider unification are possible and necessary. This will considerably reduce business costs such as implementation of European warrant. The EU directive 2006/112/WE proved Europe can have a common VAT minimum rate of 15%, so - keeping the rates different - the EU could implement common tax bases for VAT declarations and reimbursement as well as common lists of goods and services with reduced rates. As for corporate taxes the EU should implement the common catalogue of legible income costs.

3. Smart Balance between Environment and Growth

Energy is one of the biggest cost elements in business, especially for heavy industry. To remain competitive, Europe has to have stable and cheap sources of energy. Currently energy costs are almost twice as high as in the US, mostly due to low emission regulations and strict environmental policy. If Europe (and the US) alone implement strong environmental regulations without the compliance of other countries, environmental impact would be more limited, while competitiveness would suffer greatly. Therefore, a right balance should be reached between measures taken to modernize power generation systems by green technologies and renewable energy sources, and the necessity to use the traditional ones, which will continue to cover over 87% of the energy demand over the next few decades.

A qualitative change in the generation and supply systems to reduce the cost of green energy requires a technological breakthrough, which may only be fostered by intensified research. **Therefore, adequate research budgets must be secured not only by member states and the business sector but also by the EU 28.** At the same time, the EU should ensure good management over energy prices by a quick implementation of Energy Package III and the creation of a common energy market (planned for 2014), accompanied by an energy union, which would reduce foreign dominance over this market. The EU's legal framework instruments and "energy diplomacy" should lead to diversification of external providers and the supply channels of energy sources, including shale gas and LNG. The EU-US TTIP agreement might offer a great opportunity in this regard, while European potential for shale gas should not be overlooked. **EU leaders should also implement diversified framework instruments to support renewable energy (RES) within the EU 28 in view of the considerable diversification of territorial conditions and availability of raw materials.**

Furthermore, Europe should aim towards a global climate agreement that would help control climate change and create equal conditions for business operations for entrepreneurs all over the world. Some steps toward an agreement on climate change in 2015 were made at the 19^{th} Conference of Parties (COP19) talks in Warsaw. Plans for the coming two years were made but the legal nature of the agreement remains undecided. From the business perspective, Europe should be pragmatic: More prudent and less doctrinal EU policy should take into account the interests of individual EU economies (coal, nuclear fuel, shale), as well as ecological issues. A sensible debate on shale gas as an alternative to natural gas is required. The EU should also encourage businesses to search for innovative products and technologies, instead of focusing on lowering energy costs alone.

An integration of EU energy, industrial and climate policies is absolutely essential. Therefore a fundamental change in communication on energy and climate issues is needed. The technological jargon must be set aside and Europe should start speaking in terms of creating a vision for the sustainable long-term benefit of people and societies. Energy costs in Europe can be considerably reduced by the right approach of individuals who are interested in issues such as independence from electricity distributors, making money on power generation, reduction of maintenance costs of households etc. Therefore, an exchange of experience and education for businesses and households in the EU 28 are needed regarding energy efficiency as well as financial public support for individual consumers. Small generation units subsidized by governments and placed within reasonable legal systems would enable private individuals to generate their own power. Such installations may act as catalysts to change the energy mix with a shift toward green energy, but could also change consumer mentality. Once people start to recognize the direct interdependence between their daily lives and green technologies, the general public will eventually increase their support to EU initiatives aimed at modernizing the European energy market. Local governments might become the EU's most important allies in this process. Smart cities could introduce electrical vehicles in the local transportation systems and deploy solar panels to supply electricity to street lamps and traffic lights. The EU and central governments should offer financial and legal support to such innovative projects.

4. Business-Friendly Europe

The British report Cut EU red tape: Report from the Business Taskforce stresses that European companies offer excellent products and services with top world standards, but they are often restrained by regulations, which increase business costs, limit freedom of operations and, in consequence, slow growth. Simple and clear rules speed up economic activity. Therefore, the new EU leaders should place particular emphasis on simplifying administrative procedures in all member states in order to lower the barriers for business. The focus on deregulating Europe has to be accompanied by monitoring the implementation of the EU common quality standards in the EU 28.

SMEs constitute the European business core (roughly 99% of companies), provide two out of three of the private sector jobs and contribute to more than half of the total value-added created by businesses in the EU[5]. The EU's new leaders should pay special attention to this sector. Small and medium enterprises may not be able to retain costly legal counsel and could be overlooked by specific regulations at the community level. Therefore, the EU should reduce the total of the acquis dedicated to SMEs by 25% until

[5] *Fact and figures about the EU´s Small and Medium Enterprise (SME), http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/index_en.htm*

2020 and introduce exceptions from a number of regulations, such as Waste Framework Direction or data protection rules. Instead, the EU should support the formation and consolidation of national and regional associations of small firms whose task is to support the development of SMEs, including helping them obtain capital, arranging tuition on the regulations in force and on other aspects of running a business. It should also encourage changes in the bankruptcy laws to implement a positive approach for taking risks and restarting a new business after a failure.

The new EU leaders should also pursue reforming European financial instruments, especially funds for SMEs. A healthy business environment needs an adequate financial system to support growth, however grants tend to lead to dependence on public support instead of encouraging innovation. Today, the financial structures in the EU are conservative and not sufficiently open for innovative business ideas. The system is composed mainly of banks with 80% - while in the US it is only 20%. In France the national balance sheet of three main banks is larger than the country's GDP, so it is not a surprise that the banking sector is highly influential. Banks and public funds will not be willing to finance risky innovations without guarantee of success. Therefore, **to ensure innovation and development of knowledge based economy in practise, the EU leaders need to differentiate the EU financial system and enhance financial institutions such as private equity funds, venture capital, corporate bonds or credit letters to be more active.**

EU policy should ensure that start-ups and SMEs especially have easier access to external sources of funding beyond banks, such as preferential credits and loans, crowd funding, business angels and venture capital funds. It should also take action to promote the work of entrepreneurship incubators. Moreover, deep reform of the EU funds system is needed where the quality and efficiency of the projects are evaluated first. In the EU financial perspective 2007-2013, funding was often provided to companies who knew how to fill in forms, even if they were not truly innovative ones.

The EU also needs to further develop its competition policy towards a more economic approach in order to allow European companies to be globally competitive. European competition policy should always consider the global environment in which European companies compete as to facilitate the emergence of new European global players.

European education systems, different in each and every member state, may have their own strengths, but also have one weakness: The system does not provide enough skilled workers needed in business. For example, there are too few engineers to fulfill industry demand and those emerging from the system are not sufficiently qualified.

The new leaders should enhance a common EU 28 approach to education by implementing standards to ensure the right quality and quantity of human capital for a sophisticated, digital, knowledge based economy. The EU should also enhance such modification in social security systems, which would combine unemployment benefits with vocational training to prepare individuals for employment or economic activity, perhaps in the form of social business.

Social enterprises account for 6% of workplaces in EU member states and produce 10% of GDP. This approach should be promoted further as an ideal solution to mix the market needs and expectations of people, as opposed to the European social model. Both social business and corporate social responsibility (CSR) - regarded as part of a firm's strategy, and not as an element of marketing - allow to reduce costs of social policy instruments and to use public money for innovation. **Implemented properly, they boost confidence in the business community and in the idea of entrepreneurship itself.**

The approach to business is not the same in all EU 28 member states as a result of each country's culture of entrepreneurship and each society's perception of business activities. Therefore, **the EU should enhance community actions to promote entrepreneurship and specific skills needed for taking the risk of establishing a company. Business education should start in elementary schools and continue** in colleges in order to prepare students to be mentally ready for running a business one day.

Moreover, the EU should help build a positive image of entrepreneurs by underlining the private sector's role in contributing to the local, regional, national and European socio-economic environment (creating new jobs, producing new goods and services, increasing the national income etc). Business confederations, chambers of commerce and other business-related institutions should also contribute to building a better climate for entrepreneurship in Europe. In particular, the idea of entrepreneurship should be promoted among social groups with untapped potential, such as women and young people.

5. Bridge between Research and Business

In many European countries, science and business do not converge and commercialisation of research is not easy to promote. However, collaboration between European universities and companies are crucial to help the Old Continent to remain innovative and competitive. The EU leaders should build bridges between science and business by launching European common research programs and creating an **open R&D market.** Such integration would promote better allocation of resources and increase competitiveness of European products globally. Excellent conditions for new technologies and R&D sectors could be provided by the European Centers for Research and Development created partly with EU funds in the form of special economic zones. At the same time, Europe could accumulate its shared capital to make investments externally, much like the US or China.

Research requires time and money and there is no automatic cause and effect between heavy spending and successful products. However, in the US - where R&D market challenges are similar to those in Europe - motivations in private sector to invest in research commercialization are much higher. In the US innovative solutions are immediately commercialized bringing profits for business and in case of failure there is no hostility and social exclusion. In Europe, high domination of the public sphere over the private one discourages individuals to take risk and encourages them to rely on public funding for innovations.

According to experts, there are certain **differences between individual systems of state support for private activities in R&D.** Some countries offer exceptionally favorable tax and grant incentives, not encumbered with restrictions on the location, the way it is financed, and intellectual property rights. Other countries only offer basic incentives, with considerable restrictions regarding eligibility of sectors for concessions and grants and the costs of the application procedure. Most advantages are constructed in such a way as to encourage the preservation of a certain level of intensity of R&D, while the remaining incentive systems were introduced in order to increase substantive spending on R&D. Only a few systems offer tax incentives and grants for capital spending on R&D. In most countries, incentives apply to operating costs, i.e. salaries, supplies of raw and other materials, and the costs of outside services.

Highly innovative countries not only have growing R&D budgets but they also operate good networking schemes bringing together large corporations and SMEs, which helps disseminate good practices across the economy. The example of Switzerland, which is not part of the EU and does not benefit from the EU programs and other forms of support offered by the EC, proves that the ecosystem which encourages innovation matters most. **The EC should put pressure on member states to create conditions which encourage investments in R&D and innovation as well as convergence in this sector as well.**

The new EU leaders should constantly push for spending for innovation and research and less for agriculture and infrastructure. Currently the EU 28 spends on average 2.04% on R&D, which is less than the 3% target. This means that larger countries such as Germany or Sweden will need to spend more because other member states will not. Large investments in this sector require a radical change of mindsets. Poland for instance, which enjoyed the highest GNP growth in the EU, averaging 4.3% over ten years (compared with 1.2% growth for the EU) places close to Romania in the Competitiveness ranking,[6] spending only 0.77% of its GDP on R&D. This is not due to low public spending, which is adequate under current economic conditions, but as a result of limited engagement of private companies in innovative investments. Currently, in the majority of the member states that joined the EU after 2004, the public sector spends more on R&D than the private sector. Low social capital is an issue in many countries. As a result, societies lack the collaboration and teamwork skills that are required, which could be corrected by education.

At the same time, **the EU's new leaders should try to create mechanisms to attract the best minds from outside Europe by providing incentives, career opportunities and financial support (subsidies and grants) for start-ups and commercialization of research.** Such grant schemes should be open to failures as risk is a part of both business and research. At the same time, Europe needs to **keep its best people in place.** Roughly 150.000 students of new technologies leave Europe each year to study abroad and only 20% return. They need to find jobs or work, which seems easier elsewhere. Promotion for European partnerships between the scientific and business institutions from different member states and their partners beyond Europe should happen on the condition that the result of the commercialization will remain in Europe. At the same time, Europe should try to **attract more non-European capital** (investment funds, venture capital) to co-finance European R&D activities.

[6] *Witold M. Orłowski, Komercjalizacja badań naukowych w Polsce, Warszawa 2013 r.*

III

Europe in a Globalizing World: A Matter of Survival

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Summary of Recommendations

On the EU's Global Competitiveness

a) As the EU is faced with increasing disparities, all policies aimed at increasing the EU's competitiveness need to take into account the different conditions in member states and the different competitive potentials of micro units (e.g., individuals, companies, universities, NGOs, cities, regions).

b) Increase the EU's "global cultural capital" by raising the international standing and credibility of the EU leaders at the level of the Council, CFSP and Commission.

c) Promote the more universal notion of "rule of law" rather than the more specific notion of "democracy" both in the European neighborhood and worldwide, particularly in countries where the socio-economic and cultural prerequisites of democracy are missing.

d) Import global talent to Europe to enhance the "smartness" and "innovation" dimension of Europe's competitiveness.

e) Start discussions on finding ways to ensure that highly skilled non-EU immigrants would be allowed to move and work freely within the EU.

On the Relations with USA, Russia and China

a) Keep the deep-rooted political, economic and military ties with the US and bring the TTIP negotiations to a successful completion.

b) Support strongly all efforts to find a political solution for the Ukraine crisis and, based on that solution, review EU-Russia relations. Keep the door open for a revitalisation of the strategic partnership with Russia and explore the ways for deepening the economic integration of the whole European continent.

c) Raise the level and intensity of political dialogue with China with the aim of enhancing rule of law, core human rights and environmental sustainability in China.

On Neighborhood Policy and Enlargement

a) Continue the enlargement process towards Turkey and the Western Balkans.

b) Define "associate membership" criteria for the neighboring countries in the Eastern Partnership and Union for the Mediterranean, a status that would be less than full member and more than neighbor.

On Turkish Enlargement

a) Contribute to the UN plan for a fast-track and comprehensive resolution of the Cyprus question.

b) Harmonize EU and Turkish policies in the MENA region.

c) Bring the visa liberalization process to a conclusion within the scheduled timetable.

d) Open the negotiation chapters regularly, in order to bring Turkey back on the EU agenda and help solve the country’s current political stalemate in a democratic and European way.

1. Introduction: The Changing Context, Meaning and Means of Competitiveness in a Globalizing World

Globalization "de-centres" every country and every continent, puts an end to centrisms of all types and varieties, and then "re-centres" everything through a competitive process. In this globalizing world, the critical question is which cities, regions, corporations, NGOs, hospitals, research centres, universities, schools, scientists, artists, designers, ideas, and so on from Europe (and from other world regions) will pass the global competitiveness test and make their way to the global centres of influence.

With globalization the very idea of geography started to change, connoting more and more a sense of "space" as opposed to a sense of "place". Instead of imagining the world as a whole physical place made up of contiguous countries, the post-Cold War generation began to view the globe, and Europe itself, as a patchwork of cities, regions, web sites, streets, rivers, highways, internet discussion groups, film festivals, business centres, airports, vacation resorts, friends here and there, NGOs, academic meetings, restaurants, museums and so on. In this new, post-modern global space, Europe is being re-defined in the language of globalization, and it is itself a part of the emerging global space. Dramatically increased, diversified, individualized and less costly means of communication and transportation, from the email to SMS and easy jet, supplied the material conditions for the passage from place to space. This new global space is a competitive arena, with continually changing, sometimes expanding, sometimes contracting "boundaries" rather than fixed "borders". It is competitive in the sense that how much, and for how long, a given city, event, happening, building, art form, NGO or even individual will be a part of it is not to be taken for granted but decided competitively by the "market", i.e. by the decentralized decisions and signals of all the individuals who interact through that space. Because the insertion of something in the new global space, and its position in the ranking of global prestige, is never guaranteed, each individual unit tries to increase its global value by means of imaginative ways. In other words, much depends on how much a country, a city, a university, a museum, an individual spends its efforts to find a place for itself in the newly forming global space, and on how well-endowed, receptive, willing, creative, imaginative, and skilful it is.

What could the EU do to uphold and boost Europe's competitive power in a globalizing world? As a general principle, the EU's policies geared towards increasing Europe's competitiveness should take into account the different conditions in member states and different competitive potentials of micro units, individuals, companies, NGOs, cities and regions. A non-selective, non-specific, overly egalitarian policy would result not in a meaningful increase in the EU's competitiveness in the global arena, but in a larger rent distribution mechanism, regardless of the good intentions of any policy making and EU spending objectives.

2. The EU in Global Competition: Problems, Success Stories, Recommendations

The EU's foreign policy has many goals and objectives, but enhancing Europe's global competitiveness should no doubt be at the top of the policy agenda. If the European Union desires to remain a global power in a multi-polar world, improve its citizen's living standards, and expand the reach of European ideas, norms and values, such as rule of law, human rights, women's rights, democracy, social inclusion, environmental sustainability, it must prioritize competitiveness, and take appropriate external actions. The EU must prioritize competitiveness if it seeks to establish Europe as a centre for scientific discovery and technological innovation, where European companies set global trends and produce globally demanded services and products. And it must do so if it wishes to attract investment capital as well as top scientists, engineers, designers and artists from around the world, and aims to induce other states to take on their responsibilities for environmentally sound and sustainable development strategies. The question is, naturally, what specific external actions can the EU take for the purpose of enhancing Europe's global competitiveness?

The EU, as a global actor, can be viewed as a trade union, representing the "collective interests" and embodying the "collective bargaining power" of its member states. The EU can achieve what individual member states might not have achieved on their own. The EU, like a trade union, aggregates, articulates, represents and promotes the interests of its members at the global level. The EU is needed, because diverse, and often conflicting, interests of European nations, regions, corporations, associations and individuals are not likely to naturally come together and automatically add up to a common European interest. On the contrary, left to themselves in a non-cooperative state of nature, those different and contradictory interests can, and do, result in intra-European conflicts and wars, whose overall outcome weakens Europe globally. The EU is a system of democratic cooperation in an environment of regional and global competition, and it is based on its members' ability to compromise. European integration is a modern tool to ensure compromise building, based on shared values, shared responsibilities and shared benefits. As differences increase, mistrust spoils relations, which may only be overcome by strengthening partnership and mutual understanding.

In a survey of the European business community regarding Europe's competitiveness, many respondents said that they want to see an EU which is more authoritative internally and more powerful internationally. More specifically, the European business community wanted the EU to play a greater role in the making of fiscal and monetary policy at home, and to represent, with one voice, European interests at international economic negotiations. An often-cited example by the business community, on EU negotiations with the rest of the world on cross border issues, is airline industry deregulation. This provided a Europe-wide solution that "broke down internal protectionism; opened the door to new European, low-cost airlines; rationalised the process of bilateral negotiations and protected governments from being played off against each other by non-European actors". The project to create a Transatlantic Trade and Investment Partnership (TTIP) is cited as another success story, however the support of the business community is not fully shared by the general public.

The EU too shares the business community's vision to boost global bargaining power by making the EU play a more active and unified role in the global economic and political institutions, specifically in G20, WTO and UN. Thus, in the "Europe 2020" document the EU sets for itself the tasks of encouraging "trading in open, fair markets worldwide, within a rule-based international framework; promoting external aspects of various internal policies (e.g. energy, transport, agriculture, R&D); enhancing trade and international macroeconomic policy coordination; and pursuing an assertive and effective participation in international forums such as the G20, to shape the future global economic order".

Another essential goal of the EU's international economic policy, this time oriented towards the least developed countries, is to fight poverty, protect human and labour rights, and promote environmental and good governance standards. Under the Generalised Scheme of Preferences (GSP) arrangement, the EU promises a less developed country partial or entire removal of tariffs, on the condition that the government observes policies to set up institutions that ensure transparency, responsiveness and accountability; to establish a dialogue with NGOs regarding social and environmental effects of trade and economic policy; to eradicate poverty; to sustain the balances between economic growth and the protection of natural resources; and to promote core labour and human rights. The mechanisms of supervision for these goals are: (a) regular supervisory meetings between the EU and partner countries (Korea, Colombia, Peru, and so on) with which it has concluded agreements; (b) close involvement of civil society advisory groups, including environment, labour, and business organisations, in the implementation of the agreement provisions, to help identify issues and future areas of action.

One major deficit in the European economies that is hindering competitiveness is the relative lack of "smart" development, based on high technology, knowledge and innovation. According to a report published by the World Economic Forum on European competitiveness, so long as social inclusiveness and sustainability dimensions of competitiveness are concerned, the EU fares better than or as well as its competitors in the Western world, namely the US, Japan and Canada. The real problem of the EU in the area of competitiveness is to build a "smart", knowledge-based, innovative, higher value added, high technology economy. In terms of the "smartness" of its economy, the EU is lagging behind all of its competitors in the Western world, most notably the US. The European business community, in the survey mentioned above by INSEAD, Booz & Company and the European Executive Council (EEC), has also pointed to a lack of a culture of innovation as the main reason for Europe lagging behind its competitors in terms of the "smartness" of its economy. This is one area where there is ample room for EU policy making.

Based on these observations, we can make the following recommendations as a way to enhance Europe's total competitive power at the global level:

1. Raise Europe's collective bargaining power at the global level, by better coordinating the foreign and the trade policy of the EU. Such an approach would certainly require boosting the capacity and capability of EU Delegations worldwide.

2. Increase the EU's "global cultural capital", and thereby its soft power, by raising the international standing and credibility of the EU leaders at the level of the Council presidency, CFSP, and Commission. The EU must be represented in the

global arena by internationally recognized and respected leaders as an essential part of adding more substance to its soft-power.

3. Boost the EU's global soft-power, by trying to give the EU a seat among the permanent members of the UN Security Council. The EU will use this position to better voice its democratic values and its commitment to sustainable development, poverty reduction, social welfare, and peaceful resolution of conflicts. As an egalitarian power, the EU can and should also defend to expand the permanent membership of the UN Security Council in a way to include emerging powers such as Japan, India, Brazil, and Turkey, which would be more reflective of the new global distribution of economic, social, political and cultural capital. Such an egalitarian proposal would certainly increase public and elite sympathies for the EU around the globe and it will show the outside world that the EU is not simply a narrowly defined "Western" power but a global player, with global sensitivities, in the true sense of the term.

4. Ensure that third parties also comply with the EU's environmental sustainability and social protection principles and standards. This will enhance the global competitiveness of the products produced in the EU by increasing production and labour costs, and therefore the world prices, of goods produced in third countries. Inducing third countries to adopt Europe's environmental and social protection standards will take away parts of the "rents" that are accruing to them because they do not have to pay for environment-friendly technologies and they do not have to cover very costly social protection schemes such as unemployment salaries, retirement pensions, health coverage, and job security.

5. Promote rule of law in the third countries, which would increase social trust and lay the foundations of a fair and predictable economic environment. The EU may want to make a strategic choice of promoting the more universal notion of "rule of law" rather than the more specific notion of "democracy" both in its neighborhood and worldwide, particularly in countries where the socio-economic and cultural prerequisites of democracy (e.g., a relatively well-developed and widespread middle class; a minimal degree of national unity; a civic culture of dialogue and tolerance) are missing. We have to admit that democracy promotion by the EU, often following a blue-print not applicable to non-European conditions, has often resulted in more instability, social unrest, and economic downturn, when not based on the necessary preconditions of rule of law, a large layer of middle class, and the peaceful coexistence of different ethnic and sectarian groups. A fair and predictable market and investment environment, protected by well-functioning legal institutions, is a necessary condition for third parties to be able to deliver to the EU what they

promised in trade agreements; and for the EU companies to be able to survive and keep their profitability in foreign settings. One way of achieving this goal is enhancing political, social, environmental conditionality in all trade agreements with third parties, and establishing better supervisory mechanisms and a credible system of rewards and punishments, so that trade agreements could help promote rule of law, human rights, ecological sustainability in partner countries. Most agreements that the EU signed with third parties, except for the association agreements envisaging future membership, have been of an economic and commercial nature. All these agreements did have clauses that are making references to rule of law and human rights. However, these clauses were rather short, general and symbolic, and there was no conditionality embedded in the agreements that said that violation of the political values by the other party would cause significant negative effects on the implementation of the economic and commercial parts of the agreements. The EU can and should add a higher dose of political conditionality to its economic agreements. An example of such political conditionality is the EU-China Human Rights Dialogue that has taken place twice annually since 1995. The EU can set up such dialogue institutions with various other nations with whom it signed partnership and cooperation agreements. These institutions can be empowered by establishing joint ombudsman-like bodies, to which individual citizens and private associations of the nations that are party to the agreement can apply, if they think their political and economic rights, as envisioned in the agreement, have been violated. In other words, the EU can transfer a version of its own ombudsman institution into its international relations, by providing it the power to oversee the implementation of the agreement clauses in the area of rule of law and individual freedoms. This "EU-Third Party Joint Ombudsman" would be staffed by experts from both sides and ideally have the power to conduct investigations to highlight the alleged rights violations; to ask questions and gather data from private individuals and authorities involved; to form its independent opinion about the case at hand; pass its opinion on to the decision-makers; supervise the decision-makers to see if they are taking the necessary corrective actions; and in the likely event of delay, inaction or avoidance on the part of the authorities, use the "shaming effect" by bringing the case to the attention of national and international media.

6. Import global talent to Europe to enhance the "smartness" and "innovation" dimension of Europe's competitiveness. Although EU countries are some of the world's most desirable places to settle, live and work, they could not so far make enough use of this "attraction factor" to draw the world's scientific and artistic talent. EU countries lag far behind the US in their ability to attract scientific and artistic talent from abroad. The US, and to a lesser extent the UK, have been traditionally strong in importing talent, and this has been one of the determining

factors behind American leadership in the area of innovation. In a survey of the American business community conducted by the Harvard Business School, in order to enhance American competitiveness, many respondents would like the Federal government to "ease the immigration of highly skilled individuals, starting with - but not restricted to - international graduates of US universities". Public resistance to immigration in many EU countries, as well as rigid citizenship rules and language barriers stand between the EU's need for international talent and the actual import of talent to the EU countries. Unfortunately, under the current rules the establishment of an "EU residency" for such elite immigrants, to be offered not by any individual member state but directly by the EU itself, is out of question. Nonetheless, in order to establish a globally competitive European research and science space the EU may need to discuss solutions in order to ensure that highly skilled immigrants would be able to freely move and work with the EU. For the moment granting residency status to non-EU nationals is within the authority of the member states, although in 2003 the Council issued a Directive (2003/109/EC) concerning the status of third-country nationals who are long-term residents. This Directive determines "(a) the terms for conferring and withdrawing long-term resident status granted by a Member State in relation to third-country nationals legally residing in its territory, and the rights pertaining thereto; and (b) the terms of residence in Member States other than the one which conferred long-term status on them for third-country nationals enjoying that status." Given the critical importance of attracting talent to the EU, and given the fact that this is a general problem that cannot be sufficiently addressed by the member states and can therefore, by reason of the scale and effects of the action, be better achieved by the Community, in accordance with the principle of subsidiarity, the member states may choose to delegate their authority to the Community for designing a policy for attracting talented people to the EU and for issuing EU long-term resident status to elite immigrants. This approach would also create a competition among the companies, research centres and universities of the member states for creating better conditions that would attract the best minds from the talent pool.

3. The EU versus the US, Russia, China: Partners or Competitors in the Global Arena?

The US is the oldest and longest partner of the EU and the axis of stability of the global economy. Relations between the EU and the US are overshadowed by the recent spy scandals, but both parties made a wiser choice by continuing negotiations on the free trade agreement agreement - the Transatlantic Trade and Investiment Partnership (TTIP) - which shall bring benefits to both and to the international community as a whole. Independent research shows that TTIP could boost the EU's economy by €120 billion;

the US economy by €90 billion; the rest of the world by €100 billion of additional national income annually. The TTIP would be the fourth ambitious free trade agreement of the EU, followed by the ones with Norway, South Korea and Canada.

Currently, the essence of the economic relations between the EU and Russia is Russian energy against European technology, and this is unsustainable in the long term. The EU cannot continue with over-dependence on Russian energy, and Russia cannot continue without developing a viable manufacturing industry of consumer and investment products and services. Moreover, as the recent events in Ukraine have clearly demonstrated, the EU cannot carry on its integration plan with Ukraine and other Eastern Partnership countries without first establishing a modus vivendi with Russia. The EU will have to deal with the Russian question sooner rather than later, if it wants to secure its energy supplies and maintain peace, stability and prosperity in the larger eastern Europe, including the European republics and regions of the former USSR. The political and economic conditions have worsened for the deepening of the political and economic integration between the EU and Russia. Nonetheless the EU should keep the door open and not fully abandon the idea of building a truly European market place.

A quick look at the results of the INSEAD and Harvard Business School surveys with the business communities in Europe and the US, China represents both the greatest opportunity and the biggest challenge. Imports of cheap Chinese products to Europe, exports of high-end European goods and services to the Chinese market, as well as European investments in China have been the welfare engine for the EU for years. The major legal framework for the EU-Chinese economic relations has been the Trade and Economic Cooperation Agreement between the European Economic Community and the People's Republic of China, which went into force in 1985. In the field of political cooperation, there exists, since 1995, the EU-China Human Rights Dialogue, whose aim is supporting China's transition to an open society based on the rule of law and the respect for human rights. Admittedly, the EU-China Human Rights Dialogue has not yielded many tangible results and the EU's capacity to push China towards rule of law and democracy is limited. The EU, therefore, concentrated its efforts to maintain in China an environment for level playing and market viability.

We can make the following recommendations with regard to the EU's relations with the US, Russia, and China:

First, keep the deep-rooted political, economic and military ties with the US and bring the TTIP to completion. However, raise the EU's global strategic value to parity and equality with the US, in all common institutions, based on the argument that European soft power in the West's power equation carries equal weight the hard power of the US, particularly in view of rising anti-Americanism around the world and a general global sympathy for the European model of open society, cultural and artistic legacy, social justice, and gusto and quality of life.

Second, keep the door open for the normalization of relations with Russia and the eventual development of a continental Economic space.

Third, change the European public and elite perceptions of China towards that of a rising global power, in economic, political and cultural terms, instead of a factory for cheap manufacturing.

Fourth, raise the level and intensity of political dialogue with China with the aim of enhancing rule of law, core human rights and, last but not least, environmental sustainability.

4. The European Neighborhood Policy: Problems and Prospects

The European neighborhood policy was launched for its expected economic and political benefits for both Europe and the partner countries. The overriding reason behind the neighborhood policy has been to ensure stability and prosperity in the neighboring countries, and to provide the EU with a source of energy and other natural resources, a market for its exports, and an area for its capital investments. Two pillars for the Neighborhood policy are the Mediterranean Union and Eastern Partnership.

Mediterranean Union embodies long-standing relations between the partner countries and the EU, though the potential benefits have not materialised. The main reason behind the relative failure of the Mediterranean Union is that the EU lacks the carrot: It does not offer membership perspective for its southern Mediterranean neighbors, and therefore lacks the leverage to induce them to adopt European norms, values and standards. As many observers of EU integration noted, EU conditionality has not been effective for countries with no prospect of membership. A case in point is the Mediterranean countries of North Africa. The Barcelona Process, which had been set in motion in the mid-1990s to bring the Mediterranean countries to a closer political and economic cooperation with the EU, and to socialize the political class and civil society in the region into a greater acceptance of European democratic ideals and values, has not produced tangible results. A closer analysis of the "Union for the Mediterranean" reveals that, unlike the previous Euro-Mediterranean Partnership (the Barcelona Process), this second EU-Mediterranean cooperation scheme did not have much political or democratic substance. Avoiding serious commitments to democratization, the Mediterranean Union's focus has been on crime and terrorism, sustainable development, illegal immigration and energy security, and its key objective is to establish a Euro-Mediterranean free trade area.

The Eastern Partnership countries, unlike the southern Mediterranean ones, do aspire to eventually join the EU. Some Eastern partnership countries, most notably Ukraine, have gone far enough in economic restructuring and prepared to enter into deeper economic relations with the EU as foreseen in the Association agreements. Ukraine stands out among the Eastern Partnership countries with a sizeable market of over 40 million consumers. The mechanisms at work and the structure of the process are similar to the ones at the Eastern enlargement, however the risks of conflict and an eventual failure are much higher, as the EU is hesitant in offering a membership perspective to its Eastern neighbors and any further integration is likely to be perceived as a threat by Russia and pro-Russian groups in partner countries. Hence, as the recent events in Ukraine demonstrated, the sustainability of the EU's economic and political integration with the Eastern Partnership countries would be substantially facilitated if the repercussions for Russia and the other countries of the Eurasian Union are taken into account and are discussed in a political dialogue before the final decisions are taken.

5. EU Enlargement: Problems and Prospects

After the breakdown of the socialist system and the Soviet Union, political and economic stabilisation in the former socialist countries of eastern and central Europe became a must - no peace and prosperity in the continent as a whole was sustainable in the long term if one part of the continent continued to live in a poverty zone, with people without a future. The particular challenge in the former socialist countries was to address the needs of a triple system transformation: Transformation of the economic, political, and administrative systems.

Striving for EU membership has guided the countries in this difficult process of system transformation. Full market opening by 1997 came much faster than the political process of enlargement, the latter starting on the basis of the Europe Agreements. In a sense, by opening their markets earlier, the EU wanted to see whether the potential members were able to withstand the pressures of the EU market. This strategy resulted in major economic gains for those EU member states with strong central and Eastern European ties, notably Germany and Austria. On the other hand, incoming member states profited as well from the market opening, even if the restructuring process was painful and created much social hardship. As of now, the new eastern and central European members are catching up with the old members, creating a win-win situation.

The completion of the next enlargement cycle, covering Turkey and the western Balkan countries, is a political, economic and moral must. It will make a substantial difference for these countries, whether they will remain unstable or stabilized by being firmly embedded in the European family. Negotiations with many of the western Balkan countries are underway or will start soon, Bosnia-Herzegovina being the hot spot. When starting accession negotiations with Turkey, one major pro-Turkey argument was that it presented an economic opportunity for the EU, not least because of the size of its market. This type of argument has become more credible since then, given Turkey's economic performance in recent years and its political reforms to undertake the Union's membership criteria.

As opposed to the views that point to the last enlargements as the main source of the financial crisis in the EU, one can safely argue that enlargement did not contribute to the economic crisis. On the contrary, new member states like Latvia, Lithuania, Romania and Bulgaria demonstrated how to cope with financial turmoil and how to return to a growth path. On the other hand, countries like Poland and Estonia kept relatively high growth rates in an environment of crisis.

6. The Turkish Enlargement: How to Overcome the Deadlock?

A quick comparison of the current population, land size and gross national income of Turkey with the 13 new Central and East European member states and four Western Balkan candidate states shows us that, from the perspective of boosting the size of the EU economy and its competitiveness in the broader region of the Caucasus, Middle East, North Africa and Central Asia, it would be logical for the EU to prioritize Turkish accession. That being said, there has been an increasing resistance in the EU to the Turkish membership, both at the elite and public opinion levels. One factor that turned part of the EU public opinion against Turkish membership was the perceived cultural difference between Turkey and Europe. This cultural resistance can be tracked in the findings of a survey that we have conducted in five EU member states (Germany, France, Poland, Spain, and UK) in the fall of 2009. As may be seen in the survey data, when forming their opinion on Turkey's EU membership, 25% of the respondents would weigh economic factors and another 25% would consider political factors, while the proportion of those who would base their decision on cultural factors was around 40%.

Turkey has been a candidate for EU membership since December 1999 and it has started accession negotiations in October 2005. Ironically, the opening of the accession negotiations became a point from which both the EU and Turkey have taken steps that were in the direction of disengagement and divergence rather than engagement and convergence. The increasingly negative tone of the EU public opinion regarding Turkey, the Cyprus question, the financial crisis, the enlargement fatigue, the "culture" factor, Turkey's problems in the area of democracy and human rights, all have played their role in this disengagement. A severe consequence of this mutual disengagement has been that European values have been losing ground in the Turkish political and civil society, critically placed Turkish political actors and social forces have been detaching themselves from the EU project, and there have been serious setbacks in the area of democratization and liberalization reforms. Given the current deadlock in the accession process of Turkey, what concrete steps can the EU take to put the process back on a fast track?

First, there must be a renewed understanding that enlargement in general, and enlargement towards Turkey in particular, is not an external but an internal policy of the EU. The EU was not set up as an exclusive club within Europe, pertaining to a particular group of European countries. On the contrary, the EU was set up to expand to potentially cover all the countries on the European continent, including Turkey. Questioning Turkey's European identity from a historical, geographical or cultural point of view can be an interesting and legitimate intellectual exercise, but, after more than 50 years of integration at all levels between the EU and Turkey, and after so many legal agreements linking the two entities together, such intellectual opinions can not, and should not, be made the basis of Turkey's eligibility or qualification for EU membership.

Second, European officials should avoid using labels, such as privileged partnership or the like, for the finality of the process, even though they individually believe in it or they find it useful to use such labels to gain the favors of powerful anti-Turkey domestic lobbies.

Third, the EU should make sincere efforts for a fast-track and comprehensive resolution of the Cyprus question, as this has been the single most important issue for blocking some negotiating chapters. Happily, negotiations for a resolution of the Cyprus questions did restart recently, and we can only hope that they will produce positive results in a rather quick and efficient way. Both Cyprus, and particularly France, may go ahead and lift their blockages over one or two negotiating chapters, as a sign of good will, even before the end of the peace talks, if the talks are believed to proceed towards a final resolution acceptable to both the Greek and the Turkish sides. Bringing as many chapters as possible to the negotiation table will put Turkey back on the EU agenda and help solve the country's current political stalemate in a democratic and European way.

Fourth, the visa liberalization process should come to a conclusion in the shortest possible time, as this would be, for the time being, the single most important policy that would directly touch the lives of ordinary Turkish citizens and sensitize them towards the EU. The Turkish side must hold on to its commitments in the readmission agreement and the EU side must not create unnecessary delays in the existing time table for visa liberalization.

Fifth, there must be a common understanding in the EU that without Turkey being firmly anchored in the EU any European Neighborhood policy towards the Middle East, and towards the Islamic countries in general, can only come half way. Turkey, for its part, must realize that its prime value and appeal for Middle Eastern and other Islamic countries is that it is a Muslim country embracing European values of democracy, secularism, women's rights, free press, and individual rights and freedoms. An EU-Turkish collaboration is a natural and necessary condition for the success of both in the MENA region. The recent setbacks of both Turkish and European foreign policies in the face of the various crises following the Arab revolutions, most visibly in Syria, constitute further proof that a convergence of policies and close collaboration is urgently called for, if they want to exert any meaningful impact on the course of events in the MENA region.

7. Conclusion

In the last few years, as a result of "enlargement fatigue" and a severe financial crisis, the EU has turned inwards, giving priority to its internal economic and institutional restructuring. Ironically, though, this happened at a time when the pace of history hastened in the EU's southern and eastern neighborhood. Hence, by the beginning of 2011 the "Arab Spring" took off, giving way to popular uprisings, internal conflicts and regime changes in many Arab countries of the MENA region. Soon after, the Ukraine crisis hit the ground, in which Ukraine turned into a battlefield between those who wanted to stay in Ukraine and those who pursued a line of separatism and unification with Russia, with the active encouragement and support of Russia. The EU certainly needed some time to put its house in order, but history did not wait. Now it is time for the EU to face two challenges at the same time: To continue its internal reform process and to develop an active foreign policy, particulary towards the MENA region, Ukraine and Russia. Given Turkey's proximity towards both problems areas, it is also time to put EU-Turkey integration process back on solid track.

Jean-Claude Juncker, President-elect of the European Commission, in his initial statements, promised that the Juncker Commission "will be political, and not technocratic" and that they will face both the internal and external challenges simultaneously "to address the very difficult geo-political situation; to strengthen economic recovery and to build a united Europe that delivers jobs and growth for its citizens.". In the globalizing world of the 21st century the EU should certainly be a fortress, but a fortress of democracy, human rights, economic growth, distributional justice, scientific progress and technological innovation. To be a fortress in the sense of isolationism, inward-looking, disinterest or indifference in the face of regional and global challenges would mean trading long-term well-being for short-term comfort. Adapting itself to the changes in a globalizing world is not a matter of choice but a matter of survival for the EU. Given its crowning achievements in the 20th century, there is no reason why the EU cannot overcome the challenges of the 21st century.

IV

More of the Sane, or: Europe Where We Need It.

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Summary of Recommendations

In order to **increase democratic legitimacy and public scrutiny,** European leaders should:

1) Better connect the next Commission to the national arenas by having Commissioners speak more often in national parliaments;
2) Rigorously pursue the Commission's new organisation around political clusters responding to the EU's main challenges, each led by one of its Vice-Presidents;
3) Make use of EU funds more transparent by involving citizens in regional budgeting and increasing its anti-corruption profile.

As a means to **improve respect for sovereignty and subsidiarity,** leaders in member states and at the EU level should:

1) Put differentiated integration at the service of the European project by mainstreaming it based on clear conditions rather than seeing it as a measure of last resort;
2) Involve national parliaments more, mainly around the existing 'yellow card' procedure but also in their interactions in collaborative fora such as the 'Eurozone Assembly' and directly with the European Parliament;

To **improve inter-institutional cooperation and law making,** Europe's leaders should:

3) Get the Commission, the Council, and the Parliament to agree on a tripartite work programme for the 2014-19 period;
4) Sign a new 'Compact for better law-making' that will result in a net reduction of EU regulation by the end of this legislative cycle. A new agency should provide independent impact assessment for all three law-making institutions as well as make information on the actual national transposition publicly available.

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1. Introduction

Now in its fifth consecutive crisis year, the European Union is still deeply mired in a crisis of political legitimacy. What started out as a 'contagion' from the world financial crisis, 'infecting' in a way primarily the European financial institutions and the real economy, has by now morphed into an all-out questioning of the political, social, and democratic fundamentals of the Union.

An analysis of the root causes of the current malaise reveals one structural asymmetry, which is compounded by a well-known schizophrenia. The asymmetry is between the national and the European level: Starting with the 1992 Maastricht Treaty, member states have delegated certain policies to Brussels while retaining the means to execute those policies in national capitals. National and European competencies are particularly intertwined in the economic governance of the Economic and Monetary Union (EMU), the foreign, security and defence policy (CFSP and CSDP) and the coordination of social and employment policies that have developed in the new policy field. In more formal terms: While the EU's competences for market-making and market-correcting regulation have grown; the provision of the fundamentals such as security and welfare has remained at the national level. When the system cannot deliver, due to its obvious dysfunctionalities, the political and institutional imbalance is made worse by national politicians and their 'schizophrenic' tendency to blame the EU for a country's problems, while simultaneously claiming all benefits as their own success.

The question of accountability shows how this structural imbalance has also worsened the existing 'democratic disconnect'. It is true that calls to make the EU more accountable have long been a part of the - rather academic - debate about the Union's alleged 'democratic deficit'. Yet the situation is different when citizens across the EU feel that their voice is not heard in politics - or, worse, that there are no mechanisms to make themselves heard, such as in the deliberations of the European Central Bank (ECB) or the work of the Troika. Moreover, national governments share much of the blame, as they have been unable to solve the crisis, either in each member state or collectively at the European level. This apparent inability of both national and European institutions to significantly improve the situation combined with politicians' tendency to shift blame to Brussels has led to a veritable crisis of confidence among EU citizens. Citizens simply no longer trust political institutions at the national and EU level to find the right solutions to urgent issues.

These findings thus question the very nature of the European project, as it no longer seems to command the democratic legitimacy it needs. Whereas in the past, defenders of the EU would counter arguments about the lack of democratic input with reference to the Community's tangible output, in terms of economic well-being and citizen satisfaction (the 'permissive consensus'), the Union currently cannot command neither input nor output legitimacy. More than ever, people feel forced to accept decisions 'from Brussels' that they have no say in, while they clearly cannot see that even such high-level crisis management is able to 'deliver'.

All this breeds a particular kind of populism at the national level that not only threatens the EU's basic tenets but is also beyond the Union's reach in terms of countering it. Based on the assumption that only full-fledged functioning democracies can enter the club and, once they are in, they do not want the Commission to meddle into their constitutional affairs, the EU has few means to save democracy in member states. What is worse, with the elections to the European Parliament in May 2014, the EU experienced a "populist backlash". This is not to say that the EU does not deserve criticism. Yet the effect of a polarised, potentially paralysed EP with a large number of members actually working against the Commission and the Council is bound to frustrate European citizens even more. Therefore, not only the governance structure at the EU level but also the spirit of cooperation (or lack there of) will be deciding factors of going forward.

This chapter thus looks at ways in which the EU can improve its governance structures as well as the cooperation among European bodies and national institutions. The aim is to increase the EU's overall legitimacy in the eyes of its citizens. Ultimately, the competitiveness of European industry does not merely need the famous 'slashing of red tape,' but also a thriving community with a functioning institutional environment that 'enjoys citizens' support.

2. Increasing Democratic Legitimacy and Public Scrutiny

As mentioned before, legitimacy is usually understood as having both an input and an output category. Thus a government or indeed any ruling entity may be regarded as democratically legitimate if it relies on a popular mandate (input) and/or produces the results that its people want to see (output). While ideally it would equally rely on both elements, it has come to be accepted that tangible output legitimacy can make up for weak input legitimacy.

Now that both ends are in question, is there anything the EU could do, short of reinventing itself as either the supranational federation that many loath or the loose trade block that others fear? One part of the answer points to the primacy of politics in general and political leadership in particular, which have been lacking throughout the crunch.

With hindsight, we know that, in a way, there was maybe too much politics to the Euro: From its idealisation as an issue of "war and peace" (German Chancellor Helmut Kohl in 1995); to the admittance of Greece to the Euro despite the country's obvious non-compliance with the EMU criteria; to European politicians' first line of defence once the crunch had kicked in to blame American rating agencies for the EU's woes rather than recognise the continent's very own problems.

At the height of the crisis, however, it seemed as if politics had given up on itself. Rather than displaying a notion of being in charge, even the heads of state or government appeared to be driven by brute market forces. Small wonder that people started to believe that their elected representatives no longer looked after their interests but merely bowed to market pressures. As one survey conducted in the spring of 2013 by the Open Society Initiative for Europe shows, people across Europe feel that politicians have generally lost touch with the fate of ordinary citizens. The latter wants to see more rather than less European solidarity.

2.1. Connecting the Commission to National Political Arenas

Hence the importance to return to the primacy of politics: While politicians know about the influence of markets as much as the more general interdependence of a globalised world, they need to spell out the political goals guiding their decisions instead of simply reacting to perceived threats. Yes, today's politics are - or, must be - different from those of 30 years past, and they need a different kind of toolset. This holds especially true for the EU, which, in addition to the globalisation around it, has seen further ramifications of its system of multi-level governance since Maastricht. Yet, speaking of tools, politicians must go beyond taking technocratic decisions and expecting people to understand them, merely because 'there is no alternative'. This approach of non-explication has only contributed to an increased frustration among citizens who feel they have little direct input on EU-related policies that affect them.

This leads, first and foremost, to the European Commission as the 'political heart' of the integration process. This may seem odd given that the European Council has played a much more prominent role recently, yet the focus on the Commission is both normative and practical. It is normative because this is the institution that should, by Treaty definition, drive the process of European integration. The problem is that, in the past twenty years or so, the Commission has mostly focused on regulatory integration - to the minutest details that have long become the object of citizens' mockery of a European 'regulatory frenzy' - rather than on the overall political integration. In addition, targeting the Commission is practical because there are much more concrete steps one can ask of it rather than the heads of state or government. The tasks of the European

Council are circumscribed only vaguely in the Treaty, found in Articles 15 TEU, and 235 and 236 TFEU and otherwise littered over articles that relate to other institutions or policy areas. In the end, the greatest improvement of ‘the heads’ would be defining whatever they regard as ’national interest’ in a more fundamentally European way.

The Commission in all its actions is still guided by the ‘ever closer union’ principle, which has come under strident criticism more recently, not only from the UK government, but also from its Dutch counterpart and other voices throughout Europe. This, however, means reading - very literally - only half of the respective sentence from the Treaty’s preamble, which further stipulates "decisions are [to be] taken as closely as possible to the citizen in accordance with the principle of subsidiarity". Instilling this respect for subsidiarity in the new Commission would help a great deal towards rebalancing the relationship between Brussels and member states’ capitals, the subnational levels, and Europe’s citizens.

Another way for the Commission to reconnect to the people is, of course, to tie its President to a democratic vote, as it happened with the selection of Jean-Claude Juncker after the European elections in May 2014. Whether such a ‘politicisation’ of the Commission - i.e. to replace the intimate working relationship with the Council of Ministers by a ‘popular mandate’ that would count for little in the day-to-day work of technical EU legislation - is of added value, has been controversial even before the nomination of the former Prime Minister of Luxembourg. If anything, it is likely to encourage intergovernmental tendencies among member states, as they might perceive the Commission to be beholden to the European Parliament. Ultimately, this would risk ending up with a weaker, not a stronger Commission.

Despite the initial controversy around his nomination, Commission President Juncker has managed to work with member states in the Council when setting up a list of candidates for approval by the EP (Art. 17 (7) TEU). The hearings have confirmed that he not only balanced the ‘top jobs’, but also succeeded in turning the College of Commissioners into a more political (rather than politicised) body, with a number of political heavyweights from the national and European arenas having transitioned into the Berlaymont.

It is now crucial to bring the work of the Commission closer to national audiences and, thus, make it more visible. While Commissioners are of course not bound by any national directives, their ability to spark interest in the public in any member state helps increase the understanding. In the same vein, individual Commissioners should appear in national parliaments more often. This would not only connect national deputies to the European level but also give Commission members an exposure in the respective national press that they otherwise would not have. Ultimately, one way to counter the vicious circle of 'policy without politics' (or technocracy) at the EU level and 'politics without policy' (i.e. populism) in member states is to increase participation of national parliaments in EU decision-making (cf. below on subsidiarity).

2.2. Improving the Work of the College of Commissioners

Having the right people at the Commission is one thing; having the right number of them is another important aspect to its work. The Lisbon Treaty foresees a reduction in the overall number of Commissioners to two thirds of the number of member states (Articles 17 (5) TEU) starting with the current College (2014-19). This was intended to improve the Commission's working atmosphere, making more in-depth discussions possible, which is more difficult in a larger group of 28. In addition, having fewer Commissioners than member states would have underscored - to both the incumbents and those behind them in their respective capital - that the members of the Commission are indeed not representatives of national governments. However, the European Council decided in May 2013 to make use of a 'safety clause' contained in the same article and postponed this restructuring to 2019. Given the arguments that speak in favour of the Treaty change made, this is unfortunate and a transition to the two-thirds rule should be made by 2019, at the latest.

In the meantime, however, there are other ways to obtain manageable work relations even among 28 Commissioners and, at the same time, strengthen the political agenda of the next Commission. It is thus fortunate that the new President has chosen to establish priority 'clusters' corresponding to the major challenges the EU faces (jobs & growth, Euro and social dialogue, energy union, foreign policy etc.). Each cluster comprises a number of Commissioners (or all of them, in the case of better regulation or budget) under the supervision of a Commission Vice-President. Giving them the responsibility to coordinate an otherwise equal group of Commissioners does not require a Treaty change but lies within the prerogatives of the Commission President set out in Article 17 (6) TEU.

While meetings in an 'executive format' between the President and the Vice-Presidents are possible, these should be kept to a minimum in order to avoid frictions among Commissioners. Instead, topical sessions among two or more clusters on a certain issue can enable meaningful discussions that are difficult to achieve at 28. This would keep the spirit of the new Lisbon Treaty provisions aiming to make the College more flexible, while respecting the desire of member states to at least formally continue with the 'one state, one Commissioner' rule.

In addition, Vice-Presidential coordination based on political priorities should also help prevent an increase in legislation on ever-minor issues. Proposed EU regulation of olive oil bottles on restaurant tables or of the shoes that hairdressers could wear are less likely to get into the College with a Vice-President focused on the broader challenges his or her cluster faces. In particular, the veto power over new legislation given to the First Vice-President is crucial in this regard.

That may be one of the reasons why member states have so far accepted this 'hierarchisation' of the College, which naturally brings a loss of prestige to countries 'whose Commissioner' is coordinated by a Vice-President. The real difficulty will be to keep up this sensible arrangement in the face of institutional politics as well as bureaucratic persistence. Legislation still originates from the College of Commissioners as a whole, so personalities will still play a role as will organisational weight stemming from the directorate-generals that each Commissioner or Vice-President can mobilise. A new organogram doesn't yet make the Commission a more political body; it merely holds the potential for it.

2.3. Enhancing Transparency and Citizens' Involvement in the EU Spending

One issue for the EU to increase its reputation and to allow for better public scrutiny is to strengthen its declared approach of 'zero tolerance' to embezzlement and fraud even though it is true that the latter is much rarer at the European level than within member states. The European Court of Auditors, for example, which controls whether funds from the EU budget have been spent according to the Union's financial rules and whether spending programmes are well managed and effective, has not found evidence of any serious maladministration in Brussels over the past decade. Yet it is in the EU's own interest to counter any impression of wasting large sums of money, be it on useless projects or through negligence or even criminal activity.

If anything, the recent crisis has increased pressure on the Commission to show that every Euro is well spent. Beyond assuring the factual accuracy of its spending, the EU should ensure that it demystifies a debate often full of barroom clichés about how 'Brussels' is eating up taxpayers' money. Two things can help in this regard: A better resourced Court of Auditors and a well-staffed, independent anti-fraud agency.

For one, the EU should grant the Court of Auditors more resources to produce its annual as well as special reports in a more timely fashion so that they influence the debate when an issue is still on the agenda. In turn, MEPs as those giving the Commission approval for its budgetary operations on the basis of those reports, should use the

Court's findings much more proactively. Rather than being afraid of raising a critical issue for fear of 'stoking Euroscepticism', they should be the ones pressing, if necessary in public, for the EU's spending to achieve its goals efficiently. This is due to the fact that what is usually more damaging than the fraud itself is any perceived cover-up from a body that would like to see itself high on the echelon of political institutions.

Similarly, the EU's anti-fraud agency OLAF plays a central role in checking that the EU spends taxpayers' money properly. While having had some successes in uncovering fraud against the Union budget (e.g. through smuggling and VAT fraud), the agency remains poorly staffed - a mere 20 officers are responsible for investigating fraud in regional funds, which comprise roughly one third of the EU's annual budget of around €150 billion. In addition, OLAF formally remains a unit of the Commission, even though it was founded as a response to the allegations of corruption leading to the resignation of the Santer Commission in 1999.

It is advisable to reconstitute OLAF as an independent body, separate from the Commission, with adequate staff, resources, and management procedures. Admittedly, a 2005 report of the Court of Auditors maintains that OLAF's "hybrid status" - i.e. enjoying investigative autonomy from the Commission while reporting to it on other functions such as anti-fraud strategy and funding programmes - has been beneficial. A 2011 follow-up report, in contrast, does not take up this positive assessment but deplores inter alia the lack of an independent control of investigative acts in progress.

Interestingly, the Commission's first "EU Anti-Corruption Report" published earlier this year highlights cases of corruption in member states but not at the European level. Thus, if the EU wants to underline its model function in fighting corruption, it should officially ask an institution such as Transparency International - which already provides its own reports on the EU's performance in fighting corruption - to independently assess the work of its main administrative bodies, i.e. the Commission as well as the Secretariats-General of the Parliament and the Council. If EU institutions were thus ranked alongside the member-states, the European public might understand that it is the national rather than the European level, which has problems with spending European funds adequately.

Another way of making the EU budget more transparent to the citizens is involving them in the decision making process on how money is spent locally. Such community-led local development has been part of the EU's agricultural fund ever since 1991, and was more recently expanded to all budget lines covered by the EU's Common Strategic Framework (i.e. from regional development to agriculture, maritime and fisheries to social cohesion). The idea is to encourage local communities to develop bottom-up approaches to respond to structural change and, ultimately, increase the effectiveness of EU policies by promoting community ownership. Together with member states, the EU should promote this new framework as a tool for citizens to determine the use of EU funds and encourage its expansion.

3. Respecting Sovereignty and Subsidiarity

Similar to the input and output dimension of democratic legitimacy outlined above, it also helps to differentiate between various understandings of sovereignty. National governments tend to see the sharing of sovereignty in the EU framework mainly as an input function, i.e. how much independence in decision-making they can retain. The classical elements here are the veto power and policy opt-outs of member states. The former usually resides in foreign policy where national interests are thought to be particularly high. The latter is prevalent in internal affairs where national interests are similarly valued, though member states feel less affected when they let others go ahead regardless of their own objections. From this input perspective, the 'pooling of sovereignty' - i.e. of joint decision-making at the EU level - is often seen as a euphemism for actually losing sovereignty by no longer being able to make decisions independently.

However, in today's world, the question for EU member states should be less whether they have a say in an EU decision but whether their decision matters at all. In other words, what output (sovereign or not) could any of the 28 member states have alone? Such questioning should produce a change of mind-set preferring the material benefits of cooperation to the insistence on formal elements of old-fashioned sovereignty. Ultimately, with regard to the broader public debate focused on how 'Brussels constrains national (or citizens') freedoms', such a focus would highlight the EU's contribution to actually preserving the liberty of all of its citizens.

The efforts in two member states, the Netherlands and the United Kingdom, to conduct a balance of competences review with the ultimate goal of a 'repatriation of powers' from the European to the member state level, is hardly helpful in this regard. First of all, any such step would imply a Treaty change, something that is not on the agenda at present and certainly not part of the assumptions of this report. Secondly, and worse, it furthers a spirit of national cherry-picking where member states, starting from their national preferences, list the powers they would like to regain for themselves rather than assessing the challenges the EU and its member states are facing and (possibly) re-arranging the Union's competences accordingly.

Rejecting this national approach does not, however, exclude a number of efforts to boost both member state sovereignty and the principle of subsidiarity within the provisions of the current Treaty. The following are some proposals in this regard.

3.1. Putting Differentiated Integration at the Service of the European Project

Differing understandings of sovereignty have led to a number of areas where only some member states integrate their policies and others do not. The best-known examples are the Euro and the Schengen area. Beginning cooperation among a smaller group of countries - in the case of Schengen even outside of the Treaties at the time - has allowed those members wanting to advance with integration to do so without forcing others to go along.

While accepted as an alternative route to integration where the full-fledged one-size-fits-all community approach does not work, 'differentiated integration' is still often seen as a measure of last resort. One reason for such hesitance is that any integration effort in which not all member states participate bears a divisive core. The question of how potential frictions between the 'ins' and the 'outs' can be avoided, points to the decision-making procedures applied. For the existing legal frameworks, the rule is that the supranational bodies, the Commission and the Parliament, participate as normal (i.e. with their full membership), whereas in the intergovernmental body, the Council, only those member states vote which are also part of the cooperation procedure. This is also the basis for enhanced cooperation based on Article 20 TEU.

To reduce the potential for tensions and to make differentiated integration a more accepted flexible tool, such flexible arrangements should meet three core conditions. First, they should be permeable, i.e. remain open to those EU members that decide to join at a later stage. This implies permanent and close consultation mechanisms between the 'ins' and the 'outs' so that the latter have a real opportunity to join. Second, differentiated integration should - whenever possible - be organised on the basis of the respective Treaty provisions, i.e. enhanced cooperation. Staying within the EU structures secures Commission involvement and thus prepares for a long-term transfer of the scheme under the community method. Third, the aim should be to consolidate the existing opt-outs so as to minimise overlap and, ultimately, bring as many of these into the EU proper.

If equipped with this Community-oriented perspective, differentiated integration would be less of a necessary evil but could rather be used as a tool to shape intermediate cooperation when and where full integration is not yet possible. In the same spirit, member states should reorient their efforts from intergovernmental crisis management to a more integration-oriented rebuilding of the EU. Ultimately, the EU is founded on the rule of law, which is why such intergovernmental efforts should be transformed into proper law-making activities in the mid- to long-term.

The indicator of whether a proposal for differentiated integration is ‘community-friendly’ will be the Single Market. The Treaty provision for enhanced cooperation in effect forbids any detrimental effects to this core area of European integration, stipulating that it "shall not undermine the internal market or economic, social and territorial cohesion [nor…] constitute a barrier to or discrimination in trade between Member States, nor shall it distort competition between them" (Article 326 TEU). However, measures that have been taken primarily with a view to overcoming the crisis in the Eurozone, such as financial and banking regulations, also impact the eleven non-Euro states.

A case in point is the proposed EU Financial Transaction Tax, which is to be adopted under the enhanced cooperation procedure among eleven member states after failing to win the approval of all. The United Kingdom has challenged the proposal at the European Court of Justice, arguing that its extra-territorial effects on countries not participating in the scheme distort competition within the Single Market. While this case still needs to be resolved - both legally and politically - it highlights the difficulties of finding the right balance when enhancing integration for a few (or in the Commission’s jargon, creating a "deep and genuine Economic and Monetary Union") in areas that touch upon the EU’s fundamental core.

While not strictly an element of differentiated integration, the potential bilateral contractual arrangements (or ‘reform contracts’) between individual member states and the Commission are likely to have a similar effect. On the one hand, they may create sub-groups of member states that have entered similar obligations to reform. This would, ideally, also lead to an increased cooperation among the respective national parliaments in their efforts to scrutinise their government even prior to ratifying this contract (cf. also next point). However, it would also further complicate the legal and institutional foundations of the EMU, making it less transparent. Again, picking up the third ‘core condition’ mentioned above, it is in the EU’s interest to formulate those contractual arrangements in a coherent fashion (i.e. to create as much overlap between them as possible) and to gradually integrate their provisions into its legal body, the acquis, so that they are one day binding for all (Eurozone) member states.

Finally, extending the idea of differentiated integration beyond those countries that are already in the EU, membership itself should be handled more flexibly. In order to better accommodate the needs of acceding countries as well as the preparedness of the Union itself, the EU should opt for flexible arrangements such as extending pre-accession membership benefits or cooperating closely in certain policy areas. Such flexibility would be a mean to keep the EU’s enlargement policy from being stifled by an increasing amount of demands (due to an evolving Union itself) placed on countries that appear less capable of fulfilling them.

3.2. Involving National Parliaments More

With respect to subsidiarity, the national parliaments of member states have an important role to play. The Lisbon Treaty did more than elevate them from being a mere note to the protocol to an active contributor to the good functioning of the Union (Article 12 TEU). More precisely, it granted national assemblies an early warning mechanism by spelling out the idea of subsidiarity in what has been termed a "yellow card" system (Article 7 (2) of Protocol No 2). That is to say, if one third of parliaments object to a draft legislative act that according to their reasoned opinion does not comply with the principle of subsidiarity, then the European Commission must review its proposal. This is an important innovation because it ties national parliaments directly to EU legislation, beyond the control of member states' governments. If exercised diligently - parliaments have only an eight-week window to voice their concerns - then this provision has the potential to turn the assemblies from hitherto being rather toothless at the EU level into a "virtual third chamber" (next to the EP and the Council).

So far, there have been (only) two instances where parliaments flagged the yellow card: In September 2012, national parliamentary chambers in twelve member states ranging from France to Latvia, from the UK to Malta, and from Portugal to Poland as well as the three Scandinavian countries, decried the proposed legislation limiting workers' right to strike. They argued that the so-called Monti II regulation touched on an issue to be regulated at the national level. Not least because trade unions across the EU as well as MEPs had also strongly objected to the proposal, the Commission abandoned the proposal altogether, even though it maintained that it did not violate the principle of subsidiarity.

In October 2013, the national parliamentary chambers in eleven member states complained that plans to create a European Public Prosecutor Office (EPPO) breach the subsidiarity principle. They included some assemblies that had already said no to Monti II (from the UK, Malta, the Netherlands, France, and Sweden - the latter three being the most active 'complainants' in 2012) but also a number of 'first-timers' (the Parliaments of Hungary, Ireland, Romania, Slovenia,and Cyprus). Interestingly, the Commission decided to go ahead with the legislation while promising to take into account the opinions submitted by 14 national parliamentary chambers in 11 member states.

In the case of the EPPO, the Commission feels that it has strong reasons to maintain its legislation. Most importantly, the Lisbon Treaty in Article 86 TFEU explicitly called for the establishing of the Office. In addition, with the prosecutor only but exclusively being responsible for investigating the fraud of EU funds, it argues that national offices could not possibly handle cases with an intrinsic Union dimension effectively, especially when cross-border activities are involved. Finally, it points to the Lisbon Treaty, which envisions a special unanimity procedure to adopt the EPPO, whereas - failing to reach unanimity - a group of at least nine member states can pursue the proposal by means of enhanced cooperation (Article 20 TEU). In that sense, one could argue that the Commission owes this, not only to the Treaty itself, but also to those 17 national parliaments that did not see a violation in the subsidiarity principle to table the legislation.

What can those two cases of the use of the yellow card tell us about the role of national parliaments in EU legislation? Being regarded as something of a cornerstone of policing subsidiarity, some argue that a "red card" be introduced (i.e. two-thirds or, on important issues, half of national parliaments forcing the Commission to abandon the draft legislation) or that a yellow card simply be treated as a red card. The EPPO case, however, shows that things are not so simple: While critical involvement of national assemblies should be more than welcome, the reasoned objection of a minority among them should not suffice to kill the process altogether. Moreover, a yellow card issued by one third of national parliaments means that, two thirds of those chambers do not see a violation of the subsidiarity principle. That is why it would be overhasty to consider any future yellow card as an order to abandon legislation. Finally, the "orange card" by which half of national parliaments, supported by either the Council or the EP, can actually vote down a Commission proposal (Article 7 (3) of Protocol No 2), has not been tried to this date.

That's why, for the time being, the yellow card procedure should rather lead to a substantiated dialogue about how the envisaged legislation could be made to fit the requirements of subsidiarity. While the eight-week period for consideration may be deemed too short, going down the route of changing the respective Treaty protocol (for which not even the simplified revision procedure could apply) would be extremely difficult. Instead, national parliaments should enhance their practical cooperation in Brussels and through the Conference of Parliamentary Committees for Union Affairs (COSAC) in order to better respond to new Commission legislation and thus preserve the principle of subsidiarity. This also includes the use of IPEX, the InterParliamentary EU information exchange platform facilitating cooperation between national parliaments and the EP on legislative issues.

The establishment of an Inter-Parliamentary Conference for Economic and Financial Governance, based on Article 13 of the new Fiscal Stability Treaty signed by 26 member states in response to the reforms of the Eurozone, will prove critical for how national parliaments make their voices heard at the European level. Given enough political will among national parliamentarians, this new gathering, which convened for the first time in October 2013 under the Lithuanian EU Presidency, could become a permanent forum for national parliaments to discuss and comment on the Commission's Annual Growth Survey. This document, published in October of each year, sets out the broad EU economic priorities for the following year and thus launches the European Semester. In particular, a discussion among national assemblies in the Fall would thus precede both the adoption of national budgets (usually in December) and the Council's consent to the Survey in January. Regular meetings in this setting, preceding important decisions by the European Council and the Commission, would thus contribute to a higher level of parliamentary scrutiny of decisions taken at the EU level on member states' fiscal and economic policies.

In addition, a number of practical aspects can enhance cooperation between national parliaments and the EP as well as within national parliaments. For one, the EP could invite national MPs more regularly for hearings, especially if there is growing concern about a new piece of legislation's compatibility with the subsidiarity principle. To facilitate this, national parliamentarians should have direct access to the EP buildings rather than going through visitor procedures. Moreover, much should and could be done to enhance cooperation between the EU affairs and functional committees at the member states level as well as between a country's MEPs and its national deputies - from regular briefings, including to different party groups, to scheduling meetings according to the political calendars in both Brussels and the national capital, to more mundane things such as agreeing to work in English on a draft legislative proposal.

This point about the preparedness of national parliaments to get engaged on questions of subsidiarity also points to the domestic arena in member states. While the Treaty grants parliaments the right - or even the duty - to uphold the subsidiarity principle of a legislative proposal, it also gives them the right to take the EU to the European Court of Justice over an alleged violation by a law that is already passed. While it is true that the ECJ is thought of as being integration-friendly, it is the threshold for this procedure, set at national level, which makes this a useful instrument: In Germany, for example, the law implementing the Lisbon Treaty granted this right for a subsidiarity appeal to one fourth of members of the Bundestag. If they were serious about their claims about EU laws violating national (or regional) prerogatives, even minority parties could set in motion a process at the end of which EU legislation is repealed.

In addition, once national parliaments are more involved in EU decision-making by way of institutionally preparing for the yellow-card procedure, they can also better use the old-fashioned way of working through their respective governments. After all, the prospect of facing a blocking minority in the Council of Ministers has in the past led the Commission to either alter or altogether abandon a legislative proposal. This is the preferred avenue, especially when the - often times politically controversial - substance of a Commission proposal is at issue, as opposed to procedural questions.

This ‘classical’ method is also more effective than the new yellow card procedure: A one-fourth minority in the Council (i.e. 26% of the weighted votes) can block new legislation, whereas it takes a third of national parliaments for a yellow card, which forces the Commission only to reconsider its proposal. Similarly, national parliaments could use this route to propose to abolish out-dated legislation or even initiate new ones - for which the prerogative is, of course, with the Commission, but which should be forthcoming if presented with a joint initiative of national parliaments and governments.

4. Improving Inter-institutional Cooperation and Law-Making

As mentioned earlier, the past years have seen an institutional rebalancing towards both the European Council and the European Parliament. The former has gained weight thanks to the Maastricht policy inventions and the EU’s recent crisis management activities, whereas the latter’s role increased mostly due to the Nice and Lisbon Treaty provisions making it a law-maker near-equal to the Council. At the same time, the institutions of the Eurozone - both the established ECB and the Eurogroup meeting of finance ministers as well as newly created ones such as the Eurozone summit or the semi-permanent Eurogroup president - have grown in importance. Both trends took place mostly at the expense of the Commission, in terms of its political profile as well as public visibility. In order to put this new institutional tableau on more solid grounds, there are a number of considerations on how the functionality of the EU bodies, including the relations among the main (classical) institutions, can be further improved.

4.1. Getting Commission, Council, and Parliament to Agree on the EU’s Work Programme

A closer look at the fields where the European Council is most active - i.e. economic governance and foreign policy- reveals that the Commission does not have the right of initiative for these policy areas. Therefore, the involvement of the heads of state or government does not necessarily crowd out the Community method from areas where it was previously applied. Instead, it can actually help bring about the necessary consensus between member states and the Commission. This is particularly relevant with regard to the emerging economic governance in EMU.

This consensus is also needed when it comes to the EU’s work programme for the next five years. Here, the Council should join the Commission and Parliament to draw up a tripartite inter-institutional agreement outlining where the Commission as the sole initiator of legislation should become active. This is something member states neglected to do in 2009, leaving it to the EP to outline future legislation and procedures with the Commission. With the overall policy guidelines from the European Council plus the

EU's priorities co-defined by the Council in such a tripartite "European Governance Manifesto", member states would be more accountable for EU policies. This means that they could no longer blame an alliance between the Commission and Parliament for pushing supranational policies too hard.

Such a tripartite accord would allow the Commission to regain its equidistance to the other two main institutions, Council and Parliament. By establishing a work programme between the three law-making bodies, it could also promote a 'normalisation' of the role of the European Council, stepping away from concrete (crisis-driven) decision-making and becoming - again - the forum to discuss the long-term political guidelines.

Furthermore, it could provide an opening to a factual "right of initiative" of the European Parliament: As part of the accord and on certain predetermined issues, the Commission could agree to table a proposal coming from Parliament as its own. Certainly, this appears as further (unwanted) federalisation to some, even though it would not change anything in the official law-making procedure (which, ultimately, grants member states a collective veto via the Council). Furthermore, in practice it is likely that the relevant Commission units would be involved in the preparatory work at the desk level anyway, so that the final draft might not be so different after all. However, the symbolism would be huge - and precedent-setting, for better or for worse.

4.2. A New Compact for Better Law-Making

While such a tripartite inter-institutional agreement tackles new (secondary) legislation, the bulk of EU regulation is indeed by way of delegated (implementing) acts. This points to the existing 'smart regulation' agenda, through which the EU has already begun to lessen the regulatory burden on the European economy. While being on the right track, the EU - and here the Commission as the main body for proposing and implementing legislation - needs to do more to make companies more competitive in a global market place. This is not a special interest of business organisations but a feeling that is shared by the wider public. Moreover, it is not merely a concern driven by the desire to enhance the EU's competitiveness and, thus, prosperity, but also a demand of the principles of proportionality and subsidiarity. Better (i.e. often times: less) regulation then feeds back into the perception of citizens whether the EU duly exercises its powers or not.

What is thus needed is a "Better Law-making Compact" as a major focus of the next Commission's work. Building on activities that have been pursued in the field of law making since the mid-1990s, a compact would reinforce those in order to reach a clearly stated aim: To have less, not more, regulation at the end of the 2014-19 period than at its start. Such a 'net reduction' can be achieved by the following means.

First of all, the Commission should refrain from new law making to the greatest extent possible. There must be no legislation only for the sake of legislation. When legislation appears necessary, a "think small first" approach should be pursued. In addition, when proposing new legislation, the Commission should place particular emphasis on possible exemptions or lighter regulatory regimes for small and medium-sized enterprises (SMEs). In pursuing the agenda of the above-mentioned tripartite agreement, the Commission should try to integrate and simplify existing legislation wherever possible. Both codification - to bring together one or more legislative acts and their possible amendments in a single new act - and recasting - substantively changing an original act while simplifying it and its amendments - are desirable in this regard. Finally, the First Vice-President responsible for better regulation should carefully supervise such legislative work, making sure that it corresponds to the political challenges the EU faces.

Secondly, the new Commission should complete REFIT, the Regulatory Fitness and Performance Programme that has identified opportunities to reduce regulatory burdens and simplify existing laws.

This programme, initiated in December 2012, resulted in a number of proposals in its October 2013 report. It is, however, important to ensure that this effort does not fade out with the current legislative period but is carried on - and with renewed vigour - post-2014. SMEs across the EU should make it their goal that the REFIT evaluation is extended to the full regulatory acquis.

Having mainstreamed smart regulation tools such as impact assessment, stakeholder consultation and evaluation throughout the policy cycle (as the Commission claims in its report) is a first step. However, even those tools can be improved. For one, impact assessment should be independent and public. This means that any impact assessment made should be publicised, including - and especially - those that lead to the repeal of the proposed act. While this may initially appear embarrassing to the College as such or to the individual Commissioner proposing the legislation, it would help counter the public perception of the Commission as a body only keen on churning out more regulation.

As for the independence of impact assessment, some experts have proposed that the Commission's Impact Assessment Board include outside experts, nominated by the Council and Parliament. At the same time, the latter two institutions have their own share to contribute by assessing the impact of the amendments they propose as part of the legislative process. While the Commission's impact assessment only relates to the original proposal, it is the alterations coming from the European Parliament and from member states that can make a legal act much more regulation-heavy towards the end of the legislative process. (The same is true for amendments by the College of Commissioners after an impact assessment is made.) The EP has already established an impact assessment capacity, which it has to bring to use now; the Council, according to the Inter-Institutional Common Approach to Impact Assessment, is to do the same with regard to its own proposed amendments.

However, rather than trying to harmonise those activities across the three institutions, the EU should establish an independent agency conducting both impact assessment and policy evaluation for EU legislation. Agreeing on such an "Agency for Better Law-making" could be part of updating the 2003 Inter-institutional Agreement on Better Law-making. A new agreement has to take into account the post-Lisbon legislative environment and consolidate the advancements of the better law-making agenda of the past decade.

Furthermore, member states bear special responsibility when it comes to EU directives. Here, the level of regulatory burden often increases when national lawmakers add further details in the process of transposition. These range from additional regulatory measures to administrative requirements such as reports, authorisations, inspections and fees. Such ‘gold-plating’ may satisfy certain national, administrative, or special interests; however, its necessity is hardly explained to the public. Thus companies, citizens and the like perceive another EU directive that increases regulatory burden.

Simply appealing to the ‘forthrightness’ of member states governments is not enough, which is why the new Agency for Better Law-making should make information on national transposition publicly available. This would enable business organisations, academic institutions, think tanks, and watchdogs alike to critically assess overregulation at the national level. Especially if measured against the upcoming annual REFIT scoreboard of the Commission’s initiatives to simplify legislation, this will provide a more balanced picture as to where it is really ‘Brussels’ (i.e. the Commission) that drives regulation and where the Council and the EP or individual member states have to bear the blame. Building on its "Top Ten" consultations with SMEs, the Commission should explore ways to extend public hearings to the evaluation of legislation. Such ‘fitness checks’ review existing legislation to assess whether it reasonably supports economic activity and does not result in disproportionate compliance costs. Because the actual costs and benefits entailed in implementation of a directive also depend on how it is transposed at the national level, the Commission should work closely with member states on the methodology of such evaluations. Merely assessing the conformity of transposed national legislation with EU law is not enough; it needs to be evaluated with regard to its actual impact, including on the broader competitiveness of the economy. The revision of the Commission’s guidelines for evaluations and impact assessments, to be undertaken in 2014, can only be the beginning.

Ideally, stringent policy evaluation should tie back to the initial impact assessment made during the legislative process, thus informing the latter process with the actual results of a legal act and, ultimately, improving the assessments of future acts.

5. Conclusion

This chapter has shown that the EU's competitiveness hinges on much more than 'only' improving the conditions for business. Given that the Union remains engulfed in a crisis of political legitimacy, worsened by the outcome of the European Elections in May, the justified concern of business organisations as much as ordinary citizens is also on the EU's governance structures and their interplay with the national level. The proposals made here aim to increase the EU's institutional capacities so as to enhance its overall legitimacy.

Still, while institutions matter (even a great deal), they are not everything. To function properly, they also need a guiding principle, a spirit of cooperation, both within and among them. It is this spirit of cooperation and solidarity, which has suffered most from the current crisis in Europe. To overcome this malaise, any group of individuals can make a contribution. That is because, ultimately, institutions are more often a product than an agent of change. Or as the 'father of European integration,' Jean Monnet, rightly said: "Nothing is possible without men; nothing lasts without institutions". These 'men' include of course all European citizens, male or female, while targeting a specific group among them: Those elected for public office. Calling upon their 'political will' may appear futile at times, leading people to assume they had better take matters into their own hands. Yet especially when democratic procedures are questioned both at the national and European levels, it is important to work through the established procedures and hold representatives accountable.

By making concrete proposals on how to reform the EU's governance structures, this chapter contributes to the on-going debate about the necessary next steps and enables interested citizens as much as civil society organisations and business confederations to lobby for a more competitive, flexible, and effective EU.

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