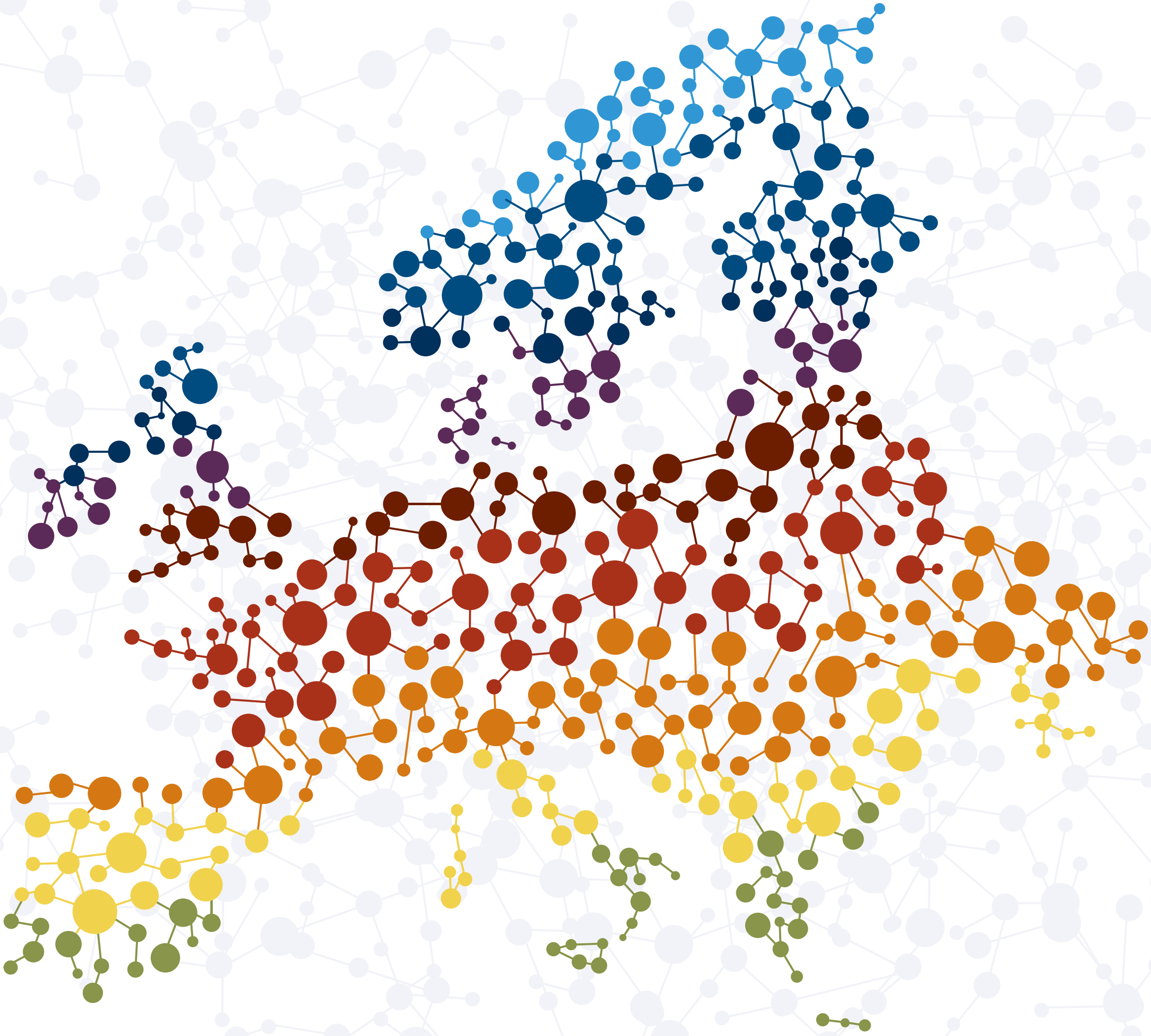


European policy and the future of the EU

Global Counsel

Introduction

Ten years of serial crises and rising voter scepticism about mainstream political parties have definitively buried the managerialist consensus that dominated EU policymaking in the early 2000s. The financial crisis, strained public finances and large scale immigration flows have exposed the delicate balance between technical problem solving, solidarity of national governments, and the subsidiarity that requires decisions to be taken 'at the level closest to the citizen', with no straightforward answers.

These post-2008 crises were an agenda of necessity rather than choice. However, in highlighting five possible scenarios for the future of the EU, the Commission's March 2017 White Paper marked an internalisation of these tensions into the EU's traditional, proactive policy agendas of deepening the single market and pursuing trade agreements with third countries. What were important questions for the drafters of the Lisbon Treaty are now existential challenges for the EU: where and how do its actions complement those of the member states? Where do interventions risk alienating voters? Where could they shore up public opinion?

This publication offers Global Counsel's contribution to this debate, drawing on the experience of our consultants in national governments and the EU institutions. We examine how the political trade-offs exposed by the Eurozone and refugee crises could play out when applied to the core EU policy agendas of the Digital Single Market, the Capital Markets Union, the Energy Union, international trade policy and immigration.

The five scenarios proposed by the European Commission are important in exposing the consequences of decisions in each of these five areas. The debate they have triggered means that political and policy choices in individual areas must be taken on their own merits and with a view to the cumulative impact on the future model, scope and priorities for cooperation between European countries and institutions.

Tom White
Head of Europe

Digital Single Market

The overhaul of Europe's digital and innovation frameworks is underlined by a growing concern over declining competitiveness. Generating higher productivity and economic growth through innovation is hardly a new policy aim – the largely forgotten Lisbon and Europe 2020 strategies were anchored on this objective. However, the urgency has been heightened by two factors. Firstly, in contrast to previous phases of industrial change, Europe has become a standard taker rather than a standard setter. European companies have largely failed to challenge software giants such as Google or Alibaba, whilst flagship hardware companies such as Nokia have declined in the face of competition from Samsung, Apple and Huawei. Secondly, international online platforms have demonstrated an ability to rapidly dominate markets and to expand into new industrial sectors, potentially creating competition for traditional European industrial strengths such as automotives.

The EU's digital single market (DSM) aims to tackle this competitiveness challenge by creating a market of scale for domestic companies. The Commission's policy response, shaped by the limits of its legal competences and budgetary constraints, has been to prioritise the abolition of cross-border regulatory barriers rather than adopt a more interventionist approach to fund and shield local companies as they start up, scale-up and internationalise. A major pillar of this strategy has been the provision of enhanced online rights for consumers with the ultimate aim of stimulating cross-border consumer demand and, in doing so, tackle the preference of European consumers for domestic and US providers above other EU providers. The most notable examples of such 'retail politics' for citizens have been new online privacy rights, the abolition of mobile roaming charges and portability rights for online subscribers when temporarily travelling across borders.

National digital economy strategies may indicate preferences for where pan-EU tools might support industrial transformation. The DSM has largely left responsibility for supply-side interventions to national governments. To varying degrees, all member states and many regional governments are implementing strategies that support technology investment, skills development and infrastructure. In some areas – such as tax incentives – these are strictly national competence. However, others reveal scope for using existing EU tools in a more targeted way, such as match funding for venture capital or leveraging networks in businesses to train workers of the future.

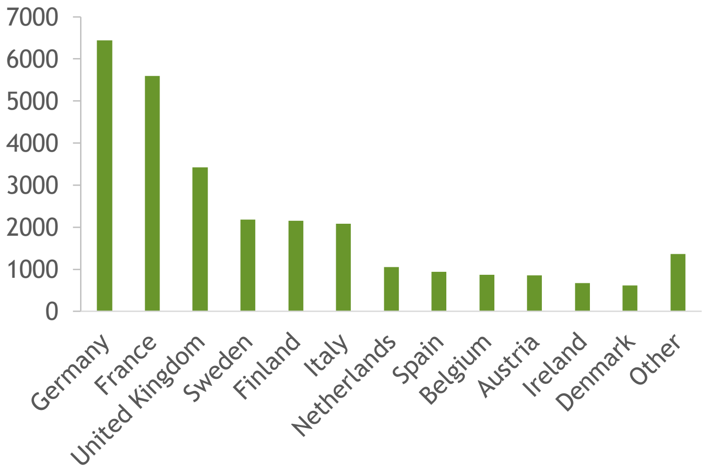
EU legislative reform...

Digital Single Market Initiatives	
Consumers	• Abolition of roaming charges • Portability of online subscriptions • Abolition of geo-blocking
Privacy	• General Data Protection Regulation • Reform of cookie rules and rules applying to telcos – e-privacy directive
Online Content	• Copyright reform • Audio-visual media services directive overhaul
E-commerce	• Postal delivery reform • Reform of online sales rules • VAT reforms
Cybersecurity	• Security of Network and Information Systems Directive – cybersecurity rules for critical infrastructure
Telecoms & Infrastructure	• Spectrum coordination • Reform of telecoms regulations

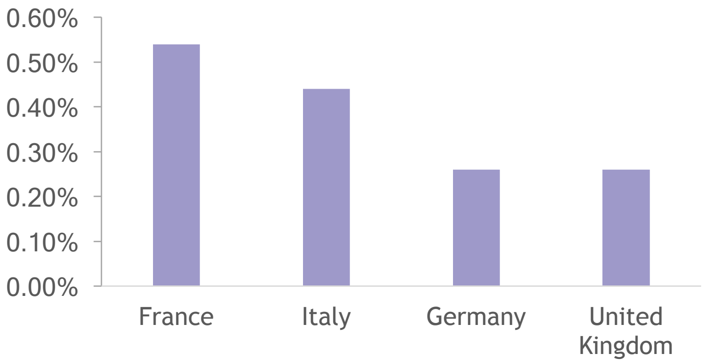
Source: European Commission, OECD

...meets national investment plans

Business R&D expenditure of the ICT sector (2013, million euro)



Telecommunication infrastructure investment as a % of GDP (2015)



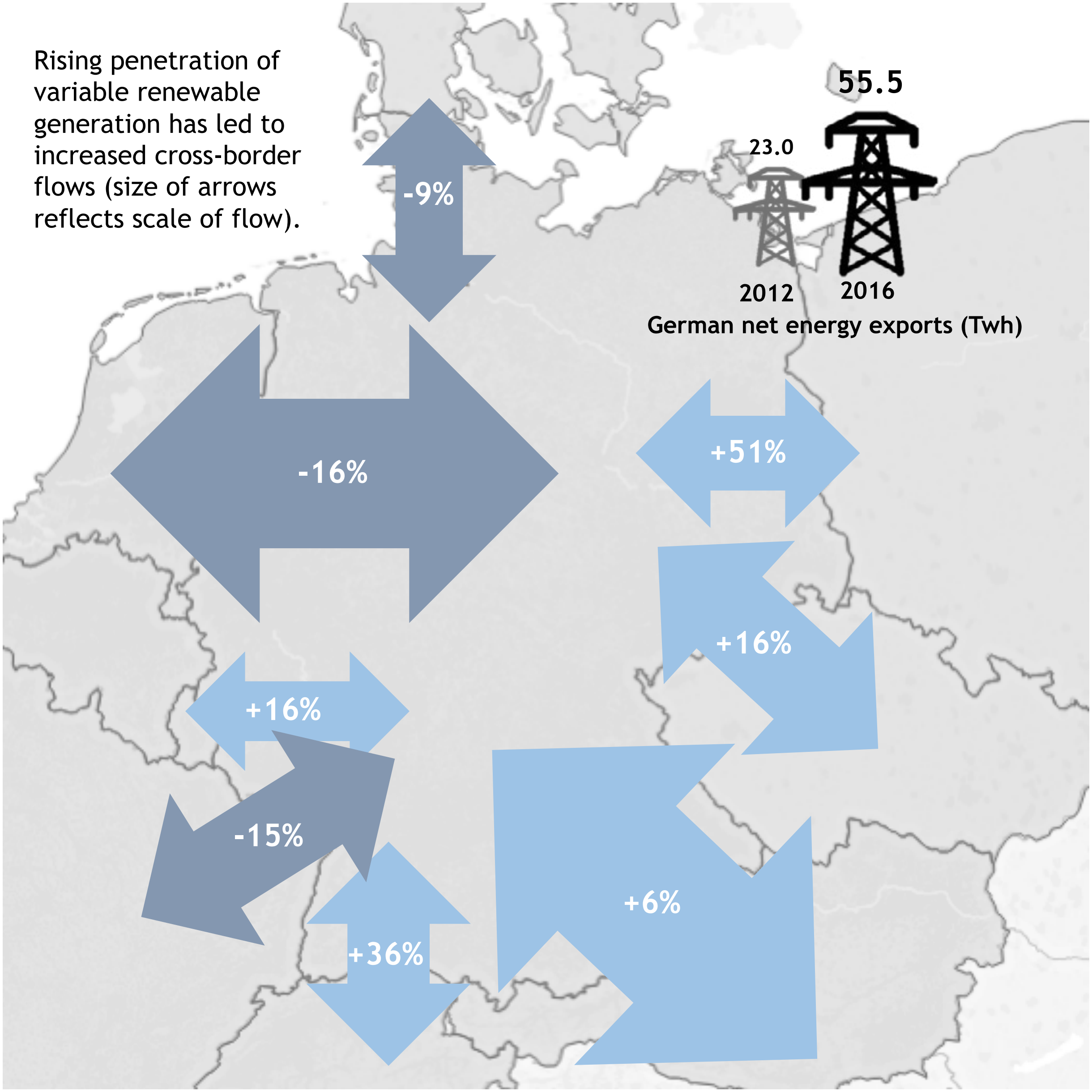
Energy Union

The last twelve months have seen an important upgrade of ambition in the ultimate goal of the European Commission's Energy Union initiative. Previous Commission approaches, notably through the Third Energy Package, have been largely about completing the Internal Energy Market by connecting member state energy markets and structural market rules such as 'unbundling' operations in power generation, transmission and distribution. The Energy Union's ambition now goes much further. Indeed, what Vice-President Maroš Šefčovič outlined in November was a transformational vision of Europe's energy future: efficient, decentralised, and decarbonised.

Inevitably, the Commission's vision is not shared in full by all member states and will require compromise and cooperation in sensitive areas. Šefčovič himself argued that member states must give up some autonomy in return for the benefits of European energy market integration and harmonisation. This much has long been implicit. However, this explicit recognition suggested a Commission which has identified energy as an area where it can make the case for more Europe. Legislative files in which the Commission has proposed 'Europeanising' energy governance will be key, particularly the Governance of the Energy Union Regulation and the Electricity Market Regulation (EMR). This seeks to bolster the role of the European Agency for Cooperation of Energy Regulators (ACER). Although the rate of change will be incremental, the successful negotiation on the revision of the Gas Security of Supply Regulation suggests that progress will be difficult, but possible.

However, the real task for both the Commission and member states will be keeping pace with market and technological developments; above all those unleashed by the national German policies of the Energiewende. With variable renewable generation now accounting for over 30% of annual generation, the German power system has increasingly relied on interconnection with neighbours – notably Poland, Czechia, and Switzerland - both to offload surplus power and make up deficits in generation. Regardless of member state sentiment, in the future, higher volumes of variable generation in Germany and elsewhere will necessitate greater cooperation at the regional and European level to manage these cross-border flows. Progress on Energy Union will be more bottom up, than top down.

Can Energy Union catch up with Germany's Energiewende?



2016 German relative bilateral electricity flows GWh (% change since 2012)
Source: ENTSOE.eu, Agora Energiewende

Financial stability and financial services

The EU Financial Services Action Plan and Banking Union agendas were unique in global financial regulation in setting common standards across diverse national economies, enhancing the resilience of financial institutions. Common standards for prudential regulation, market infrastructure oversight and disclosure of trading activities have helped strengthen taxpayer and investor confidence. There are also some sub-sectors of financial services that have become genuinely cross-border, such as wholesale banking and professional investment services. Meanwhile the creation of pan-European supervision, most notably the Single Supervisory Mechanism in the ECB and to a lesser extent the European Supervisory Authorities, have begun to harmonise regulatory practices with the potential to reduce compliance costs, although they have also been criticised for excessive guidelines that restrict profitability.

The Juncker Commission's decision to refocus on integration and competitiveness alongside stability has exposed a more complex mix of national and sectoral interests. A single rule book has only partially delivered a genuine single market. Many of the core financial services sectors – retail banking, insurance, pensions – remain resolutely national in nature. Meanwhile technological advances in financial technology, and the prospect of redistributing activity from the UK's export-oriented finance sector, has drawn political attention to the direct economic benefit of financial services, as well as the more familiar role they play in the wider economy. This confluence of opportunities is generally positive for the sector, which has long argued that profitability is a condition of rebuilding capital buffers, but it may also strain the consensus of working at a pan-European level. The pursuit of 'profit centres' is likely to be harder for governments to share and collaborate on than the sharing of 'cost centres' in the post-crisis re-regulation, with level playing field arguments potentially giving way to a desire for (low-risk) arbitrage.

This tension is likely to play out in a series of reforms planned for 2017 and 2018, with 'regulatory competition' between member states losing its taboo and potentially driving innovation. This year sees the Commission taking a number of steps to try and improve the competitiveness and innovation by accelerating and harnessing the development of the single market. As EU policymakers enter this space, they confront strong and entrenched national interests in job creation, financial inclusion and boosting public finances, which may also expose the differing levels of freedom in regulation enjoyed by Eurozone and non-Eurozone countries in national financial sector strategies.

From serving the economy to an economic opportunity

Competitiveness

H1 2017

- Agreement on Prospectus Regulation
- Agreement on Money Market Fund Regulation
- Proposal on a Pan-European Personal Pension Product
- CMU mid-term review

H2 2017

- FinTech Action Plan
- Agreement on Securitisation (STS) Directive
- Fee cuts in non-Euro cross-border payments
- Agreement on amended Venture Capital and Social Investment regulations
- Proposal on passporting of cross-border investment funds

2018

- Proposal to relax capital requirements on investment firms
- Consumer Financial Action Plan legislation:
  - Insurance
  - Loans
  - Payments
  - Credit Scoring
- Solvency II review
- AIFMD Review

2019

- Completion of Capital Markets Union

New opportunities for cross-border business?

Strains over winners and losers from 'growth' measures?

Finance as a utility

H1 2017

- Review of EMIR
- Criteria on relocation of EBA
- Consultation on European Supervisory Authorities

H2 2017

- Agreement on CRDIV and BRRD (Banking Reform Package)
- Commission Sustainable Finance recommendations

2018

- Finalise Technical Standards on KIDs in PRIIPs Regulation
- EU-wide EBA stress test
- MiFID II enters in force

2019

- Completion of Banking Union

Financial Services

International Trade

The political ground lost during transatlantic trade negotiations and an erosion of political and public support for open markets have put the direction of EU trade policy in question. Member states' governments remain generally supportive of EU trade negotiations, but opponents of liberalisation have mobilised diverse constituencies – from trade unions to nationalist movements to environmentalists – to the extent that trade policy now features in national election campaigns. National parliaments have, as a result, sought to affirm their role in the field, thus raising the prospect of multiple vetoes. The frayed ratification process of the Canada-EU Trade Agreement showed that what is by any standards a fairly benign trade deal with a close partner still risks failure at the final stages. The recent European Court of Justice (ECJ) Opinion on the division of competences between the Commission and member states in the EU-Singapore FTA was therefore well-timed to trigger a reassessment of the structure and substance of future EU FTAs, including narrowing the scope of EU FTAs to areas of exclusive EU competence so as to minimise uncertainty during the ratification process.

Amending the process and content of trade agreements will not be sufficient to address concerns that the benefits and costs of trade are not fairly shared. Addressing some of the institutional blockages in the EU's ratification process of free trade agreements is worthwhile, but the European Commission's recently published paper on Harnessing Globalisation sought to go further and address deeper political anxieties among EU producer interests. This built on earlier emphasis on consumer benefits and the emphasis in the 2015 Trade Policy Strategy on improving the governance, transparency and normative content of EU trade policy. The latter made FTAs contingent on high social, labour and environmental standards.

Supporting those who bear the costs of liberalisation is an established principle in many member states, but the most concrete action at EU level may be to mitigate those costs by strengthening trade defence measures. Providing retraining, support for finding alternative work and investing in the development of alternative industries are among the activist responses of member states that have seen industrial change accelerate due to increased global competition. However, using trade defence measures, such as temporary higher tariffs and quotas, which have also been put on the table by the US administration, may in the short term create policy space for the proactive policy reviews on trade agreements that the EU urgently needs. In this regard, the UK's exit from the EU is set to tip the balance in the Council in favour of those member states that advocate for tougher trade defence actions.

'Free' traders and 'fair' traders?

General position on key trade policy questions: 8 largest votes in Council + Sweden
Source: GC analysis

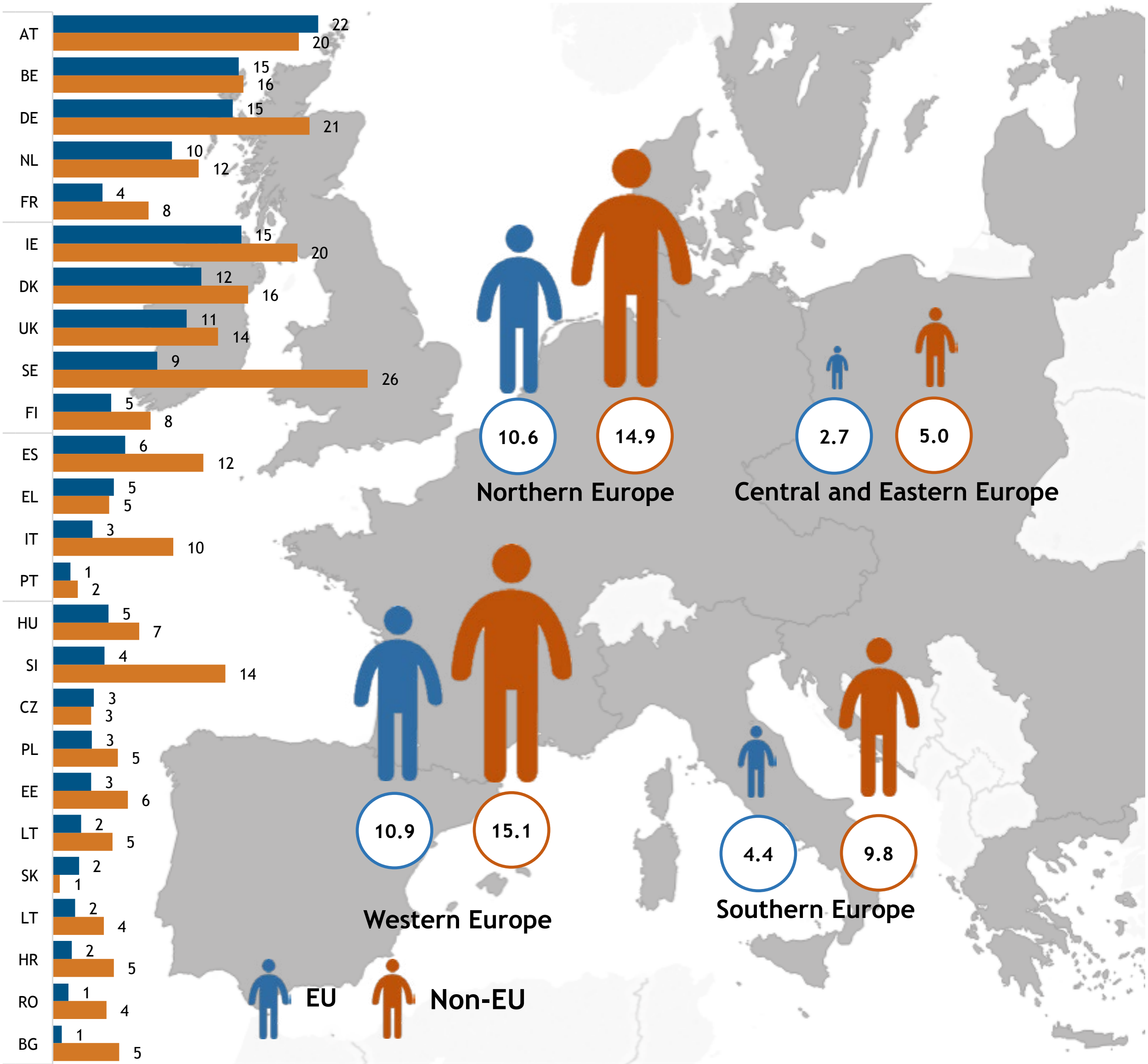
Migration

Free movement of people continues to be one of the most tangible benefits of EU membership, but the policy tools that manage it require constant attention to remain relevant and fit for purpose. For individuals, it brings opportunities to travel, work and start businesses with limited difficulty; for employers, it enables them to post workers to other EU and EEA member states and to recruit from larger talent pools; for governments, it helps coordinate national policies on refugees and asylum. The EU already has a well-developed toolkit to maintain labour market protections and prevent abuse of benefits. However, the speed and scale of recent intra-EU migration has, in some countries, increased public concern about integration and about the bargaining power of existing workers. The rapid increase in refugees from the Middle East has also exposed an urgent need to revise the Dublin Agreement and other policy tools regulating migration from outside the EU.

Migration has drawn the most serious division line between the 'old' and 'new' EU member states in a decade. The EU faces a double challenge as political pressures in richer countries to manage intra-EU migration could further reduce CEE countries' appetites to share the burden of settling refugees. Opposition to the quota system of allocating refugees in a number of member states has been further aggravated by slow implementation and lack of political and policy instruments, such as a common asylum system and readmission mechanisms, that would ensure confidence in the system. A more focused collective approach to future EU integration, which many new member states favour, with both penalties and incentives, may be a way to overcome divisions, but many of the tools to achieve this still lie with national governments.

In the future, the EU will need to find ways to withstand and absorb calls for temporary suspensions to the Schengen zone or even to free movement itself. With population mobility increasing and labour markets evolving more rapidly than ever, the EU will have to strike some balance between national interests, external challenges and the need to maintain Single Market principles. Some member states may advocate for updated transitional arrangements for future enlargement in South East Europe, arguing this can make the pace of social change that migration can trigger more sustainable.

The EU's experience of migration is far from uniform



Total 2013-2015 migration per 1,000 population (ex. CY, MT, LU)
Source: Eurostat

About Global Counsel

In Europe, Global Counsel provides advice and strategic support to businesses navigating political, policy and regulatory developments in Brussels and other EU capitals. Our advisers can interpret and anticipate the impacts of policy initiatives for businesses and other stakeholders, and help clients develop plans for shaping and adapting to them. We have also advised on quasi-judicial procedures such as competition and trade defence cases, as well as decisions on spending, taxation and trade negotiations with non-EU countries.

Global Counsel advisers in Brussels and London, and our wider network of former policymakers in EU capitals, represent experience in every area of public policy and political communications. With sector specialisms including manufacturing, energy, financial services, technology, media and telecommunications, our Practice Leads combine decades of experience working with the European Commission, European Parliament and member states in the EU Council.

www.global-counsel.eu

Contributors

Stephen Adams, Senior Director

Tom White, Head of Europe

Carmen Bell, Practice Lead - EU Institutions & Policy

Daniel Capparelli, Practice Lead - Trade Policy

Conan D'Arcy, Practice Lead - Technology, Media & Telecoms

Matthew Duhan, Practice Lead - Energy

Roberto Robles, Senior Associate

Alexander Smotrov, Practice Lead - Russia, CIS & CEE

Global Counsel

www.global-counsel.eu

@global_counsel

London

5 Welbeck Street, London W1G 9YQ
E: info@global-counsel.co.uk
T: +44 [0]203 667 6500

Brussels

Residence Palace, rue de la Loi 155
Brussels 1040
E: info@global-counsel.eu
T: +32 2 808 5250

Singapore

50 Scotts Road, #02-01, Singapore 228242
E: info@global-counsel.com.sg
T: +65 6597 7403