



# *An EU fit for purpose?*

## Insights from the CEPS Ideas Lab

### The Egg, 25-26 February 2016

April 2016

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#### Introductory note

*An EU fit for purpose?* This was the question that CEPS tabled at its third Ideas Lab, at which high-level decision-makers shared their expertise on the complex challenges facing Europe. More than 730 participants, representing 52 different nationalities, contributed to the wide-ranging discussions on numerous European policy areas.

This report provides an overview of the main discussion points made at the lab sessions and prime talks during the two-day conference, with reference to the implications for policy-makers, where appropriate.

This event was organised in collaboration with the Dutch Presidency of the Council of the EU; other research institutes and foundations contributed to individual Labs with both human and financial resources and various CEPS Corporate Members also provided financial means. We are grateful to all of them for their support and input, which helped to make this year's Ideas Lab a great success. Encouraged by the positive feedback from our partners and participants, we commit to organising another Ideas Lab in early 2017.

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# *An EU fit for purpose?*

## Insights from the CEPS Ideas Lab

April 2016

### Opening Plenary: Perfect storm, or storm in a teacup?

The Opening Plenary of the Ideas Lab addressed the question of whether the crises now facing the EU amount to a perfect storm or, when seen in a global context, are more of a storm in a teacup.

In order to hear perspectives from beyond Brussels CEPS invited Prof Qi Ye, University of Beijing, and Samir Saran, Vice-President of the Observer Research Foundation in Mumbai for an open dialogue.

In the view of Prof Qi Ye, the current situation is more than just a storm in a teacup, or “the teacup would have to be very big”, but for every European problem China had a comparable one – without going so far as to consider them as real crises. Indeed, dealing with global challenges is “a new normal that we should get used to”.

Samir Saran shared this view, noting that the test of a political system is its ability to deal with challenges such as terrorism, climate change, and migration. For the European Union, the first step should be to identify the problems that are common to all – something that in itself is proving difficult, but “to have a common identity, you need common problems”.

In the opinion of the Indian expert, one of the main challenges for Europe at the moment is “managing Russia”. In this regard, he believes that recent developments in the EU’s Eastern neighbourhood are the result of policy mistakes made in the past: “Europe has neglected its periphery, and that is coming back to bite”.

Furthermore, the European Union should acknowledge that it is now regarded as a global player (as exemplified by the COP21 agreement) and, consequently, should live up to the expectations of its international partners.

Prof Qi Ye concurred, going so far as to say that “the EU is one of the most brilliant inventions in human history” and that it has “many lessons to offer the world on standards and problem-solving”. In particular, he made the point that China could benefit from valuable insights from Europe on how to manage the economy through decentralised horizontal governance, rather than through a fully fledged government.

In this respect, however, the EU is faced with one more obstacle than China: namely, the need to respect democratic procedures. Indeed, Prof Qi Ye quipped that although there is no vote in China people do have a say; in the European Union, however, “people can elect a new government, but can’t get new policies”.

## Digital Economy

### *Introduction*

With seemingly never-ending negotiations on the overhaul of the data protection regime and the formulation of a comprehensive Digital Single Market (DSM) strategy, it has been a productive year for policy and regulation in the area of digital economy. Better online access to digital goods and services would enable the EU to become a larger and more seamless digital marketplace – a propellant for start-ups to become tomorrow's so-called digital unicorns (companies whose valuation reaches €1 billion or more). While Europe's start-up scene is gathering pace there is a general concern that, compared to other regions, it lacks the environment to enable companies to scale up to the next level, and is hampered by insufficient skills, a lack of finance, and regulatory constraints.

### *Added value of the discussions*

The Digital Economy Lab focused on many of these challenges and considered how to (re)design rules to match the pace of technology and support infrastructure development to allow Europe's economy, industry and labour market to benefit from the enhanced competitiveness and productivity growth that digitalisation may offer. Discussions ranged from the role of online platforms, access to finance for start-ups and scale-ups, to the suitability of telecoms regulation in the digital era.

There was general acknowledgement that online platforms bring benefits in terms of facilitating information flows and cutting transaction costs, or in creating new business opportunities and increasing consumer choice over a wide range of products and services. The rise of big data and predictive analytics in media and finance nevertheless generates concern about transparency and accountability. Some participants saw the need to regulate certain aspects of platform activities, such as access to data and relations with third parties, and they stressed the need to define data ownership, to harmonise distinctions between personal and non-personal data, and to provide more information on users' data footprints and ensure algorithmic accountability. Conversely, others felt that overregulating online platform activities risked nipping innovation in the bud. Instead, self- or co-regulation mechanisms could be used to complement public legislation. More generally, exploring the role of data in this 'new' economy would appear to be key to understanding platforms' activities and dynamics, including interactions between platforms and with users. According to some participants, data are replicable and not exhaustible (unlike other commodities) and thus do not constitute an economic barrier to entering a particular online market. For others, data constitutes a barrier to entry just like any other, but one that does not necessarily require revision of the competition policy framework. Opinions were also divided on whether the liability regime (i.e. e-commerce/e-privacy directive) was still well designed in today's context, or whether more clarity was needed regarding its implementation.

Red tape was singled out as a major obstacle for digital entrepreneurs, especially where national regulation contradicts European rules. Setting up a company across the EU, opening bank accounts and dealing with disparate VAT rates costs EU start-ups much more than their US counterparts for a similar sized market. Yet, private investment in start-ups is much lower in the EU than in the US.



### *Implications for policy-makers*

A clear consensus emerged on the need for a more systematic common approach to reinforcing consumer protection and competition rules on an EU-wide basis. Participants advocated switching from a procedure-oriented to a more principles-based, outcome-oriented and holistic approach to policy-making. As regards telecoms rules, participants advocated a move from dependence relationships between incumbents and newcomers in order to revitalise competition. While sector-specific telecoms regulation was originally seen as a transitory regime, the time has come to adopt a horizontal and service-based approach.

In creating data-driven infrastructures and consolidating Europe's entrepreneurial scene, more emphasis should be placed on the substantial value added of such businesses to the real economy. Although the digital economy is characterised by an increasing number of software-based companies valued at over €1 billion by public or private market investors, some of those companies are not profitable but entirely venture-capital dependent, which can make their business models questionable in the long term. Counting unicorns is therefore only one measure of the success of the digital economy. Ensuring a more resilient digital start-up economy means looking beyond speculators' dreams. EU policy-makers should stress the importance of integrating new business models into a powerful data backbone infrastructure to help reshape urban communities, for instance through smarter resources management (i.e. with smart metering and grids to help control energy distribution and consumption) and improved transportation systems (i.e. whereby apps offer a better match between supply and demand, or may help monitor traffic and facilitate intermodality). At the same time, however, close attention should be paid to users' protection and access rights.

Disruption was generally seen by participants as a double-edged sword: it is necessary to challenge traditional regulatory frameworks and benefit consumers but it may also dangerously unravel the structural social security nets that have been in place for decades. Legacy regulation at all levels, which sometimes dates back to the industrial revolution, will not be removed overnight and should rather be adjusted smartly. A third way should be drawn by inventing innovative mechanisms that offset the risks of unconsidered social exposure. Similarly, decades of underinvestment and policy denial on digital skills are only now beginning to be corrected. The view of participants was that Europe is facing not just a skills shortage but rather a 'skills crisis' in which market needs are not transposed fast enough into effective public policies for education.

## Regulation & Innovation

### *Introduction*

EU institutions often refer to innovation as the only way for Europe to return to smart, sustainable and inclusive growth. This is both good and bad news, since Europe has been trapped in an ‘innovation emergency’ pattern for two decades. Reviving innovation and entrepreneurship in the EU has become a precondition to achieving other long-term goals. Against this background, regulation stands out as a key driver of innovation. The European Commission has recognised the potential for better regulation to pave the way for innovation-driven investment and is actively pursuing an agenda to use better regulation to promote innovation. Both industry and institutions have invoked the adoption of an ‘innovation principle’ in the EU’s better regulation agenda to oblige administrations to think about long-term innovation impacts when crafting new rules. The single market is another important driver of innovation at the EU level, since a large market is a powerful incentive for invention and innovation. Being able to market an innovative product (whether a good or a service) in 28 member states – the largest market in the world – is certainly an attractive prospect for a would-be entrepreneur.

### *Added value of the discussion*

The relationship between regulation, regulatory governance and innovation at the global and EU level is an ambiguous, multifaceted and ever-changing one. On the one hand, well-crafted rules can spur innovation. Policy-makers should set challenging regulatory targets to tackle societal challenges (such as environmental sustainability and social inclusion) and leave the market free to devise the solutions to achieve such targets. This approach would lower barriers to entry, enhance competition and allow for disruptive innovation. On the other hand, unnecessary rules and related costs are an obstacle to innovation insofar as they crowd out new investments and lead to an inefficient allocation of resources. In that sense, growth and jobs in the EU depend on policy-makers’ ability to cut ‘red tape’. Interestingly, regulatory costs are often generated by national implementation (the so-called ‘gold plating’) rather than by the direct application of EU rules. Hence, cutting regulatory costs requires a broader uptake of the better regulation principles at all levels of government.

High quality rules and their uniform application across the EU are pivotal to a well-functioning internal market, whose full potential is still untapped. More needs to be done to remove the obstacles still hindering the cross-border trade of goods and services and to revive the ‘classic’ Single Market Strategy. An important step to regain political consensus entails the identification and measurement of indicators that are able to capture the multiple benefits generated by the common marketplace. More prominence should also be given to enforcement. For instance, SOLVIT is an interesting service that assists citizens and businesses when their EU rights are breached by public authorities in another member state. Following this example, more effective tools should be devised to empower citizens and companies to detect (and help remove) any barrier to the functioning of the internal market.

### *Implications for EU decision-making*

The current debate on better regulation seems to place too much emphasis on regulatory simplification and cost-cutting rather than improving the quality of EU rules and their effective and homogeneous implementation across Europe. Re-orienting regulation towards innovation and



investment would require an update of the REFIT methodology, and a clear methodological framework for assessing the impact of innovation. This does not mean that the so-called 'innovation principle' should replace the 'precautionary principle'. Rather, they should complement each other since under certain conditions more precaution can lead to more experimentation and innovative solutions to existing challenges. In this respect, the more central role envisaged for public consultations in the EU's better regulation toolkit can improve the overall quality of final rules. Yet public consultations can slow down the regulatory process, making it less reactive to innovation, which by its very nature is a moving target.

In summary, better regulation and stronger market integration are crucial innovation. Better rules are both less burdensome, more 'fit for purpose' and future proof. Improving the functioning of the internal market requires action both to create new markets (e.g. the Digital Single Market, the Energy Union, the Capital Market Union) and to ensure that the 'old' ones still work smoothly. In this sense innovation is a means to an end, the way forward to Europe's economic (and possibly political) recovery.

## Global Trade

### *Introduction*

Mega-regional trade deals such as TTIP, TPP and the further opening of China in bilaterals or via TPP or via plurilaterals (but linked to domestic Chinese reforms) were the main topics of debate on Trade. The global economy is evolving in such a way as to make countries' trade relationships stronger and more focused on the so-called Global Value Chain (GVC). Free Trade Agreements (FTAs) are changing too; the harmonisation or mutual recognition of market regulations and the adoption of global standards are gaining importance in negotiations. In fact, it is only when Non-Tariff Measures (NTMs) are dismantled, together with tariffs and other trade measures, that SMEs can successfully engage in international trade.

### *Added value of the discussion*

Trade agreements are increasingly being used to cut trading costs to access the market. This is implemented by removing non-tariff measures, often by trying to align standards in a wide range of topics not directly related to trade, such as the labour market; environmental standards; data protection and digitalisation; investment protection; and market access. Mega-regional agreements are crucial to these objectives. In this sense, TTIP and TPP represent a major step forward for international trade policy. Referring to this change in FTA negotiations, one discussant said: "Do not focus only on percentage increases in GDP, but on the consequence for our position in the world economy [...] Protectionism does not make any sense anymore due to the Global Value Chain". In the specific case of TTIP, NTMs constitute around 80% of what the negotiations are about. The EU and the US have the most elevated standards worldwide and a well-defined agreement on the latter would make TTIP a new template for future WTO and FTA negotiations.

TPP includes an entire chapter on environmental standards and commitments on labour standards that developing countries (e.g. Vietnam) have signed and promised to implement. Failure to do so would mean the loss of trade privilege with the US and other partners. Through their selective



harmonisation of market regulation, FTAs like TPP are also shaping the investment environment, which has a far greater impact on the economic inclusion of small players and on overall development than trade alone. In the view of one discussant: “With only trade liberalisation there are inevitable winners and losers at sector level, but with negotiations on regulation, it becomes a win-win agreement. That is how you deal with public opinion.”

### *Implications for policy-makers*

China and its reform process are also critical for the success of this trade strategy. TTIP and TPP can exert external pressure to help China, as an economic giant, undertake domestic reforms and stay competitive internationally. China’s economic slowdown and the so-called *new normal* cannot be considered as a Chinese problem only; there are negative spillovers for third countries and global output might be impacted as well. China’s transformation to a consumption-driven economy, the greater use of services and higher quality products will change positions in GVCs as China will gradually move away from being a mere assembling economy. China’s export basket is now much more diversified and the quality of its exports is improving fast too. The EU-China trade relationship is changing accordingly. Besides the structural reform process, the big challenge now is how to tackle the overcapacity issues that negatively affect China’s trading partners.

## Economy

### *Introduction*

The economic challenges currently facing Europe are substantial. The Economy Lab discussed ongoing and potential strategies for three of the key issues: persistent low inflation; the lack of enforcement of fiscal rules; and subdued investment rates.

### *Key points arising from the discussions*

#### *QE one year on - a long-term policy for the ECB?*

Discussants agreed that an evaluation of the effectiveness of QE after one year is still premature, but what seems clear is that under the current framework (negative interest rates, capital key, eligibility criteria of bonds) the ECB will not be able to continue QE for an extended length of time, despite the fact that a central bank’s balance sheet could theoretically be increased without limit.

QE was broadly considered to be a legitimate tool as long as it serves the ECB’s mandate of the 2% inflation target in the medium term; this is a fundamental difference to the Securities Markets programme, which had other objectives and no legal basis.

The view that monetary policy has reached a point of diminishing returns was not fully shared. An expansion of QE was announced by the ECB a few weeks after the Ideas Lab, but there is growing doubt about what the ECB can and should do in terms of additional unconventional measures.

#### *How to instil ownership for fiscal prudence throughout the EU*

The discussion focused on the role of fiscal rules and the legitimacy and accountability issues surrounding further fiscal integration. Panellists pointed to the contradiction between the call for supranational bodies to make EMU sustainable in the long run and the need for decentralisation





and national ownership in fiscal policy matters, and how these issues relate to economic growth and the potential of fiscal policy. On the one hand, the enforcement of rules and legitimacy seemed to go hand in hand and require a decentralised approach to governance, on the other hand, there was agreement that the whole debate about governance should be put in the broader context of growth and job creation.

#### *Can the EU invest its way to recovery?*

Discussants agreed it was still too early to draw conclusions about the effectiveness of the recently launched European Fund for Strategic Investment (EFSI) programme. There was consensus that past and current underinvestment, both public and private, is the result of constrained fiscal space, on the one hand and, on the other, institutional barriers and low confidence following several years of crisis and the new regulatory framework in terms of risk taking.

Panellists stressed the current paradox of abundant liquidity in the market (savings) and weak bank lending (investment). They also raised the question of whether low investment is not only a finance problem but also the consequence of low demand driven by structural changes in the economy rather than by the business cycle. Overall, while the structure of the EFSI and the EIB involvement seem to be guided by correct assumptions and their broad objective is desirable, expectations are fairly low that it will make a substantial difference to strengthening demand.

#### *Implications for European policy-makers*

While both the monetary and fiscal (at the Union level) stance have been expansionary, as measured by the QE and the actions of the EFSI, the effects on the real economy, although difficult to assess, are likely to be small. On the one hand, this can be interpreted as a need to continue with these policies and even consider additional measures. On the other, the lack of effectiveness of either tool to strengthen the economy could lead policy-makers to consider alternative approaches, or even an alternative diagnosis. This should include the acknowledgement that slow growth may be a persistent phenomenon after the crisis, and consideration of the implications this has for the legitimacy of the EU project.

## Social Europe

### *Introduction*

Although the EU has seen substantial reforms in recent years, little effort has been made to create a 'social Europe'. Admittedly, the EU has limited competences in this area, but it should not be overlooked because it contributes to economic and social cohesion, reinforces solidarity and bridges the gap between institutions and citizens. The three sessions on social Europe were devoted to the topics of corruption, inequality and the position of workers in the sharing economy.

### *Key points arising from the discussions*

#### *Is corruption the hidden obstacle to a social Europe?*

Corruption could be one of the reasons that the economic reforms imposed during the crisis have not been effective across all EU member states. It was agreed that this is an important but much-neglected topic. Corruption is not only an obstacle to social Europe but also to investment and growth; it is part of a much broader problem of state capacity and inefficient government spending. It was noted that for the Union to become stronger, public administration needs to function well. Two solutions were put forward: centralisation and transparency. In both areas, the EU has already made some efforts but much work lies ahead, e.g. involving the public in the monitoring of procurement procedures. As one discussant noted: "Corruption is like Nokia, it connects people". Anti-corruption policies and discourse may become part of the problem, however, and could even backfire and generate mistrust. Discussion leaders agreed that political will is needed to address these issues.

#### *Which inequality poses the greatest threat to Europe?*

Although there has been great inequality in Europe for over three decades, the issue came to the fore after the crisis, when convergence turned to divergence for many EU member states. Different forms of inequality were mentioned but the debate mostly concentrated on three topics: poor national institutions, which cannot be tackled by redistribution. Secondly, many countries suffered from a lack of reform of the EU's institutions and functioning during the crisis, which reinforced imbalances in the monetary union. Thirdly, a type of inequality that is often overlooked is intergenerational inequality, which is a huge burden that will fall on the young. Combined with the high youth unemployment in many member states, this could be a real threat for the continent. Discussion leaders agreed that this inequality needs to be addressed in policy.

Memorable Lab quote: "Equality is a legal question, inequality is an economic question".

#### *The sharing economy: Do we need a European approach?*

The so-called sharing economy emerged in the aftermath of the Great Recession, offering new ways of organising work to a growing number of people worldwide. Yet this phenomenon is not new. Episodes of massive unemployment have coincided with the emergence of new jobs from unexpected places, driven by technological change, since the 1970s. The rise of the sharing economy has thus put old issues back on the agenda, such as the protection of workers' rights and status, namely the social protection of workers for tasks performed online. At this point, "the sharing economy is like the Wild West, before a sheriff was elected". It was agreed that regulation



would need to target both the worker and business side of platforms; on taxation, platforms, should be obliged to share information with the authorities.

### *Implications for EU policy-making*

In order to further develop social Europe, the EU needs to continue taking measures to support economic and social cohesion, especially in the areas of state capacity, government spending and inequality. On the sharing economy, more research, clear definitions and a better understanding are needed before regulation is put in place.

## Finance

### *Introduction*

In uncertain times, greater diversity in the financial system provides stability and the necessary funding sources for economic recovery and growth. The financial crisis and the ensuing sovereign debt crisis showed that not only the intensity but also the quality of the financial integration process matters. The retrenchment of financial flows within national borders in recent years became particularly worrisome. Banking Union (BU) and the Capital Markets Union (CMU) are two important initiatives that could lead to more 'sustainable' cross-border financial flows and strengthen the virtuous circle of financial integration, financial stability and economic growth.

### *Key points arising from the discussions*

#### *Capital Markets Union*

CMU should be regarded as a single market project. Many of the barriers that currently hamper cross-border financial transactions require immediate action. Company and financial instruments data should be more comparable across Europe; there should be less discretion in the enforcement of accounting rules (e.g. internal valuation models); a common EU business registry; and a centralised database for company filings and so on. Rather than focus on a single headline tax rate, we should tackle the complexity of reclaim procedures for withholding tax or other procedures for the collection and refund of local taxes. These measures would reduce cost unpredictability in cross-border transactions and allow national differences to coexist with minimal harmonisation effort. In some EU countries, the tax bias in favour of debt could be reversed, with increasing tax incentives/relief for much-needed equity investments. Less discretion in the procedures during insolvency is also preferable. Further consolidation of the financial market infrastructures across business lines is also desirable due to potential synergies and the need to reduce liquidity fragmentation.

Achieving the convergence of supervisory outcomes across the EU may prove very difficult without a more formal mechanism to promote convergence, however. Deeper financial integration may require ESMA's direct supervision in well-defined areas, a stronger role in the peer review process but also more independent management. Proposals on securitisation and covered bonds could allow banks to secure long-term funding to counterbalance the issuance of more costly bail-in-able financial instruments.

*A common deposit insurance scheme*

When the entire banking system of a country is under stress, the accumulated funds in the national DGS (Deposit Guarantee Schemes) are likely to be insufficient. In principle, a common deposit insurance scheme should be better equipped to address systemic problems but this shouldn't be triggered in the first instance. There is a general consensus that the Commission's proposal for a European Deposit Insurance Scheme (EDIS) seeks to break the sovereign bank nexus. Nonetheless, there is disagreement about pre-conditioning the establishment of EDIS to the implementation of concrete measures to further reduce risks in the banking sector, in particular, whether or not banks should be restricted in their holdings of national sovereign bonds. But there are also many national and economic policy measures which, directly or indirectly, affect the risk profiles and thus the solvency of banks. Good implementation of the resolution framework is paramount to reducing both the probability and the amount of loss for the DGS. Additional measures may be required to improve the position of the insured deposits in the event of resolution, i.e. ensuring the loss absorption capacity of banks by requiring a minimum of own funds and liabilities that can be bailed in through regulation rather than the competent authorities' discretionary assessment and embedding the priority position of insured deposits in legislation.

*Cross-border banking*

The integration of wholesale banking was partially undone by the financial crisis. Commercial and retail banking remains largely fragmented along national lines. On the assets side, a strong home bias persists, which is reflected in the loan, bond and equity portfolios. Placing caps on sovereign domestic bonds' holdings may encourage diversification but it poses challenges in terms of the ability of markets to absorb potential sell-offs. QE may provide an opportunity to do this in a less disruptive way. On the liabilities side, this so-called 'schizophrenia' stems from the fact that other than the official financiers (ECB, EIB), most bondholders are domestic. A potential bail-in could trigger a negative feedback loop. At macro-level, evidence shows that banks retrenched from capital flows while institutional investors and asset managers are really taking over. Bank balance sheets are often managed at national level. This often requires an inefficient asset allocation, since banks are only partially able to use their excess deposits in one country to fund their shortages in another country, because of exposure requirements and capital charges. Whether organised as branch or subsidiary, the legal structure still matters in the current context, both from a business and supervisory perspective. Undoubtedly, there is increasing demand for cross-border services by certain customers. Digitalisation and the further harmonisation of regulation and supervisory practices will make it easier to deliver those cross-border services, i.e. products developed in one country can be sold in other countries without an expensive distribution network.

*Implications for EU decision-making*

Banking Union cannot rest on its two first pillars only: the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM). Completing Banking Union involves some mutualisation of risks (through a common deposit insurance scheme) and some form of fiscal backing. While the banking sector is expected to remain the dominant source of finance for Europe's economies, a fully integrated European capital market could provide alternative funding opportunities for firms, in particular for SMEs, and better choices for investors. It could also enhance private risk-sharing in the EU, e.g. equity holdings that are resilient to asymmetric shocks.



## Energy

### *Introduction*

Rapid geopolitical and technological developments both challenge and provide opportunities for Europe's energy system. Energy Union, the EU's main project to address those issues, has delivered some positive results, but more needs to be done. Technological breakthrough in energy storage might accelerate the transition to a decentralised electricity system in Europe, challenging the current status quo and raising questions about who will pay for the grid. Europe needs to do better on estimating its gas demand and plan its infrastructure accordingly.

### *Who cares about the Energy Union?*

The relatively new concept of an Energy Union has become an important part of the EU's policy debate. Built on five elements, it is still focused on the security of supply of natural gas and the internal energy market. Energy Union has already delivered some promising results: the efforts of EU energy diplomacy were crucial in mediation between Ukraine and Russia; connecting cross-border infrastructure was further strengthened and wholesale gas prices have more or less converged across Europe.

There are a number of challenges that still need to be addressed: South East Europe lacks functioning gas and electricity markets and price convergence is not happening. Views on the role of markets, diversification and solidarity continue to differ among member states. This became apparent when discussing different attitudes towards the Nord Stream 2 project.

### *Who will make money on electricity in the future?*

2015 saw a growing number of corporates announcing their intention to enter the battery market and deliver low-cost storage. Combined with cheap solar, low-cost storage offers a possibility to minimise the use of the power grid and limit the amount of electricity purchased from large, centralised power stations. For many residential consumers, self-sufficiency rates of 50% seem feasible. This will accelerate the transition to a decentralised power system in Europe.

In this new reality, all players will change their roles: consumers will become 'prosumers', utilities will focus their activities on the distribution of electricity (rather than generation), while technology providers will become one of the main market players. Utilities may no longer be systemically relevant players in this new reality. This development raises the question of who will pay for the grid and for the long list of cost components in the electricity bill that are totally unrelated to electricity supply – only direct consumers or all taxpayers, through dedicated taxation?

### *How much gas does Europe really need?*

While global gas demand continues to increase, mainly driven by China and the Middle East, gas demand in the EU seems to have peaked in 2010. The main reasons are the economic crisis, declining output in energy-intensive industrial products, the increasing deployment of Renewable Energy Source (RES) in the power sector and energy efficiency measures. Discussions focused on the role gas will play in the transition to a low-carbon Europe.

Two conflicting scenarios were discussed: decreasing vs increasing gas demand in the future. The main reasons presented for a continuing decrease were Europe's climate policies, the further deployment of RES in the power sector and improved energy efficiency in industry and housing. The main arguments presented in favour of an increasing role of gas included lower prices, a switch from coal to gas in the power sector, and the ability of gas to balance intermittent RES flexibly. Given that Europe's track record of estimating gas demand has been poor, new infrastructure needs to be planned in such a way as to avoid stranded assets in the future.

### *Implications for EU decision-making*

- The Energy Union project needs to continue to address challenges in South East Europe, a region lacking functioning gas and electricity markets.
- The developments of off-grid electricity consumption pose the challenge of who will pay for the grid – only direct consumers or all taxpayers, through dedicated taxation?
- Europe's track record of estimating gas demand has been poor. New gas infrastructure needs to be planned in such a way as to avoid stranded assets in the future.

## Climate Change

### *Introduction*

The Climate Change lab focused on three topics, which are closely inter-related as they concern the interactions between international and domestic climate policy: i) COP21: What does it mean for the EU? ii) The state of the EU ETS and iii) Can carbon leakage risk be addressed without international cooperation?

### *Added value of the discussion*

While the French presidency deserves praise for its work in bringing the Paris Agreement into being, much remains to be done to implement the Agreement in the coming years. Intense climate diplomacy will continue to be necessary, especially in the next five years, and the EU can play an important role here. It can contribute by building new partnerships and bringing its experience and standing to the table in areas such as energy technology and carbon pricing, for example during the development of the new mechanism. Other countries have learned from the successes and failures of the EU ETS, but the EU should also look at how others have tried to improve on the European carbon market experience.

Competitiveness and carbon leakage concerns need to be addressed to unlock investment. Sufficient safeguards to limit the risk of carbon leakage help create the necessary investment climate. While at the moment there is no proof that carbon leakage has occurred, the risk is likely to increase as carbon prices rise. Carbon pricing is a useful tool, but cannot work effectively without international cooperation. If carbon leakage becomes more significant, international cooperation may need to be explored.

WTO is a possible forum where this international cooperation can be discussed. At the UNFCCC all WTO members agreed on the need for ambitious climate change action, yet that agreement has not spilled over to the ongoing WTO negotiations. Trade policy should take climate change



concerns into account, and leave room to address the carbon content of traded goods. This could be done by building upon the EU's experience with carbon intensity benchmarks.

### *Implications for EU policy-makers*

The investment climate in the EU needs to change in order to drive on the innovation that is required; important factors here include the feeling of inevitability about the increased stringency of climate change policies and higher carbon prices in the future. The creation of the Innovation Fund in Phase 4 and increased Horizon 2020 spending on research and innovation – especially for energy – are welcome, but insufficient, steps. Low carbon prices also undermine the spending power of the Innovation Fund, and undermine the long-term perception of scarcity in the ETS.

The EU ETS functions relatively well as a market, its short-term environmental targets have been reached, and each regulatory change attempts to strengthen the instrument. It is, however, hampered by past design flaws, such as supply rigidity, which are only being corrected slowly, if at all. The current price of EUAs (€5) cannot drive change, or innovation, towards a low carbon economy. Emissions reductions and the economic efficiency of climate change policy need to go hand in hand, as the current wave of decarbonisation is not happening efficiently and is not driven by explicit carbon pricing, but by other policy areas, most notably renewable energy policy.

The EU's domestic arrangements in terms of timing and ambition need to be matched at the international level. Lifestyle changes, while not popular, may be necessary to reach the 1.5° pathway internationally, and to reach the EU's target of 80-95% reductions in greenhouse gas emissions by 2050.

The international playing field will not be level in the near future, but the Paris Agreement does ensure that it will be far more level than it could have been without the Agreement. Other jurisdictions may still be behind in terms of stringent climate change policies, but they will face significant efforts to ratchet up ambition and catch up with the EU. Significantly, however, the EU is no longer isolated in implementing its climate change policies.



## Rights & Security

### *Introduction*

The Rights and Security Lab sessions tackled the topical and complex questions of migration, asylum and the rule of law. A cross-cutting challenge that was identified throughout the discussions was the lack of adherence to common EU principles and legal standards, both inside the Union and when the EU as a whole cooperates with third countries. The degree to which the EU can safeguard compliance with these common standards will prove crucial to finding sustainable and legitimate European solutions to the current refugee crisis.

### *Added value of the discussion*

Discussions on the EU's migration policy priorities covered cooperation with third countries. Some participants acknowledged that there is not enough Europe in dealing with the current refugee crisis and that EU development cooperation policies have failed to improve conditions in third countries. Another challenge identified was the EU's push for readmission agreements, which constitutes a threat to the human rights of migrants. The conditionality, or 'more-for-more' approach, pursued by the EU in relation to third countries, and the signing of readmission agreements, was seen as a Eurocentric and ineffective approach. In discussions on EU asylum policy there was broad agreement that the Dublin system had failed, even by its own objectives. The relocation plans of the Commission were not seen as a viable alternative, with several participants pointing to the haphazard implementation so far. A post-Dublin architecture and model was therefore seen as being necessary.

All these challenges relate to upholding the rule of law in the EU. The emergence of 'illiberal democracies' in Hungary and Poland also shows that member states' commitment to the rule of law, in the absence of sound monitoring mechanisms, has failed. Discussion leaders criticised the EU for turning a blind eye to the systemic deconstruction of the rule of law in Hungary, whereas Poland was subjected to the new 'pre-Article 7' procedure. The panel was divided on whether the question should be dealt with politically or legally. Some argued that it is more realistic to engage in discussions with national parliaments and, only if they fail, to go for legal sanctions. Others made the point that the EU has a competence to oversee rule of law compliance in *all* member states.

### *Implications for EU decision-making*

When it comes to migration and asylum relations with third countries, some of the proposals identified in the discussions amount to, firstly, the need for more intra-EU responsibility in the approach to the migration crisis, secondly, to shifting the focus of negotiations away from readmission and returns and towards more legal channels for migration and asylum. As for the EU's asylum system, any reform of the Dublin system would necessitate a broader rethink of the Common European Asylum System, such as a central EU asylum service to enhance determination procedures and the mutual recognition of positive asylum decisions. To uphold rule of law standards across the EU, proposed solutions elaborated on the need to set up a new EU rule of law monitoring mechanism and an annual evaluation scoreboard that would benefit from the inputs of an EU Rule of Law Commission of independent experts.



## Institutions

### *Introduction*

The UK referendum on EU membership, the migration crisis, the need to adapt the Union to 'reality' and discussions on EU reform and deeper integration were the main topics of discussion in the European Institutions Labs.

### *Added value of the discussions*

The general public's current perceptions of politics – both at national and EU level – were considered by participants, who noted an overall shift to the political periphery, due to a lack of trust in politicians and public institutions and a generalised feeling of insecurity. Radical, or at least populist, parties are making capital out of citizens' fears – fear of economic instability and unemployment, fear of too many migrants arriving in Europe, fear of terrorist attacks. These parties wish to be seen as alternatives to the mainstream parties, which in many voters' eyes are failing to deliver on the complex challenges facing Europe.

A general consensus during the discussions was that this element of fear should be taken seriously by the more established parties. Should radical parties have a greater say in the political arena than they do now? Mainstream parties have tended to exclude them from official political debate – both nationally and at EU level. But by letting them present their views other parties might actually be able to present stronger counter-arguments. This would require making sure that democratic values are upheld and that radical views do not become 'standardised' in society and in the media. The challenge for mainstream parties now, therefore, is how to engage with radical parties, and how to make voters feel safe.

Another topic of discussion was the nature of the EU integration process. Linked to the above-mentioned issues, the Union's integrationist ambitions are being thwarted by a public that is increasingly sceptical of its institutions and its capacity to solve common challenges. This is illustrated by discussions around Brexit and the questioning of the notion of 'ever closer Union'. Should the EU uphold this as an ambition or not?

It was felt that the overall direction of the EU will not change dramatically simply because of concerns about ever closer Union, but there will undoubtedly be more differentiated integration and a greater uptake of the concept of a *multi-speed Europe*. This is not a new phenomenon, but in view of the challenges to the eurozone, Schengen and enlargement – which are in effect failures of ever closer Union – it is likely that those member states that are wary of differentiated integration will have to accept this as the new reality.

Despite the numerous challenges facing Europe, they will not be the breaking-point for the EU. To respond appropriately to 'reality', both member states and the EU institutions may need to incorporate the concept of differentiated integration into the treaties. But differentiated integration is not enough to solve crisis situations. Tensions between member states need to be overcome because in times of crisis we cannot afford to forget about solidarity; many of today's problems can only be solved by common solutions.

## Europe in the World

### *Introduction*

At a time when policy-planners in the European External Action Service and the foreign affairs ministries of member states are engaged in a strategic re-think about how to endow the EU with a new Global Strategy on Foreign and Security Policy (EUGS), CEPS invited thinkers from China, India, South Africa and the US to present their personal/country's/region's perception of the EU and its supposedly 'Common' Foreign and Security Policy. The question they and the audience considered was *Is the EU 'fit for purpose'* as a strategic player on the global scene and in its geographical neighbourhood.

### *Added value of the discussions*

While being recognised by its strategic partners as an important global actor, the EU still falls short of being seen as a political entity that speaks with one voice. The fact that different member states have different geographical priorities and focus on specific regions in their external policies impedes the EU's efforts to conduct its own cohesive foreign policy. Moreover, some international players (especially those from Africa and Asia) believe that the EU represents countries that are guided, to some extent, by their colonial and imperialistic legacies. China would like to see more interaction with the 'One Belt, One Road' initiative. India, however, asks for patience from the EU in forging stronger bilateral ties while the sub-continent continues its own 20<sup>th</sup> century internal development and modernisation project.

At the same time, the EU's view of itself is rather different from the one held beyond its borders. While pessimism about the EU's future is spread by the English language tabloid press, other global players acknowledge the EU's economic power and engagement in the resolution of various conflicts (particularly by non-military means, if compared to NATO). The US, in particular, is happy with Europe's strong stance vis-à-vis Russia over Ukraine.

Views from participants in the audience added perspectives from other strategic partners, such as Brazil and Canada. While the EU is generally still seen as an important soft power and a partner in building a rules-based international order, it is also perceived by BRICS countries as a 'status quo' power that hampers the modernisation of global governance institutions. The general perception from the outside is that Europeans fuss too much about their internal problems and are held back by what was termed as a 'tyranny of grammar' – the way in which member states in the Council always have to agree by consensus, which often leads to a race to the bottom and bland, compromise statements. What matters most, however, is not the level of internal coherence but whether 'Europe' is seen to act, effectively and on behalf of all. Here, the international jury is encouraging the EU to attach greater belief to its inherent strengths and to develop a rhetoric that is oblivious to whether it comes from Germany, France or the UK.

### *Towards a common defence - when and how?*

The focus of this session was on the current and future set-up of the European Union's Common Security and Defence Policy, because recent security trends in the Eastern and Southern neighbourhood (and beyond) require a stronger EU capacity to respond to and deter crises. Drawing on the CEPS Task Force proposal to establish a European Defence Union, panellists argued that there is a need for the EU to get back to hard power and to face threats with adequate military



capabilities. In the particular case of relations with Russia, panellists stressed the importance of being tough on principles but pragmatic on tools, in order to reduce risks of escalation and prevent the military gap between Russia and NATO from widening. Remarks from the audience focused on important issues such as the possible implications of Brexit on the CSDP, the ways in which NATO and the EU can better cooperate on maritime security in the Mediterranean and address the refugee crisis. Overall, both panellists and audience agreed on the need for a stronger CSDP and its contribution (together with NATO) to territorial defence, but the underlying issue of member states' divergent preferences was not addressed in sufficient depth.

#### *Differentiation in the European Neighbourhood Policy: How far can we go?*

Each time the EU has to resolve the dilemma between normative and pragmatic agendas, the EU appears less predictable and more confusing for other global players. This conflict of agendas is especially evident in the EU's policy towards its neighbours, which has delivered mixed results. The recent review of the ENP focuses on the necessity of stabilisation along Europe's borders, while giving less attention to the traditional 'democracy promotion' agenda. On the one hand, it might provide the EU with more flexible policy instruments, particularly in relations with states that do not seek closer ties to Europe. On the other hand, the EU might lose its credibility as a human rights defender by adjusting its policies and pursuing 'differentiation' with difficult neighbours because the latter are unlikely to include democracy and human rights as part of the cooperation with the EU. As some speakers noted, in spite of significant novelties introduced in the revised ENP – cooperation in a security sector between the EU and partner countries, for example – the revision did not transform it into a breakthrough strategic document. It does not propose much that is particularly new (in addition to the Association Agreements and Deep and Comprehensive Free Trade Agreements) to the more advanced countries of the Eastern Partnership (Georgia, Ukraine, Moldova). However, the main problem of the EU's approach towards its neighbours and the EU's foreign policy remains the lack of consensus on common interests and threat perceptions, and no common understanding of how to deal with the regional players that challenge the EU's policies abroad.

#### *Implications for EU policy-makers*

According to the majority of participants, in order to tackle the aforementioned problems the EU and its member states should devote special attention to the development of the forthcoming Global Strategy to create a truly strategic document that would clearly define and prioritise the EU's goals in the international arena. Emphasis was also placed on developing a stronger partnership with NATO, particularly regarding emerging security challenges (terrorism, cybersecurity, energy security) and on information sharing, with one of the panellists making the point that 2016 is a transformative year for EU-NATO relations. While pursuing its interests abroad, the EU should collaborate more actively with the civil societies of partner countries in order to better understand the needs of their populations. Finally, conference participants argued the need for the EU to reinforce the PR and public diplomacy dimension of its foreign policy. There is an increasing necessity to provide the governments and citizens of foreign states with balanced information about the ongoing political debates within the EU and clearly present achievements in different policy spheres to the international public.

On migration:

How to turn the challenge into an opportunity? The consensus on this issue was for modest ambition. It would be dishonest not to acknowledge the initial costs involved and the fact that it will take time, education and language training to integrate the majority of migrants into labour markets. In fact, as noted by one participant, it is better not to confuse the humanitarian disaster with that of long-term population ageing and related fiscal issues. Indeed, the migration challenge will have to be dealt with – whether or not it is an opportunity.



### Prime Talk on Rebuilding Trust in Transatlantic Cybersecurity

Privacy and cybersecurity are topical issues spanning a number of domains, including law, international relations and technology that are bound into network infrastructures and information systems. The *Rebuilding Trust in Transatlantic Cybersecurity* session discussed the proliferation of conflicts of legal jurisdiction affecting privacy, freedom of expression, consumer protection, intellectual property rights and security. It also underlined the importance of network and information security to the viability of the digital economy as a whole, in protecting critical infrastructures and data flows. Although the US and EU are working closely to establish a more trusted transatlantic market for data, system designers and engineers lack well-defined and standardised tools and practices to mitigate privacy risks while ensuring full network security. The ability to ensure collective security relies mostly on the capacity to share information about threats effectively and, therefore, dialogue on better cooperation between regulatory and law enforcement authorities is key. The concluding remarks focused on the fact that, in principle, EU and US legal cultural heritage and goals were more similar than dissimilar, although more effort is needed to explain the respective regulatory systems on both sides of the Atlantic.

### Prime Talk on The Future of EMU Governance

This session sought to debate the various paths towards enhancing the long-term sustainability of EMU governance. The question was raised as to whether the focus should be on i) increasing the flexibility on rules, ii) achieving stronger coordination, possibly via a Treasury Minister, iii) or creating some sort of EU fiscal capacity. As pointed out during the debate, there are strong economic and political arguments in favour of and against each of these paths. Concerning the creation of fiscal capacity to stabilise the EMU, a consensus seemed to emerge that any attempt to pool resources would require strong rules and control mechanisms in order to prevent free-riding behaviours. While most commentators agreed that more fiscal integration seemed to be required from an economic point of view, the debaters raised the central question of how fiscal integration (be it via common resources or an 'EU Treasury') could be compatible with the fundamental democratic principles of sovereignty.

### Prime Talk on China: Dragging down the world economy?

This session generated lively debate among the speakers and audience since it was one of the hot topics of the week. The speakers agreed that China's growth prospects show a large downside risk and that the slowdown, and importantly the anticipation of it, will have significant repercussions for the world economy. The impact will be felt by EU exporters who have close ties with China, such as Germany, but the strongest and most immediate shock has and will come via commodity prices. Slowing Chinese demand with continued overproduction will cause serious economic disturbances in the emerging market economies. Commentators from the audience disagreed

about whether the recent reforms will reduce Chinese overproduction by any significant amount, since the feared impact on employment and ultimate social tensions will prevent any major restructuring. Nevertheless, most participants shared the view that China will have to reduce its investment rate, which is no longer (if it even had been before) in line with its annual growth rate.

Beside the debate on policy responses it was striking how many experts were optimistic that the slowdown would hamper world trade growth but not bring about another 'recession' on a global scale.

### Prime Talk on Migration: Transforming a Challenge into an Opportunity

Both discussion leaders stressed the fact that Europe is facing the biggest humanitarian disaster since the war in ex-Yugoslavia. There was general agreement that the corresponding response by European member states – or lack thereof – left much to be desired. Equally deplorable was the lack of unanimity behind the modest plan of redistributing migrants voted through in the Council last year in a qualified majority procedure. Both discussion leaders and the audience expressed concerns that member states might not be honouring the human rights commitments set out in the Geneva Convention. On the other hand, it is clear that there is a need to manage and maintain public support and a positive perception of how the crisis is handled. This conflict between living up to agreed international rules on protecting refugees and asylum seekers and a population weary of letting in more than the bare minimum of migrants is real in many member states. However, conventions were drawn up precisely for times of crisis, and are not to be shredded when they are inconvenient.

### Prime Talk on EU Budget Policies and Resources Fit for Europe

Is the EU budget fit for today's Europe? What should be its primary purpose, should it tackle inequality, should it be a shock absorber, or should it contribute to other EU priorities? In presenting the challenges facing the budget the speakers made the point that the last decade challenged the present rationale of the budget's expenditures and resources.

Despite the enhanced flexibility of the current EU budget, it cannot cope with the growing number of EU objectives and expectations placed upon it in these times of crisis. Reforms are needed to ensure that the EU budget focuses on those areas that bring added value and where individual action by member states is less efficient. These reforms should include an overhaul of own resources, because the current arrangement holds insufficient incentive to render the EU budget more effective and to seek actions with European added value.

The open debate showed the growing concern among participants that the EU is not able to respond to serious European challenges, simply because the common means are missing. The issue of military cooperation was also raised, where common capabilities would be cheaper and more effective than the present fragmentation. This session exposed the impossible equation facing the budget: the EU lacks the financial clout and appropriate instruments to support the ever-increasing demands placed upon it.





## Concluding Plenary: The Future of the European Union

The final session opened with a speech by the Dutch Minister of the Interior Ronald Plasterk, representing the Dutch Presidency of the Council of the EU, the main partner in the organisation of the CEPS Ideas Lab.

Speaking only months after the Paris attacks, the Minister called for unity in the fight against international terrorism: “Now is not the time to stand divided”. He stressed that increased intelligence coordination is vital to deal effectively with this ever-growing threat.

Better cooperation is also necessary to cope with the other big issue on the EU's agenda: managing the migration flows into the EU, and addressing the political and humanitarian concerns posed by the refugee crisis – “a crisis that cannot be solved by countries alone”.

His speech was followed by contributions from BBC broadcaster and Director of the China Growth Centre at the University of Oxford, Linda Yueh, and Ivan Krastev, Director of the Centre for Liberal Strategies of Bulgaria, who focused on the politico-economic prospects for the European Union.

Linda Yueh underlined that the world is seeing the growth of large trade blocs, with populations of between 500 million and 1 billion, most recently with the creation of a single market among the ASEAN countries, so “the EU needs to get its skates on”.

The EU should also streamline and render more effective its economic governance system, as “the eurozone has come up with a lot of institutions that could be successful, but will take time to bed in”.

For his part, Ivan Krastev gave an historical appraisal, making the point that while in the past the question used to be “which country will join the EU next?” – now it is rather more a question of “which member state will leave first?”

In his view, the biggest problem the EU will have to face is how to reconcile politics with policies, in a context where “politics is making a dramatic come-back”. In fact, this is an issue that all western democracies are confronted with, and in this respect what is happening in Europe could be interpreted as a crisis of the nation state.

In answer to a question from the audience, the three panellists embarked upon a lively debate on whether the EU is falling victim to ‘referendum disease’. Linda Yueh argued that an EU-wide referendum might be necessary to achieve the legitimacy of institutions, while her co-panellists were rather critical of the excessive use of this direct democracy instrument.

Minister Plasterk pointed out that “Europe can only exist through compromise”, reconciling different positions on complex matters, which can never be achieved in referenda that are by nature centred on binary yes/no choices. Krastev was even more unequivocal on this point, stressing that having more consultations will not lead to more Europe: on the contrary, he warned “if the EU wants to kill itself, then the weapon is multiple referenda”.

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