EUROPEAN POLICY CENTRE

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Post-Summit Analysis

# *A welcome moment of calm in the midst of the storm*


**Summary**

'Unspectacular' is probably the word that best sums up the 17 June European Council, with no immediate crisis to deal with, few headline-grabbing initiatives and no major surprises. But, as this EPC analysis explains, this was a welcome change after months of emergency meetings dominated by the mounting euro-zone crisis, and EU leaders tried to use the occasion to send out a signal of confidence to their citizens, the financial markets and the wider world.


**Full report**

EU leaders normally prepare for Summits by casting around for headline-grabbing initiatives, but not this time. 'Unspectacular' is probably the word which best sums up the 17 June European Council meeting, but that suited them just fine.

For the first time since the start of the year, there was no immediate crisis overshadowing their discussions, they were able to stick to the pre-planned agenda and finish the one-day meeting without going into overtime, and there were no major surprises. After a string of emergency meetings over the last few months, which began with the Greek sovereign debt crisis but escalated into a crisis for the euro zone as a whole and the most serious challenge in the history of European integration, this came as a huge relief.

Just a few weeks earlier, at the summit of euro-zone leaders on 7 May, the EU had found itself on the verge of a financial collapse similar to that triggered by the fall of Lehman Brothers in September 2008.

A €750-billion emergency loan package, unprecedented European Central Bank (ECB) measures and the introduction of tough national austerity measures in many EU countries were required to calm the waters.

In the days and hours before last week's Summit, there was renewed speculation that the crisis might spread. This time it was Spain - current holder of the EU's rotating Presidency - which found itself in the eye of the storm, amid rumours that it was facing severe difficulties in financing its deficit. However, before the Summit began, Spain succeeded in borrowing money on the financial markets and rumours that Madrid would ask for support from its European partners via the €750-billion stability mechanism proved unfounded.

Nevertheless, this latest - but probably not final - chapter in the crisis underlined the fragility of the current situation, and EU leaders were eager to send out a signal of confidence to their own citizens and to the outside world, and to convince global partners and the financial markets that EU was not only ready to rise to the challenge but also able to take concrete decisions.

It was in this spirit that the Summit agreed the Europe 2020 Strategy, endorsed the emerging approach to reforming the EU's system of economic governance and the financial markets, developed a common position for the G20 Summit in Toronto, and addressed a range of other non-economic issues.

## Europe 2020 - progress, but not enough

After postponing a decision at the March European Council, EU leaders finally adopted the Europe 2020 Strategy for "jobs and smart, sustainable and inclusive growth".

The strategy, aimed at boosting competitiveness, productivity, growth potential, social cohesion and economic convergence, will replace the Lisbon Strategy adopted in 2000, which largely failed to meet its core objective - to turn the EU into the world's "most dynamic, knowledge-based economy" by 2010.

In concrete terms, EU leaders reached a political agreement on five headline targets for employment, innovation, climate change, education and poverty:

- increasing the employment rate among 20-64 year-olds to 75%;
- improving the conditions for research and development, with a renewed commitment to increase combined public and private R&D investment to 3% of GDP;
- reducing greenhouse gas emissions by 20% compared to 1990 levels, increasing the share of renewables to 20%, and moving towards a 20% increase in energy efficiency, reaffirming the climate-change targets set in 2008;
- reducing school drop-out rates to less than 10% and increasing the share of 30-34 year-olds who have completed tertiary or equivalent education to at least 40%;
- promoting social inclusion, in particular by reducing poverty, with the aim of lifting at least 20 million people out of the risk of poverty and exclusion.

The decision to set fewer targets than in the Lisbon Strategy and to focus on important drivers for smart, inclusive and sustainable growth are welcome. However, there are three critical points which need to be raised.

First, almost all of these targets ran into problems in the run-up to the Summit. Some were challenged by Member States on subsidiarity grounds (for example, Germany on the education targets); others argued that, in many cases, it is impossible to agree on common standards for 'measuring' the achievement of certain targets, such as poverty.

The resulting compromise is by no means perfect, with, for example, three different indicators of poverty ('at risk of' poverty, material deprivation, jobless households), and with Member States free to pick and choose by setting their national targets on the basis of the "most appropriate of these indicators".

Second, the strategy does not go far enough: a stronger focus on structural reform of public services and public transfers, and closer integration with fiscal policy governance was required.

Political agreement on Europe 2020 is clearly not the end of the story, but rather the beginning of a process, and one core task remains: to link the new strategy to the debate over future European economic governance.

Third, the biggest problem which plagued the Lisbon Agenda has not been solved: implementation. Governance remains the weak point of the new growth strategy. Although it proposes tighter monitoring of national reform programmes, governance is largely in line with the previous model and still relies mainly on the political will of Member States, which remain responsible for implementing the policy priorities set by the new strategy. EU governments were once again unable to agree on concrete mechanisms to ensure they will actually do what they have signed up to.

## Reform of economic governance and financial markets

Not surprisingly, given the sovereign debt crisis, issues related to future European economic governance and reform of the financial system dominated the Summit. Four subjects ranked particularly high on the agenda: closer coordination of national budgets, the publication of bank stress tests, the establishment of a system of levies and taxes on financial institutions, and the introduction of a competitiveness scoreboard.

### *Coordination of national budgets*

Following a European Commission proposal in May, EU leaders agreed to enhance the coordination of national budgets from 2011 onwards. The new peer-review system aims to strengthen the preventive arm of the Stability and Growth Pact (SGP) to avoid a repetition of the Union's current debt debacle. It is part of an overall effort to convince financial markets that Member States' fiscal policies will return to - and remain on - a sustainable path.

Under the new system, surveillance would take place in the first half of the year during a "European semester" before national budgets and economic reform programs are finalised. This is intended to allow the Commission and Member States to comment on - and possibly suggest changes to - national budget plans to ensure they are in line with SGP targets.

However, some EU governments were opposed to submitting a draft budget in Brussels before presenting it to national parliaments. New British Prime Minister David Cameron, attending his first EU Summit, declared that the UK would always present its budget to Westminster first and, at his insistence, the final Summit Conclusions state that the new system will take "national budgetary procedures" into account.

EU leaders also agreed, in principle, to strengthen sanctions for countries with excessively high deficits or debt levels. But what form these sanctions will take has yet to be agreed and it is questionable whether it really is the right way forward. None of the sanctions already foreseen since the Maastricht Treaty have ever been applied in practice, with governments understandably reluctant to impose penalties on other countries facing financial problems.

That is one reason why the Commission has proposed that sanctions should apply automatically in the future. This would certainly increase the pressure on countries that persistently break the rules, but the EU should not concentrate solely on the development and imposition of sanctions. It also needs to focus on creating incentives to 'motivate' national governments to stick to the fiscal goals set by the SGP.

### *Publication of bank stress tests*

In response to a Spanish initiative, which eventually won the support of France and Germany, EU leaders agreed to publish the results of stress tests on European banks. Madrid decided to publish the results of its national stress test to counter mounting concern about problems in the Spanish savings-bank sector, and argued others should do the same. "The best way of gaining the highest level of confidence is transparency," insisted Prime Minister José Luis Zapatero.

The agreement on this issue was one of the very few surprises of the Summit. The move aims to strengthen market confidence in the European banking sector, with the EU now following the American example, albeit after some delay: the Obama administration's decision last year to publish the results of a stress-testing exercise has been widely credited with improving market sentiment and confidence in the US banking system.

The European stress-test exercise now underway covers major financial institutions deemed to be of 'systemic' relevance, and the results will now be published by the end of July. Representatives of major European banks and banking associations openly opposed the move because of concerns about potential misinterpretations and negative consequences for European banks - especially in Greece and Spain - but EU governments, supported by the ECB and the International Monetary Fund, appear convinced that full transparency is necessary to improve market sentiment and confidence in the European banking sector.

***Introduction of financial levies***

Going further than had been anticipated, the European Council agreed that Member States should introduce a system of levies and taxes on financial institutions. The new system aims to ensure fair burden-sharing by including banks' contribution to future bail-outs and to set incentives to contain systemic risks. Precise details still need to be worked out, with concrete proposals expected by October.

European Council President Herman Van Rompuy declared after the Summit that Member States would "go forward" even if there is no agreement on this at a global level, but some EU governments - including the Czech Republic and Italy - are insisting that there must be agreement in the G20 framework (hence the footnote in the Summit Conclusions stating that the Czech Republic "reserves its right not to introduce" a system of levies and taxes on financial institutions).

Prague wants more details of how the new system would work before signing up to it and also has concerns that bank customers - rather than the banks themselves - will end up footing the bill. But the UK, France and Germany have indicated that they may follow the Swedish example and unilaterally introduce a bank levy even if there is no agreement in the EU or beyond.

***Competitiveness scoreboard***

Turning to macroeconomic surveillance, EU leaders endorsed the Commission's proposal to develop a scoreboard to "better assess competitiveness developments and imbalances" and allow for early detection of "unsustainable or dangerous trends". This regular scoreboard would rank the relative competitiveness of Member States, and the Commission has proposed warning euro-zone members when their policies do not favour strengthening their national competitiveness.

The details of this peer-review mechanism have yet to be agreed, making it far too early to judge its potential added value. It is clear that the increasing competitiveness gap within the EU has contributed to the current euro-zone crisis, but doubts remain over whether the introduction of a scoreboard would substantially motivate weaker EU countries to increase their competitiveness *vis-à-vis* other Member States. It is also unclear whether stronger EU economies would recalibrate their national policies to reduce major trade imbalances, which are in many ways the result of the growing divergence of competitiveness in Europe.

**The bumpy road to economic governance**

On some points, the European Council Conclusions reflect the outcome of first meetings of the Task Force on future European economic governance chaired by President Van Rompuy, who presented a first progress report at the Summit. The group, which is scheduled to hold its next meeting on 12 July, still faces many hurdles before delivering its final report in October.

The long list of controversial issues includes:

- the enhancement of economic policy coordination, including a joint assessment of developments related to competitiveness and trade imbalances;
- the possibility of imposing political sanctions, including (for example) the German proposal to withdraw the voting rights of countries which repeatedly ignore deficit reduction recommendations;
- the introduction of tougher and earlier financial penalties, including (for example) the suspension of EU Structural Funding;
- the definition of a procedure for 'orderly state insolvencies' proposed by the German Finance Minister Wolfgang Schäuble in his nine-point plan;
- the creation of Eurobonds (such as 'blue and red bonds'), an idea supported by President Van Rompuy and Eurogroup President Jean-Claude Juncker, but rejected by France, Germany and a number of other euro-zone governments;
- the introduction of a permanent European crisis resolution mechanism (for example, a 'European Monetary Fund') when the current, temporary mechanisms expire;
- the suggestion that private debt levels should be taken into account in the EU's new fiscal rules, made by countries such as Italy which have high public debt but low private debt ratios compared to other Member States.

One fundamental issue which still needs to be settled is whether the new system of economic governance will require changes to the Lisbon Treaty.

Berlin, backed by Paris, has argued in favour of reforming the EU's primary law if this proves necessary. This could be done within the framework of the Croatian Accession Treaty to avoid the 'adventure' of yet another Convention and/or complex Intergovernmental Conference. However, most governments are eager to avoid another round of treaty reform after the painful experience with the Constitutional and Lisbon Treaties. They are fearful of opening a Pandora's Box and want to focus instead on what can be done quickly and within the framework of the existing Treaties - a position supported by both President Van Rompuy and the Commission.

What seems to be off the table - at least for the time being - is the French proposal to hold regular meetings of euro-zone Heads of State and Government and turn them into a *gouvernement économique* with a separate secretariat.

French President Nicolas Sarkozy has been pushing for meetings of a "Eurogroup Council" to be part of the Union's institutional machinery and able to take autonomous and binding decisions - an idea firmly rejected by German Chancellor Angela Merkel on numerous occasions, including at a meeting with President Sarkozy just a few days before the Summit.

There are two main reasons why the German government is eager to avoid a further differentiation between euro- and non-euro countries. First, Berlin fears that a strengthening of the Euro-16/17 would shift the balance of power in the EU towards France and the southern European rim, as most new Member States in Eastern Europe have not yet adopted the common currency. Second, it fears that establishing a *directoire* would create a deep split within the EU - a concern shared by non-euro countries, which fear that they would be marginalised in a two-speed Europe dominated by the euro-zone countries.

A vast majority of Member States insist that decisions on the Union's economic policy should be taken in an institutional framework which includes all 27 EU countries. But this does not rule out holding occasional euro-zone 'summits' if need be - something that has happened several times since the crisis began even though such meetings are not foreseen by the EU Treaties.

**On the road to Toronto**

Just days before the 26-27 June G20 Summit in Toronto, EU leaders discussed their approach to the meeting and agreed a common position.

This fourth gathering of the G20 heads of government is likely to be dominated by two key issues: progress on coordinated reform of the financial system and how to square the need for fiscal consolidation with the need for continued economic growth.

On the reform of the financial system, EU leaders pledged to lead efforts to introduce levies and taxes on financial institutions. The EU will ask the G20 to agree that banks should pay a special tax to contribute to the costs of potential future crises. After the European Council agreed to push ahead with a system of bank levies, President Van Rompuy declared: "We have a common position of all European countries, and we are determined to defend it in Toronto."

However, there is no great optimism that the G20 will follow suit. The idea is popular in the United States, but Australia, Brazil, Canada, China and Japan are opposed and the EU will find it hard to persuade countries such as Brazil or China which did not have to bail out their own banks after the collapse of Lehman Brothers in 2008 of the merits of such an approach.

The Summit Conclusions also refer to the idea of a global financial transaction tax, stating that this "should be explored and developed further" in the context of the G20. This sentence was added on the day of the Summit and is formulated very vaguely, as there is no consensus on this issue among Member States. It is supported most strongly by Germany, France and Luxembourg, which have publicly declared their readiness to introduce such a tax even if there is no agreement in the EU or in the G20 framework; but other EU countries, especially the UK, are strongly opposed. It seems highly unlikely that there will be global agreement on this issue in Toronto, not least given US opposition to the move.

The second issue likely to dominate the G20 Summit concerns squaring the need for fiscal consolidation with the need for continued economic growth. The Conclusions state that the G20 should agree on a "coordinated and differentiated exit strategy to ensure sustainable public finances".

This issue is likely to prompt fierce debate in Toronto, in light of recent US criticism of the tough austerity measures announced by numerous EU governments to reduce public deficits and debts. The Obama administration fears that a rapid and drastic return to fiscal austerity could cause a new global slowdown, with US Treasury Secretary Timothy Geithner warning of the need to strike a balance between financial austerity and continuing growth incentives. There are also mounting US concerns that major EU countries are exporting their problems to the US, as Europeans benefit from large transatlantic trade imbalances and this trend is likely to continue given the euro's weakness and the low levels of private consumption in many EU countries.

**From 'climate euphoria' to 'climate fatigue'**

The European Council took note of the Commission's communication analysing the potential consequences of moving from a 20% reduction in greenhouse gas emissions to 30% and the risk of 'carbon leakage'.

The communication argues that moving from 20 to 30% is both affordable and technically feasible, not least given the impact of the economic slowdown on emissions: the Commission estimates that the cost of meeting the 20% target has fallen from €70 billion a year until 2020 (the initial forecast made in 2008) to just €48 billion. It also says that moving to a 30% target would now 'only' cost an extra €11 billion (on top of the €70 billion originally envisaged). The Commission's analysis of the risk of carbon leakage - i.e. that companies would move from the EU to countries with laxer rules - suggests that this is rather low.

It nevertheless seems unlikely that EU governments will agree to move to the more ambitious target. The political climate has changed dramatically since 2008, with the financial and economic crisis and the frustration caused by the Copenhagen debacle prompting 'climate fatigue' in many Member States. The number of EU countries opposed to further unilateral climate change measures has increased, with Germany and France announcing that they would only support moving to a 30% target if other nations make comparable efforts - and that is unlikely to happen in the near future.

**Beyond the economy**

The focus on economic and financial affairs overshadowed a number of other issues on the Summit's agenda which deserve a mention.

The European Council welcomed the Commission's positive opinion on Iceland's application for EU membership and decided that negotiations should be opened. It also welcomed the Commission's proposal that Estonia should become the $17^{th}$ member of the euro zone on 1 January 2011, with EU leaders hoping that this will send a positive signal to the financial markets by showing that the common currency is not losing its power of attraction despite the recent turmoil.

The Summit also reaffirmed Member States' commitment to meet the Millennium Development Goals by the 2015 deadline, in the face of claims by NGOs that governments are using the financial crisis as a pretext to shirk their development aid commitments. The European Council agreed to return to this issue annually from now on.

EU leaders also expressed their appreciation for the work of *Project Europe 2030* Reflection Group chaired by former Spanish Premier Felipe Gonzalez, but did not decide to initiate any concrete follow-up measures on the basis of the Group's report, which now risks simply gathering dust on the EU's shelves.

By contrast, the Summit Conclusions explicitly welcome former Internal Market and Competition Commissioner Mario Monti's report on a new strategy for the Single Market and the Commission's intention to follow this up with concrete proposals, promising to come back to this issue in December.

In the foreign policy arena, the European Council adopted a Declaration on Iran endorsing an earlier decision by EU foreign ministers to adopt strong sanctions to accompany and support United Nations Security Council Resolution 1929.

EU leaders underline their concerns about Teheran's nuclear programme and reaffirmed the EU's intention to impose new restrictive measures on Iran, with concrete measures due to be adopted at the next Foreign Affairs Council meeting on 19 July. The sanctions will focus on trade, the financial sector, the transport sector, key parts of the gas and oil industry, and new visa bans and asset freezes. But EU leaders also confirmed their commitment to work for a diplomatic solution.

Finally, unnoticed by the wider public, just seven months after the Lisbon Treaty entered into force, the European Council adopted a procedure to amend it, in order to increase the number of MEPs to 754 (three more than foreseen under Lisbon) until the end of the current European Parliament term in 2014. This amendment became necessary after the June 2009 EP elections were held under the Nice Treaty provisions, which limited the number of MEPs to 736. Lisbon increased the number of MEPs from 12 Member States and Germany has been allowed to keep its current total of 99 MEPs till 2014, when the number will be cut to 96 as foreseen by the Lisbon Treaty.

To introduce these transitional provisions, EU leaders agreed to hold a 'technical' Intergovernmental Conference (IGC) to provisionally adapt the total number of MEPs before the end of the Spanish Presidency. The European Parliament had already agreed not to convene a Convention, given the limited nature of the proposed amendments. This treaty revision will need to be ratified by every Member State.

**The Spanish Presidency - the end of an era**

As is so often the case, the Spanish Presidency began in January with a very ambitious but not particularly focused agenda. The long list of priorities included economic recovery and job creation, with the Europe 2020 Strategy top of the agenda; implementation of the Lisbon Treaty; expanding European citizens' rights and freedoms, with a particular focus on gender equality and gender violence; and strengthening the EU as a global player, focusing on its relationship with Latin America and establishing the European External Action Service.

Spain's record since then has been rather mixed. However, one should bear in mind that Madrid had to operate under difficult circumstances, burdened by two major factors.

First, it was the first country to hold the rotating Presidency since the Lisbon Treaty entered into force, and had to adjust and define its role in the new institutional set-up. Given the new limitations on the rotating Presidency's role - with some key functions taken over by the new semi-permanent European Council President and the double-hatted EU foreign policy chief - Spain might have been tempted to obstruct the functioning of the new system in a mistaken attempt to preserve a legacy of the past. But it did not succumb to the temptation and deserves praise for playing a constructive role in this important first phase of transition from the Nice to the Lisbon institutional architecture.

It was against this backdrop that the Spanish Presidency was confronted with the most serious challenge in the history of European integration: a sovereign debt crisis which has revealed some of the major weaknesses in the European construction.

Spain was not only in the Presidency hot seat when the crisis struck, but also found itself at the centre of the spreading financial storm. This made it difficult for Madrid to steer both the immediate crisis management and the more fundamental debate about reforming European economic governance. That task fell instead to President Van Rompuy, with the Spanish Presidency doomed to play a secondary role.

Altogether, the Spanish Presidency marked the end of an old era and the beginning of a new one. Future rotating Presidencies will continue to play a key role in the organisation of sectoral Councils and the coordination of policies in COREPER, but they will no longer be in the EU's driving seat.

This may be difficult for some of them to swallow, but is in fact good news, especially in view of the upcoming Belgian Presidency. In light of 13 June election results, Belgium is likely to be governed by an interim caretaker government at least until September 2010 and it will take several months for the country's divided political parties to agree on a coalition programme.

In the past, such a political vacuum would have prompted concerns that the EU system would severely suffer from a lack of leadership. The new institutional system means this is no longer such a worry. The Presidency programme has been agreed and the government has already announced that the Belgian Presidency will take a back-seat role to EU foreign policy chief Catherine Ashton and President Van Rompuy, who was of course Belgian prime minister until late last year - a neat historical coincidence!

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