

## Greece back on centre stage: the results of a *déjà vu* summit

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### Summary

The March 2015 European Council might not enter history books, but the outcome of an informal 'mini summit' between seven EU leaders has the potential to prepare the grounds for a breakthrough in the negotiations between Athens and its lenders. In this post-summit analysis, Janis A. Emmanouilidis argues that the search for a compromise promises to be a cumbersome, time-consuming and nerve-racking exercise. But a solution now seems possible, proving all those doomsayers who have been predicting a 'Grexit' or 'Graccident' wrong. On other topics, EU leaders committed their countries to build an Energy Union, although questions remain about whether member states will agree to cede sovereignty on a number of significant points. This analysis looks also at the economic issues dealt with at the Spring Summit, with a focus on the perspectives for the European Semester and the Juncker Investment Plan. It ends with a summary of decisions taken on a number of other topics, including relations with Russia and Ukraine, the upcoming Eastern Partnership summit, developments in Libya and in Tunisia, and the endorsement of the Council's new Secretary General.

### Full report

Despite the fact that EU leaders dealt with a long list of diverse topics, the European Council meeting on 19-20 March 2015 was one of those gatherings of EU leaders that will not find its way into the history books – although the potential consequences of a failure could have been severe for the future. This has to do with an issue that was not even foreseen on the original agenda, but now has re-entered centre stage after a period of relative calm in 2013/2014 – the 'Greek crisis'. The Spring European Council was a reminder of the early years of the 'euro crisis' when Greece was a constant subject at countless EU summits. The risk of an escalation of the Greek crisis had prompted the President of the European Council, Donald Tusk, to accept the request of the new Greek Prime Minister, Alexis Tsipras, to arrange an informal meeting between Tsipras, Tusk, Chancellor Merkel, President Hollande, and the Presidents of the European Commission, the European Central Bank (ECB) and the Eurogroup.

The fact that 26 EU leaders were not invited urged severe reactions from a number of heads of state or government and delayed the start of the European Council meeting. The prime ministers of the Benelux countries were particularly outspoken, expressing their annoyance with the fact that they had not been invited to the exclusive meeting with the Greek prime minister – a 'mini summit' with potentially severe repercussions for the euro area and the EU as a whole.

In terms of its outcome and although many issues remain uncertain, the rather extensive meeting with Alexis Tsipras could provide the grounds for a breakthrough in the impasse between the new Greek government and its lenders that had gradually emerged after the elections of 25 January. This does not mean that negotiations in the upcoming days, weeks and months will be easy. On the contrary, the search for a compromise promises to be a cumbersome, time-consuming and, at times, nerve-racking exercise. However, it now seems much more likely that a compromise is possible and that all those doomsayers, who ahead of the Summit speculated that negotiations would collapse and that Greece would have to leave the euro, will (once again) be proved wrong.

A number of positive signals from the Summit indicate that EU leaders will aim to avoid a 'Grexit' or 'Graccident', as they fear the incalculable negative economic, financial, political, and especially

geopolitical consequences for both Greece and the euro/EU in case the situation would spiral out of control. One can only speculate about the potential cornerstones and details of a future deal between Athens and its lenders, but one thing seems certain: the design and subsequent ratification of a new arrangement is likely to be a very difficult exercise from now until the summer, although prospects have improved after the 'meeting of seven'.

Besides the Greek crisis, two other issues preoccupied the Spring European Council: Energy Union and issues related to Europe's economy. EU leaders committed themselves to building an Energy Union on the basis of the Commission's framework strategy, which has the potential to be one of Europe's major projects in this political cycle. However, EU institutions and member states, who have not set a specific target date for its completion, still have a long way to go before the Energy Union will be worth the name. And some important limits, like the choice of the energy mix, will not be overcome, signalling the member states' reluctance to cede sovereignty in an economically and politically delicate policy field.

Day 2 of the Summit was largely devoted to economic issues as EU leaders concluded the first phase of the 2015 European Semester; discussed the Commission's Investment Plan; and were updated on the state of affairs regarding TTIP negotiations with the US. In terms of the European Semester, in almost all EU countries the implementation rate of country-specific recommendations remains low, which means that more substantial reforms are needed to make it more effective. Regarding the Commission's ambitious Investment Plan, its basic concept points in the right direction, but its overall potential is in danger of being undermined by a number of factors, making it unclear whether the European Fund for Strategic Investments (EFSI) will live up to its expectations.

This analysis addresses all these topics in more depth. It also briefly summarises some of the other issues on the agenda: relations with **Russia and Ukraine**, preparations for the upcoming **Eastern Partnership** summit, developments in **Libya**, the recent terrorist attack in **Tunisia**, and the endorsement of the **Council's new Secretary General**.

### **The meeting of seven – on the way towards a new agreement between Greece and its lenders?**

Although it was not even on the European Council's original agenda, the 'Greek crisis', which had once again reached centre stage in the weeks before the meeting, with speculations about an (accidental) Greek exit ('Grexit'/'Graccident') dominating headlines, became the major point of public attention. Following a request from Alexis Tsipras, President Tusk altered the Summit's schedule and arranged an informal meeting between them, Chancellor Angela Merkel, President François Hollande, Commission President Jean-Claude Juncker, ECB President Mario Draghi, and the President of the Eurogroup, Jeroen Dijsselbloem.

The 'meeting of seven' started at 10.30pm on Day 1 of the Summit and lasted for around 3 1/2 hours. Details of the exact content of discussions were not made public, but gradually leaked in the days after the Summit. Following the meeting, Presidents Tusk, Juncker and Dijsselbloem merely issued a short statement saying the participants "fully adhere" to the Eurogroup's 20 February 2015 agreement, and that everyone was committed in the "spirit of mutual trust", to speed up the work on completing the review and concluding negotiations as fast as possible.

Prime Minister Tsipras had asked for the meeting with key EU leaders for a number of reasons. First, with Athens facing a severe cash crunch, he wanted to speed up the review process so that Greece would get access to additional funding. In the run-up to the Summit, Greece had found itself under severe liquidity pressures with difficulties in servicing its financial obligations including repaying its debts. The Greek government was hoping that bringing forward the review would enable it to avoid a sovereign default by (i) freeing the disbursement of funds from the remaining €7.2 billion of the second bail-out programme, (ii) appropriating the €1.9 billion from ECB gains arising from net interest income of Greek securities purchased under the Securities Markets Programme (SMP), or (iii) increasing the present ceiling of €15 billion on the issuance of short-term bonds, which are currently purchased mainly by Greek banks and have become the main source of liquidity as long as the country is unable to borrow from money markets.

Second, as the political climate between the new Greek government and the other members of the euro area had deteriorated in the weeks ahead of the Spring European Council, Prime Minister Tsipras wanted to publicly showcase

that his government was not isolated. He also wanted to show that ‘real negotiations’ were taking place at the (highest) political level in Brussels, rather than with technocrats from the ‘old troika’ (Commission, ECB and International Monetary Fund (IMF)).

Third, he wanted progress in the negotiations to counter the increasing uncertainty about the country’s future inside the euro area, which has already severely affected the real economy, the level of tax collection, and the banking sector (which has suffered severe capital outflows and depends on Emergency Liquidity Assistance (ELA) from the ECB). Latest estimates indicate that the deposits in Greek banks have declined from €164 billion in November 2014 to around €135-140 billion today – on top of even bigger outflows since the onset of the ‘Greek crisis’ in 2010.

In the meeting, Prime Minister Tsipras agreed that his government would present a “full list” of specific reforms in the next days, without specifying a date. This list will then have to be further specified and agreed with the institutions before the government can receive a financial lifeline. The statement says that “policy talks” will take place in Brussels in the framework of the ‘Brussels Group’, and that technocrats will carry out fact-finding missions in Athens. Finance ministers in the Eurogroup will be the ones to take the binding decisions.

Despite the decision to speed up negotiations, there are a number of major questions and uncertainties about both the agreement reached at this informal meeting and the interpretation of the earlier Eurogroup statement on Greece:

- **Unclear content of the “full list” of reforms:** It is not clear how many, and what kind of proposals the Greek government will put forward. EU partners expect the Greek authorities will now be ready and able to present a comprehensive, detailed list including concrete estimates of fiscal costs/revenues that come from implementing or withdrawing precise structural reforms.

According to reports by Peter Spiegel (Financial Times), Prime Minister Tsipras opened the meeting “with demands for additional cash with few strings attached”, but his counterparts quickly made it clear that this was “unachievable”. In February Athens had already promised to present proposals and that these measures/actions would not undermine the fiscal objective of retaining a primary surplus for 2015 and beyond.

In his press conference after the Summit, the Greek Prime Minister signalled that the list would include measures to improve the efficiency of the public sector, counter money laundering and tax evasion (including in-depth investigations regarding the so-called “Lagarde list”), tackle corruption, and introduce further measures to ease the humanitarian crisis. But he stressed that his government would not commit to any “recessionary reforms”, such as increasing VAT or further cuts in social expenditure. Reports in the Greek media suggest that Greek authorities are working on a 50-page list of detailed proposals.

In terms of the humanitarian crisis, the European Commission has offered to make a quick disbursement of up to €2 billion for projects addressing this crisis, with an emphasis on measures to support (youth) employment and economic growth.

- **Timing and conditions for further financial support:** It is not clear when and under what conditions Greece will receive the much-needed additional financial support from its lenders. However, the ECB has made it clear that financial relief is unlikely to come from issuing additional short-term debt obligations. The Bank has already indicated that it is unwilling to grant the issuance of more ‘T-bills’ above the agreed ceiling of €15 billion. This means the Greek government only has the option of freeing money from two other potential funding sources.

In her press conference after the Summit, the German Chancellor repeatedly quoted the Eurogroup 20 February agreement, which says that any disbursement of the outstanding tranche of the current EFSF programme and the transfer of the 2014 SMP profits requires an “approval of the conclusion of the review” by the institutions. And the (partial) disbursement of both would require Eurogroup approval.

In this case, when can Athens expect the transfer of funds required to honour its financial obligations in light of fact that the government might run out of money? This question remains unanswered: Tusk, Juncker and Dijsselbloem's statement merely says that the Eurogroup is ready to reconvene as soon as possible.

There was speculation that euro finance ministers might meet on 27 March, i.e. one week after the Summit, to lay the grounds for disbursing the ECB's SMP profits. But it is doubtful that this would give the Greek authorities enough time to present a detailed list of measures, and it is also unclear which preconditions will have to be fulfilled for decisions to be taken by the Eurogroup. In addition to a "full list" being submitted and accepted it will most certainly require that the Greek parliament agrees to implement "prior actions" before additional funds are transferred. Some unconfirmed sources argue that the seven leaders already discussed which reforms could pass Greek Parliament in the immediate future.

- **Squaring the circle between sovereignty and control:** One key question to be settled is how much room for manoeuvre the Greek government will have when presenting and implementing its reform proposals. This issue goes beyond semantics related to the term 'troika'. The statement issued after the 'meeting of seven' merely says that Greek authorities will have "ownership of the reforms", leaving ample room for interpretation.

The Greek government has already committed itself to refrain from any rollback of measures and unilateral changes that would "negatively impact fiscal targets, economic recovery or financial stability". However, the introduction of measures to counter the humanitarian crisis (including food stamps and free electricity to those hit hardest by the crisis) worth around €200 million (i.e. much less than the amounts promised by SYRIZA in the electoral campaign) and a 100-installment payment scheme for taxpayers to settle their debts to the state (aiming at collecting immediate state revenues of €800 million) led to complaints from Greece's partners in the days before the Summit that the government was employing unilateral actions.

In more fundamental terms, one must ask what kind of balance can be found between the Greek government's quest to expand its political room of manoeuvre to implement its (leftist) economic reform agenda and the lenders' wish to ensure sufficient and continuous control in the absence of trust *vis-à-vis* the Greek authorities. Greece's lack of ownership and the public perception that reforms had been imposed from the outside were key shortfalls for the implementation of previous bailout programmes, as this undermined public support and allowed previous governments to argue that reforms had been imposed from the outside.

It is in both the Greek government's and its partners' interest that any future structural reforms are perceived to be in the country's genuine interest, while lenders are still able to verify that the Greek authorities are implementing what has been commonly agreed. It is still very unclear how both Greece and the institutions will be able to square the circle in practice, so it is therefore no surprise that a great part of the discussions between Tsipras and the other leaders centred on the practical arrangements for the fact-finding missions in Athens. In this context, Presidents Draghi and Juncker complained strongly that Greek authorities had been uncooperative and that the institutions' representatives had been mistreated in the weeks leading up to the Summit. Prime Minister Tsipras was also advised to do his best to stop anti-EU rhetoric coming from some cabinet members.

- **Content and nature of a new arrangement/agreement:** Finally, it is necessary to clarify what will happen when the four-month extension of the current agreement runs out at the end of June. The extension granted in February will help bridge the time for discussions on a possible "follow-up arrangement" between the Eurogroup, the institutions and Greece.

Given the current state of affairs, it seems likely that Athens will require a new agreement. But it is not clear what this new arrangement will entail in detail, raising some difficult questions. Firstly, will the new arrangement foresee additional financial assistance and if so, how much will be needed, under which conditions will it be granted, where will it come from, and how will its implementation be monitored? While Finance Minister Yanis Varoufakis has repeatedly argued that Greece will not ask for additional financial support, how will Greece be able to pay all its bills after the current agreement runs out?

Secondly, will EU partners agree to reduce the agreed primary surplus targets for 2015 and beyond? The Eurogroup statement on Greece merely states that the 2015 surplus target of 3% will “take the economic circumstance in 2015 into account”. This seems to imply a lower surplus target for 2015, but what will happen in the future to the target which has been set at a very ambitious level of 4.5%? Last, but certainly not least, will both sides agree to some kind of (additional) debt relief?

The many unanswered questions and uncertainties indicate the magnitude of the challenges ahead and that negotiations in the upcoming weeks and months will not be easy. However, the Summit gave a number of positive signals that a compromise might be possible: the mere fact that Tsipras, Merkel, Hollande, Juncker, Tusk, Draghi, and Dijsselbloem met signalled that key EU leaders are ready to cooperate with the new Greek government; the atmosphere in which this meeting took place seems to have been constructive, honest and amicable; and the fact that Chancellor Merkel has invited Prime Minister Tsipras to visit Berlin in the week following the Summit provides the chance to deepen discussions. In the words of President Tusk: “This was not a meeting to take decisions, but to have a reality check and to avoid misunderstandings at the highest political level. We had a constructive and honest exchange. [...] I believe this was an important meeting, in which we managed to rebuild trust.”

The meeting of seven indicated that all sides want to identify solutions and that EU partners are ready to grant the newly-elected and still inexperienced Greek government more time, despite the negative impressions it made in many EU capitals in its first weeks in office. Nevertheless, the search for a compromise promises to be a cumbersome, time-consuming and at times nerve-racking exercise.

Following the informal meeting, Merkel, Hollande and Tsipras were eager to send the message that now the time had come to de-escalate and look ahead to seek jointly-agreed solutions. The fact that Merkel and other EU leaders took the time to sit down with Prime Minister Tsipras, despite the dissonances of recent weeks, especially between Athens and Berlin, was a symbolic success for him and significant in terms of political communication – something other leaders are very consciously aware of. It allows him to show his home audience that he is defending national interests and Greek sovereignty, which is politically important considering the high pressures on him and his government, especially from certain parts of SYRIZA critical of a compromise with lenders.

It seems likely that all those doomsayers, who in the weeks ahead of the Summit speculated that negotiations would collapse and Greece would default, leading to a bank-run forcing the country to leave the common currency, will once again be proved wrong. While the risk of a Grexit or Graccident should not be ignored, it seems that EU leaders, who will have to take vital decisions for the future of their country and the EU as a whole, will aim to avoid this outcome for a number of different reasons.

From the Greek perspective, an (involuntary) exit from the common currency could have devastating economic, social and (geo-)political effects. It is thus no surprise that a vast majority of Greeks has always been in favour of the country remaining in the euro area. This majority, which to a large extent has – at least up till now – supported Alexis Tsipras’ approach, wants the Greek government to defend the country’s interests, while not endangering its Eurozone and EU membership. They want the government to avoid a fundamental rupture, because they fear the manifold potential negative consequences of a Grexit. The newly-elected government is aware that the electorate would rapidly turn against it in case it fails to live up to this expectation.

People in Greece fear that an exit from the euro would lead to problems in the banking sector, (very) high levels of inflation, massive and repeated currency devaluations, increasing import prices, unsustainable levels of external debt, and limited access to capital markets. These could lead to massive corporate defaults with even more severe negative effects for the country’s growth and employment perspective.

Exiting the common currency would not in itself increase the competitiveness of the Greek economy, as other factors, including the macroeconomic, institutional and bureaucratic environment, are equally important. Re-introducing and devaluing a new national currency would not solve the underlying fundamental structural problems, so Greece would have

to continue introducing painful reforms and suffer the negative effects of fiscal consolidation, but outside the EU's core and without the stabilising framework of a strong currency.

All these potential consequences of a Grexit, could lead to even higher levels of pauperisation and to social and political unrest, undermining the country's internal and external stability.

From the perspective of Greece's partners, the country's departure from the common currency could have incalculable economic, financial, political, and geopolitical effects/costs, even if the euro area seems more resilient today than it was at the height of the crisis in 2012. It could challenge the notion that the euro is irreversible and spark a renewed bout of market speculation about which country might be next. In the worst case, this could result in a negative spiral, which could eventually force more countries to leave the euro with negative effects for the stability of the euro and the EU in general. One cannot exclude the possibility that an escalation of the 'euro crisis' could have strong negative spill-over effects on other policy areas, including the Single Market, prompting more protectionist reflexes, a competitive race to the bottom, pressure on the free movement of labour, or the imposition of capital controls undermining the 'four freedoms'.

In political terms, a Grexit could (further) undermine the relationship between states and national societies. The resurgence of national stereotypes, nationalistic chauvinism, historical resentments, and the damaging blame-game between member states could increase the levels of distrust. If the crisis experience affects the public's collective memory, with a potentially negative impact on attitudes towards the EU and towards deeper cooperation at European level, the consequences could haunt Europeans for years to come. In the worst case, the European integration process might reverse its general direction without a clear guarantee where this might end.

In concrete economic terms, a Greek exit would impose huge financial losses on its lenders, who have guaranteed billions to rescue the country within the euro zone. It would imply even more costs, as Athens' partners would most probably have to support the country financially for many years, even after it would have left the Eurozone. In addition, doubts about the future of the world's second largest reserve currency could destabilise global financial markets, with severe repercussions potentially well beyond the consequences of the fall of Lehman Brothers as a result of a sovereign default.

Last, but certainly not least, there is the risk that Greece's potential economic and political destabilisation could have devastating geopolitical effects in an already unstable region. The fear of the potential geopolitical consequences has become the biggest concern in the EU and beyond. The geopolitical dangers have increased since 2011/2012, when the Grexit option was discussed for the first time, because of the escalation of conflicts in the Middle East and North Africa and as a result of the stand-off between the West and Putin's Russia following the Ukrainian crisis and the annexation of Crimea. It is thus no surprise that the Obama administration actively intervened over the past few months and just ahead of the March Summit to persuade all sides to seek a realistic compromise.

One cannot predict with certainty which of the (above mentioned) negative effects would materialise in case of a Grexit/Graccident. But the risk that they might become reality is already a strong incentive for both Greece and its partners, who are all in their own ways responsible for the negative developments in recent years, to seek a compromise – not out of solidarity, but out of enlightened self-interest. This compromise is needed to eradicate the uncertainty about the country's future in the euro area, which, since 2010, has poisoned the country's economic perspectives and burdened the EU's sustainable recovery from the 'euro crisis'.

From today's perspective, we cannot predict the concrete elements and details of a 'deal' between Greece and its lenders that will have to be elaborated before the summer and then ratified by all parliaments. But one can at least speculate about some of the potential cornerstones of an agreement.

Firstly, Athens will have to firmly re-commit itself to a primary surplus for future years, although this promises to be lower than the one previously agreed between Greece and its lenders (3% in 2015; 4.5% from 2016 onwards) and might include the introduction of a 'growth clause' reflecting the country's actual GDP growth rate. The Greek finance minister has already called for a surplus of 1-1.5%.

Secondly, given the opposition in many lender countries and the fact that around 80% of Greece's debt is held by official creditors, one cannot expect any fundamental debt relief in nominal and net present value terms, but rather some kind of a partial debt restructuring involving lower interest rates, a further extension of debt maturities and grace periods, and a binding agreement to periodically re-examine the country's overall debt sustainability.

Thirdly, and most significantly, the new arrangement could involve a multi-year 'Growth, Investment and Competitiveness Agreement' between Greece and the EU institutions providing targeted financial support in return for a credible reform programme aiming to strengthen the country's competitiveness. Financial means could come from the European Stability Mechanism (ESM), the EFSI and the EIB. In return for a renewed Greek commitment to continuous structural reforms, lenders would have to give a firm promise to provide adequate support to Greece until it regains full market access, provided it honours its commitments.

One does not need a crystal ball to predict that the design and subsequent ratification of such a 'new deal' in national parliaments will be a very difficult exercise. The most challenging part will be drawing up a credible and acceptable mechanism for controlling the implementation of the agreement, while simultaneously securing the ownership of reforms by respecting Greek sovereignty. Given the lack of trust on all sides, the monitoring mechanism is likely to be very complicated and require a multi-level system of governance involving a plenitude of European actors including the Commission, the ESM, the Eurogroup, the European Parliament, national governments and parliaments, and possibly also the OECD in a consultative role.

### **Energy Union – political endorsement of a limited new grand project**

As so often in the course of the past year, EU leaders once again discussed the prospects of an Energy Union, which has the potential to become one of the Union's most ambitious projects. Following a presentation by President Juncker, the heads of state and government committed themselves to building an Energy Union, based on the Commission's framework strategy published at the end of February. While this aims to shape the Union's overall approach to energy and climate policy, EU institutions and member states still have a long way to go before the Energy Union will be worth the name, and given member states' opposition to cede sovereignty, it will also have some limits, like the choice of energy mix or the right to individually purchase energy.

The idea of an Energy Union has come a long way since it was first proposed by Donald Tusk, the then Prime Minister of Poland and current President of the European Council in April 2014. In light of developments in Ukraine, the original proposal emphasised the need to enhance the EU's energy security by calling for a collective purchasing of gas; linking and strengthening the Union's electricity transmission system; and making full use of the EU's fossil fuel reserves. Since then, the idea has gained attraction and member states' overall support.

In the course of the last year, the original Tusk proposal developed into a more holistic and balanced strategy. The Commission's Communication mentions five dimensions, which have been endorsed by EU leaders and explicitly mentioned in the Summit Conclusions: (i) energy security, solidarity and trust; (ii) a fully integrated European energy market; (iii) energy efficiency contributing to the moderation of demand; (iv) decarbonising the economy; and (v) research, innovation and competitiveness.

While emphasising the importance of all five dimensions, the March European Council explicitly mentions the following nine points: (a) acceleration of infrastructure projects, including interconnections, for electricity and gas; (b) full implementation and enforcement of existing energy legislation including the implementation of the Third Energy Package; (c) reinforcement of the legislative framework for the security of supply for electricity and gas; (d) assurance that all agreements related to buying gas from external suppliers comply with EU law, notably by reinforcing transparency; (e) assessment of options for voluntary demand aggregation mechanisms (see also below); (f) development of a more effective and flexible market design with enhanced regional cooperation; (g) review and development of legislation related to emissions reduction, energy efficiency and renewables to underpin the 2030 targets and develop a reliable and transparent governance system; (h) development of an energy- and climate-related technology and innovation strategy; and (i) use of all external policy instruments to establish strategic energy partnerships with increasingly-important producing and transit countries.

In general terms, the Summit Conclusions are another strong endorsement of member states' robust support for an Energy Union. In the words of Commission President Juncker: "We are adding a fifth freedom – the free movement of energy in Europe". There has been considerable momentum on this issue since the beginning of the Ukrainian crisis. Political pressure on EU governments to progress towards an Energy Union promises to remain high, as the stand-off between the EU and Putin's Russia is unlikely to deescalate in the immediate future. States and stakeholders seem to recognise that the main challenges Europe faces in energy field are deeply interconnected and can no longer be treated separately and without a larger EU role (see also Marco Giuli, [The Energy Union: what is in a name?](#), *EPC Commentary*, 18 March 2015). As a consequence, the prospects for more cooperation in energy matters seem high, especially as the European Council President and the Commission seem very committed and eager to push things forward.

Together with the Digital Single Market and the Capital Markets Union, the creation of an Energy Union is going to be one of the EU's major projects in this political cycle. It provides (different) benefits to all EU countries and potential knock-on effects in various areas, including energy security, industrial policy, sustainable development and climate policy, and the completion of the Single Market. In the current political and economic climate, an Energy Union clearly offers the potential to demonstrate the Union's added value, as it has the ability to deliver benefits for many different groups of member states, stakeholders, and citizens. (For a more detailed account see also the second report of the 'New Pact for Europe' project available at: [www.newpactforeurope.eu](http://www.newpactforeurope.eu)).

However, despite the progress achieved and the broad political support, the past year has also shown how difficult it will be to create an Energy Union worth its name. There are a number of open questions and uncertainties, which still need to be settled and some hurdles are likely to remain:

- How can one merge different and sometimes very diverse objectives of an Energy Union? For example, how to effectively reconcile a desire to reduce energy costs with the ambitious climate goals defined in the framework of the 2030 Energy and Climate Package, agreed at the October 2014 European Council? Many green NGOs have already expressed their worries that energy efficiency and climate goals are not being adequately pursued. Decarbonising Europe's economy, which in the past was a key objective of the Union's energy policy, has already lost traction, as energy security and the price of energy for households and industry have become more important due to foreign policy and economic considerations.
- What kind of governance system should the Energy Union have? This question has become one of the most sensitive issues and still needs an answer. The Commission's Communication has merely laid down the general objectives of a future governance system, but without giving any details, so many questions remain: who will ensure that the agreed measures will be implemented at national level? To what degree will the Community method be applied? What competences will the European Parliament have? How big a role will the Commission play when it comes to negotiating energy agreements with third countries? Will the Commission Vice-President responsible for the Energy Union, Maroš Šefčovič, be able to ensure the coherent implementation of the framework strategy across different policy areas?
- What are the perspectives for common gas purchasing or for a stronger Commission role when it comes to *ex ante* overseeing agreements between member states and energy suppliers? On these points member states are very divided and/or defensive. The vast majority of EU countries in Eastern Europe, who are heavily dependent on individual importers, want to increase the Union's negotiating power. Other members want to defend their independence and their prerogatives based on the *status quo*: for Hungary and Germany, this means low prices, for Slovakia, transit fees, and for Austria, keeping the hub. As a consequence, the section of the Commission's Communication on the joint purchase of gas says that the Brussels executive will only assess the various options of a "voluntary demand aggregation" – a formulation that found its way into the Summit Conclusions. This suggests that the Commission is not expected to present any concrete legislative proposals, and that member states prefer to deal with external suppliers through market mechanisms rather than through a joint gas purchase.

The debates of past months have also revealed other factors limiting the overall potential of an Energy Union worth its name. This has become most obvious with respect to the choice of energy mix, with member states strongly defending their

right to continue deciding this crucial aspect on their own. This helps them to defend their comparative economic advantages, to continue exploiting indigenous fossil fuels, and to protect the privileges of national energy companies and national energy markets against external competition. The same goes for the decarbonisation of the economy, where no additional steps towards a centralised approach are suggested. All these examples indicate the limits of an Energy Union, as member states seem disinclined to cede key sovereignty rights in this economically- and politically-crucial policy field.

## **Europe's Economy – European Semester, Investment Plan and TTIP**

Following a long tradition of EU summits, Day 2 of the Spring European Council was mainly devoted to economic issues. EU leaders discussed the state of Europe's economy, concluded the first phase of the 2015 European Semester, discussed the Commission's Investment Plan, and were updated about the state of TTIP negotiations with the US.

### ***Economic prospects and European Semester – in the need of further reforms***

EU leaders discussed the state of the EU's economy with a special focus on the situation in the euro area. They agreed that there are strong indications that recovery was on its way as Europe's economy was profiting from low energy prices, a weak euro that has depreciated against the US dollar by almost a third, and low borrowing costs as ECB interest rates are almost zero. They agreed these positive conditions should be used to implement structural reforms in order to boost the longer-term growth perspectives. In the words of President Juncker: "This recovery is mainly of a cyclical nature and we would like to structuralise it. We should make good use of this period of economic calm to launch structural reforms, which in the medium term will lead to a higher growth potential of the European economy."

With respect to the European Semester, the European Council endorsed the 2015 Annual Growth Survey's three main pillars: (i) a boost to investment underpinned by the Investment Plan for Europe; (ii) a renewed commitment to structural reforms with an emphasis on labour markets, pension and social protection systems, more flexible product and services markets, and more efficient public administrations; and (iii) the pursuit of fiscal responsibility in line with the Stability and Growth Pact. The European Council invited member states to reflect these priorities in their forthcoming National Reform Programmes and Stability or Convergence Programmes.

In terms of next steps, and following the Commission's analytical economic assessment for each member state published at the end of February, this April EU countries are due to present their plans for sound public finances (stability or convergence programmes). They will also present their reforms and measures to make progress towards "smart, sustainable and inclusive growth" in areas such as employment, education, research, innovation, energy and social inclusion (national reform programmes). In May, the Commission will propose its country-specific recommendations (CSRs) in areas deemed as priorities for the next 12-18 months. Following a discussion in the Council, the next European Council in June should endorse the recommendations, which will then need to be formally adopted at the end of June or in early July.

Following the experience gained since 2011, in November 2014 the European Commission proposed to streamline and reinforce the European Semester by giving it a sharper focus, clarity and a more political role based on the objectives of the Annual Growth Survey. In order to provide more time to scrutinise the Commission's analysis and to discuss the findings at EU and national level, documents were published three months earlier than in previous European Semester cycles to enhance national discussions and ownership of the process.

However, it is doubtful whether these and other procedural modifications will be sufficient to tackle the basic underlying problem related to the effectiveness of the instrument. The experience of past years has shown that the implementation rate of country-specific recommendations is low in almost all EU countries. Mindful of possible domestic opposition, member states are often reluctant to translate the Commission's economic recommendations – which they all agreed at European level – into practice, and in the past a number of EU governments have even publicly criticised 'Brussels' for dictating to them what to do.

The main advantage of the European Semester exercise is that it reveals member states' structural macroeconomic deficits and imbalances, and, at least in some instances, helps trigger a debate about what needs to be done at national level.

A prominent case has been Germany, where leading representatives of the social democrats (SPD) picked up calls by the Commission to stimulate domestic demand, which fostered the debate about Berlin's macroeconomic policies. But such experiences are rare. In most cases the CSRs are not widely noticed and end up in the drawers of national public administrations, despite all the time and energy invested at both national and European level.

As in the final instance member states cannot be forced to implement reforms against their will, it is necessary to think of more substantial innovations to foster the implementation of country-specific reforms. Past experience shows that neither reliance on peer pressure nor fines and sanctions will do the trick. The three most promising innovations would be to (i) link the implementation of structural reforms to greater flexibility in applying the Stability and Growth Pact (SGP), (ii) provide additional 'carrots' by offering targeted financial incentives to countries ready to undertake reforms, and (iii) increase national ownership through strengthening the role of national parliaments in implementing reforms.

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

On the second innovation, the incentives for national reform programmes could be increased by introducing a new fiscal capacity. The current architecture of the euro area does not allow for an adequate response to large country-specific shocks when individual member states do not have the means to address them and when a centralised monetary policy cannot offset the impact of localised shocks. The crisis has shown that, when national fiscal buffers are too low, countries cannot stabilise the situation on their own. Although lengthy discussions between EU governments have failed to deliver tangible results, it makes sense to restart the debate about new arrangements between individual countries and the EU institutions, supervised and administered by the Commission and supported by funds from a new financial instrument.

On the third innovation, national parliaments could be given a stronger role in translating decisions and recommendations made in the framework of the European Semester into action. National governments could be held to account on implementing of EU macroeconomic policies and country-specific recommendations. To foster better implementation of national reform programmes, the way the recommendations are drawn up should be further reviewed, focusing on a smaller number of key priorities for each country.

These and other reforms could be discussed, further developed and proposed in the framework of the new 'four presidents report' that aims to develop concrete mechanisms for stronger economic policy coordination. In October 2014, the Euro Summit invited the Commission President, in close cooperation with the European Council President, Eurogroup President and the ECB President, to prepare "next steps on better economic governance in the euro area". An Analytical Note, analysing the reasons which led to the 'euro crisis' and raising a number of questions on the future of euro-area governance, was presented at the informal European Council in February and first deliberations started at the level of Sherpas in the week before the March EU Summit.

However, it is not clear in which direction the proposals in the second four presidents report will go and how ambitious they will be. In a speech two days ahead of the March European Council, ECB President Draghi called for a "quantum leap" in institutional convergence by enhancing the executive powers of EU institutions and strengthening the Union's democratic accountability, without explaining in detail how such a fundamental EMU reform could be translated in practice.

But one thing does seem clear: the appetite in most capitals for a major reform of the current EU Treaties is rather limited. Multiple fears are blocking further steps: the fear that another round of treaty change would open up a Pandora's box, possibly leading to a further transfer of power away from the national level; governments' fear of losing control of the reform process in another Convention exercise; the fear that high 'consensus costs' among 28 member states, which will each ask for something in return for their readiness to amend the EU's primary law; and the fear that any new treaty might once

again fail at the ratification hurdle in one or more member states, with the ‘constitutional trauma’ of 2005 – when the ‘no’ in France and the Netherlands marked the end of the Constitutional Treaty – still haunting the collective memory of many policy-makers.

All these fears limit the ambition to further reform economic governance. It will be interesting to witness how ambitious the next four presidents’ report will be and whether it will be able to avoid the fate of its predecessor, which despite all its good ideas and intentions was rejected by a majority of national governments.

### ***Investment Fund – a good idea in risk of failing expectations***

Regarding the Commission’s Investment Plan, which aims to mobilise €315 billion of additional investment from public and private resources in 2015-2017, EU leaders acknowledged that the Council’s general approach on the European Fund for Strategic Investments (EFSI) was an “important step” towards achieving an agreement between co-legislators by June, so that the EFSI can be fully deployed from mid-2015.

The basic idea behind the Plan points in the right direction. However, its overall potential is undermined by a number of factors: First, it is unclear whether the Plan will live up to expectations, as the aspired leverage ratio of 1:15 (€21 to €315 billion) is highly ambitious and it is doubtful whether this target can be reached, which would severely limit its potential economic impact.

Second, there is a lack of ‘new money’ for the initial contributions to the EFSI. Since a substantial amount of these contributions is reshuffled from other parts of the EU budget, it is questionable whether the EFSI can adequately fund additional projects or just replicate investment projects that would have happened anyway (see also Jan David Schneider, [\*Growth for Europe – Is the Juncker Plan the answer?\*](#), EPC Discussion Paper, 20 March 2015).

Third, countries with fiscal space, such as Germany, are not very supportive of the Investment Plan and thus reluctant to engage in higher spending, while those most willing to engage are restricted by fiscal constraints and rules.

Finally, there is a real risk that funds coming from the EFSI will not be spent in areas where the actual needs and potential for growth and employment are greatest, but that the money will be dispersed throughout the EU, providing everyone with a ‘slice of the cake’. In terms of geographical allocation, there is a risk that the mechanisms will be designed in a way that could disproportionately benefit more economically stable and stronger countries and regions. It is therefore significant that the bodies responsible for selecting appropriate projects (Investment Committee; Task Force on Investment) will consist of independent experts rather than politicians.

### ***TTIP – in desperate need to persuade***

Commission President Juncker informed EU leaders about the state of play on the complex and difficult negotiations with the US on TTIP (Transatlantic Trade and Investment Partnership), which the Commission estimates could be worth an additional €100 billion to the EU’s GDP. The Summit Conclusions state that the EU and the US should make every effort to conclude negotiations on an “ambitious, comprehensive and mutually beneficial agreement” by the end of 2015, which is highly ambitious given the complexity of the prospective agreement and negative attitudes on both sides of the Atlantic.

Acknowledging the (severe) public reservations in a number of member states and in the European Parliament, EU leaders called on the Commission to step up efforts to communicate the benefits of the agreement and to enhance dialogue with civil society. The so-called investor state dispute settlement (ISDS) mechanism is the main cause of public controversy, amid public concerns that a trade agreement with the US could weaken and lower food safety standards and erode EU consumer standards.

## **Other issues on the Summit agenda – Russia/Ukraine, Eastern Partnership Summit, ENP review, Libya, migratory flows, Tunisia, and a new Council Secretary General**

In addition to the informal meeting on Greece, the establishment of an Energy Union and economic issues, EU leaders discussed and took decisions on a number of other topics.

On Day 1 of the Summit, EU leaders had a discussion about relations with **Russia and the situation in Ukraine**. The European Council called on all parties “to swiftly and fully implement” the Minsk Agreements brokered by Chancellor Merkel and President Hollande and to honour their commitments, and specifically underlined the Russian authorities’ responsibility for the crisis. EU leaders declared that the Union stood ready to support the process, notably as regards the OSCE’s ability and capacity to monitor and verify the implementation of the agreements.

Following debates among member states about the **future of sanctions** against Moscow, the European Council agreed to align the duration of the restrictive measures, adopted on 31 July 2014, enhanced on 8 September 2014 and ending this July, to the “complete implementation” of the Minsk agreements, which is foreseen by the end of 2015. This means that the sanctions regime is *de facto* prolonged, although the Council still needs to take the relevant legal decisions in the coming months.

Following strong pressures, particularly from Baltic countries, Poland, the UK, and Denmark, EU leaders stressed the need to challenge Russia’s ongoing “disinformation campaigns” and invited the High Representative of the Union for Foreign Affairs and Security Policy to prepare an “**action plan on strategic communication**” by June. Establishing a communication team based in Brussels and tasked with identifying and correcting misleading information and providing member states with reports clarifying what actually happened, is a first step in this direction.

With respect to **Ukraine**, the Summit Conclusions state that the EU will continue to support Kiev’s reform process and called on the Council to adopt the third **Macro-Financial Assistance Package** for Ukraine as a matter of urgency, while calling on Kiev to further intensify reform efforts.

In view of the upcoming summit in Riga in May, EU leaders reiterated that they are fully committed to the **Eastern Partnership** and that the Union will strengthen relations with each of its six partners “in a differentiated way”. Leaders agreed that a priority area was to build up state institutions and strengthen the rule of law, based on each country’s needs and preferences and particular efforts will be devoted to advance cooperation in state building, mobility and people-to-people contacts, market opportunities, and interconnections.

Regarding the ongoing review of the **European Neighbourhood Policy**, the European Council conclusions state that the process should ensure continued EU involvement with both Eastern and Southern partners. Without taking any concrete decisions, EU leaders announced that they will have a broader discussion on the Southern Neighbourhood in October 2015.

Following recent developments in **Libya**, the Summit Conclusions acknowledge that the country’s crisis is a serious challenge to international peace and security that requires the Union’s full attention. The European Council called for an immediate and unconditional ceasefire, and for Libyan parties to rapidly agree on a Government of National Unity. Indicating the Union’s readiness to support this once it has been achieved, EU leaders stated that the Union will be ready to contribute to its implementation and called on the High Representative to present concrete proposals.

Following the continuous loss of lives of would-be asylum seekers in the Mediterranean, the European Council underlined the need to step up the implementation of the actions agreed by the Council of Ministers in October 2014 to “**better manage migratory flows**” including a strengthening of Triton, the Frontex Operation in the Central Mediterranean. The Summit Conclusions state that a more concerted effort is needed to increase the EU’s support to the countries of origin and transit, and to manage migration concerns properly in the EU as a whole. Hence the European Council welcomed the Commission’s initiative to submit a European Agenda for Migration in May.

In reaction to the killing of at least 21 people at the National Bardo Museum in Tunis two days ahead of the March EU Summit, the European Council issued a statement condemning the terrorist attack. EU leaders signalled the readiness of the EU and its members to intensify cooperation with **Tunisia** to counter this “common terrorist threat”, to strengthen the country’s promising democracy and assist its economic and social development, without specifying what this might mean in practice.

Finally, the heads of state or government endorsed President Tusk’s proposal that Jeppe Tranholm-Mikkelsen, Denmark’s Permanent Representative to the EU, will be the **next Secretary-General of the Council**. He will replace Uwe Corsepius, who after four years in Brussels will return to his previous position in the German Chancellery as Chancellor Merkel’s main European political advisor, replacing Nikolaus Meyer-Landrut, who will become Germany’s ambassador in Paris.

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