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REFORMATTING THE EUROPEAN INTEGRATION PROCESS: OPPORTUNITIES AND RISKS FOR THE UKRAINE-EU ASSOCIATION



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This publication presents an analytical report that summarises the main directions of policies to reformat the European integration process and introduce changes into the mechanisms of the European Union. It carries out a coherent analysis of key determinants underlying the crisis in European integration that led to the current changes in its functioning, as well as identifies baseline potential scenarios of further EU development. Special attention is paid to the issues of completion of the EU's Economic and Monetary Union, which are singled out in a separate, most voluminous section of the report. The final section of the report analyses potential influence of the European integration reformatting on Ukraine and the Ukraine-EU Association.

The report is supplemented with materials that analyse the institutional development of the EU and its policies in the security sector. The publication also contains three extensive articles, which present an analysis of EU problems in the security and defence sector, migrant crisis issues and European migration policy, as well as the UK's exit from the EU and the potential impact of this event on the EU in the future.

A comprehensive analysis of the issues of European integration reformatting has allowed to formulate a number of practical recommendations regarding the policy of Ukraine's European integration, which aim to create a multi-level system to manage this process in Ukraine.

An outline of expert opinions expressed during the expert discussion held on 15 November 2018 completes this publication.

Opinions expressed in this publication do not necessarily reflect the views or receive approval of the donor.

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Friedrich Naumann
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Ten years have elapsed since the European Union entered a new period in its evolution – one of the most complex in the history of European integration. This period started with the 2008-2009 global economic and financial crisis, which caused the Euro area crisis and the Greek debt crisis, and later spread to other, non-economic areas. Eurosceptical political forces inside Europe are becoming increasingly more active and influential, which is a proof of the comprehensive nature of the crisis within the EU and the inevitability of its major reformatting. All this contributed to the emergence of a new analytical direction – theory of disintegration, which is a clear testament to the fundamental nature of the current European integration problems.

This gives rise to the following questions: What is the future of the European Union? How will the integration association change in the future? What will be its impact on the development of the global economy and what place will it take in the global competitive environment?

Answers to these questions are especially important for Ukraine, given that since 2014 its strategic course of fundamental socio-economic and political transformations has been very closely connected with the European integration idea, and the Association Agreement with the EU has become a key mechanism that determines the pace and directions of Ukrainian reforms. Disappointingly, the necessary deep analysis of these issues is progressing rather inactively and indistinctly in Ukraine. Formalistic and often meaningless pro-European rhetoric has not merely become a fashion trend, but also has produced ideologically motivated taboos regarding any serious criticism of what is happening in the EU. This is dangerous, because it prevents us from seeing problems and obstacles on the country's development path, and hence, from taking the necessary political measures in a timely manner.

Razumkov Centre, which has always taken a politically and ideologically unbiased approach in researching key issues of socio-economic and political development, deems it necessary to study the complex and ambiguous processes taking place inside the European Union. In doing so, we should not underestimate some of the factors that complicate these processes, while avoiding catastrophic predictions and scenarios exploited by certain political groups. It is necessary to conduct a balanced and highly constructive analysis, researching new ways and instruments that can help ensure effective policy in the conditions when European integration undergoes reformatting.

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LIST OF ABBREVIATIONS

CFSP	Common Foreign and Security Policy of the EU
CMU	Capital Markets Union of the EU
CSDP	Common Security and Defence Policy
EC	European Commission
ECB	European Central Bank
EUCO	European Council (heads of state or government of the EU member states)
EDIS	European Deposit Insurance Scheme
EEC	European Economic Community
EFTA	European Free Trade Association
EMF	European Monetary Fund
EMU	Economic and Monetary Union
EP	European Parliament
ESM	European Stability Mechanism
EU	European Union
FDI	Foreign direct investment
GAMM	Global Approach to Migration and Mobility
GDP	Gross domestic product
IMF	International Monetary Fund
MFF	Multiannual Financial Framework
OECD	Organisation for Economic Co-operation and Development
PPP	Purchasing power parity
RES	Renewable energy sources
SME	Small and medium-sized enterprises
SRF	Single Resolution Fund
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism

ECONOMIC AND NON-ECONOMIC ASPECTS OF REFORMATTING EUROPEAN INTEGRATION: OPTIONS AND POSSIBLE OUTCOMES

The powerful wave of European integration, which originated in the mid-1980s with the adoption of the Single European Act, was furthered by a combination of the rapidly progressing globalisation processes and geopolitical changes associated with the collapse of communist ideology and practices in Eastern Europe. It reached its peak in 2004-2007 with the unprecedented EU enlargement from 15 to 27 members. Ambitious commitment to form the Economic and Monetary Union (EMU), which started to come to life as a result of the Maastricht and Amsterdam Treaties, has led to the introduction of a single European currency, the euro – a true symbol of European unity and global power of the European community. It seemed that Europe had a long period of prosperity and consolidation ahead of it, and the very model of European integration, as implemented through the EU, was becoming a model not only for the neighbouring countries, but also for other states seeking to establish a civilised social system.

But history is full of extreme paradoxes and often unpredictable. One of its most outstanding paradoxes regarding the EU is that it started experiencing major problems at the very peak of the integration process. Although, was it really a paradox? Or maybe we tend excessively to extrapolate current trends onto the future, ignoring the objectively wave-like nature of social development and failing to notice new, indistinct signs of future fundamental changes in time?

The 2008-2009 global economic and financial crisis deeply affected the absolute majority of countries and regions of the world. But no part of the world has experienced such powerful and long-term socio-economic and political destabilisation as the EU, primarily the Euro area. Reality has taught Europe

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an important lesson: integration is not a panacea for successful development – it can only stimulate certain processes developing inside the member states' societies. It can easily change its value from plus to minus, if policies are faulty, mismatched with new conditions appearing in the course of change. This is what happened in the EU, where the benefits of integration were questioned amidst the global crisis, and the complexity of European bureaucratic procedures necessary for formation and approval of socio-economic policies did not allow to provide a timely response to new challenges.

In this situation, people at different levels of socio-political structure inside the EU started rethinking many of the ideas used by European integration leaders as guidance. Regular surveys of EU member states' citizens conducted by the Eurobarometer started to show a change in public opinion and assessment of the real effectiveness of the European integration process. In response, politicians that carried European ideas have been gradually substituted by politicians with nationalist and eurosceptical ideas. This process ("the renaissance of nationalism") engulfed most of the EU countries, and in some – became critically important. United Kingdom's decision on exiting the EU,¹ the radically-minded nationalistic governments of Poland and Hungary that risk coming into open conflict with the EC, powerful political movements in leading EU countries (incl., Germany and France) that propose alternative views of Europe's future, etc. – all of these are not just random details on the political landscape, but rather – the manifestations of the tectonic forces acting within the European community and preparing a "change of course of the European ship". These forces receive major socio-energetic support from the US President D. Trump, who became the main architect of economic nationalism in today's world.

Yet, the problem is not only the eurosceptical politicians, – it has more objective origins connected with significant deficiencies of the European integration process itself. Amidst fast and triumphant European integration in the 1990s-early 2000s, isolated warnings of shrewd and socially responsible researchers were drowned in the ocean of glowing praise to European integration, however, when the crisis hit, the critics were suddenly remembered.

Among them, possibly most noteworthy are assessments by Jacques Delors, former EC president and the main architect of the powerful European integration wave that led to formation of today's EU structures. J.Delors – a person, who dedicated his life to European integration and is infinitely far away from the modern populist eurosceptical politicians in his views – expressed major concern regarding the EU's growing membership and gave a 50% chance of EU disintegration after

¹ See article by K. Markevych "Brexit: Whim or Necessity?" in this publication.

its 2004 enlargement. He insisted that the EU must find a realistic way of future cooperation with its 27-plus member states, or else “the three big countries – perhaps tomorrow, four or five – will remove their cards from the table and choose to play alone. And that will be the end of the dream of the fathers of Europe”. And, according to Mr. Delors, such an outcome for the European Union is by no means a remote possibility.²

Euro area crisis that came “in the wake” of the 2008-2009 global economic and financial crisis, greatly strengthened these predictions and gave birth to their different politological variations. Some authors renamed the EU to the European Disunion,³ others saw Europe as entrapped,⁴ the third – compared EU’s current situation with the former Soviet Union on the eve of its disintegration.⁵ This group was especially intriguing due to the presence of a world famous personality of George Soros, who not only saw signs of tragedy in the EU, but directly said that “the European Union is on the verge of collapse”.⁶

Along with publications that contain loud declarations regarding the collapse of European integration, there is another, more reserved level of studies that actively developed in the context of the disintegration theory.⁷ There are various theories, with all of them typically containing a deep study of conditions, under which integration processes slow down and turn to reverse tendencies. They are based on the understanding

² Source: Charlemagne: The return of Jaques Delors. – *The Economist*, 12 February 2004, <http://www.economist.com/node/2424124>.

³ For more information, see: Hayward J., Wurzel R. (eds.). *European Disunion: Between Sovereignty and Solidarity*. – New York: Palgrave Macmillan, 2012.

⁴ For more information, see: Offe C. *Europe Entrapped*. – Cambridge, UK: Polity Press, 2015.

⁵ For more information, see: Gilman N., Steven W. Back in the USSR. Is the European Union heading for a Soviet-style collapse? – *The American Interest*, Vol.12, No.3, 12 December 2016, <http://www.the-american-interest.com/2016/12/12/back-in-the-ussr>.

⁶ For more information, see: Soros G. (with G. P. Schmitz). *The Tragedy of the European Union: Disintegration or Revival?* – New York: Public Affairs, 2014; Soros G., Schmitz G.P. The European Union is on the Verge of Collapse. – *The New York Review of Books* (an interview), Vol.63, No.2, 11 February 2016, <http://www.nybooks.com/articles/2016/02/11/europe-verge-collapse-interview>.

⁷ Here are a few examples: Eppler A., Scheller H. (ed.). *Zur Konzeptionalisierung europäischer Desintegration. Zug- und Gegenkräfte im europäischen Integrationsprozess*. – Nomos Verlagsgesellschaft, Baden-Baden, 2013; Vollaard H. Explaining European Disintegration. – *Journal of Common Market Studies*, Vol.52, Issue 5, September 2014, p.1142-1159; Scheller H., Annegret E. European Disintegration – non-existing Phenomenon or a Blind Spot of European Integration Research? – Preliminary Thoughts for a Research Agenda. Institute for European Integration Research. Working Paper, No.02/2014, https://eif.univie.ac.at/downloads/workingpapers/2014_02_Eppler_Scheller.pdf. Webber D. How Likely Is It That The European Union Will Disintegrate? – A Critical Analysis of Competing Theoretical Perspectives, Austrian National University, ANU Centre for European Studies Briefing Paper Series, Vol.2, No.3, October 2011.

that disintegration is not necessarily an unwanted destructive process, but rather – a process that can help correct the undesirable directions of integration development that ceased to meet objective conditions and prevailing expectations of participants. They may also play the role of a prerequisite for future reformatting of the integration process.

This approach is justified by the fact that crisis manifestations observed in the EU development gave rise not only to euroscepticism, but also to intensive search for new ways to develop European integration. EU crisis stimulates new attempts to implement the course of EMU completion.⁸ So in reality, we are dealing with a complex, multidimensional and even internally controversial process, which should not be described as only black or white, or be determined through just a single trend of future development. We are facing an entire range of possible options of further evolution of the European integration process and the EU. The choice between these options will largely depend on the level of political willpower and creativity of relevant political forces, their ability to think strategically, outside of the narrow box of “here and now”, and their ability to do a thorough and balanced analysis of the entire complex of factors underlying European integration.

These are the fundamental approaches that determine the goal and objectives of analysis in this analytical report and articles that follow. The goal of the analytical report is to present a step-by-step analysis of factors, areas and potential consequences of the current crisis in the development of European integration in general and the European Union in particular (Section 1). This will allow for a detailed analysis of existing options (scenarios) for future evolution of the EU and European integration process (Section 2). Special attention is paid to the mechanisms of operation of the Euro area and Economic and Monetary Union completion (Section 3), as both, historically and logically, it is the events within the Euro area that influence the evolution of the entire European integration process most. And, lastly, Section 4 analyses the potential influence of reformatting the European integration process on the Ukraine-EU Association mechanisms, new risks arising in this area, and new opportunities in connection with adjustment to new challenges and demands.

The analytical report is supplemented by articles covering topics that are crucial for the European integration process, namely, the issue of the UK’s exit from the EU, migrant crisis and new threats and challenges to European security.

⁸ The main directions and tools of this policy are detailed in the publication: Sidenko V. Policy of Completion of the European Economic and Monetary Union: Main Trends and Possible Consequences for Ukraine. – Economy of Ukraine, 2014, No.10, p.51-66 (in Ukrainian and Russian).

1. CRISIS PROCESSES IN THE EU: ORIGINS, SOCIO-ECONOMIC AND POLITICAL CHARACTERISTICS, POSSIBLE OUTCOMES

The European Union is undergoing a difficult period in its development: possibly, the most difficult in the entire history of European integration, starting from the 1950s. Different challenges confronting the EU, their grand scale and variety allow to speak of a *systemic crisis* of the European integration process. As any other systemic crisis, it is not a coincidence, but originates from the long-term accumulation of preconditions since the triumph of the European integration.

1.1. MAIN FACTORS OF CRISIS PHENOMENA IN THE DEVELOPMENT OF THE EUROPEAN INTEGRATION PROCESS

The current crisis, the dimensions of which will be analysed in this report, came after a period of extremely intensive development of European integration processes that were taking place for almost a quarter century, starting with the impetus given by the adoption of the Single European Act in the mid-1980s, and subsequently, the Maastricht and Amsterdam Treaties in the 1990s. These processes culminated, on the one hand, in the introduction of a single European currency, intensive formation of an economic and monetary union supplemented with political union elements (which would seem like an organic continuation of EMU formation), and on the other – in the unprecedented EU enlargement to 28 members, which turned it into the most powerful global actor (alongside the USA).

The success of European integration gave birth to certain Euro-euphoria, when it seemed like the Westphalian system of international relations between sovereign and self-sufficient national states has exhausted itself and was being substituted if not with a European federation, then at least with a new political formation based on delegating a portion of national states' powers to supranational institutions. Yet the reality has demonstrated the fragility of such ideas and policies in the situation of the significantly changing conditions of global development.

The 2008-2009 global economic and financial crisis became the end of the European integration triumph and started a regional crisis that was proving in a fast and convincing way that the very structure of the European integration process

is gravely unbalanced and asymmetrical, which makes further movement not only problematic, but also dangerous. The global crisis demonstrated the *relative nature of benefits of large economic communities* and the fact that they can not only stimulate socio-economic development, but also become a catalyst for socio-economic troubles. The growing realisation of this fact created a powerful “anti-wave” of new European nationalism.

Today we are observing quite a fast-paced revival of nationalism in the EU states. Nationalist surge gave rise to the development of different disintegration concepts, which found strong political support as a result of combined influence of the UK’s decision to exit the EU and accession to power of D.Trump’s administration in the USA with their protectionist policies and undoing of a number of existing international treaties. In this context, quite exemplifying is the evolution of Poland and Hungary – the countries that were at the forefront of pro-European transformations in the post-socialist societies in 1990s, and now turned into targets of accusations by EU’s governing bodies regarding violations of a number of European principles, appearing as defendants in court cases and targets of sanctions.

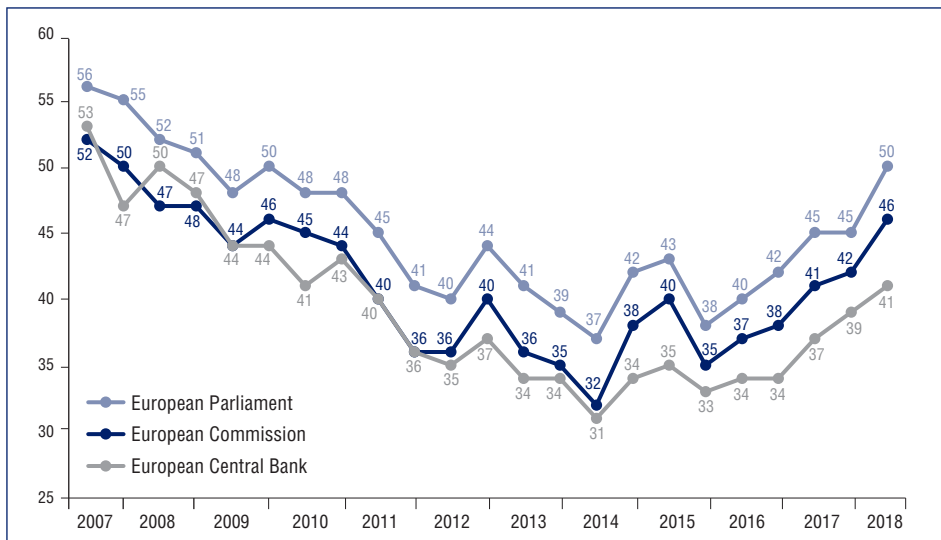
This new course may be getting even more “support” from the thwarted hopes for European integration, which turned out to be overextended and created a major disappointment of large groups of citizens in EU member states in the practical outcomes of such development, as well as a drop of public trust in key EU institutions. This is convincingly supported by regular sociological Eurobarometer surveys (diagram “Public Trust in Key EU Institutions”, p.12). Despite the fact that in the past three years we have observed gradual restoration of Europeans’ trust in EU institutions, at the moment it has not been completely restored to its 2007 pre-crisis level.

The main primary sources of current crisis processes in the development of the EU are major contradictions and asymmetries in the Euro area mechanisms and in the declared policy of EMU completion. The European integration model created in the 1990s had Robert Mundell’s concept of optimum currency areas as one of its basic ideas, which was considered a powerful catalyst for economic growth that works through significant reduction of transaction costs and elimination of currency risks due to replacing different national currencies with a single European one. Yet the conditions, under which the optimum currency area would be successful, formulated in scientific works on this topic,² were ignored. These conditions included not only the possibility of labour and capital mobility, flexibility of prices

¹ Built using data from: Public opinion in the European Union. – Standard Eurobarometer (Spring 89, Autumn 88, Spring 87), European Commission, <http://ec.europa.eu/commfrontoffice/publicopinion/index.cfm/Survey/getSurveyDetail/instruments/STANDARD/surveyKy/2180>.

² For more information, see: Frankel J.A., Rose A.K. The Endogeneity of the Optimum Currency Area Criteria. – The Economic Journal, 1997, Vol.108 (449), p.1009-1025.

Public Trust in Key EU Institutions



and salaries in the entire single currency area, but also the presence of a system of fiscal transfers to compensate for mobility effects and neutralise the adverse effects for less developed parts of the area, as well as a tight connection between the economic cycles of member states. Monetary policy within the Euro area was not supported by respective fiscal redistribution mechanisms, and thus, significantly deviated from the said conditions.

It is also worth mentioning that the Euro area included *economies that significantly differed, both structurally and institutionally*. And in these circumstances, it was impossible to adhere to the main condition of the monetarist approach – ensure precise alignment between money supply and economic growth potential. As distinguished macroeconomy experts note,³ a uniform interest rate for all Euro area members produces “asymmetric impacts” in those countries whose inflation and growth rates deviate from the averages.

Moreover, a rapid introduction of a single currency has created an *asymmetry of monetary and fiscal macroeconomic regulation* in the member states of the Euro area due to the fact that a national state ceased being able to use a combination of monetary and fiscal regulatory instruments, as monetary regulation functions were centralised at the European Central Bank and the European System of Central

³ For more information, see: Scharpf F.W. Monetary Union, Fiscal Crisis and the Preemption of Democracy. – LEQS Annual Lecture Paper 2011, Paper presented at the LEQS Annual Lecture “Saving the Euro – at the expense of democracy in Europe?” on 12th May 2011 at the London School of Economics, pp.12, 19-20.

Banks managed by it. The actual disintegration of the classical system of national macroeconomic regulation that resulted from this, left only budgetary financial regulation instruments in national jurisdiction. At the same time, a Euro area member state that is deprived of the possibility to independently determine its monetary policy, cannot effectively regulate its own external balance of economic transactions, adjust current account deficit in its balance of payments. As a result, in the situation of simultaneous disruption of internal and external economic equilibrium (such phenomena were typical during the 2008-2009 global economic and financial crisis), a state may have no choice but *to excessively apply budgetary financial regulation levers*, which is a direct way to increase budget deficit and public debt, and destabilise the entire public finance system.

Centralisation of monetary policy development functions in the Euro area has led to formation of a certain “one size fits all” policy for all member states – both strong and weak. In these circumstances, the economies that were relatively weaker in their structural and institutional aspects (such as Greece and some other countries in the south of Europe), found themselves in a trap, when the “remedies” prescribed for them by EU monetary regulation bodies together with the IMF only aggravated their existing socio-economic situation.⁴

But the problem lies not only in the difficulty of macroeconomic balancing of structurally different economies in the Euro area. The deepening crisis in certain Euro area member states has led to more far-reaching consequences, bringing the debate on the possible *EU legitimacy crisis* to the foreground.

Thus, one of the most reputable researchers of European integration processes in Germany, Fritz Scharpf (at Max Planck Institute for the Study of Societies, Cologne), is warning⁵ that the EMU “has systemically caused destabilising macro-economic imbalances that member states found difficult or impossible to counteract with their remaining policy instruments. These effects have undermined the economic and fiscal viability of some EMU member states and have frustrated political demands and expectations to an extent that may yet transform the economic crisis into a crisis of democratic legitimacy”. Similar to this are the conclusions of Nobel Prize laureate in Economics J. Stiglitz expressed in his research “How a Common Currency Threatens the Future of Europe”.⁶

⁴ A renowned American economist J. Galbraith called such macroeconomic recipes for treating the “sick” economy of Greece “a poisoned chalice”, which destroys the national economic organism. For more information, see: Galbraith J. *Welcome to the Poisoned Chalice: The Destruction of Greece and the Future of Europe*. – New Haven, CT: Yale University Press, 2016.

⁵ See: Scharpf F. *Monetary Union, Fiscal Crisis and the Preemption of Democracy* – MPIfG Discussion Paper 11/11, Max Planck Institute for the Study of Societies (Cologne), July 2011, p. 2, http://www.mpifg.de/pu/mpifg_dp/dp11-11.pdf.

⁶ See: Stiglitz J. *How a Common Currency Threatens the Future of Europe*. – New York-London: W. W. Norton & Company, 2016.

There is thus an explicit conclusion that *the problem of inadequate mechanisms of Euro area operation that disregards major differences between the member states in the level of their economic development, maturity of economic regulation institutions, and competitiveness potential, is a key destabilising factor in the development of the EU, which, in times of global instability, turns into a powerful additional channel of macroeconomic destabilisation for relatively weaker Euro area members.*

However, this is not the only source of EU problems. The *unprecedented EU enlargement* since 2004 has also played a significant role in driving the EU into the crisis phase. Despite the lengthy period of institutional preparation for EU accession, on the overall, the newly accepted members were much weaker by their level of development than the absolute majority of the 15 EU member states (with the exception of Greece and Portugal). The *increasing heterogeneity within the socio-economic space of the European Union* (diagram “The Level of GDP per Capita in Selected EU Member States”⁷) has greatly complicated joint political decision-making in different areas, as any “average” decision might be a major diversion from the optimal decision for an individual member state. This situation creates preconditions for the growth of contradictions in the process of joint decision-making, which can well turn into significant political disagreements that stem from a *different vision of development prospects and priorities.*

Moreover, *different historical experiences and specific cultural traditions*, under these circumstances, can cause significant conflicts on certain fundamental issues between the European integration centre (EU common institutions) and individual member states, which will hinder the development of European integration.

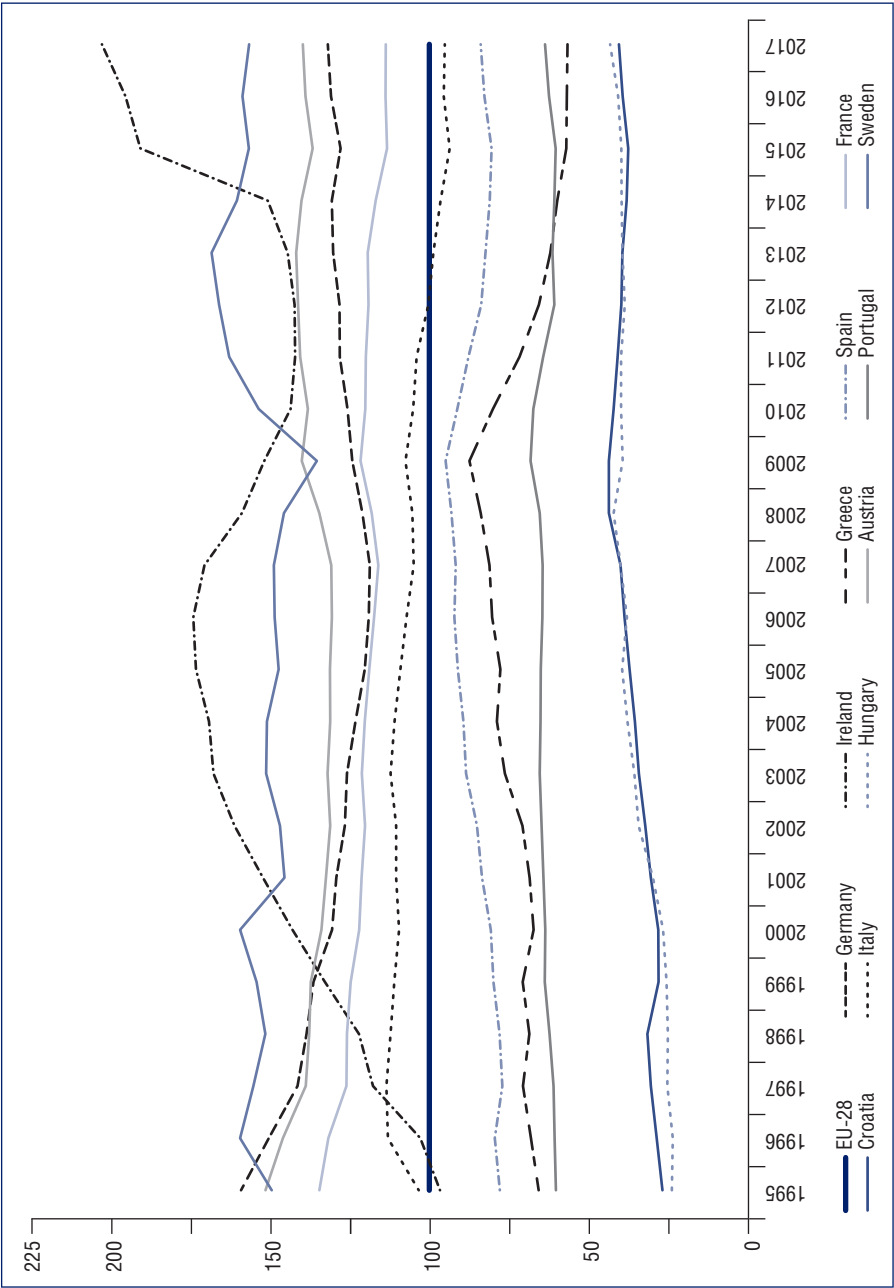
Moreover, even in the European integration institutions themselves, the increasing heterogeneity of member states’ development parameters has challenged the efficiency of coordination processes and attainment of agreed positions. After all, this requires, if not identical, then at least a close understanding of the content of issues on the agenda of the integration community. But is it not utopical to believe that a common ground will be reached every time simply due to the fact that all member states adhere to a certain shared system of European values?

Apparently, with all the importance of Europeanisation, the process of moulding a *single European culture*, including the culture of governance, is far from being complete. And thus, there is still a wide margin for *conflict of different governance cultures* within the intergovernmental bodies and governing institutions of the EU. All of this is a great challenge on the way to reaching optimal decisions in joint regulation.

Essentially, contrary to the widespread notion, *there is no single European model of socio-economic development.* In reality, we observe the interaction between different

⁷ Created on the basis of Eurostat database information: Main GDP aggregates per capita, http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=nama_10_pc&lang=en.

The Level of GDP per Capita in Selected EU Member States (EU-28=100)



models, which differ significantly in a number of parameters. So, for instance, the UK's economic model is much more liberal by many fundamental characteristics than the majority of continental EU countries, and, to tell the truth, has more in common with the US economy, than with France or Scandinavian countries. Until the issue of speeding up EMU completion was raised, it had been possible to level out these differences in some way. But after the creation of a full-fledged EMU was put on the agenda, another major question arose: what shall we do with differences inherent in various national models of socio-economic development?

Key conclusion that can be drawn is as follows: *if the differences in the national models of socio-economic development constitute an inseparable part of the national value system and life principles, this will become the precondition for a possible slowdown and even a halt in the European integration process, and in the future – inception and spread of disintegration trends*. In this context, a more balanced approach should be present in analysing the reasons of Brexit: we should not overlook its *objective preconditions*, and refrain from treating it as just a result of political games.

In general, the possibility of crises in European integration is largely determined by the very structure of the European integration policy implemented since 1990s. Here, two dimensions of the problem are of critical importance: (1) combining the deepening of the integration process with expanding the number of its members; (2) ensuring correlation between different economic, political and cultural development foundations.

Speaking about the first of these dimensions – “deepening vs. widening” – one must clearly understand that *the very fact of making the deepening and widening processes simultaneous is putting extreme pressure on the entire institutional system of the Eurointegration*.

The core thing is that *the processes of deepening the integration and widening its territorial scope substantially differ in their nature and structure*. They objectively require different conceptual approaches and different logic of implementation. Clearly, any major structural or institutional transformations (and these are the things that determine the content of integration processes) require high concentration of resources and effort in the areas connected to such transformations. Thus, *it is much easier and wiser to implement profound transformations in a limited space*. Combining these two processes in time leads to stronger adjustment shocks arising from the lack of ability to cope with new organisational principles. Territorial expansion, moreover, an increase of participants' heterogeneity by qualitative parameters, significantly increases the *risk of institutional failure in the process of reforms*.

Accepting new, less developed members into the EU cannot but put on the agenda the issue of slowing down the in-depth integration. Attempting to *put additional strain on the institutions of the new countries unprepared for a large integration*

development leap, seems more like a gamble based on a disconnect with the sense of reality. The only way out of this dichotomy is a drastic increase of financial transfers between the member states in order to level out the differences in national economic environment conditions. This, however, would require radically different approaches based on the actual formation of a *European federation of states*. At the moment, this looks like a fantasy, given the issues that stem from the second aspect of the problem.

This second aspect is connected with the fact that ***moving to a higher level of economic integration development (EMU creation), cannot happen outside the creation of a corresponding political union of states***. Integrating economies and national social systems without a powerful and autonomous (independent from national states) political centre that develops and implements a *common European socio-economic development policy* – is a dangerous utopia.

J. Delors, the main architect of the European integration wave in the mid-1980s, understood this very well. Back in the early 2000s, he expressed concern regarding the destiny of the “united Europe” idea. According to the politician and his supporters, neutralisation of risks of the EU’s unprecedented territorial expansion objectively required stronger “European discipline” and an increase of the role of European regulatory norms. Otherwise, “institutional disintegration” was inevitable.⁸

Actually, this was the way the EU leaders had chosen from the start by proposing to approve the so-called Constitutional Treaty of the EU, which envisaged a significant strengthening of the supranational authority of the union, including the introduction of European laws with direct regulative action. Yet the failure of this idea during the 2004 referendums in France (which has always claimed the role of the main generator of European integration ideas!) and the Netherlands, vividly demonstrated the prematurity of the proposed new political format for Europe, its incompatibility with the national sentiment of the broad masses. And this was by no means a coincidence, especially given the fact that this case was not the first accident in the long EEC/EU history.

A change of the Constitutional Treaty format to the Treaty of Lisbon structure, with a much greater degree of freedom, could not but afflict the efficiency of EU’s community mechanisms, as it greatly shifted the balance between the regulative levers from the imperative nature of common norms to coordination mechanisms between independently acting members. These mechanisms have been increasingly complex and cumbersome, and required too much time in the situation of significant growth of EU membership and the objectively growing complexity of member states’ economic structure in the course of their development.

⁸ For more information, see: Charlemagne: The return of Jaques Delors. – The Economist, 12 February 2004, <http://www.economist.com/node/2424124>; Rousselin P. “Après les pompiers, l’UE attend les architectes”: interview avec Jacques Delors. – Le Figaro, 15 June 2010, <http://www.lefigaro.fr/politique/2010/06/15/01002-20100615ARTFIG00681-delors-l-europe-attend-les-architectes.php>

Essentially, *plans to build a political superstructure over EMU have mostly failed*, which was caused by a number of important reasons.

First of all, it should be noted that the factor of economic relevance of EMU formation is very important, but not enough to quickly change the self-identification of the member states' citizens, among which only a minority identifies foremost as Europeans: in reality, *national self-identification prevails, and sometimes, even regional* (for instance, as in Italy, Belgium, certain parts of Spain and Germany) (table "Self-Identification of EU Population"⁹). Also, while in the situation of stable economic development people tend to be internationalists or even globalists, – in the times of socio-economic challenges, they are usually prone to more local orientation. This aspect has caused a major rise of the role of right-wing nationalist parties and movements in most EU countries, especially as the global economic and financial crisis continued in the Euro area. Under such tendencies, there is hardly any reason to expect a substantial increase of the role of supranational bodies within the EU.

Besides, the process of strengthening the role of European institutions is facing a barrier that numerous publications have called the "*democracy deficit*" in the functioning of European institutions. In this context, it should be noted that despite the positive changes in the structure and decision-making procedures in the EU's governing bodies over the last quarter century, and especially after the Treaty of Lisbon, the majority of European states' citizens perceive European institutions as the centre of uncontrolled bureaucracy, independent from them. They realise that continued expansion of common bodies' functions will lead to a greater centralisation of the real power, removing it further away from citizens' place of residence, and will make European powers even more disconnected from common citizens than they already are at the moment. There are particular concerns about further concentration of powers in public funds management, as this may weaken the traditional national schemes for support of socio-economic development.

Finally, the processes aimed at strengthening coordination between member states' economic policies have their own objective limitations, beyond which time and resources used for such coordination are unlikely to be justified by the benefits of creating the larger economic space. This could, in particular, mean economic policies' lower level of flexibility and slower response to new opportunities and challenges, especially in the context of current revolutionary technological changes. Innovations are known to originate in local environments, with subsequent

⁹ Built using data from: European citizenship. – Standard Eurobarometer (spring 2010, spring 2014, spring 2018), European Commission, <http://ec.europa.eu/commfrontoffice/publicopinion/index.cfm/Survey/getSurveyDetail/instruments/STANDARD/surveyKy/2180>.

Self-Identification of EU Population,
% of respondents

	National only			More National than European			More European than National			European only		
	2010*	2014	2018	2010*	2014	2018	2010*	2014	2018	2010*	2014	2018
EU-28	46	39	35	41	51	55	7	6	6	3	2	2
Austria	49	33	41	42	55	48	6	8	8	1	2	2
Belgium	33	33	30	46	54	57	10	8	10	6	3	3
Bulgaria	51	49	46	36	41	41	5	6	6	2	0	1
United Kingdom	70	64	51	24	30	41	2	2	6	2	1	1
Greece	50	49	51	41	47	47	5	3	1	2	1	0
Denmark	43	37	36	52	58	60	4	3	3	1	1	1
Estonia	49	38	40	43	56	52	4	4	6	2	1	0
Spain	35	27	20	50	56	63	6	5	5	5	5	6
Italy	45	45	37	41	46	57	8	5	3	2	1	1
Ireland	58	49	37	34	46	59	4	3	3	2	2	1
Cyprus	39	52	40	44	42	55	7	4	3	6	1	1
Latvia	52	45	44	33	44	44	8	8	8	3	2	3
Lithuania	60	45	44	32	49	50	3	4	5	2	1	0
Luxembourg	22	21	12	46	60	65	12	11	15	16	6	7
Malta	39	26	28	54	69	64	4	3	6	2	1	1
Germany	39	27	26	47	59	57	8	10	11	4	2	3
Netherlands	36	22	28	52	61	63	8	6	7	2	1	1
Poland	44	36	32	48	55	62	6	4	4	1	1	1
Portugal	43	42	32	46	53	64	6	3	3	2	1	1
Romania	50	47	47	18	46	43	13	4	6	6	3	1
Slovakia	41	44	30	45	48	59	10	6	6	3	1	0
Slovenia	55	37	35	37	56	57	4	3	4	3	2	1
Hungary	47	46	25	47	44	64	5	8	10	1	2	1
France	42	34	38	44	57	54	9	6	6	3	1	1
Finland	48	36	37	44	56	54	6	6	7	1	1	1
Croatia	н/д	37	32	—	54	58	—	6	8	—	2	1
Czech	59	48	34	36	45	57	3	4	7	1	3	1
Sweden	48	31	37	44	63	56	5	5	4	1	0	1

* Due to a change of methodology, in 2010, there were no “hard to say”, “refuse to provide an answer”, “no answer” options.

expansion to a wider area. The birth of new technological solutions can require the destruction of the existing global or macroregional connections to give way to the development of new things.

In this context, *certain manifestations of disintegration of the outdated can become a precondition for further development.*

It can be postulated that at the time of fundamental technological breakthroughs, the most important factors are the level of creativity, creative energy and time, not the size of the existing economic space. The new growth of the role of large economic spaces in line with the processes of globalisation and regional integration, must take place *in future* along with the establishment of a new technological paradigm, which will require large amounts of money for its wide dissemination. However, at the present stage of development the importance of integration (due to the very logic of processes of technogenically driven restructuring) is likely to be somewhat reduced. In the current situation, the emphasis on further integration, and hence on stronger unification of the economic space, *may hinder technological development, since it will take large amounts of time and energy for coordination and unification, which could otherwise be used to create new things.*

Thus, a conclusion can be made that ***current crisis processes within the EU*** are not as much a result of political mistakes, the game of national ambitions, or a consequence of sudden external events (spontaneous migration waves or aggressive actions of certain countries), as an ***internally driven process*** that demonstrates a ***wave-like nature of socio-economic and technological development.***

1.2. KEY DIMENSIONS OF CRISIS PROCESSES IN THE EU

Giving the assessment of today's complications in the EU development, one needs to be extremely careful to properly characterise both positive and negative aspects of integration dynamics.

On a positive note, we cannot ignore the fact that since the creation of the European Coal and Steel Community in 1952 and the European Economic Community and Euratom in 1957, European integration in general has been impressively successful, having created the largest common economic space in the world with a rather high level of integration and interdependence of national and regional economies, free movement of goods, services, capital and people ("four freedoms"), and lately, also information and knowledge ("the fifth freedom").

It is important to take into account that these achievements of European integration took place *not as a consistent, steady and continuous process, but rather, as quite pronounced waves – rises and falls, including rather lengthy interruptions and failures.* The integration process has been politically and socially challenging in

all of its stages, as member states have always had differences, which is indicated by numerous publications on the history of European integration:¹⁰

(1) some member states sought “tighter unity” in decision-making as opposed to those, who considered it appropriate to preserve their own national sovereignty within the EU in the most significant areas;

(2) the desire of more developed member states to strengthen their positions and unpreparedness to concede their national interests for the benefit of common European ones;

(3) attempts of economically stronger countries to dictate conditions to less developed ones, and reluctance of the latter to find themselves under political and/or economic protectorate of the former.

At times, this led to major collisions. For instance, the failure of creating the European Defence Community back in the 1950s, the so-called “Empty Chair Crisis” (when the French Government recalled its representatives from the EEC Council of Ministers) in 1965, which was the result of the idea to expand the supranational powers of the European Commission, the early 1970s failure of far-reaching plans to create an economic and monetary union (Barre Plan, 1969; Werner Report, 1970). In other words, *crises have always been a part of the European integration process*.

Yet, after the failure to ratify the Constitutional Treaty and its substitution with the Treaty of Lisbon in 2007, the EU experienced one of the most complicated decades in its history, and crisis processes within the Union gained a different quality – became longer, deeper and more broadscale. They ceased being a purely economic or political problem, and became accompanied by a rise of euroscepticism movements. *The integrated nature of crisis processes and their complexity have become their typical features*.

Thus, a famous researcher of European integration Iván Berend¹¹ described *a simultaneous presence of nine crises* in the EU development in one of his latest papers – five avert ones (the euro crisis, the Greek debt crisis, the Russian challenge to European security, UK’s exit from the EU, the migration crisis) and four more hidden crises (“a demographic time bomb”, continued EU enlargement and its controversial neighbourhood policy, reverse trends in Eastern Europe’s transformation and certain negative attributes of contemporary capitalism: speculative crises, unemployment, and inequality).

It should be noted that such a large number of crises may be a sign of the systemic nature of socio-economic and political perturbations. There are sufficient arguments to consider these nine crises as *different aspects (dimensions) of one overall crisis process in the development of European integration*.

¹⁰ See, for example: European Union: from Crisis to Crisis. – National Strategy Issues, 2011, No.1 (6), p.7-25 (in Russian).

¹¹ Source: Berend I. The Contemporary Crisis of the European Union: Prospects for the Future. – New York: Routledge, 2017.

The 2008-2009 global economic and financial crisis became a catalyst for fundamental problems of European integration and gave rise to a number of systemic risks that destabilised integration processes within the EU.¹²

One should also notice that crises of the past decade have made the defects in the EU mechanisms so apparent that it caused a sharp increase in the use of ad hoc mechanisms, “manual” management, irregular mini-summits, increased intergovernmental nature of EU policies and enhanced influence of certain states. This allowed to implement urgent rescue measures, but did not solve all the problems. Moreover, this was a distraction from the really important strategic problems. Another consequence of this situation was the loss trust in the work of European integration institutions among the majority of population, because they have never been as democratic and transparent as the ones in the national states with their historically tried and tested mechanisms of public control over the work of government institutions.

Because crisis manifestations were long-term and multi-dimensional, they became a factor that destroyed consensus within the EU’s governing bodies, as pragmatic nationalistic considerations started prevailing over the feeling of historical unity (Euro-idealism). Moreover, differences in political and economic issues ceased being sporadic (arising from time to time) and local (in certain places), and started manifesting themselves *regularly and on a broad scale* as contradictions between the more developed North and less developed South, between the “old” and the “new” EU members (“New Europe”). All of these constitute evidence that ***the system found itself in the state of bifurcation*** (at a crossroads) with different possible scenarios of further development.

Particular political intensity was added to internal contradictions in the European integration development by the UK’s decision to exit the EU, which was an unprecedented move in the more than 60-year-history of European integration, and could not but raise the issue of the *possibility of a reverse process*, and thus, challenge the very European idea in the format that had been developed after World War II. In the presence of national populism centres in a number of other EU countries, this creates certain ***potential for a major change of format of European integration and the overall political agenda of the EU***.

An illustrative symptom of European integration dysfunction is the *increase in the number of anti-European or “eurosceptical” political parties and movements in recent years*. EU countries, where they became important players on the political arena, include Austria, United Kingdom, Greece, Denmark, Italy, Netherlands, Germany, Poland, Hungary, France, Finland, Czech Republic, and Sweden. Some of the eurosceptical parties achieved significant success in national and local elections (insert “Strengthening of Anti-European and Eurosceptical Political Forces in EU Member States”), and also managed to pass to the European Parliament in 2014, with 25% of the 751 seats.

¹² Source: Archick K. European Union: Current Challenges and Future Prospects. – Congressional Research Service, 27 February 2017, <https://fas.org/sgp/crs/row/R44249.pdf>

STRENGTHENING OF ANTI-EUROPEAN AND EUROSCEPTICAL POLITICAL FORCES IN EU MEMBER STATES

Austria: The country's new government was created after the National Council elections (lower chamber of the parliament) in October 2017 on the basis of a coalition between the centre-right Austrian People's Party (Österreichische Volkspartei) and ultra-nationalist Austrian Freedom Party (Freiheitliche Partei Österreichs, FPÖ), representatives (or nominees) from which include Vice-Chancellor and Heads of the Ministry for Europe, Integration and Foreign Affairs (Bundesministerium für Europa, Integration und Äußeres) and the Ministry of the Interior.

United Kingdom: eurosceptical forces in the leadership of Conservative and Unionist Party have achieved success in the form of the decision on the UK's exit from the EU (Brexit).

Greece: anti-EU sentiment became widespread during the Greek debt crisis and many political forces within the country (namely, Golden Dawn, Panhellenic Socialist Movement, Communist Party) associate them with unfair (in their opinion) treatment of Greece by the governing bodies of the EU and some of the influential EU member states.

Denmark: starting in 2014, new parties with a more radical approach regarding EU policy have appeared in the country (e.g., The New Right, National Party). Note that in 2014 the nationalistic and anti-immigration Danish People's Party won the country's European Parliament elections with a record 27% of votes. In 2015, based on results of national parliamentary elections, the party got 21% of votes, becoming the second centre-right party in the country.

Italy: the new government, formed by the coalition of the anti-European "Movement of Five Stars" (Movimento 5 Stelle) and the "North League" (Lega Nord), has already embarked on "derailing" common EU policy in migration regulation and harmonisation of financial and budgetary parameters, directly threatening to destroy the common position on the continuation of EU sanctions against Russia.

Netherlands: The newly created right-wing nationalistic party "Forum for Democracy" (Forum voor Democratie, FVD) was the winner in the March 2019 election for the provinces. Thus, it will become (in May 2019) one of the two biggest parties represented in the Senate holding the same number of Senate seats as the liberal People's Party for Freedom and Democracy (VVD) – the core of the current government coalition.

Germany: the right-wing nationalist movement "Alternative for Germany" (Alternative für Deutschland) has gained greater popularity, won seats in the Bundestag, and in October 2018, became third largest faction in the Bavarian Landtag, having taken away almost one fourth of supporters from the ruling Christian Social Union (CSU) party.

Poland: the nationalist party "Prawo i Sprawiedliwość" (Law and Justice Party), which supports euroscepticism gained the majority of votes in the parliamentary elections in October 2015.

Hungary: : President V.Orban (is a eurosceptic) has an open conflict with the EC and European Parliament on a number of issues related to accusations stating that Hungary violates EU's fundamental principles. His party "Fidesz" (Hungarian Civic Alliance) got the support of almost 49% of all voters in the parliamentary elections in spring 2018.¹³

Finland: currently, moderate eurosceptic "Finns Party" is a part of the coalition government.

France: during the presidential election in the spring of 2017, candidate Marine Le Pen ("National Front", Fr. "Front National", as of 01.06.2018 – "Rassemblement National"), who promised to lead France out of the Euro area and hold a referendum on the country's future membership in the EU within 6 months after becoming president, managed to get to the second round of elections.

Czech Republic: at the moment, both the president of the country M.Zeman and its prime minister A.Babis are eurosceptics.

Sweden: even in this country, recent parliamentary elections led to a notable strengthening of eurosceptics' positions. Thus, in early September 2018, eurosceptical party "Sweden Democrats" came third by the number of votes – 17.6%.¹⁴

¹³ Source: Santora M., Bienvenu H. Hungary Election Was Free but Not Entirely Fair, Observers Say. – The New York Times, 9 April 2018, <https://www.nytimes.com/2018/04/09/world/europe/hungary-election-orban-fidesz.html>

¹⁴ Source: Kirk L. Overseas votes could swing Sweden election result. – Euobserver, 10 September 2018, <https://euobserver.com/elections/142774>

A key factor in the extremely rapid spread of eurosceptical sentiment in EU member states has been the severe European migrant crisis caused by the so-called “Arab Spring”¹⁵ (insert “EU Migrant Crisis”).¹⁶

EU MIGRANT CRISIS

The continuous inflow of migrants, especially illegal, who left their homes with a hope to find better life because of problems in North Africa and Middle East, is the most topical problem for the EU today. According to Eurostat, between 2013 and 2016, the inflow of illegal migrants into EU countries was rapidly growing. It peaked in 2015, when 2.1 mln people’s arrival was recorded. In 2017, the number of illegal migrants was 618.8 thousand people, having gone down 37% (compared to 2016) and 71% (compared to 2015).¹⁷

Among EU member states that recorded the largest numbers of illegal migrants from non-EU countries in 2017 were Germany (156.7 thousand), France (115.1 thousand), Greece (68.1 thousand), United Kingdom (54.9 thousand) and Spain (44.6 thousand). These states received about 71% of all illegal migrants to the EU.¹⁸ Most of them were citizens of Syria, Afghanistan, Iraq and Albania (table “Top-10 Countries That Supplied the Largest Inflow of Illegal Migrants”¹⁹).

Top-10 Countries That Supplied the Largest Inflow of Illegal Migrants, persons

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Overall, 2008-2017
Overall, among them:	583 255	568 525	508 850	474 690	439 420	452 270	672 215	2 154 675	983 860	618 780	7 456 540
Syria	4 545	4 670	4 115	5 430	17 165	33 090	118 865	859 035	213 080	39 335	1 299 330
Afghanistan	49 860	50 605	42 060	46 425	35 750	26 095	48 550	409 275	151 825	35 415	895 860
Iraq	37 425	23 465	16 770	12 150	9 315	6 525	10 275	185 315	92 985	36 405	430 630
Albania	72 730	69 020	52 465	17 245	18 655	27 325	32 195	50 150	36 135	40 025	415 900
Morocco	39 505	32 560	29 770	28 990	28 135	27 255	32 075	41 740	39 470	38 060	337 560
Pakistan	13 245	15 540	19 495	33 120	3 0355	27 440	24 005	81 850	46 530	33 580	325 160
Eritrea	21 030	10 690	7 070	8 075	6 025	10 235	50 795	41 575	23 270	17 880	196 645
Algeria	15 745	15 925	19 335	18 220	17 755	15 370	15 415	19 375	23 785	25 005	185 930
Ukraine	12 835	11 510	11 205	12 750	12 930	12 675	16 905	23 920	29 785	33 795	178 310
Nigeria	16 440	16 425	16 910	14 080	12 130	14 365	16 410	20 395	20 545	19 390	167 090

¹⁵ In the early 2015, there was a major surge in the number of refugees and illegal migrants from the conflict areas in the Southern and Eastern Mediterranean to the EU, which was not ready to accept and distribute them.

¹⁶ For more information on the EU migrant crisis, see also article by V.Holub in this publication.

¹⁷ Source: Non-EU citizens found to be illegally present in the three most affected EU Member States, 2008-2017. – Eurostat, http://ec.europa.eu/eurostat/statistics-explained/index.php/Statistics_on_enforcement_of_immigration_legislation#Non-EU_citizens_found_to_be_illegally_present

¹⁸ Differences in migration policy implementation, administrative, statistical and legal acts, as well as judicial procedures affect the statistics provided by the EU member states.

¹⁹ Source: Non-EU citizens found to be illegally present in the three most affected EU Member States, 2008-2017. – Eurostat, http://ec.europa.eu/eurostat/statistics-explained/index.php/Statistics_on_enforcement_of_immigration_legislation#Non-EU_citizens_found_to_be_illegally_present

The highest percentage of illegal migrants – 79.3% – was among men. Persons aged 18-34 y.o. made up 61.2% of the total number of detained illegal migrants in 2017, 25.8% – 35 y.o. and older, 13.1% (or 79.2 thousand) – children aged 0 to 17 y.o.

Despite the fact that record high migration flows in the EU, recorded in 2015-2016, went down in 2017, still, the inflow of migrants remains at a rather high level. In 2018 and in the future, given the consequences of international and national conflicts, climate change and a growing economic gap between the EU and “third world” countries, migration pressure is unlikely to go down. Thus, the EU has to find ways to adjust to the new reality and be prepared for irregular migrant flow. At the moment, the EU is implementing a number of measures reflected in the EU Budget, which has approximately €4.1 bn allocated for the regulation of migration and security issues in 2018, while the total funding of these areas in 2015-2018 was €22 bn.²⁰

EU migrant crisis has challenged the possibility of preserving unity among member states and achieving a compromise regarding this painful issue. Indeed, a significant increase of the number of migrants creates major additional risks for these states' security, puts significant financial burden on their budgets (as well as on family budgets of citizens – taxpayers in the EU), – and this cannot but result in an increase of anti-European sentiment.

Ironically, the very aspect of free movement of persons without borders, which for a long time was considered possibly the largest social achievement of the European integration process by a large number of EU citizens, has turned into its most destabilising factor. It is this factor that is reviving nationalist instincts of the past on the subconscious level and is nourishing the anti-European right-wing nationalist parties and movements.

Of course, mass migration alone would not have caused this rise of contradictions within the EU, if it did not overlap with economic challenges in most EU countries. These complications greatly slow down migrants' adjustment in the accepting countries, thus exacerbating the socio-economic contradictions.

Global economic recession of 2008-2009 and the Euro area crisis, which was triggered by a critical increase of national debts, have significantly influenced European economies, slowing down economic growth, increasing unemployment, and jeopardising the stability of the European banking system. Drastic austerity measures aimed at curbing budget deficit and reducing national debt, which were introduced by some EU member states' governments, had a negative effect on economic activity, although they did create certain preconditions for recovery in the long run. However, a number of member states have recorded low growth rate and a high level of unemployment, especially among young people (insert “Ongoing Challenges in the EU Economy”, p.26).

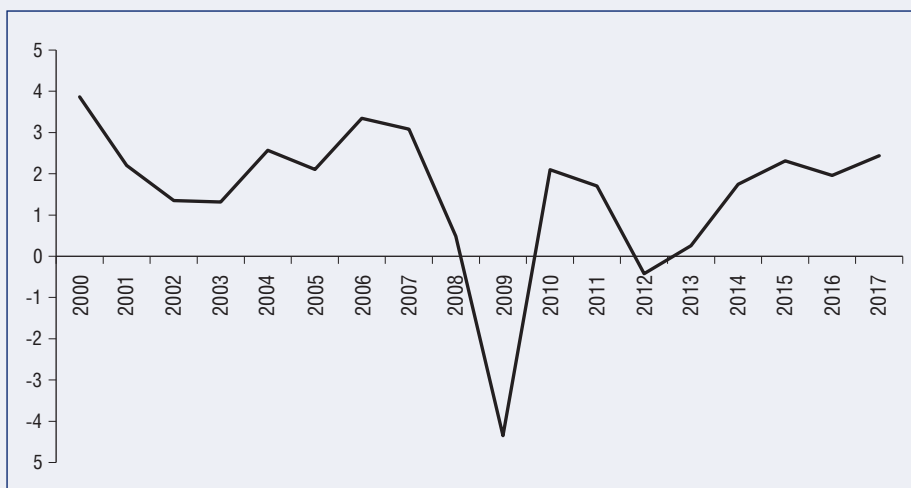
²⁰ Source: Bassot É. Ten issues to watch in 2018. – European Parliamentary Research Service, January 2018, 25 p., [http://www.europarl.europa.eu/RegData/etudes/IDAN/2018/614650/EPRS_IDA\(2018\)614650_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2018/614650/EPRS_IDA(2018)614650_EN.pdf)

ONGOING CHALLENGES IN THE EU ECONOMY

Measures to overcome the consequences of the 2008-2009 global economic and financial crisis have cost the EU the total of over €4.5 trillion, or 37% of the total GDP of the EU countries.²¹ Yet even with such costs, the EU did not manage to overcome the negative consequences completely, and therefore, the imbalances caused by the global crisis turned into prolonged complications in the areas with the weakest economies, leading to a critical aggravation of debt problems at the “periphery” of the Euro area. These complications overlapped with the general unfavourable trend of EU’s decreasing role in the global economy due to faster growth of some dynamic “third world” countries, as a result of which, EU’s share in the global GDP (PPP) between 1980 and 2017 went down from 30.1% to 16.5%,²² and in global export – from 41.5% to 33%.²³

And only in 2017, for the first time since 2007, the EU has reached proper indicators of economic growth rate (diagram “GDP Growth Rate in EU-28”²⁴) due to generally improved situation in global economy, increased level of trust, reduced financial expenses, stabilisation of extrabudgetary balances and improved labour market conditions.²⁵

GDP Growth Rate in EU-28, %



Yet, even in the current situation, a major problem remains unresolved: disproportionate external debt of some Euro area member states, which is caused by forced allocation of large amounts of state funds for overcoming long-term structurally determined imbalances.

²¹ Source: Privatizing Europe. Using the Crisis to Entrench Neoliberalism. – Working Paper. Transnational Institute Amsterdam, March 2013, https://www.tni.org/files/download/privatising_europe.pdf

²² Source: IMF DataMapper. – World Economic Outlook (October 2018), <https://www.imf.org/external/datamapper/PPPSH@WEO/OEMDC/ADVEC/WEOWORLD/EU>

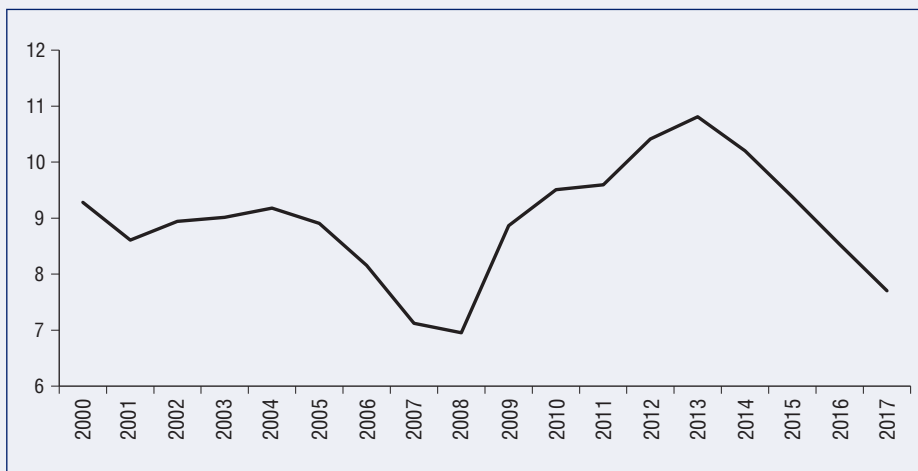
²³ Source: World Bank Indicators. – The World Bank, <https://data.worldbank.org>

²⁴ Built using data from: World Bank Indicators. – The World Bank, <https://data.worldbank.org>

²⁵ Source: European Economic Forecast (Spring 2018). – Institutional Paper 077, May 2018, European Commission, https://ec.europa.eu/info/sites/info/files/economy-finance/ip077_en.pdf

Another topical issue is the extremely high level of unemployment, especially among young people. Although, compared to 2013, there is clearly positive dynamics in this issue: the overall level of unemployment in the EU is approaching the pre-crisis level of 2007-2008 (diagram “Level of Unemployment in EU-28”²⁶). That said, the level of unemployment among young people (15-24 y.o.) is almost 17%.

Level of Unemployment in EU-28, %



A further growth of employment level can be slowed down by the termination of temporary fiscal measures to stimulate economy in member states,²⁷ increasing shortage of skilled labour supply both in manufacturing and in services, as well as the (expected) increase of labour productivity due to introduction of technological innovations.

All of these problems are greatly enhanced by the *growing uncertainty about further development*, which is caused by endogenous (entering the period of fundamental technological transformations and corresponding structural changes in economy and employment), as well as exogenous factors (new trade and tax policies of U.S. President D. Trump and the general escalation of geopolitical tensions in the world).²⁸

In general, experts are increasingly apprehensive that *the world is nearing a possible recurrence of global economic recession*. At least, there were warnings about this from several reputable experts, who took part in the global think tank

²⁶ Built using data from: World Bank Indicators. – The World Bank, <https://data.worldbank.org>

²⁷ Examples of such measures include temporary reduction of social security contributions in Italy, active employment policy in Spain, and tax incentives to facilitate creation of new jobs in France.

²⁸ For more information, see: Economic and Budgetary Outlook for the European Union 2018. – European Parliament, January 2018, [http://www.europarl.europa.eu/RegData/etudes/STUD/2018/614655/EPRS_STU\(2018\)614655_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2018/614655/EPRS_STU(2018)614655_EN.pdf)

summit “T20 Argentina” (on 16-18 September 2018 in Buenos Aires, Argentina),²⁹ which resulted in a package of 20 recommendations for the G20 summit in the end of November – beginning of December 2018. Among key global risks that directly concern the EU and its “core” – the Euro area, is the lack of effective mechanisms for solving the sovereign debt problem, which is dangerous in the context of a significant increase of financial resources being allocated for economic development.³⁰

In this context, *the debt crisis in Greece and in some other Euro area countries* is an extremely important measure of crisis processes. Indeed, over the past eight years, debt problems of a number of Euro area countries have become truly global and have created a pan-European debt problem, which raises concerns about the viability of the Euro area itself. The average amount of aggregate government debt in Euro area countries for this period has been increasing fast every year – from 78.4% of GDP in 2008 to almost 92% in 2014. And even after a certain reduction in 2017, according to IMF, it still amounted to 86.6%.³¹ This indicator by far exceeds the level established by the Maastricht criteria, according to which government debt should not exceed 60% of GDP (insert “Maastricht Convergence Criteria for the Euro Area”).

MAASTRICHT CONVERGENCE CRITERIA FOR THE EURO AREA

In 1992, EEC member states signed the Maastricht Treaty, which was the first step to introducing a single currency – the Euro. The Maastricht Treaty legalised the so-called convergence criteria – a set of rules for member states and those who wish to join the Euro area in the future. To join the Economic and Monetary Union, states had to commit themselves to control inflation, government debt and government budget deficit, as well as maintain exchange rate stability and convergence of interest rates. Namely:

- The inflation rate cannot be higher than 1.5 percentage points above the rate of the 3 best-performing member states.
- The long-term interest rate should not be higher than 2 percentage points above the rate of the 3 best-performing member states in terms of price stability.
- Government budget deficit cannot be higher than 3% of GDP.
- Government debt cannot be higher than 60% of GDP.
- The candidate has to participate in the exchange rate mechanism (ERM II) for at least 2 years without strong deviations from the ERM II central rate and without devaluing its currency's bilateral central rate against the euro in the same period.

²⁹ One of the authors of this report – Volodymyr Sidenko – took part in this summit representing the Razumkov Centre.

³⁰ According to H.Kharas from Brookings Institution (USA), this problem creates significant potential for a build-up of a new global shock.

Despite the clearly established criteria, the EU still failed to prevent an extensive debt crisis. Some of the underlying reasons are: (1) leading member states' recurrent failure to adhere to the requirements of the Stability and Growth Pact (especially destructive were the "precedents" set by France and Germany); (2) underestimation by EU leaders of the growing risks associated with EU enlargement and accession of countries with lower economic potential; (3) the phenomenon of divergence between Euro area countries by the level of their economic development, which was becoming increasingly more apparent since the beginning of the global crisis, and the increasing gap between the "strong North" (Austria, Belgium, Germany, Netherlands, Finland and France) and the "weaker South" (Greece, Spain, Italy, Portugal).

As a response to the spreading negative influence of the debt crisis, the EU has implemented a number of measures in relation to systemically important institutions, including putting on the agenda the issue of *Banking Union* creation, reforming of mechanisms of macroeconomic regulation and coordination through the so-called *European Semester*, as well as implementation of new rules of economic and fiscal supervision aimed at creating the Fiscal Union.³²

In the same context, a decision about expanding the lending potential of the European Financial Stability Facility was made and the European Stability Mechanism was founded. Starting from 2010, these institutions, as well as the IMF have given a large number of macroeconomic support loans to some of the most problematic countries in the Euro area.³³ Yet, despite this fact, the government debt of the most problematic debtor countries still remained large (as of 2017): Greece – 181.9%, Italy – 131.5%, Portugal – 125.6%.³⁴

It is predicted, however, that due to systematic long-term effect of implemented measures, government debt to GDP ratio in the Euro area will be going down, which will be also facilitated by the so-called snowball effect.³⁵ Yet, even with

³¹ Source: World Bank Indicators. – The World Bank, <https://data.worldbank.org>

³² For more information, see: Sidenko V.R. Policy of Completion of the European Economic and Monetary Union: Main Trends and Possible Consequences for Ukraine. – *Economy of Ukraine*, 2014, No.10, p.51-66 (in Ukrainian and Russian).

³³ In May 2010, Greece received a €110 bn loan, and in March 2012 – €130 bn; in November 2010, Ireland was given a €67.5 bn loan; in April 2011, Portugal received a €78 bn loan. For more information, see: Bohdan T. Global Risks of "Hovering" Debts in Developed Countries and Ways to Minimise Them. – *Bulletin of the National Bank of Ukraine*, 2014, No.6, 39-46 (in Ukrainian), http://www.irbis-nbuv.gov.ua/cgi-bin/irbis_nbuv/cgiirbis_64.exe?C21COM=2&I21DBN=UJRN&P21DBN=UJRN&IMAGE_FILE_DOWNLOAD=1&image_file_name=PDF/Vnbu_2014_6_4.pdf

³⁴ Source: General government gross debt (Percent of GDP), IMF Data Paper. – International Monetary Fund, http://www.imf.org/external/datamapper/GGXWDG_NGDP@WEO/EURO/AUT/BEL/CYP/FRA/MLT/DEU/ITA/GRC/IRL/LVA/LTU/LUX/NLD/EST/SVK/SVN/FIN/PRT/ESP

³⁵ Snowball effect explains the influence on the acceptable debt level that occurs if real interest rate exceeds real GDP growth. According to EC data, the snowball effect will facilitate the reduction of Euro area government debt-to-GDP ratio by slightly more than 1 percentage point of GDP/year on average for the projected period.

these positive trends, in 14 member states this rate will remain in 2019 above 60% (the Maastricht debt criterion), and in seven countries – Belgium, Cyprus, France, Greece, Italy, Spain and Portugal – it will exceed 90% (table “General Government Gross Debt in Euro Area Member States”³⁶).

General Government Gross Debt in Euro Area Member States.
% of GDP

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018 (projections)	2019 (projections)
Euro Area	68.6	78.4	83.8	86.1	89.4	91.3	91.8	89.9	88.9	86.6	84.2	81.7
Austria	68.4	79.6	82.4	82.2	81.6	81.0	83.8	84.3	83.7	78.8	75.4	72.0
Belgium	92.5	99.5	99.7	102.6	104.3	105.5	106.8	106.0	105.7	103.2	101.0	99.1
Germany	65.1	72.6	80.9	78.6	79.8	77.4	74.7	71.0	68.2	64.1	59.8	55.7
Greece	109.4	126.7	146.2	172.1	159.6	177.9	180.2	178.8	183.5	181.9	191.3	181.8
Ireland	42.4	61.5	86.1	110.4	119.7	119.6	104.7	77.1	72.9	68.5	67.1	64.9
Spain	39.4	52.7	60.1	69.5	85.7	95.5	100.4	99.4	99.0	98.4	96.7	95.1
Italy	102.4	112.5	115.4	116.5	123.4	129.0	131.8	131.5	132.0	131.5	129.7	127.5
Cyprus	44.1	52.8	55.8	65.2	79.2	102.1	107.5	107.5	107.1	99.3	97.0	89.5
Latvia	16.2	32.5	40.3	37.5	36.7	35.8	38.5	34.9	37.4	34.8	32.9	31.9
Lithuania	14.6	29.0	36.2	37.2	39.8	38.8	40.5	42.6	40.2	36.5	34.2	31.4
Luxembourg	14.9	15.7	19.8	18.7	21.7	23.7	22.7	22.0	20.8	23.0	22.9	22.8
Malta	62.6	67.6	67.5	70.1	67.8	68.4	63.8	58.7	56.2	52.6	48.6	45.9
Netherlands	54.5	56.5	59.3	61.6	66.3	67.8	68.0	64.6	61.8	56.7	53.5	50.9
Portugal	71.7	83.6	96.2	111.4	126.2	129	130.6	128.8	129.9	125.6	121.2	117.5
Slovakia	28.1	35.9	40.7	43.2	52.2	54.7	53.5	52.3	51.8	50.4	49.0	46.6
Slovenia	21.6	34.5	38.2	46.4	53.8	70.4	80.3	82.6	78.4	75.4	72.1	69.8
Finland	32.7	41.7	47.1	48.5	53.9	56.5	60.2	63.6	63.0	61.4	60.5	59.6
France	68.7	82.9	85.1	87.8	90.7	93.5	95.0	95.8	96.6	97.0	96.3	96.2
Estonia	4.5	7.0	6.6	6.1	9.7	10.2	10.7	10.0	9.4	8.8	8.5	8.1

The negative state of public finance in a number of Euro area countries is directly related to the low level of bank capitalisation, which, in turn, is generated by large volumes of bad loans (according to the European Banking Authority, as of 2016, the volume of problem loans in the EU was estimated at around €1 trillion, or 5.4% of all loan portfolio), low profitability, more difficult conditions for compliance with capital

³⁶ Built using data from: General government gross debt (Percent of GDP), IMF Data Paper. – International Monetary Fund, http://www.imf.org/external/datamapper/GGXWDG_NGDP@WEO/EURO/AUT/BEL/CYP/FRA/MLT/DEU/ITA/GRC/IRL/LVA/LTU/LUX/NLD/EST/SVK/SVN/FIN/PRT/ESP

adequacy ratio norm under Basel III rules, problems with dividend payments.³⁷ Lack of capital in banking institutions prevents them from carrying out their loan functions, and a decreased level of access to loans for entrepreneurs hampers economic growth.

In general, we can conclude that *despite certain improvements that took place after the peak of crisis in 2014-2015, the EU and its European integration “core” in the form of the Euro area are still under the influence of a number of powerful and diverse destabilising factors, which may become significantly more influential in case of a new wave of global economic shocks. Partial reforms implemented in the EU and the Euro area in recent years are incomplete and allow for movement along different trajectories, which in turn leads to a variety of potential outcomes.*

1.3. POTENTIAL OUTCOMES OF CRISIS DEVELOPMENTS IN THE EU: REFORMS OR DECLINE?

Current crisis processes in the EU launched broad and fundamental discussions, with a variety of different assessments and predictions – depending on ideological principles: from statements about the inevitability of a new intensive integration period, a real breakthrough in the EMU completion, and formation of a political union – to predictions of a deepening decline, the loss of global influence and, ultimately, disintegration of the Union in its current form.

At the moment, we cannot dismiss with certainty any of the alternatives. Today's world finds itself in transition – experiencing fundamental and comprehensive changes towards a new global economy of the future. In such transitional times, according to principles of complexity (synergetic approach), chances for realisation of different development scenarios are likely to be equal.

That said, EU's future path will greatly depend on correct understanding of the nature of current complications in European integration development and the ability to clearly identify the drawbacks within its system, which started to fail at performing its functions.

In this context, without claiming to present an exhaustive and completely correct list of problematic aspects that complicate EU's effective recovery from the current crisis, we intend to point out some crucial aspects.

First of all, we should take into consideration that the EU in general and the Euro area in particular *do not have at the moment a single or at least sufficiently coordinated strategic vision* of the mechanisms needed for further development of the integration community. Instead, there are fundamental differences between member states that hamper the development of such a vision.

³⁷ Source: Štefanec I. How to ensure the survival of the monetary union. – European View, Volume 16, 2017, <https://www.martenscentre.eu/sites/default/files/publication-files/eurozone-future-european-view.pdf>

We are observing some countries' and political forces' desire to prevent the EU from becoming a "supernation" with centralised regulation of most processes, and form a lighter integration structure as opposed to that – so to speak, "EU-light" – i.e. a union, where member states would regain some of the powers they have formerly delegated to Brussels.³⁸ Eurosceptics therefore attack principles based on application of unified political approaches lacking sufficient consideration for national interests and specific conditions (the so-called "one-size-fits-all" policy), which, according to them, means an unacceptable reduction of the level of national sovereignty and powers delegated to democratically elected national governments for ensuring proper living and development environment for citizens. Hence the firm intention *to block the further extension of powers of EU's supranational structures, on the one hand, and to stop the process of further EU enlargement, on the other.*

Although some experts state that increasing the number of EU member states is necessary to ensure economic growth and security within the Union, many others, to the contrary, express scepticism regarding the prospects of national governments giving more powers to Brussels.³⁹ Some even believe that EU enlargement has reached its geographical limit, and including more countries may compromise further economic and fiscal integration, while also making foreign policy efforts extremely difficult.

Collision of these different views of further prospects causes *permanent changes in the ultimate balance of political powers*, which, in turn, leads to ***volatility of the EU's strategic course.***

In this context, it is rather interesting that in early February 2018 the EC published its "enlargement strategy"⁴⁰, and in April it recommended that European Council start accession negotiations with Macedonia and Albania. However, participants of the "EU-Western Balkans Summit" that took place on 17 May 2018 in Sofia

³⁸ For more information, see: Dorosh L., Ivasechko O. Aspects of Operation and Challenges in the Development of EU in the Near Future (2017-2018). – Humanitarian Vision, vol.3, issue 1, 2017, p.19-24, <http://science.lpnu.ua/sites/default/files/journal-paper/2017/nov/6650/dorosh.pdf> (in Ukrainian).

³⁹ Emmer F., Petrovi S. The Past, Present, and Future of EU Enlargement. – Fordham International Law Journal, Vol.37, 5 Issue 2014, <https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=2350&context=ilj>; Xing Hua. EU Enlargement in the 21st Century: New Stage and Challenges. – China Institute of International Studies, 23 September 2014, http://www.cis.org.cn/english/2014-09/23/content_7254504.htm; Jano D. Brexit implications on EU enlargement: is it make or break time? – Policy Brief, 27 June 2016, EU Policy Hub Communicating Europe, http://www.eupolicyhub.eu/wp-content/uploads/2017/09/1.-Brexit_implications_on_EU_enlargement.pdf; Stojić M. EU enlargement after Brexit: temporary turmoil or the final nail in the coffin of enlargement? – The European Parties Elections and Referendums Network (EPERN), 15 December 2016, <https://epern.wordpress.com/2016/12/15/eu-enlargement-after-brexit-temporary-turmoil-or-the-final-nail-in-the-coffin-of-enlargement>

⁴⁰ For more information, see: A credible enlargement perspective for and enhanced EU engagement with the Western Balkans. – European Commission, Strasbourg, 6 February 2018, https://ec.europa.eu/commission/sites/betapolitical/files/communication-credible-enlargementperspective-western-balkans_en.pdf

(Bulgaria)⁴¹ were already talking only about the general European prospects for Western Balkans, and not the future EU accession, which is currently looked upon with major reservations by France, Netherlands and Denmark. On the one hand, there is a statement (in the Rome Declaration of 2017) that “the door [is] open to those who want to join later”⁴², on the other – there are officially voiced concerns regarding the negative consequences of further EU enlargement, due to potential adverse institutional effects, unstable economies in a number of countries and the overall identity problem regarding the countries that have pronounced cultural differences, e.g. Turkey, or poorer countries of the Wider Europe, which usually includes Ukraine, Moldova, Georgia, Armenia, and Azerbaijan.

The same hesitation is also observed regarding further deepening of European integration. In this context, the strength of euroscepticism is based on the fact that it is not a random occurrence, but a way of thinking that is deeply rooted in people’s minds and is formed by the answer to the following question: is there a viable alternative to EU membership? And when citizens of a country are more optimistic about its ability to act alone, they become more sceptical towards European integration.

At the same time, let us also keep in mind that since the beginning of European integration, policy-making mechanisms inside the EU have undergone significant changes. Originally, political decisions were made by each state independently. *Today, this process is much more complex, and de facto multi-level*, involving different non-governmental unions, associations and networks, which deprives national states of their role as the only entity within European integration processes. The new political reality is that *further development of European integration is impossible outside of synergy between the different entities within this process*, which make up social structures in general, provide this process with necessary social energy, and ultimately, make it legitimate.

Yet, this does not mean that further development of European integration does not require strong leaders with strategic vision anymore. They are necessary,⁴³ and their absence in recent years has had a strong adverse effect on the evolution of European integration processes. In the absence of a generally recognised leader, who would become the ideologist of the “new European integration course”, we

⁴¹ For more information, see: EU-Western Balkans summit in Sofia. – Council of the European Union, <http://www.consilium.europa.eu/en/meetings/international-summit/2018/05/17/>

⁴² Source: The Rome Declaration. Statements and Remarks, 149/17. – Council of the EU, 25 March 2017, <http://www.consilium.europa.eu/en/press/press-releases/2017/03/25/rome-declaration/pdf>

⁴³ And Europe always had them at its crucial development points. Major role was played by citizens of largest European countries, foremost, France, Germany, Italy, and in the issues of common foreign policy and security policy formation – also the United Kingdom.

see the obvious increase of centrifugal trends, a growth in the number of opinion differences, and the shrinking of the area for coordinated action aimed at conscious formation of the future. Multi-faceted manifestations of crisis processes cast doubts on the adequacy and unity (in views) of upper EU leadership in the context of their search for the necessary compromise.⁴⁴

The search for effective answers to EU's crisis challenges makes us revisit many principles that were for a long time considered immutable. In particular, we believe that further homogenisation of general rules for the entire Union (towards which the EC is so strongly inclined) is not what is required for overcoming the European integration crisis. Such inclination is facing increasingly more significant barriers connected with the rise of economic and social inequality within the EU. What could work here, are *the principles of flexibility and diversity as applied to formation of European structures, given that effective cooperation is ensured in truly important strategic issues*.

That said, further activity must be based on assumption that the *conditions of the environment, in which European integration is developing, will keep getting more complicated*. This will further highlight the importance of concentration of EU governing agencies on key issues.

New, more complicated conditions of EU development will be largely determined by negative demographic processes within the EU, which lead to a decreasing number of working age population (table "Working Age Population in Some EU Member States"⁴⁵): according to predictions, from 2005 to 2030, the quantity of working age population in Europe will go down 20.8 million persons.

Working Age Population in Some EU Member States
(age 15-64 y.o.)

Country	million persons			1950-2010		2010-2050	
	1950	2010	2050	1950-2010 index	Change, %	2010-2050 index	Change, %
Germany	46	54	41	1.19	19	0.75	-25
France	28	41	42	1.48	48	1.02	2
Italy	30	40	31	1.31	31	0.79	-21
United Kingdom	34	41	43	1.21	21	1.05	5

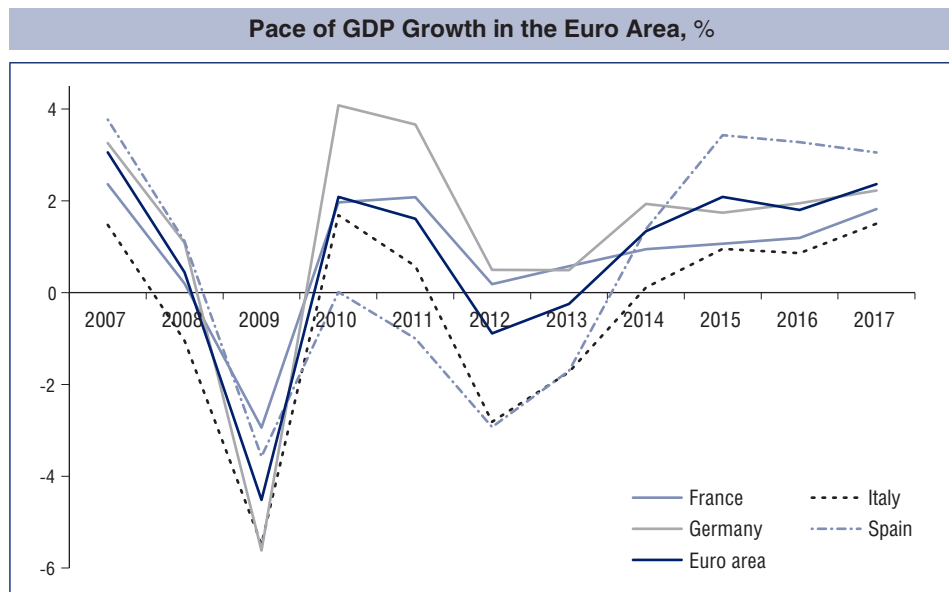
⁴⁴ Catherine E. de Vries. What is the future of the European Union? – OUPblog, 11 March 2018, <https://blog.oup.com/2018/03/future-european-union-euroscpticism>

⁴⁵ Source: World Population Prospects – UN, Volume I: Comprehensive Tables, 2010 version, http://www.un.org/en/development/desa/population/publications/pdf/trends/WPP2010/WPP2010_Volume-I_Comprehensive-Tables.pdf

This factor may fundamentally alter the attitude to migration issues in the future, turning immigration from a social challenge to an economic imperative that compensates for the lack of own labour force. Yet, at the same time, this factor may significantly complicate the social structure of leading member states, making them even more multicultural, and forming social environments, where development and implementation of “one-size-fits-all” template solutions will be simply impossible.

An equally complex and important issue is the *possible increase of divergences in the overall economic dynamics of member states*, which is likely to be strongly influenced by *the existing differences in science and technology capacity of different EU members and their ability to effectively harness the achievements of the advancing Fourth Industrial Revolution*. This is a very important aspect of maintaining the unity of EU’s economic space, as joint approaches to macroeconomic regulation and implementation of joint economic policy in general are possible only on condition of synchronised economic cycles of member states.

In previous periods, general economic conditions in the Euro area countries presented a rather high correlation (diagram “Pace of GDP Growth in the Euro Area”⁴⁶).



⁴⁶ Built using data from: GDP growth (% annual), World Bank Indicators – World Bank, <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?view=chart>

In this context, it was the leading member states that served as key centres setting the general parameters in the area.⁴⁷ This was largely due to the fact that these leading member states were at the same time the largest markets, the most important innovation centres, as well as the most powerful finance and investment centres. They housed the absolute majority of top corporations, which served as key market entities that interconnected the countries.

Yet, there are reasons to believe that further growth of EU's largest economies will not be sufficient to provide for adequate dynamics of the EU economy in general, and Euro area in particular. *Large-scale structural transformations that will be taking place as part of the Fourth Industrial Revolution can cause major technological gaps in the EU and form a kind of technological paradigm diversity.* Under certain conditions, this diversity can create **new technological borders in Europe**, which will start fragmenting the single economic space of the EU and cause a divergence of economic dynamics curves. If this happens, developing and attempting to implement not even a single, but just a coordinated economic policy within the EU and the Euro area may become a hopeless illusion.

And there are certain preconditions for this prediction to come true. In the past decades, synchronisation of cycles within the EU and convergence of economic development parameters was in many aspects based on the possibility of relatively free movement of capital and technologies, and the establishment of subsidiaries of the most technologically advanced multinational companies. This ensured the necessary diffusion of innovations from the leading countries to the periphery. Yet, will this order remain in place in the midst of the Fourth Industrial Revolution? Today, there is no definitive answer to this.

Any new technologies originate in geographically restricted local spaces, which provide the best conditions for the support of creativity. We are talking not just about the availability of the necessary venture capital (in a free, integrated capital market, this is not an insurmountable problem for less developed countries). The main obstacles arise in a different plane – the availability of an environment for creative activity and a significant efficient demand for innovations. These two key parameters are regulated by EU's single market mechanisms to a much lesser degree; conversely, they are still being determined in a mostly independent manner, by the member states within the framework of their specific national environment.

⁴⁷ For more information, see: Business cycles in the euro area – Working Paper Series No.1010, February 2009, European Central Bank, <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1010.pdf?6a152725bc8a3eac717517daf3c3720>; 1% GDP growth of each of these countries leads to Euro area GDP growth of 0.2-0.5%. For more information, see: Sidorov A. General Economic Situation in the Euro Area. – Global Economy and International Relations, 2016, vol.60, No.3, p.49-57.

These parameters are not purely economic, and depend significantly on the general social characteristics and existing cultural beliefs.

The arrival of new technologies of the Fourth Industrial Revolution can cause very different reactions in various social environments of the member states and have a very different impact on their innovation activity. As new technologies (characterised as “disruptive”) spread in these countries, there can appear both new centres of fast technological and economic growth, and new centres of stagnation and decline. Ultimately, these trends may cause *new fragmentation of the economic and technological space*. Realisation of these trends can lead to a *fundamental change in the level of EU member states and the Euro area capability to withstand competition pressure in the single market, as well as disrupt the aspiring countries’ ability to achieve the required membership criteria*.

It is crucial to take into consideration that EU’s future evolution is likely to happen *in conditions of a major change in the geoeconomic balance of forces*, along with a *powerful trend of the rise of new market economies and relatively decreasing influence of the leading G7 countries*.

Thus, according to one of the latest forecasts by a leading international consulting company PricewaterhouseCoopers,⁴⁸ by 2050, global economic power will shift towards E7 countries (China, India, Indonesia, Brazil, Russia, Mexico, Turkey), whose aggregate economic size will be twice as large as G7 economies in terms of GDP already by 2040, and in 2050 – will reach almost half of the world’s GDP. Meanwhile, by 2050, EU-27 share in the global GDP (PPP) will go down from the current 15% to 9%, and will be smaller than India’s share alone (15%) due to slow economic growth pace of European economy (slightly over 1% on the average).

Obviously, if these predictions come true, according to principles of the so-called gravity model, the world will experience the emergence of new centres of gravity, which will alter national economies’ incentives to participate in different regional integration structures. This may *present the EU with the prospect of its declining role as the leading integration centre*. To a certain extent, this prospect looms already real due to the implementation of China’s transcontinental “One Belt One Road” initiative, unprecedented by its scale. In the Asia Pacific macroregion, different integration associations are being formed, which are trying out new integration principles, namely, they are built on the open regionalism concept and are not using supranational principles in their integration management bodies. If their effectiveness is proven, the EU can face rising criticism of its existing principles of European integration organisation, where member states have to accept the limitation of their national sovereignty.

⁴⁸ Source: The Long View: How will the global economic order change by 2050? – PricewaterhouseCoopers, February 2017, <https://www.pwc.com/gx/en/world-2050/assets/pwc-the-world-in-2050-full-report-feb-2017.pdf>

It should also be taken into account that the abovementioned predictive assessment is based on today's visible development trends. Yet, there is no guarantee that these trends will persist in the situation of major technological transformations that will be taking place in the world in the next two or three decades. Also, we cannot ignore the EU's huge potential of high tech development, especially in the areas of environmental protection and sustainable development technologies, – which will be crucial in the future. So these predictions should not be perceived as a verdict for the EU and G7, rather, they are a possible *worst-case scenario*, if these organisations fail to ensure their technological leadership.

Current crisis processes within the EU are foremost a serious challenge for the European community. They demonstrate that the ***established mechanisms and cooperation forms are not working as intended anymore, as they ceased to correspond to the reality of modern development:***

- they have too many bureaucratic complications and different coordination procedures that are time-consuming;
- they are overly dependent on the political will of one (or several) countries that can easily block decisions important for the entire community or the majority of member states;
- they do not have sufficient flexibility and ability to adjust to the fast-paced transformations in today's world;
- the policy of EU's governing bodies contains a lot of eloquent phrases and references to European values, yet not enough real-world pragmatism in resolution of specific problems with due regard to particular national or regional conditions and interests;
- the policy of unifying regulatory mechanisms became too broad, which does not match the objectively existing divergences between member states;
- EU's governing bodies, foremost, the European Commission, produce too many ambitious documents, for efficient implementation of which there are no sufficient preconditions, as it often turns out later.

If these defects remain in place, the European integration system is unlikely to retain its development momentum, and today's crisis processes may become the beginning of decline.

Thus, European integration ***is in dire need of reformatting, which would give it new life***. It is necessary to search for new solutions, able to significantly increase the efficiency of cooperation in resolving truly strategic issues, while giving more freedom to member states in the issues, where they find it appropriate to rely primarily on their own resources and effort.

2. SCENARIOS OF FURTHER DEVELOPMENT OF THE EU

Major problems in the EU development, which started to show after the 2008-2009 global crisis, stimulated activity aimed at identifying the causes and main characteristics of crisis processes, as well as different directions of EU's possible development in the long run. This was done on many levels: community – in EU governing bodies, foremost, the European Commission; in member states and through their bilateral and multilateral contracts, where France and Germany are traditionally especially active in developing proposals; in different formats of non-government agencies, including academic circles, who analysed the development of European integration.

2.1. OFFICIAL DECLARATIONS AND SCENARIOS OF THE EU GOVERNING BODIES

The EU faced diverse and complex problems in its development, which compelled EU leadership to seek and develop a response to the challenges posed by European integration, and plan for the necessary reforms, which would support further integration and transformation of the union into a more cohesive and efficient structure.

Originally, EU leaders' approaches clearly showed that intensifying and even radicalising European integration policy was a priority. Obviously, the leaders of key EU institutions thought that the best answer to complications was to double or triple their efforts aimed at deepening the integration. This approach was reflected in the well-known “*Five Presidents' Report*”, adopted in 2015.¹ Its goal was the formation of four unions – a genuine *economic*, a *financial* (including the Banking Union and Capital Markets Union), a *fiscal*, and a *political* union. It also stressed the importance of structural convergence:

- (1) overcoming structural and cyclical differences between Euro area economies;
- (2) tightening fiscal restrictions policy and boosting competitiveness, strengthened

¹ For more information, see: Five Presidents' Report, 2015: Completing Europe's Economic and Monetary Union. – Report by Jean-Claude Juncker in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz. European Commission, https://ec.europa.eu/commission/sites/beta-political/files/5-presidents-report_en.pdf.

implementation of the Macroeconomic Imbalance Procedure; (3) stronger coordination of economic policies.

However, UK's referendum on Brexit has called this path of European integration development into question. And this was not just about the rather negative psychological effect of a major disintegration step taken by one of the key EU members for the first time in history. Everyone realises that Brexit is just the first occurrence in the long line of challenging events that will be happening inside the EU due to member states' more or less significant objections to the radical course of further deepening the European integration. So, in this situation, there came an understanding that finding definite and efficient answers to new challenges requires *looking for new conceptual (and most importantly, effective) approaches to further operation of the EU*, as the old mechanisms and methods failed to work as intended and ceased to resolve conflicts that keep proliferating and becoming increasingly more critical. In this context, the leaders of EU member states have started a broad discussion about the future of the European Union, which was named "*political reflection on the future of the EU*".²

In September 2016, leaders of EU-27 held such initial discussion in Slovakia and adopted The **Bratislava Declaration**³ based on its results, which stated that "although one country has decided to leave, the EU remains indispensable for the rest of us". EU leaders have also reached an agreement on the need to search for solutions for the current problems and to improve communications between EU's top leadership and its citizens. The Bratislava roadmap⁴ defined "concrete measures" in a number of areas: (1) resolving some aspects of the migrant crisis; (2) countering terrorism; (3) stronger cooperation in security and defence; (4) improved conditions for economic development, especially for youth. However, despite attempts to demonstrate unity in the face of crisis threats, some EU leaders were disappointed that the proposed measures were not bold enough, did not offer a strategic vision of EU's future and were focused mainly on isolated problem solutions or were reduced to reiteration of support for already existing initiatives.

In the early February 2017, EU-27 leaders held further discussions regarding directions determined in Bratislava negotiations in the fall of 2016, and prepared a proposal for the European Council summit that took place on 25 March 2017. At this summit, EU leaders adopted **The Rome Declaration**,⁵ in which they identified

² Source: The Bratislava Declaration and the Bratislava Roadmap. – European Council, 16 September 2016, <https://www.consilium.europa.eu/media/21250/160916-bratislava-declaration-and-roadmapen16.pdf>.

³ Ibid.

⁴ Ibid.

⁵ The Declaration was signed by the leaders of 27 EU member states (without the UK) and EP, EC and European Council heads.

the key directions of further integration in Europe (*insert “Rome Declaration Agenda”*⁶). The Document states that in the ten years to come the Union has to become safe and secure, prosperous, competitive, sustainable and socially responsible, and with the will and capacity of playing a key role in the world and in shaping globalisation. The document aims to consolidate EU effort for overcoming internal risks and external threats, and its practical implementation can become the basis for developing an adequate response to topical issues.

ROME DECLARATION AGENDA

- ✓ **A safe and secure Europe:** a Union where (1) all citizens feel safe and can move freely, where external borders are secured; (2) with an efficient, responsible and sustainable migration policy, respecting international norms; (3) a Europe determined to fight terrorism and organised crime.
- ✓ **A prosperous and sustainable Europe:** a Union which (1) creates growth and jobs; (2) a Union where a strong, connected and developing Single Market, embracing technological transformation, and a stable and further strengthened single currency open avenues for growth, cohesion, competitiveness, innovation and exchange, especially for small and medium-sized enterprises; (3) a Union promoting sustained and sustainable growth, through investment, structural reforms and working towards completing the Economic and Monetary Union; (4) a Union where economies converge; (5) a Union where energy is secure and affordable and the environment clean and safe.
- ✓ **A social Europe:** a Union which (1) based on sustainable growth, promotes economic and social progress as well as cohesion and convergence, while upholding the integrity of the internal market; (2) a Union taking into account the diversity of national systems and the key role of social partners; (3) a Union which promotes equality between women and men as well as rights and equal opportunities for all; (4) a Union which fights unemployment, discrimination, social exclusion and poverty; (5) a Union where young people receive the best education and training and can study and find jobs across the continent; (6) a Union which preserves our cultural heritage and promotes cultural diversity.
- ✓ **A stronger Europe on the global scene:** a Union (1) further developing existing partnerships, building new ones and promoting stability and prosperity in its immediate neighbourhood to the east and south, but also in the Middle East and across Africa and globally; (2) a Union ready to take more responsibilities and to assist in creating a more competitive and integrated defence industry; (3) a Union committed to strengthening its common security and defence, also in cooperation and complementarity with the North Atlantic Treaty Organisation, taking into account national circumstances and legal commitments; (4) a Union engaged in the United Nations and standing for a rules-based multilateral system, proud of its values and protective of its people, promoting free and fair trade and a positive global climate policy.

Given the current threats to European unity, the adopted common goals of EU's further development cannot be undervalued. Yet, commemorative political declarations alone, adopted on the 60th anniversary of the Treaty of Rome (1957),

⁶ For more information, see: The Rome Declaration. Statements and Remarks, 149/17. – Council of the EU, 25 March 2017, <http://www.consilium.europa.eu/en/press/press-releases/2017/03/25/rome-declaration/pdf>.

could not serve as a sufficient political stimulus for further development of the European integration process. This required a deeper analysis of different development alternatives and assessing the existing political support for each of them – and the European Commission undertook this task.

At the beginning of March 2017, the EC formulated the ways of European integration development, and presented them in the “*White Paper on the Future of Europe. Reflections and scenarios for the EU-27 by 2025*” (table “*Five Possible Scenarios for the EU-27 by 2025 according to the European Commission (March 2017)*”⁷).

Obviously, the list of scenarios formulated by the EC cannot be considered complete, since it does not allow for the possibility of disintegration processes to prevail in the EU. And this position is completely understandable: from the purely political standpoint, the EC, together with other EU institutions, simply cannot allow for this alternative to get into the narrative, although, as noted further, it cannot be ruled out.

According to **Scenario 1**: Carrying on, EU member states will continue operating without deviations from the chosen strategic political course and will use mostly existing cooperation mechanisms, while preserving their unity through political will and unbreakable euro-optimism of EU leaders and member states.

Thus, *Scenario 1* is hardly realistic in the light of changes that have taken place inside the EU in recent years, and given the growing number of problems the European community currently faces.

Scenario 2: Nothing but the single market – would be a major adjustment of the European integration course announced in 2014. It stipulates that EU member states return to the idea of preserving a single market in the format that was created according to the Treaties of Maastricht and Amsterdam, followed by partial improvements as reflected in the 2007 Lisbon Treaty. This scenario means that the EU will have to abandon a lot of mechanisms planned for implementation in the context of EMU completion and development of a political union. Moreover, according to this scenario, a number of centralised components of the cooperation mechanism would have to be “decentralised” and moved to the national level. Essentially, this scenario includes partial disintegration for the purpose of preserving integration prospects in the key areas.

This scenario *looks more realistic from the point of view of its functionality. Yet, it also contains a threat: it is hard to stop disintegration processes at a certain desired point once they have been initiated*. At the moment they are launched, they get their own development “logic” and group of political supporters.

⁷ Source: European Commission. White Paper on the Future of Europe. Reflections and scenarios for the EU27 by 2025. – Brussels, 1 March 2017, https://ec.europa.eu/commission/sites/beta-political/files/white_paper_on_the_future_of_europe_en.pdf.

**Five Possible Scenarios for the EU-27 by 2025
according to the EC (March 2017)**

	Carrying on	Nothing but the single market	Those who want more do more	Doing less more efficiently	Doing much more together
Single market and trade	Single market is strengthened, including in the energy and digital sectors; the EU-27 pursues progressive trade agreements	Single market for goods and capital strengthened; standards continue to differ; free movement of people and services not fully guaranteed	As in "Carrying on", single market is strengthened and the EU-27 pursues progressive trade agreements	Common standards set to a minimum but enforcement is strengthened in areas regulated at EU level; trade exclusively dealt with at EU level	Single market strengthened through harmonisation of standards and stronger enforcement; trade exclusively dealt with at EU level
Economic and Monetary Union	Incremental progress on improving the functioning of the Euro area	Cooperation in the Euro area is limited	As in 'Carrying on' except for a group of countries who deepen cooperation in areas such as taxation and social standards	Several steps are taken to consolidate the Euro area and ensure its stability; the EU-27 does less in some parts of employment and social policy	Economic, financial and fiscal Union is achieved as envisioned in the report of the Five Presidents of June 2015
Schengen, migration and security	Cooperation in the management of external borders stepped up gradually; progress towards a common asylum system; improved coordination on security matters	No single migration or asylum policy; further coordination on security dealt with bilaterally; internal border controls are more systematic	As in "Carrying on" except for a group of countries who deepen cooperation on security and justice matters	Cooperation on border management, asylum policies and counterterrorism matters is systematic	As in "Doing less more efficiently", cooperation on border management, asylum policies and counterterrorism matters is systematic

**Five Possible Scenarios for the EU-27 by 2025
according to the EC (March 2017)**

(continued)

Foreign policy and defence	Progress is made on speaking with one voice on foreign affairs; closer defence cooperation	Some foreign policy issues are increasingly dealt with bilaterally; defence cooperation remains as it is today	As in "Carrying on" except for a group of countries who deepen cooperation on defence, focusing on military coordination and joint equipment	The EU speaks with one voice on all foreign policy issues; a European Defence Union is created	As in "Doing less more efficiently", the EU speaks with one voice on all foreign policy issues; a European Defence Union is created
EU budget	Partly modernised to reflect the reform agenda agreed upon by 27 member states	Refocused to finance essential functions needed for the single market	As in "Carrying on"; additional budgets are made available by some member states for the areas where they decide to do more	Significantly redesigned to fit the new priorities agreed at the level of the EU-27	Significantly modernised and increased, backed up by own resources; a Euro area fiscal stabilisation function is operational
Capacity to deliver	Positive agenda for action yields concrete results; decision-making remains complex to grasp; capacity to deliver does not always match expectations	Decision-making may be easier to understand but capacity to act collectively is limited; issues of common concern often need to be solved bilaterally	As in "Carrying on", a positive agenda for action at 27 yields results; some groups achieve more together in certain domains; decision-making becomes more complex	Initial agreement on tasks to prioritise or give up is challenging; once in place, decision-making may be easier to understand; the EU acts quicker and more decisively where it has a greater role	Decision-making is faster and enforcement is stronger across the board; questions of accountability arise for some who feel that the EU has taken too much power away from the member states

If exit of just one member, albeit as large as the UK, has caused detrimental effects impossible to fully assess at the moment, what will happen as the integration trend “gets broken” in certain areas of cooperation for all EU members?

According to principles of synergetics, in a system that finds itself in the state of bifurcation (systemic transition), even hardly noticeable micro-influences can have macro-consequences. So, despite the functional compactness of this alternative, *the high level of risk it contains makes its implementation unlikely.*

Scenario 3: Those who want more do more – is based on the concept of multi-level or multi-speed integration, where each EU member unilaterally decides on its *a la carte* selection of integration options that best matches its national interests. Thus, the more interested EU member states, should they so choose, may freely take the way of developing integration, regardless of the position of the more eurosceptical members (for more information, see Appendix 1 “*The Main Dilemmas of Reforming the Institutional Framework of the EU*” in this publication).

Obviously, from the purely practical standpoint, this alternative would be very *convenient* and would allow to “*curb*” many *controversies* within the Union. Yet, it could easily lead to differentiation of the EU into set areas with different level of integration and create, if we may call so, “EU-1”, “EU-2”, “EU-3”, etc. At a certain point, the increasing heterogeneity of mechanisms could well lead to the *de facto* disintegration of the EU single economic space – in the same way as this happened, for instance, with the single economic space of the former Soviet Union.

So, although this alternative looks politically *realistic*, it is rather risky and would require member states *to adhere to certain limits, so as not to turn different pace of integration into integration formations different at their core.*

Scenario 4: Doing less more efficiently – involves a comprehensive revision of the existing forms and areas of cooperation in order to concentrate European integration efforts and resources on the key integration areas. Such “restructuring” of the European integration is aimed at achieving *more efficient cooperation through the concentration effect*. Which areas this might include is still up for discussion (so far, the priorities have not been set), but clearly, one of the most important sectors for the EU is the area of innovations and ensuring global competitiveness of European companies at the time of the Fourth Industrial Revolution. Another important priority is faster restructuring based on the New Climate Economy principles.⁸ There are

⁸ Corresponding documents were developed and approved by the Global Commission on the Economy and Climate in 2014. Immediate implementation of measures in the framework of this approach is expected to pave the way for the “new era of economic growth” based on fundamentally different principles. Despite the significant cost of “climate action” (approximately \$90 trillion to develop the necessary infrastructure until 2030), risks and losses from inaction in this area will be much greater. At the same time, it is planned that decisive steps in countering climate change and corresponding adjustments will generate direct economic profit of \$26 trillion by 2030. For more information, see: New Climate Economy. Unlocking the Inclusive Growth Story of the 21st Century: Accelerating Climate Action in Urgent Times. – A Report of the Global Commission on the Economy and Climate, World Resources Institute, August 2018, <https://newclimateeconomy.report/2018>.

sufficient reasons to believe that concentration of effort and resources on such crucial and globally important issues can foster integration much more effectively, than lots of declarations calling for unity.

Scenario 5: Doing much more together has been presented by the EC as the most acceptable and promising one. The foundation for this course of reforms titled “A New Start for Europe” was proposed by EC President Jean-Claude Juncker back in July 2014,⁹ with its main principles reflected in the 2016 Bratislava Declaration.

According to this scenario, member states have to transfer their powers in a broad number of areas to the supranational level. It involves simplification of decision-making procedures (decisions are to be agreed faster) and increased efficiency of their implementation. Expanding the area of application of qualified majority voting in decision-making could facilitate this process.

Yet, implementation of this scenario is only possible on condition that the crisis of citizens’ trust in supranational structures is overcome and that a balance is achieved in the economic development of most member states, as an objective precondition for implementation of development priorities. Otherwise, further increase of influence of nationalist parties and movements is inevitable, including the possibility that they could ultimately come to power in one or several most influential member states and put an end to the policy of euro-optimism.

On 12 September 2018, President of the European Commission Jean-Claude Juncker gave a speech in Strasbourg (France) titled “State of the Union 2018. The Hour of European Sovereignty”. He determined a number of key priorities for the future (insert “*10 Political Priorities of EC President Jean-Claude Juncker*”¹⁰), which are an extension of the ones he proclaimed prior to taking office as the President in 2014. He also expressed his opinion regarding methods of EU member states’ cooperation that would make it even “stronger and more democratic”. One of the main messages of the EC President is that Europe needs to establish itself as a more influential and sovereign player on the global political arena. He also urged to “*reject the kind of exaggerated nationalism that projects hate and destroys all in its path*” and stressed that “*We must do more to revive the lost art of compromise... It is time we put an end to the sorry spectacle of a divided Europe*”.

⁹ See: A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change. – Political Guidelines for the next European Commission, Strasbourg, 15 July 2014, https://ec.europa.eu/commission/publications/president-junckers-political-guidelines_en.

¹⁰ Source: State of the Union by Jean-Claude Juncker, President of the European Commission, 12 September 2018. – European Commission, https://ec.europa.eu/commission/sites/beta-political/files/soteu2018-brochure_en.pdf.

10 POLITICAL PRIORITIES OF EC PRESIDENT JEAN-CLAUDE JUNCKER

1. A new boost for jobs, growth and investment.

Increasing the level of employment among youth will remain a priority under the next Multi-annual Financial Framework of the EU. The EC has proposed that member states with a significant number of young people not in employment, education or training invest at least 10% of their European Social Fund Plus (ESF+) resources to measures helping young people find a job.

The Commission has proposed to *guarantee predictable and transparent working conditions for people in non-standard forms of employment, and ensure that all workers, including the self-employed, have access to social protection.*

The focus is on *developing liquid capital markets and sustaining growth in Europe*¹¹.

2. A connected Digital Single Market

It is stressed that Europe needs a *trusted Digital Single Market*¹², to make the lives of its citizens easier, enhance economic growth and generate new jobs.

Another priority is to *tackle the spread and impact of online disinformation in Europe and ensure the protection of European values and democratic systems.*

3. A resilient Energy Union with a forward-looking climate change policy

The Energy Union and the fight against climate change are key elements for the modernisation of the European industry and economy. EU Energy targets by 2030: (1) at least 40% cuts in greenhouse gas emissions; (2) at least 32% renewables in energy consumption ; (3) 32.5% energy efficiency. Among other priorities:

- *ending energy isolation of the Baltic Sea region;*
- *synchronising electricity grid of member states – Estonia, Latvia, Lithuania and Poland – with the continental European network by 2025.*

4. A deeper and fairer Internal Market with a strengthened industrial base

- Introduction of a *Single Digital Gateway*,¹⁴ which will be an easily accessible entry point for people and companies to find information, administrative procedures and assistance linked to their Single Market rights.
- Expanding funding opportunities for innovative and small businesses; encouraging green investments and promoting financial innovation.
- Continued implementation of fair and efficient tax rules.¹⁵

¹¹ In 2018, the EC presented a number of proposals on further development of Capital Markets Union, including a new EU framework for covered bonds and the simplification of the rules for cross-border marketing of investment funds.

¹² In March 2018, the EC presented an Action Plan on Financial Technology (FinTech) to make the most of rapid advances in new technologies such as blockchain, artificial intelligence, while at the same time shielding consumers from cybersecurity threats. And since May 2018, the right to a secure online environment has been reinforced thanks to the first EU-wide legislation on cybersecurity.

¹³ In recent years, the EC: has made a decision about transition to a clean economy, in particular, in the transport area; has launched an information resource “Energy Poverty Observatory” as an enabling action to support clean energy transition.

¹⁴ Aimed at expanding and integrating national and European portals to create a user-friendly information system.

¹⁵ The Commission proposed a major overhaul of the system for value added tax to better tackle fraud, setting out the cornerstones of a single EU Value Added Tax area.

- New binding transparency rules that oblige member states to exchange automatically an array of tax information with each other are gradually entering into force.
- A strengthening of controls by national authorities and customs officers to prevent unsafe or counterfeited products.

5. A deeper and fairer Economic and Monetary Union

- Complete the *reform of EMU* (institutional component) to preserve the stability of Euro and to enhance its role in global financial markets.
- *Complete the Banking Union in the part of introducing the European Deposit Guarantee Schemes* to reinforce stability and confidence in the EU banking system.
- Progressive transformation of the European Stability Mechanism (ESM) into a *European Monetary Fund*.

6. Open and fair trade in a rules-based global system

- Well-balanced trade agreements that boost economic growth, as well as trade defence tools that protect against abuses.
- *Reform the World Trade Organisation.*
- Update the multilateral rules for faster response to challenges, such as intellectual property theft, forced technology transfer, industrial subsidies, distortions created by state-owned enterprises, and overcapacity.

7. An area of Justice and Fundamental Rights based on mutual trust

The importance of the *rule of law and judicial independence* are highlighted in the context of *overseeing the sound financial management of the EU budget*. Priorities include:

- national courts must live up to high standards of impartiality and independence;
- step up civil protection to ensure that the EU can deliver help more quickly and effectively to those struck by natural disasters;
- finalise mechanisms of confiscation and freezing of assets, the control of large cash flows and the harmonisation of criminal offences related to money laundering;
- action to fight illegal content online (removal within one hour) and preventing the use of online resources for terrorist propaganda.

8. Towards a new policy on Migration

Despite achievements in the area of migration and border control¹⁶, to increase the level of safety and reduce the number of irregular migrants, the following remains a priority:

- *increasing safe and legal pathways for those in need of international protection* to prevent dangerous irregular journeys facilitated by criminal smuggling networks;

¹⁶ Systematic checks on everyone who is crossing the EU's borders have been introduced; IT systems to exchange information between member states in real time have been improved; EU continued to fight against migrant smuggling, which allowed to save over 690 thousand lives; tailor-made migration partnerships with key countries of origin and transit are now in place.

- further *strengthening the capacities of the European Border and Coast Guard Agency* for better protection of external borders (it is proposed to establish a standing corps of 10,000 EU border guards by 2020);
- further *reform of the Common European Asylum System*, EASO;
- softening entry and residence conditions for third-country nationals for the purpose of highly skilled employment (“Blue Card proposal”).

9. A stronger global actor

- Continue to develop strong relations *with all Eastern Partnership countries*.
- Continue to intensify cooperation *with African continent countries*¹⁷ with a prospect of a continent-to-continent free trade agreement.
- Develop multilateral international cooperation mechanisms. Further cooperation with *G7* and *G20*, international organisations, such as the United Nations, the African Union and NATO, as well as establishing strong relations with partners in the entire world, not just bilateral, but also multilateral.
- Intensify work on creating a fully operational *European Defence Fund*.
- Extend the tasks of the *European Public Prosecutor’s Office* to include the fight against terrorist offences.
- The EU is stepping up its role as a security and defence provider and building a *European Defence Union*.

10. A Union of democratic change

- *Step up the frequency of Citizens’ Dialogues*¹⁸ to ensure EU’s democratic legitimacy.
- *Improve the connection with citizens at the next European elections* to make the EU work more efficiently.
- To improve transparency about who is trying to influence the policy work of the EU institutions, negotiations continue with the Parliament and Council on the Commission’s proposal for a *mandatory Joint Transparency Register*¹⁹.

¹⁷ Namely, the President stated: “We need to invest more in our relationship with the nations of this great continent. And we have to stop seeing this relationship through the sole prism of development aid. Donor-recipient relations are a thing of the past, substituted by reciprocal cooperation commitments. Today, we are proposing a new Alliance for Sustainable Investment and Jobs between Europe and Africa. This Alliance – as we envision it – would help create up to 10 million jobs in Africa in the next 5 years alone”.

¹⁸ New proposals and current legislation are at the moment subjected to comprehensive public scrutiny through the mechanisms of deeper cooperation with citizens. Citizens are using possibilities to participate in EU policy formation increasingly more often. This step is necessary for more efficient use of the Union’s resources and a more efficient contribution of local and regional governments to policies.

¹⁹ Almost 12,000 organisations and individuals now appear in the Transparency Register.

EC leadership's dedication to the new course – active advancing of the European integration process, readiness to support it and stand up for it against opponents and different adverse factors – is an extremely important characteristic of strategically-minded leaders, which commands respect. Yet, it can also contain a threat of dogmatic defending of principles despite major socio-economic and political changes, which, under certain conditions, may make this course nonviable. And such changes have obviously arrived. It is impossible to ignore Brexit, the overall growing influence of eurosceptics in a number of other member states, strong debate regarding migration issues and compliance with basic EU principles, a lot of research with analysis of imperfections within Euro area mechanisms, and pretend that everything is fine. Disregarding unfavourable trends in the member states and seeing only the common European idea creates a danger of losing this very idea.

Thus, *Scenario 4 is, in our opinion, the most practical one from the point of view of balancing interests of different stakeholders in the European integration process, and therefore, the most viable one.* Whether the EC will take the path in this Scenario is hard to say.

2.2. EUROPEAN INTEGRATION AND EU PROSPECTS AS SEEN BY INTEGRATION LEADERS – FRANCE AND GERMANY

Despite the important role that the EC plays in determining European integration course, it is not the main centre of decision-making regarding these issues. The history of European associations' development exposes the defining role of the France-Germany duo in these processes, thus making the European integration foremost a version of the Franco-German "political synthesis". That said, the French have been leading generators of European integration ideas: founders of European integration R.Schuman and J.Monnet, the creator of "modern EU" J.Delors – are just several of the most prominent figures. So, by no coincidence, it was the French President who created the ambitious plan of reformatting the EU, laying out the foundations of the new "Initiative for Europe" in his famous speech at the Sorbonne on 26 September 2017.²⁰ He stressed: "We cannot afford to keep the same policies, the same habits, the same procedures and the same budget", and this is a direct negative answer to European Commission's Scenario 1 presented above. Also, the President of France rejected the idea of locking in within national borders.

Macron's formula consists of three cornerstones of Europe's foundation – sovereignty, unity and democracy (insert "Main Ideas of French President Macron's New Initiative for Europe").

²⁰ For more information, see: Initiative pour l'Europe – Discours d'Emmanuel Macron pour une Europe souveraine, unie, démocratique. – Publié le 26 Septembre 2017, <http://www.elysee.fr/declarations/article/initiative-pour-l-europe-discours-d-emmanuel-macron-pour-une-europe-souveraine-unie-democratique/>; Main ideas presented in English: Initiative for Europe. A sovereign, united, democratic Europe. – <http://www.elysee.fr/assets/Initiative-for-Europe-a-sovereign-united-democratic-Europe-Emmanuel-Macron.pdf>.

MAIN IDEAS OF FRENCH PRESIDENT MACRON'S NEW INITIATIVE FOR EUROPE

A sovereign Europe

1. A Europe that guarantees every aspect of security:

- ✓ establish a **common intervention force**, a **common defence budget** and a common doctrine for action. Encourage the implementation of the European Defence Fund and Permanent Structured Cooperation as quickly as possible, and supplement them with a **European intervention initiative** enabling member states to better integrate their armed forces at every stage;
- ✓ ensure closer ties between member states' intelligence services by creating a **European Intelligence Academy to facilitate the fight against terrorism**;
- ✓ create a **common civil protection force**.

2. A Europe that addresses the migration challenge:

- ✓ create a **common area for border management, asylum and migration**;
- ✓ create a **European Asylum Office** that will speed up and harmonise procedures in this area; establish **interconnected databases** and **secure biometric identification documents**; gradually establish a European border police force that ensures rigorous management of borders and the return of those who cannot stay; and finance a large-scale **European programme to train and integrate refugees**.

3. A Europe looking to Africa and the Mediterranean:

- ✓ external policy focused on a few priorities, firstly the Mediterranean and Africa;
- ✓ develop a **new partnership with Africa**, based on education, health and the energy transition.

4. A Europe exemplary in sustainable development:

- ✓ Europe needs to be the spearhead of an efficient and equitable ecological transition;
- ✓ foster investment by **fixing a fair price for carbon**: through a significant minimum price within EU borders; **introduce a European carbon tax at EU borders**;
- ✓ establish an industrial programme to support clean vehicles and the required infrastructure;
- ✓ ensure food sovereignty, **by reforming the Common Agricultural Policy (CAP)** and establishing a **common inspection force** to guarantee food safety for Europeans.

5. A Europe of innovation and regulation adapted to the digital world:

- ✓ Europe needs to introduce its **own model in globalisation, combining innovation and regulation**;
- ✓ establish an **Agency for breakthrough innovation**, jointly funding new fields of research;
- ✓ ensure **equity and confidence in the digital transformation**, by rethinking the tax systems (taxation of digital companies) and regulating the major platforms.

6. A Europe standing as an economic and monetary power:

- ✓ make the Euro area the heart of Europe's global economic power;
- ✓ introduce instruments to make Euro area an area of growth and stability, including a **budget allowing it to fund common investments and ensure stabilisation in the event of economic shocks**.

A united Europe

1. Concrete solidarity through social and tax convergence:

- ✓ encourage convergence across the whole EU, setting criteria that gradually bring member states' social and tax models closer together. Respect for these criteria needs to be a precondition for access to European solidarity funds;
- ✓ define a “corridor” for corporation tax rates; in social affairs, guarantee a minimum wage for all, adapted to the economic realities of each country, and regulate social contribution competition.

2. The cement of culture and knowledge::

- ✓ create a sense of belonging, which will become the strongest cement for Europe;
- ✓ step up exchanges, so that all young Europeans spend at least six months in another European country (50% of each age group by 2024), and all students speak two European languages by 2024;
- ✓ create European Universities: networks of universities that enable students to study abroad and attend classes in at least two languages;
- ✓ establish a process of harmonisation or mutual recognition of secondary education diplomas.

A democratic Europe

Europe's overhaul cannot be achieved away from the people, but only by involving them in this roadmap from the very outset:

- ✓ introduce broad national and local debates through democratic conventions;
- ✓ strengthen the European Parliament based on transnational MP lists.

Europe-2024

1. The European Union, a common framework:

- ✓ common basis provided by the EU: (1) common democratic values that are non-negotiable; (2) a simpler, more protective single market, along with an overhauled trade policy (transparency in the negotiation and implementation of trade agreements; social and environmental standards; and reciprocity, with a European trade prosecutor responsible for ensuring competitors' respect for the rules and rapidly sanctioning any unfair practices);
- ✓ gradual expansion of the EU to include the Western Balkan countries;
- ✓ reform of EU institutions, with a smaller Commission (15 members).

2. Differentiation through ambition:

- ✓ within this EU, those who want to go further and faster need to be able to do so unhindered. Cooperation will always be open to all, based on the sole criterion of the level of shared ambition, with no predefined format.

3. The Franco-German engine:

- ✓ it will be decisive in the face of challenges dealt with by the EU;
- ✓ undertake a review of the Élysée Treaty showing France and Germany's renewed common ambition.

4. All member states and European institutions who share this ambition can take part in the launch of a “group for overhauling Europe”.

In his famous speech at the European Parliament on 17 April 2018²¹, the President of France added a number of new visions to his “Initiative for Europe”, including: *a renewed sense of “European sovereignty” in the face of increasing nationalism and authoritarianism in some EU countries* that is based on a fascination with the illiberal ideas. Macron proposed creating an *EU fund to support local communities that welcome and integrate refugees*. The French president also called for an “urgent road map” for reforming the Euro area and a new levy on the digital economy to help finance the EU budget once Britain has left the bloc.

Analysis of E.Macron’s initiatives shows a high level of similarity to EC proposals created in recent years and mostly consistent with Scenario 5 from the “White Paper”, even though they are titled “Sovereign Europe” instead of “Unity”. However, despite these political ideology tricks, unavoidable among the growing nationalistic sentiment in Europe, *the ultra-pro-European core of Macron’s proposals is rather obvious*.

The problem is that implementing these ideas in EU-27 with much stronger nationalist forces may turn out quite difficult. The European Council summit in June 2018 proved this, as, against expectations, participants did not discuss future reform plans, which may further confirm the lack of consensus on a number of issues.

In this situation, the President of France chose possibly the wisest course of action – reaching a prior consensus with another key EU player – Germany. His negotiations with Federal Chancellor Angela Merkel on 19 June 2018 resulted in the adoption of the **Mezeberg Declaration**²², which determined a common (or at least harmonised) position of France and Germany on reforming Europe.

This concise, yet meaningful document is based on the idea that at the moment the EU faces a number of *existential challenges*, and an adequate response is possible only through European cooperation. It confirmed the need to complete the review of the Élysée Treaty by the end of 2018²³ to stimulate achievements

²¹ For more information, see: Macron calls for ‘European sovereignty’ to combat authoritarianism in speech at European Parliament. – France 24, <http://www.france24.com/en/20180417-live-france-macron-eu-reform-european-parliament-speech-brexit-strasbourg>.

²² Source: Mezeberg Declaration. Renewing Europe’s promises of security and prosperity. – Presse- und Informationsamt der Bundesregierung. Die Bundesregierung, 19 June 2018, <https://archiv.bundesregierung.de/archiv-de/meta/startseite/meseberg-declaration-1140806>.

²³ This was finalised on January 22, 2019 by signing the *Treaty of Aachen (Treaty on Franco-German Cooperation and Integration)*, which complemented the Élysée Treaty as of 1963. This event happened after the publication of the Ukrainian version of this research.

in economic, social and fiscal convergence between the two leading EU member states and introduce new instruments for their transborder cooperation, while at the same time paying attention to developing multi-lateral cooperation mechanisms. The document is generally based on proposals from E.Macron's Sorbonne speech, with a number of adjustments reflecting Germany's perception of key issues in the European Union.

Thus, *in foreign policy, security and defence sectors* it is proposed to discuss the possibility of creating an *EU Security Council*, tighter cooperation at different international forums (e.g. at the UN Security Council and other UN agencies), and also explore possibilities of using majority vote for political decision-making in this field. Notably deeper integration is planned in the defence sector, with an expected emergence of "*shared strategic culture*" through implementation of the European Intervention Initiative. To pursue joint efforts in the field of capability development, corresponding European land and air defence systems will be launched, namely: *Main Ground Combat System* (MGCS) and the *Future Combat Aerial System* (FCAS). An important call is to swiftly propose legislative measures at EU level to combat illicit contents promoting terrorism online.

In the area of *development, migration and asylum*²⁴, it is planned to relaunch a comprehensive Migration Agenda combining three pillars: external (increased cooperation with origin and transit countries); at the EU borders (improved protection through strengthening in terms of staff and mandate of Frontex); internal (a Common European Asylum System which ensures a fair balance of responsibility and solidarity²⁵). There is a call to tackle secondary movements inside the EU (by decreasing incentives to do so). Germany has agreed to setting up a genuine European border police building on the existing Frontex and creating a European Asylum Office to harmonise policies in this important sector. An agreement has been reached on facilitating Africa's socio-economic development as a priority in resolving the migration problem. In this context, a *High level group of "wise persons" on the European Financial architecture for development* is to be created.

In areas of *competitiveness and economic policy*, parties agreed to develop the link between European Structural Funds and economic policy coordination to *strengthen economic, social and fiscal convergence*²⁶. This provision, which is close

²⁴ The combination of migration and development issues in one paragraph is very important and signifies attempts to approach the entire problem differently and try to resolve it in a wider context of socio-economic development.

²⁵ That said, it is being stressed that uncoordinated unilateral action of member states can lead to a growth of irregular migrant inflow and put Schengen at risk

²⁶ This is a key condition for removing one of the main factors that facilitate the spread of disintegration processes within the EU.

to the idea presented in E.Macron's Sorbonne speech, was expanded with a proposal to develop "a new medium to long-term strategic perspective for sustainable growth and employment at the European level, through innovation-enabling legislation, further deepening of the EU single market and promoting world class competitiveness of industry"²⁷. It is planned to implement an ambitious EU trade policy based on open market and multilateralism principles, along with modernisation of the multilateral trade system, in particular with a view to strengthening the disciplines on market distortive practices and restoring the full operation of the dispute settlement mechanisms²⁸.

In the **taxation** sector, France's idea of "convergence" of corporate taxation systems may start coming to life in the bilateral format, with inviolable support of the EC proposal to establish a *Common Corporate Tax Base* in Europe. By the end of 2018, an agreement had to be reached on a *fair digital taxation*.

New harmonised approaches to **EMU completion** deserve particular attention, given the fact that the unresolved issues in this area are among the main sources of crisis processes in the EU, but also because it is Germany's position that largely determines further development of this system. Parties agree that Europe needs to create "a strong currency union". To strengthen and deepen this union, a roadmap is proposed, which includes²⁹:

- introduction of a new instrument – a *common backstop instrument* – within the European Stability Mechanism (ESM), along with enhancing the effectiveness of ESM instruments and its incorporation into EU law;
- improved mechanisms of *sovereign debt service guarantees* through the introduction of improved instruments;
- completion of the Banking Union according to the roadmap of June 2016³⁰ and ensuring its operation;
- introduction of the *European Deposit Insurance Scheme* (EDIS);

²⁷ For more information, see: Mezeberg Declaration. Renewing Europe's promises of security and prosperity. – Presse- und Informationsamt der Bundesregierung. Die Bundesregierung, 19 June 2018, <https://archiv.bundesregierung.de/archiv-de/meta/startseite/meseberg-declaration-1140806>.

²⁸ At the moment, they are "paralysed" due to destructive actions of the United States, which is critically disposed towards the WTO.

²⁹ For more information, see Section 3 of this Report.

³⁰ See: : Council of the EU. Council Conclusions on a roadmap to complete the Banking Union. Press release 353/16, 17/06/2016, <https://www.consilium.europa.eu/en/press/press-releases/2016/06/17/conclusions-on-banking-union/pdf>.

- decisive progress towards a *Capital Markets Union*;
- ***establishing a pluriannual Euro area budget*** within the framework of the European Union to promote competitiveness, convergence and stabilisation in the euro area, starting in 2021. Its priorities will include investment in innovation and human capital. Countries will examine the issue of establishing a *European Unemployment Stabilisation Fund*.

In the areas of ***research, innovation, higher education and digital technologies***: a swift launch of a pilot project to fund breakthrough innovation; setting up a joint French-German centre for research on artificial intelligence; a quick set up of the first “European universities”, initially consisting in bottom-up networks of universities across the EU; a search for solutions to address new challenges in space policy.

In ***climate policy***: development of an EU strategy 2050 for the long-term transformation towards carbon neutrality, i.e. achieving net zero carbon emissions in the atmosphere by balancing a measured amount of carbon released with an equivalent amount sequestered or offset. In this context, countries agreed to set up a joint interministerial High Level Working Group on climate change to intensify cooperation in this cross-cutting field and build up common views on energy transition and tools for triggering sustainable finance and economic incentives, including carbon pricing issues.

Lastly, parties agreed to support the idea of ***reforming the EU institutions***, including cutting the number of EC staff and putting in place transnational lists for European elections as of 2024.

France and Germany’s joint position on the ways of reforming EU operation mechanisms added a lot of strength to euro-optimists’ capacity for action on the eve of discussions regarding these plans at European Council summit in December 2018. Even more so, as E.Macron’s first proposals, which initially lacked practical implementation mechanisms, were elaborated and received practical interpretation. Yet, this is not a guarantee for their uninhibited adoption by all member states’ governments, many of which are influenced by forces that are rather far from euphoric.

However, the problem lies not just in political and ideological perception of this issue. These plans also contain major *intrinsic* problems.

First of all, note that both, E.Macron’s first initiative and the Mezeberg Declaration contain mostly EU’s ambitious development *goals* and lack precise formulations

as regards *instruments* to achieve these goals. Potential means of achieving the set goals mostly include creation of an even larger number of European institutions and community regulation instruments – a rather traditional way to attempt to solve problems for the EU. This raises a number of difficult questions.

First of all, approval of plans and reform programmes does not guarantee their further implementation on its own. EU history has a lot of examples when such broad plans and programmes failed to work as intended. There were numerous cases of delayed implementation of many measures in the previously approved plans on EMU completion, as well as insufficient impact of the previously adopted European programmes for stimulating innovation and ensuring global competitiveness of the EU.

EU is the undisputed global leader by the number of ambitious programmes for supporting innovation and competition, and the number of European institutions created for this purpose. So will the creation of new institutions and support centres be enough to bridge the gap between the EU and its main geoeconomic competitors – USA and Japan – in the development of many crucial future technologies, and can it prevent formation of such a gap between the EU and new East Asian technological leaders? It is not the number of support institutions that is important, but *how efficient they are* and whether they are *changing the business climate*. Support institutions and joint innovation centres alone are unlikely to influence the situation, if the overall market demand for innovation remains low³¹ and existing mechanisms stay inflexible and unaccepting of risks necessary for the operation of venture capital.

There are sufficient reasons to believe that lack of innovation in the EU (compared to world leaders in technology) is due to problems in the structure of member states' economic models, not so much the lack of united effort. If the absence of a broad integration space was truly an insurmountable obstacle to successful innovative activity, how would such relatively small East Asian countries as South Korea, Singapore, Malaysia, which had never participated in deeply integrated regional unions, become so innovation-capable?

Secondly, it is clear that expanding the European agenda in the context of deeper integration will lead to allocation of additional funds for these purposes. There are no

³¹ In this context, the EU has a high demand for environmental innovations, and thus is an undoubted global leader in this area.

“free of charge” reforms: they all entail additional costs related to creation of some institutions and liquidation/reorganisation of others, developing or changing a system for their informational support, staff training or retraining, etc.

Traditionally, Germany has been Europe’s “money bag”. Yet, is this “money bag” “bottomless” and is Germany itself happy with the prospect of redistributing even more of its national income to benefit “others”, without sufficient guarantees of *political control over the use of these funds*? Will A.Merkel’s political influence be enough to convince her partners in Germany (for instance, from the more eurosceptical Christian Social Union) of the need for such sacrifice? Ultimately, a debate may arise in Germany over *further increase of economic unity and transition to a single budget that would require a corresponding political superstructure over the Union to guarantee the country’s control over its economic resources*. But are other EU member states ready for such potential developments, especially those that have been lately raising the issue of national sovereignty?³²

Thirdly and finally, neither E.Macron’s initiative, nor the joint Franco-German Declaration give an idea about definite *algorithms to achieve the numerous ambitious goals they set*. Therefore, despite the numerous “roadmaps”, there is no clarity as to the course of reforms.

In this context, let us remember the famous principle of effective economic policy, formulated back in 1952 by J.Tinbergen, who later became a Nobel Prize laureate, according to which: *the number of economic policy targets cannot exceed the number of non-conflicting instruments at government’s disposal*³³. Even though it was formulated for macroeconomic policy, there is nothing preventing us from applying it to the policy of creating regional integration spaces, which are always based on creating a single economic space. Thus, *simultaneous* setting of a large number of different objectives for an integration policy is dangerous, as along with their number, the *probability of conflict between individual targets* will increase, and some of them will be missing instruments for targeted influence.

³² E.Macron is trying to substitute the concept of national sovereignty with a phonetically close, but conceptually very different notion of “sovereign Europe”. It is distinctly similar to the system, where powers of national states have mostly been transferred to supranational governing bodies. Maybe, this is the ideal of transnational financial capital. But does the majority of EU member states’ population share such “European values” at the moment?

³³ Source: Tinbergen J. On the Theory of Economic Policy. – North-Holland Publishing Company, Amsterdam, 1952, p.78, <http://hdl.handle.net/1765/15884>. . Special attention should be paid to Chapter 5 “Inequality between Number of Targets and Number of Instruments: Alternative Instruments or Incompatible Targets”.

Possibly, this was the “economic philosophy” used by founders of European associations, which for a long time were implementing policies based on the concepts of neofunctionalism. The latter was characterised by distinct gradualism and a spillover of integration processes to new areas after achieving success in more local sectors³⁴. Neofunctionalists were guided primarily by pragmatic achievement of positive results in areas with best preconditions and minimal political controversy, and approached integration itself as a set of events, interrelated in time and space, avoiding the ideology of establishing large-scale ambitious, politically conditioned integration projects. By its logic, this was a totally different approach from those that started to dominate since 1990s.

Today, euro-optimists’ approaches typically include *numerous goals, which make large integration projects vulnerable in the part of providing the required instruments*, even more so, as these instruments are in the hands of regulation entities of different levels (some are concentrated at the community level, some – at the national, and some – at the internal regional level (in case of federations). Harmonisation and consolidation of such diversified and structurally complex governing mechanisms is problematic and hardly realistic. It inevitably results in an *extremely cumbersome system of bureaucratic dealings, which are closed off from public, and not only slow down the decision-making, but also increase its cost*.

Can the EU keep up this course? Clearly, it can, if political mega-ambitions keep prevailing over pragmatic assessment of joint (community) regulation potential. But ***creating an increasing number of new common regulatory institutions, which is bound to lead to dramatic redistribution of funds from national governments to common regulatory bodies, does not guarantee improved efficiency of regulation***.

This is why implementation of approaches developed by the European Commission and supported mainly by the France and Germany duo, is hardly providing any reliable guarantees as to reaching the ambitious goals set for the Union, no matter how strong the appeal to European values is. In turn, this is unlikely to stimulate the member states with nationalistically-minded leaders or influential eurosceptical parties and movements. If corresponding political declarations are approved at the EU member states’ summit, their practical implementation is likely to be met with major obstructions.

³⁴ For more information, see: Schmitter P. Neo-neo-functionalism. – European University Institute, July 2002, <https://www.eui.eu/Documents/DepartmentsCentres/SPS/Profiles/Schmitter/NeoNeoFunctionalismRev.pdf>, Rosamond B. Theories of European Integration. – Basingstoke and New York: Palgrave Macmillan and St. Martin’s Press, 2000.

So, to have a real chance at bringing the EU out of the current multi-faceted systemic crisis, *European agenda must be significantly decongested and made functionally more adequate for effective common regulation*. Quite possibly, if the “integration front” is narrowed down to the really small number of crucial priorities (where real action is impossible without the pooling of efforts), the risky prospect of multi-level integration with disappear as well.

2.3. INFORMAL ASSESSMENTS OF THE PROSPECTS OF EUROPEAN INTEGRATION AND THE EU

Informal assessments of European integration prospects are very important for three fundamental reasons. First, most of them are much more independent, and thus less politically biased. Second, as they present positions of analytical and scientific communities, they are based on more thorough assessment of the existing mechanisms for reaching different goals. Third, they are important from the standpoint of civil society institutions’ support for government decisions.

Some of these approaches are extremely direct, not to say primitive, politically biased and come down to four simple and straightforward alternatives³⁵:

1. **Muddling Through**: the EU goes on without any major transformations or reforms. This will lead to a number of negative macroeconomic consequences, a drop in efficiency of existing common macroeconomic regulatory mechanisms and single market functioning, refusal to complete the Banking Union and the Capital Markets Union, along with conservation of the migrant problem, and a further drop of trust in the European idea.

2. **Establishing two speeds**: the EU becomes³⁶ a two-level organisation consisting of a deeply integrated core and the periphery, with the latter having greater freedom of choice to select EU policies, in which they want to participate. It is expected that the core countries will flourish, and the periphery – decline, with corresponding social consequences.

³⁵ For more information, see: Archick K. European Union: Current Challenges and Future Prospects. – Congressional Research Service Report, 27 February 2017, <https://fas.org/sgp/crs/row/R44249.pdf>; W. Boonstra. Four Potential Future Scenarios for the EU, Association of Accredited Public Policy Advocates to the European Union, <http://www.aalep.eu/four-potential-future-scenarios-eu>. Curiously, the text in both of these seemingly independent alternatives is so similar (up to the wording of specific phrases) that it makes one think they might be coming from the same source.

³⁶ Many believe that the two-speed EU already exists, with a different number of countries in a range of EU initiatives, such as the Euro area, Schengen, defence policy, justice and home affairs policy. Others believe that a formal two-speed structure can undermine solidarity even more and create even bigger contradictions between the core and periphery member states.

3. *A looser, more intergovernmental configuration*: to an extent, this is a disintegration scenario, when further EU integration is essentially suspended and member states' sovereignty in some areas is increased. It envisages numerous problems, namely: increasing differences of opinion between countries, deterioration of cooperation and trade as the common market falls apart and the union returns to the rudimentary customs union, hence – a drop in the welfare, devaluation of currencies after exit from the Euro area and even financial chaos with potential nationalisation of major banks, introduction of limitations on capital movement, etc. In this scenario, political cooperation is terminated.

4. *A tighter, more integrated configuration*: the EU comes out of the current turmoil more united and integrated. This alternative leads to completion of the Banking Union and Capital Market Union, transformation of the Euro area into an “optimal currency area”, which, according to predictions, will stimulate investment, ensure economic growth and low level of unemployment with progressive convergence of prosperity levels between member states, and a surplus in national budgets.

Looking at these “alternatives” makes one think: what is to be discussed, if out of four possible “alternatives” one is bad, one – utterly catastrophic, and one – good only for those, who took the path of accelerated integration? In general, if we proceed from the assumption that integration is the only factor that creates conditions for economic growth and social development, the field for scientific and political-economic discussions simply vanishes: what remains is the dogma of integration to be followed relentlessly. In reality, in such cases we are observing a distortion of scientific and analytical foundations of international integration processes, which can only hurt real European integration. Integration is not a source of economic growth and social progress that yields results under any circumstances. On the contrary, *under certain conditions it can trigger negative processes within the integrated union*. This is why its development requires a balanced approach.

Thankfully, the approaches above are just isolated examples among a large number of works containing a thorough analysis of European integration processes and prospects for its further evolution, which do not dismiss the possibilities of complete or partial disintegration, but analyse them in great detail. A co-author of this report has published his research with a more detailed description of a number of major research works in this area (table “Certain Concepts of Possible Pessimistic Scenarios of EU Integration Evolution”³⁷, p.62-64).

³⁷ For more information, see: Sidenko V. The Crisis Processes in the EU Development: Origins and Prospects. – Ekon. Prognozuvannâ (Economy and Forecasting), 2017, No.1, p.7-30, http://eip.org.ua/docs/EP_17_1_07_en.pdf.

Certain Concepts of Possible Pessimistic Scenarios of EU Integration Evolution

Author and source	Concept and potential political consequences or proposals
G.Soros¹	The EU is on the verge of collapse.
N.Gilman, S.Weber, USA²	EU's current state is similar to the period of disintegration of the USSR.
C.Franzius, F.C.Mayer, J.Neyer, Germany³	The EU has reached objective limits of integrational development.
D.Chalmers, M.Jachtenfuchs, C.Joerges, different countries⁴	The end of the Eurocrats' dream due to European diversity.
J.Delors, France, former head of the EC⁵	<p>Possibility of EU disintegration due to governance problems in expanded EU. Practical proposals:</p> <ul style="list-style-type: none"> ✓ strengthen "European discipline" and ensure the growing role of European regulatory norms; ✓ allow groups of countries to go forward with a deeper integration and their own forms of cooperation.
J.E.Stiglitz, Nobel Prize laureate in Economics, USA⁶	<p>A possible collapse of the Euro area that is "flawed at birth" and has inbuilt deficiencies in its structure – norms, rules and institutions, which do not reflect the diversity of member states' situations.</p> <p>The Euro mechanism contributes to growing, not decreasing divergences between states, and thus, only increases the gap between member states. There are two possible ways out: either "more Europe" or "less". Practical proposals:</p> <ul style="list-style-type: none"> ✓ fundamental reforms in the eurozone structure and policies imposed upon its member states; ✓ a well-managed exit from the experiment with the euro as the single currency; ✓ a bold creation of a new system to sustain the functions of a "<i>flexible euro</i>" (instead of the single eurozone currency, there would be several groups, each with its own electronic currency).

¹ For more information, see: Soros G., Schmitz G. The European Union is on the Verge of Collapse. – An Interview, The New York Review of Books, Vol.63, №2, 11 February 2016, <http://www.nybooks.com/articles/2016/02/11/europe-verge-collapse-interview>; Soros G., Schmitz G. The Tragedy of the European Union: Disintegration or Revival? – New York: Public Affairs, 2014.

² For more information, see: Gilman N., Weber S. Back in the USSR. Is the European Union heading for a Soviet-style collapse? – The American Interest, Vol.12, №3, 12 December 2016, <http://www.the-american-interest.com/2016/12/12/back-in-the-ussr>.

³ For more information, see: : Franzius C., Mayer F., Neyer J. Grenzen der europäischen Integration. Herausforderungen für Recht und Politik. – Baden-Baden: Nomos Verlagsgesellschaft, 2014, https://www.nomos-shop.de/_assets/downloads/9783848706341_lese01.pdf.

⁴ For more information, see The end of the Eurocrats' dream: adjusting to European diversity (edited by D.Chalmers, M.Jachtenfuchs, C.Joerges). – Cambridge, New York: Cambridge University Press, 2016.

⁵ For more information, see: Charlemagne: The return of Jaques Delors. – The Economist, 12 February 2004, <http://www.economist.com/node/2424124>; Rousselin P. Après les pompiers, l'UE attend les architectes. – Interview avec Jacques Delors. Le Figaro, 15 June 2010, <http://www.lefigaro.fr/politique/2010/06/15/01002-20100615ARTFIG00681-delors-l-europe-attend-les-architectes.php>.

⁶ For more information, see: : Stiglitz J.E. How a Common Currency Threatens the Future of Europe. – New York – London: W.W.Norton&Company, 2016, <https://emf.neocities.org/tmp/TheEuro.pdf>.

Author and source	Concept and potential political consequences or proposals
F.W.Scharpf, Germany⁷	<p>The phenomenon of monetary over-integration of the structurally divergent "Northern" and "Southern" political economies. Justification of the controlled disintegration scenario as opposed to the officially proclaimed scenario of forced structural convergence in the Eurozone.</p> <p>Practical proposal:</p> <ul style="list-style-type: none"> ✓ introduction of a flexible <i>two-level European Currency Community</i>, that would combine the Eurozone (structurally more coherent monetary union) and countries that belong to the already existing exchange rate mechanism (ERM II).
H.Vollaard, Netherlands⁸	<p>Possibility of partial exits (opt-outs) of eurosceptical countries from the European integration participation or attempts to limit the cost of participation in the EU, or bringing down the level of compliance with EU rules for countries with less effective national government systems. The reality of creating a "<i>truncated union</i>".</p> <p>Possibility of intensified interaction on the level of "sub-national regions" and formation of trans-nationalized multi-layered and multifaceted political constructions.</p>
P.C.Schmitter, USA and Z.Lefkofridi, Greece⁹	<p>Risks of disintegration due to increasing diversion of trade outside the EU in a number of countries, as well as the low capacity for resolution of important social problems (unemployment, income inequality).</p>
D.Webber, Austria¹⁰	<p>EU's decreased sustainability due to changes in decision-making methods in the EU, a gap between the growing volume of transnational exchange and the slow growth of European political identity. Germany's inconsistent position regarding Europe, the weakening of its pro-European stance, with a possibility of a kind of "Britanisation" of its policy. It is necessary to take into account the possibility of restricting the role of supranational bodies in favour of more intergovernmental mechanisms and advancing "differentiated" integration forms (<i>Europe à la carte</i>) with a corresponding change of EU configuration and development of a less cohesive format of connections between member states.</p>

⁷ For more information, see: Scharpf F. Scharpf F. Forced Structural Convergence in the Eurozone – Or a Differentiated European Monetary Community. – MPIfG Discussion Paper 16/15, Köln: Max-Planck-Institut für Gesellschaftsforschung, December 2016, http://www.mpiifg.de/pu/mpifg_dp/dp16-15.pdf; Scharpf F. The Costs of Non-Disintegration: The Case of the European Monetary Union; Eppler A., Scheller H. Konzeptionalisierung europäischer Desintegration. Zug- und Gegenkräfte im europäischen Integrationsprozess. – Baden-Baden. Nomos Verlagsgesellschaft, 2013.

⁸ For more information, see: Vollaard H. A Theory of European Disintegration. – Fourth Pan-European Conference on EU Politics 25-27 September 2008, University of Latvia, Riga, <http://www.jhubc.it/ecpr-riga/virtualpaperroom/017.pdf>; Vollaard H. Explaining European Disintegration. – Journal of Common Market Studies, Vol.52, Issue 5, September 2014, p.1142-1159.

⁹ For more information, see: Schmitter P., Lefkofridi Z. Neo-Functionalism as a Theory of Disintegration. – Political Science Review, 2016, №1, p.1-29.

¹⁰ For more information, see: Webber D. How Likely Is It That The European Union Will Disintegrate? – A Critical Analysis of Competing Theoretical Perspectives Austrian National University, ANU Centre for European Studies Briefing Paper Series, Vol.2, №3, October 2011.

Author and source	Concept and potential political consequences or proposals
H.Scheller, A.Eppler, Austria¹¹	<p>Possibility of <i>simultaneous</i> integrative and disintegrative trends in different dimensions (institutional, territorial, economic, and socio-cultural).</p> <p>The EU has been experiencing disintegration processes primarily in the economic aspect (internal market started disintegrating into regional sub-markets, with specific market environment parameters) and the legitimacy aspect – as a result of major losses after drastic austerity measures had been imposed upon the troubled states in the South, which caused negative economic effects and social disintegration.</p>
J.Zielonka, USA¹²	<p>None of the possible scenarios promises a bright future for the EU. The most likely and favourable alternative is the new <i>medievalism</i>, with more intense differentiated integration according to concentric circles concept – intensification of cooperation in some areas, and maintained weak interaction in others; the EU will be moving closer to the medieval paradigm, which entails overlapping authority, multiple loyalties, fuzzy borders, and duality of competing universal claims. Practical proposals:</p> <ul style="list-style-type: none"> ✓ more diversity and flexibility in the governance system, with integration efforts contained to only a few selected fields (trade, competition, and energy policy); ✓ soft, rather than hard, laws used as instruments of regulation, focus on providing incentives instead of introducing sanctions; ✓ focus not as much on convergence and homogenisation, as on deliberative problem solving and mutual learning.
I.Krastiev, Bulgaria – a founding member of the European Council on Foreign Relations¹³	<p>The prospect of EU disintegration is real as objectives of “ever closer Union” and “deeper democracy” have come in conflict. EU’s main threats come from revolt at the “center”, consisting of countries with more established democratic traditions, but less from destabilization on the “periphery”.</p> <p>EU disintegration is possible, as it is currently undergoing an <i>existential crisis</i>. There is a mental split between the post-communist new member states and Western countries. The author claims that EU ideology-makers and executives have lost their connection to the historical context and understanding of what is happening in the global arena and in their own societies.</p>

¹¹ For more information, see: Scheller H., Eppler A. European Disintegration – non-existing Phenomenon or a Blind Spot of European Integration Research? – Preliminary Thoughts for a Research Agenda, Institute for European Integration Research, Working Paper №02, 2014, Institut für europäische Integrationsforschung, Wien, https://eif.univie.ac.at/downloads/workingpapers/2014_02_Eppler_Scheller.pdf.

¹² For more information, see: Zielonka J. Disintegration Theory. International Implications of Europe's Crisis. – Georgetown Journal of International Affairs, Winter/Spring 2012, p.51-59.

¹³ For more information, see: Krastev I. A Fraying Union. – Journal of Democracy, Vol.23, №4, October 2012, p.23-30; Krastev I. After Europe. University of Pennsylvania Press, 2017.

Presenting the views of representatives of *different countries, different professions and different schools of thought*, the table above allows for clearly seeing *a pronounced gap between the range of assessments and proposals of the EC and top European integration ideologists from specific member states, and the range of assessments arising in the course of discussions outside of government offices.* This gap indicates major differences in the perception of key EU trends. It seems that EU leaders are more focused on the views of transnational financial elite that finds EU problems troublesome. They also demonstrate a lack of ability (and possibly, lack of desire as well) to understand that deep nature of the current EU crisis and the numerous factors that caused it. This is what supports their main political priority – *keep moving even faster towards EMU completion and creation of a political union, – essentially, follow the path that has brought the EU to today's troubles.*



Already today, EU mechanisms are extremely complicated and intricate, incomprehensible for the general public, and thus, failing to inspire trust. This excessive complexity and inconsistency cannot but affect the efficiency of operation of European institutions. And although certain efforts aimed at optimising these mechanisms may seem relevant and give certain positive results,³⁸ these results may be easily lost in the process of further complication of regulatory systems as more regulatory functions are transferred to the community level in the future.³⁹

European integration proponents have trouble realising the aspect of ***excessive complexity, and thus, vulnerability of the entire European regulatory system.*** And nowhere else is this problem more apparent than in the issues of reforming EMU – the economic core of the entire European integration process.

³⁸ In this context we can reference, for instance, a comprehensive study of optimising the division of EU government functions between communitarian and national authorities. For more information, see: How Europe Can Deliver. Optimising division of competences among the EU and its member states. – Gütersloh: Bertelsmann Stiftung, July 2017.

³⁹ In five out of eight areas analysed in the above-mentioned study, it was recommended to focus powers on the level of the EU, and only in two cases (income protection as part of agricultural policy, and in pre-school and higher education policy) – to solve these issues mainly on the national level.

3. KEY ASPECTS OF REFORMING EURO AREA MECHANISMS

Establishing the Economic and Monetary Union (EMU) is a guarantee of resilient development of the European integration process. Through EMU functioning, based on states delegating a part of their powers to common bodies that act according to supranational power principle, in-depth interaction is achieved. Integration in this area creates a powerful incentive for greater political unity – formation of a political union within the EU. At the same time, this is where the most dangerous mechanisms of potential EU destruction originate. Nobel Prize winner J. Stiglitz deftly pinpoints this idea by directly associating Europe's future with the fate of its common currency – the euro.¹

3.1. MAIN DIRECTIONS FOR COMPLETION OF THE ECONOMIC AND MONETARY UNION

As mentioned in Section 1, *Euro area crisis was the turning point in the overall development dynamics of European integration*. The main problem is that to eliminate the macroeconomic disproportions and imbalances built into today's *incomplete EMU system* the EU needs to ***further strengthen macroeconomic regulation on the community level (common EMU structures) while the necessary political preconditions for this in the member states (on the national level) are currently lacking.***

Discarding the unviable inertial scenario of keeping the *status quo* via ignoring the growing mass of problems inside the system, as well as the politically unacceptable scenario of uncontrolled disintegration, there remain only two ways out: (1) *significant deepening of integration and completing a genuine EMU* or (2) *controlled partial disintegration, including returning a portion of previously centralised monetary powers to nation states and actual transformation of the common currency's role and function.*

EU leaders and the European Commission proposed the first option – pushing forward EMU completion as a process aimed at eliminating asymmetries in monetary and fiscal regulation.

¹ See: Stiglitz J.E. How a Common Currency Threatens the Future of Europe. – New York-London: W.W.Norton&Company, 2016, <https://emf.neocities.org/tmp/TheEuro.pdf>.

In order to objectively assess this potential scenario of further European integration, it makes sense to analyse the route followed by the group of leading EU member states since the EMU plan was approved in 1989. Implementation of this plan led to formal launch of the EMU on 1 January 1999 with the introduction of euro and creation of the European System of Central Banks headed by the European Central Bank, which became the centre of formation and implementation of the single monetary policy.

From the very start, between 1 July 1990 to 31 December 1993, foreign exchange controls were completely lifted and complete freedom of capital movement was introduced. To avoid uncontrolled destabilising capital flows the so-called **euro convergence criteria** (aka *Maastricht criteria*)² were introduced in 1992 – a number of macroeconomic parameters, which all European Union member states were required to meet. From 1996, member states had to undergo every two years a special monitoring to check their compliance with the convergence criteria.

In 1997, *the Stability and Growth Pact* was approved, which served as a tool for ensuring budget discipline after creation of the Euro area and aimed to introduce a new exchange rate regulation mechanism for countries outside of the Euro area (*Exchange Rate Mechanism-II – ERM-II*). In June 1998, the ECB was created as a key monetary regulation institution, which opened the way to full introduction of a single European currency in the early 1999.

However, it should be noted that despite original expectations, converging economic policies of member states turned out to be a problem, especially in the aspect of budget deficit and debt ceilings. And thus, the single currency's foundation lacked strength from the very start. Overall, **the initial EMU format was incomplete and skewed: full integration of monetary policy (single currency and single monetary regulation system) coupled with retained major autonomy of banking systems, fiscal and budget areas caused major structural deformations inside the Euro area regulatory system. They undermined Euro area's resistance to external shocks and made it particularly vulnerable** to the events of 2008-2009 global economic and financial crisis. All of this prevented recovery from the global crisis in the Euro area, instead – *the global crisis in the EU region transformed into the Euro area crisis*. This transformation, as is usually the case, happened through the parts of the system most vulnerable to destabilising factors and risks. Particularly notable among the countries that found themselves in these conditions was the case of Greece.

² Introduced by the Maastricht Treaty in 1992 and currently included into the updated Treaty on the Functioning of the European Union (Art.140). For more information, see insert "Maastricht Convergence Criteria for the Euro Area" in Section 1, p.28.

Rapid unfolding of the Euro area crisis in 2010 under the impact of debt crises and state finance crises in a number of member states could not be handled using the functionally limited mechanisms of the uncompleted EMU, and therefore brought the issue of making a *full-fledged EMU* to the agenda, coupling monetary integration with a *banking and fiscal unions, as well as tighter integration in macroeconomic policy*.

This vision fully emerged in the early 2012, when 25 EU member states (except the UK and Czech Republic) signed *The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG)* on 2 March 2012³. Its most important innovation was the introduction of a balanced budget rule titled *“Fiscal Compact”* which entered into force on 1 January 2013, and was fully applied to Euro area member states, and (with certain exceptions) to other contracting member states.

Thus, EU leaders generated a new, more ambitious vision of full-fledged EMU formation, having published the *Roadmap “Towards a Genuine Economic and Monetary Union”*⁴ and a detailed European Commission plan on this issue⁵, which were approved by the European Council in December 2012. Based on this, the EU promptly developed and adopted legal framework to form the Banking Union and unfold instruments for economic policy coordination. It set the principle that all major economic policy reforms are subject to systemic *ex ante* discussion and coordination, if necessary, between member states with participation of EU regulatory institutions. Thus, a *comprehensive ternary process* of EMU completion emerged, which was based on the implementation of three key directions of further integration:

- ✓ creation of the Banking Union;
- ✓ creation of the Fiscal Union through tighter integration of member states’ fiscal systems;
- ✓ introduction of a single European macroeconomic regulation system called “the European Semester”.

³ See: Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, 2 March 2012, https://www.consilium.europa.eu/media/20399/st00tscg26_en12.pdf.

⁴ See: Herman Van Rompuy, President of the European Council, in close collaboration with: José Manuel Barroso, President of the European Commission, Jean-Claude Juncker, President of the Eurogroup, and Mario Draghi, President of the European Central Bank. Towards a Genuine Economic and Monetary Union. – Brussels, 5 December 2012, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/134069.pdf.

⁵ See: A blueprint for a deep and genuine economic and monetary union: Launching a European Debate. COM(2012) 777 final/2. – European Commission, 30 November 2012.

Later, after Jean-Claude Juncker took office as President of the European Commission, a fourth element was added – creation of a Capital Markets Union (CMU). Because the CMU is tightly connected with the Banking Union, these two EMU elements were officially united under the name of **“Financial Union”**. At the same time, the element connected with a single European system of macroeconomic regulation is now emerging as the basis for the **“Economic Union”**. Tellingly, such form of integration as **“Political Union”** is also mentioned in the context of EMU formation⁶, which is a direct acknowledgement of a high level of interdependence between economic and political processes within European integration.

Yet, we believe that this intention to significantly deepen integration, which looked absolutely logical from a purely economic and technical standpoint, ***does not fully account for (1) specific political and ethno-cultural aspects of development, and (2) major technical complexity of proposed regulation mechanisms.***

In the first aspect, practical implementation of this course would mean *significant strengthening of the role of EU’s common agencies and, therefore, limiting the autonomy of national macroeconomic regulation bodies*. In reality, this would definitely lead to a *new attempt at federalisation of the EU, or more precisely – of its nucleus in the form of Euro area*, as the intensification of “supranational” features in important aspects of economic policy-making, from the functional standpoint, cannot but lead to formation of a *political union*.

Thus, placing this ambitious integration initiative on the agenda led to exacerbation of arguments between EU member states regarding EU’s future development and promoted consolidation of eurosceptics, who stood against the prospect of EU transformation into a European federation. Moreover, in conditions of a major upsurge of unregulated migration flows this debate quickly challenged the very idea of EMU completion.

Regarding the second aspect, the whole system can effectively function only within the so-called *integrated economic policy framework*, aimed, among other things, at avoiding major differences between member states’ level of global competitiveness and strengthening the ability to withstand external shocks and speculative bubbles in financial markets. This meant significant strengthening of EU mechanisms for monitoring the state of potentially dangerous economic imbalances (including the already created mechanisms of ***European Semester***⁷, ***Macroeconomic Imbalances***

⁶ See: A deeper and fairer economic and monetary union. – European Commission, https://ec.europa.eu/commission/priorities/deeper-and-fairer-economic-and-monetary-union_en.

⁷ “European Semester” was introduced on 7 September 2010 as a format of budget and economic policy harmonisation that consolidated previously separate mechanisms and procedures into a single process with a clearly defined schedule, which allows to achieve synergy in their application.

*Procedure*⁸ та *Euro Plus Pact*⁹), as well as promotion of structural reforms, including making arrangements with corresponding EU institutions regarding temporary provision, on a flexible and targeted basis, of limited financial resources supported by corrective action plans. Special attention should be paid to macroprudential policy to prevent major fast-growing imbalances caused by financial problems on the national level. This should be done via provision of corresponding functions to the new *single supervisory authority (ECB Supervisory Board)* and enhanced role of the *European Systemic Risk Board (ESRB)*.

Intensification of partnerships between member states in the corresponding area was to become an important characteristic of the EU's system of macroeconomic policy coordination. It refers to the *Partnership for Growth, Jobs and Competitiveness*, which involved the adoption of *contractual arrangements mutually agreed* by member states, the European Commission and the EU Council on the basis of National Reform Programmes¹⁰ and related solidarity mechanisms, i.e. provision of mutual support by member states (loans, grants, guarantees, etc.).

Annual Growth Surveys and *Alert Mechanism Reports* prepared by the European Commission as part of European Semester macroeconomic coordination were to play the key integrating role in financial stabilisation, including stabilisation of payment relations. These documents are meant to become the basis for recommendations for individual countries, which must then be used in national reform programmes.

The structural complexity of EMU completion and strong political contradictions regarding the process determined a complicated trajectory of its development, with pronounced impulses coming from EU governing bodies (foremost, the EC) to ensure its dynamics and prevent the original impetus as of 2012 from fading away.

⁸ *Procedure for regulating macroeconomic imbalances*, effective in the EU since 13 December 2011, meant to prevent formation and correct high current account deficit in the balance of payments, foreign debt and "bubbles" in real estate markets via stronger supervision over macroeconomic policy. The procedure has two blocks: imbalance prevention (preventive arm) and correction (corrective arm).

⁹ *Euro-Plus Pact* was adopted in March 2011 by Euro area member states and a number of other EU members (Bulgaria, Denmark, Latvia, Lithuania, Poland, and Romania) to coordinate reforms aimed at increasing fiscal capacity and competitiveness as well as employment rate in corresponding countries. It was an attempt to develop the Stability and Growth Pact, although its implementation is based on legally non-binding mechanisms – so-called open methods of coordination (guidelines and indicators, benchmarking and sharing of best practice).

¹⁰ In the fall of 2013, the EC prepared proposals for ex ante coordination of key economic reforms between member states.

In this context, key aspects in advancing EMU formalisation were:

- ✓ presentation of the EC's **"White Paper on the Future of Europe: Reflections and scenarios for the EU27 by 2025"** (1 March 2015)¹¹;
- ✓ June 2015 publication of the **Five Presidents' Report** (EC, EUCO, Euro-group, ECB, and EP)¹², which set the goal to complete EMU by 2025;
- ✓ implementation of the goals set in Commission's Communication **"On steps towards Completing Economic and Monetary Union"** (21 October 2015)¹³;
- ✓ the 2017 publication of two **Reflection Papers on the Deepening of the Economic and Monetary Union, and on the Future of EU Finances**¹⁴, which summarised conclusions of public and expert discussions that took place in the course of debate regarding potential EU development scenarios;
- ✓ identification of EU priorities in the annual State of the Union Address (2017 and 2018) by the Commission's President¹⁵;
- ✓ EC's approval (6 December 2017) of a new EMU Roadmap **Further Steps towards Completing Europe's Economic and Monetary Union**¹⁶, which laid out specific steps for the period until 2020. Further discussion of these proposals in the EU summit on 15 December 2017 and EUCO session on 28-29 June 2018.

Thus, there is an ongoing intensive process of EMU formalisation, which is based on a highly complex and intricate mechanism of mutual approval. This process

¹¹ See: White Paper on the Future of Europe. Reflections and scenarios for the EU27 by 2025. – European Commission, 1 March 2017, https://ec.europa.eu/commission/sites/beta-political/files/white_paper_on_the_future_of_europe_en.pdf.

¹² See: Five Presidents' Report, 2015: Completing Europe's Economic and Monetary Union. – Report by Jean-Claude Juncker in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz. European Commission, https://ec.europa.eu/commission/sites/beta-political/files/5-presidents-report_en.pdf.

¹³ See: Communication from the Commission to the European Parliament, the Council and the European Central Bank "On steps towards Completing Economic and Monetary Union". – European Commission, 21 October 2015, <https://ec.europa.eu/transparency/regdoc/rep/1/2015/EN/1-2015-600-EN-F1-1.PDF>.

¹⁴ See: Reflection Paper on the Deepening of the Economic and Monetary Union. – European Commission, 31 May 2017, https://ec.europa.eu/commission/sites/beta-political/files/reflection-paper-emu_en.pdf; Reflection Paper on the Future of EU Finances. – European Commission, 28 June 2017, https://ec.europa.eu/commission/sites/beta-political/files/reflection-paper-eu-finances_en.pdf.

¹⁵ See: State of the Union by Jean-Claude Juncker, President of the European Commission. – European Commission, 13 September 2017, https://ec.europa.eu/commission/sites/beta-political/files/state-union-2017-brochure_en.pdf; State of the Union by Jean-Claude Juncker, President of the European Commission. – European Commission, 12 September 2018, European Commission, https://ec.europa.eu/commission/sites/beta-political/files/soteu2018-brochure_en.pdf.

¹⁶ See: Communication from the Commission to the European Parliament, the European Council, the Council and the European Central Bank. Further Steps towards Completing Europe's Economic and Monetary Union: a Roadmap. – European Commission, 6 December 2017, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017DC0821&from=EN>. For more information, see subsections 3.2-3.5 of this Report.

may be appealing on paper, but *extremely hard to implement in real life* because of its complexity and multifacetedness, which requires coordination of an immense amount of details in time and space.

These complications gain special importance under the highlighted (in research already made on the topic), *specific conditions of the current Euro area structure, which intensify structural divergence and thus undermine the area's long-term stability*.¹⁷ In particular, it is noted that ECB's "one-size-fits-all" monetary policy is not equally effective for all countries in the observed economic environment. Moreover, ECB's inflation targeting further complicates the economic situation. In most cases, its interest rate policy does not match the economic conditions of South Europe countries. *Euro exchange rate causes market distortions*, as it is undervalued for such countries as Germany and overvalued for South Europe countries.

Note that in real life, macroeconomic harmonisation mostly means imperative adaptation of weaker Union members to economically more powerful ones. Indicative of this was the *unjustified expansion of Germany's experience of increasing competitiveness*, acquired during its labour market reforms in 2003-2005 onto all Euro area members. According to the Euro area reform scenario, South Europe countries had to be reformed according to this Germany's model: restrict labour market regulation to increase competitiveness, growth and employment. It was expected that a decrease of nominal wages will bring down relative labour costs per unit of product, and thus result in increased competitiveness of companies internationally, leading to a growth of exports, higher economic development and a drop in unemployment rates. The real results can be observed in Greece and other Mediterranean countries.

Given the above, *the EU does not really have a politically perfect option* at the moment: all available options entail major risks and significant political opposition. Meanwhile, the balance of political forces supporting fundamental reforms cannot be constant: it will keep changing, depending on the socio-economic dynamics in the EU and changes in the global economy and politics.

Thus, if crisis exacerbates, it will stimulate more radical transformations, and positive dynamics – on the contrary – will weaken the incentive for reforms. At the moment, the EU is experiencing a period of comparatively positive economic development, but will it last? (Insert "*The Current State of Economic Development in the Euro Area*").

¹⁷ Source: Storm S. How a Flawed Structure is Hurting the Eurozone – INET Conference "Reawakening" Edinburgh 21-23 October 2017, <https://www.ineteconomics.org/uploads/papers/STORM-INET-2017-Storm-Panel-Future-of-the-Eurozone.pdf>.

THE CURRENT STATE OF ECONOMIC DEVELOPMENT IN THE EURO AREA

For the first time since the global crisis, the highest rate of GDP growth in the Euro area was recorded in 2017, which was facilitated by increased domestic demand (private and public consumption) and net export growth. Yet, experts still note the relatively lower level of private consumption resulting from a weaker employment rate growth and inflation (2.1%). Investment in the Euro area grew in 2017 at the highest rate since 2007, which was propelled by the increasing confidence in business, high volumes of orders, increasing profitability of companies, and low funding costs.

At the same time, experts acknowledge that the situation may change. For instance, in October 2018, production in the Euro area was at its lowest growth rate in the past several years. The so-called *Manufacturing Purchasing Managers' Index*¹⁸ that determines business conditions among manufacturing companies, has recorded the lowest rate of expansion in the manufacturing sector since September 2016, which caused a reduction in production on new orders and a drop in employment (diagram “*Manufacturing Purchasing Managers' Index*”¹⁹). What prevented growth of production and orders was the slowdown of export commodities sales, the appreciation of the euro, along with a drop of demand in key export markets of the EU, namely, the US, as well as concerns about trade wars and uneasiness associated with Brexit.

Manufacturing Purchasing Managers' Index



¹⁸ *Manufacturing PMI (Manufacturing Purchasing Managers' Index)* – is an indicator of economic health for manufacturing, the purpose of which is to provide information about current business conditions in the sector: inventory levels, employment, supplier deliveries, production volumes and new orders. A PMI reading under 50 represents a contraction of business in the sector. A PMI above 50 represents an expansion in manufacturing. The PMI is based on monthly surveys of opinions of senior purchasing executives.

¹⁹ Source: IHS Markit Eurozone Manufacturing PMI® – final data. – IHS Markit, 1 June 2018, <http://news.ihsmarkit.com/press-release/ihs-markit-eurozone-manufacturing-pmi-%E2%80%93-final-data-2>.

In any case, it will be impossible to keep the Euro area as it is (with incomplete EMU) for a long time, and the potential new wave of global crisis would make the necessity of changing Euro area mechanisms extremely topical. The way of radical deepening of integration is politically unrealistic, especially with Eurosceptic forces currently gaining momentum. What is necessary is the implementation of a course based on “the art of the possible”. This implies the importance of a *compromise between Euro-optimists and Euro-pessimists* using a formula that would satisfy both sides. We believe that this is **possible, if the EU implements the forth scenario of the EC – Doing less more efficiently**. This scenario might allow to “unburden” the European integration centre due to partial disintegration in areas, where it is more sensible to have flexible national mechanisms (it might be a sort of “political curtsy” for Eurosceptics). On the other hand, it would leave room for tighter integration in the narrow area of top priority issues, thus fulfilling the ambitions of Euro-optimists. This course would allow to get rid of certain elements of “overintegration” that cause excessive dispersal of limited common resources, unnecessary “Eurobureaucratization” of economic processes and a loss of time – all of them complicating effective adaptation to new global economic challenges amidst fundamental structural and technological transformations.

3.2. FORMATION OF THE BANKING UNION

Among all EMU components, the Banking Union is probably the least controversial one that enjoys the highest support. This is not surprising, as banking sector is the most globalised sector of economy, and is also the source of the most powerful waves of economic destabilisation.

For the Euro area, likewise the EU on the whole, consolidation in the banking sector is very relevant, however experts²⁰ draw attention to some obvious destabilising factors currently existing in this area. For example, the viability of the current banking system of the Euro area is a cause for worry, as it is affected by *structurally weak profitability and high stocks of non-performing loans*. Italian banks have over €300 bn of such loans, or almost 1/5 of total loans given out in this country. German economy – the largest and strongest one in the Euro area – is also dealing with a banking crisis: e.g. in 2016, the IMF rated the country’s largest bank – *Deutsche Bank AG* – as the most dangerous bank in the world that is a source of systemic risks for the global financial system.²¹

²⁰ Source: Storm S. How a Flawed Structure is Hurting the Eurozone. – INET Conference “Reawakening” Edinburgh, 21-23 October 2017, <https://www.ineteconomics.org/uploads/papers/STORM-INET-2017-Storm-Panel-Future-of-the-Eurozone.pdf>.

Despite the fact that monetary stimulation methods used by ECB in the past years – open market operations (purchasing government bonds of Euro area counties in secondary markets) and introduction of the Long Term Refinancing Operations programme – have somewhat consolidated the banking sector and brought down bond interest rate spreads²² for Italy, Spain and Portugal, and also prevented bankruptcy of a number of banks, this was achieved not through institutional capacity-building of the banking system, but via artificial increase in liquidity²³.

In the situation of *imbalance between risks* (they are rather high) *and available economic policy buffers*²⁴, when further intensified use of ECB's monetary policy tools becomes dangerous, chances for increasing banking sector competitiveness and efficiency lie foremost in its *institutional capacity-building*. However, given the de facto global nature of today's banking sector, this requires cooperation or coordination of effort on international level. Therefore, ***further development of European integration in the banking sector is imperative not just for the Euro area states, but for the entire EU.***

Integrated financial framework adopted in 2012 played a major role in this context. It defined conditions for creating a *Banking Union* within a short term.²⁵ In particular, it was planned to introduce:

- the ***Single Supervisory Mechanism (SSM)*** which is a system of national supervisory banking authorities integrated around the ECB that is open for all EU member states, not only the Euro area countries. This mechanism boosts functions of the *European Systemic Risk Board (ESRB)* created back in 2010. Its main goal is: to ensure that all banks comply with the EU's single banking

²¹ Source: Euro Area Policies. – IMF Country Report № 17/235, International Monetary Fund, 2017.

²² That is the difference between the weighted average interest rate earned on the bank's interest-earning assets and the weighted average interest rate paid on its interest-bearing liabilities.

²³ A number of Euro area banks have received over €1 bn of additional liquidity via these mechanisms, and ECB purchased over €2 tn in sovereign and corporate bonds. For more information, see: Storm S. How a Flawed Structure is Hurting the Eurozone – Economically and Politically. – INET Conference "Reawakening" Edinburgh, 21-23 October 2017.

²⁴ Source: Reflection Paper on the Deepening of the Economic and Monetary Union. – European Commission, 2017, https://ec.europa.eu/commission/publications/reflection-paper-deepening-economicand-monetary-union_en.

²⁵ Source: A Roadmap towards a Banking Union: Communication to the European Parliament and the Council, COM(2012) 510 final. – European Commission, 12 September 2012, <https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:52012DC0510>.

rules, to provide early detection of financial problems and imbalances via the *European Banking Authority*, and to determine banks' resistance to possible shocks (*stress test*);

- the ***Single Resolution Mechanism (SRM)*** that is directly applied to resolve a bank's serious difficulties through the Single Resolution Board and ensure direct recapitalisation of failing banks through the ***Single Resolution Fund (SRF)*** financed by contributions from the banking sector;²⁶
- the ***Single Rulebook*** including more strict commercial bank capital requirements (*Capital Requirements Regulation and Directive, CRR/CRDIV*), *Deposit Guarantee Scheme Directive* and rules that prevent bank bankruptcy (*Directive on Bank Recovery and Resolution*).

In November 2015, the creation of the Banking Union was boosted by the publication of the **European Commission's Communication "Towards the completion of the Banking Union"**²⁷, which was based on the well-known "Five Presidents' Report". It proposed:

- 1) to introduce a *common deposit insurance scheme within the Banking Union*, as one of its three pillars (next to SSM and SRM), beginning with the re-insurance approach, then, over the course of several years, gradually moving to a full insurance scheme;
- 2) to start working on strengthening a *coordinated mechanism of provisional financing* ("bridge financing"²⁸) to support the SRF while it is being formed;
- 3) begin working on developing a *joint emergency lending mechanism – a common backstop* – in order to distribute banking risks between member states.

²⁶ These common mechanisms amend and develop the financial assistance system of the (*European Stability Mechanism, ESM*), which was created on 27 September 2012 with a maximum lending capacity of €500 bn fund. Within its framework, money market instruments are being issued, as well as medium-term and long-term bonds of up to 30-year maturity, which provide immediate access to financial assistance for Euro area member states in case of financial difficulties.

²⁷ See: Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions "Towards the completion of the Banking Union" COM(2015) 587 final. – European Commission, 24 November 2015, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015DC0587&from=EN>.

²⁸ So-called "bridge financing" is an interim financing option used by companies and other entities to consolidate their short-term financial position until a long-term financing option can be arranged. See: What is "Bridge Financing". – Investopedia – Investopedia, <https://www.investopedia.com/terms/b/bridgefinancing.asp>.

At the same time, the EC formulated detailed proposals for the introduction of the *European Deposit Insurance Scheme (EDIS)* for bank deposits.²⁹ In turn, this single system is based on the system of national deposit guarantee schemes, key parameters of which are regulated by **Directive 2014/49/EU**,³⁰ and which require *all banks of EU member states (including branches created in other member states)* to provide protection for all deposits. The guaranteed reimbursement amount of €100 thousand is provisioned for all deposits of one individual depositor in one banking institution. It is important that the insurance fund is to be formed via contributions from the banking system, not at the expense of taxpayers. The objective of the EDIS initiative is to ensure stronger guarantees and better harmonisation of payments among Euro area member states, thus reducing the vulnerability of deposits to external shocks while *raising and balancing the levels of confidence* in national banks across different parts of the Euro area. It is expected that the role of the EDIS in its interaction with corresponding national deposit insurance systems will gradually increase – until completely common EDIS system is operational.

An important step towards this objective was the Council decision as of 17 June 2016 **on the Roadmap towards a Banking Union**, which had been developed by the EC in September 2012.³¹ It was targeted at completion of the Banking Union by 2019. But as the initial plan for this institution lacked necessary legislative efforts, this idea failed. Given this experience, new initiatives to finalise the Banking Union were proposed in 2017. They were presented in the relevant EC

²⁹ See: Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme, COM(2015) 586 final. – European Commission, 24 November 2015, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015PC0586&from=EN>.

³⁰ For more information, see: Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (recast). – Text with EEA relevance, Official Journal, No.173, 12 June 2014, p.149. It should be mentioned that the first EU directive on these matters was adopted back in 1994, but it did not require a high level of harmonisation in this area. After the 2008-2009 global crisis, when financial shocks caused major problems in the banking sector (with corresponding outflow of deposits), in 2009-2010, the EU adopted directives aimed at increasing the level of deposit guarantees first up to €50 thousand, and later – up to €100 thousand.

³¹ See: Council Conclusions on a roadmap to complete the Banking Union. – Press release 353/16, Council of the EU, 17 June 2016, <https://www.consilium.europa.eu/en/press/press-releases/2016/06/17/conclusions-on-banking-union/pdf>; A Roadmap towards a Banking Union, Communication from the Commission to the European Parliament and the Council, COM (2012) 510 final. – European Commission, 12 September 2012, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012DC0510&from=EN>.

Communication,³² which regulated the introduction of the EDIS system coupled with other Banking Union instruments, such as mechanisms to regulate *non-performing loans*³³ and the *framework for the development of Sovereign Bond-Backed Securities (SBBS)*.³⁴ These proposals also planned to implement measures for introducing a *common backstop instrument as part of the European Stability Mechanism (ESM)*.³⁵

In May 2018, the Council approved a comprehensive package of Commission's proposals aimed at increasing EU banking sector's resilience by complementing the already existing elements of the Banking Union: the Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD) approved back in 2013, the Bank Recovery and Resolution Directive (BRRD), and the Single Resolution Mechanism Regulation (SRMR),³⁶ both adopted in 2014.

We would like to highlight the particular importance of removing ***negative over-dependence of European banks on governments***, in the course of creation of the Banking Union. This excessive dependence not only increases policy-generated financial sector risks, but also places additional burden on regular taxpayers within this system, who always turn out to be the main victim of crises, paying a high price for banking sector losses.

Overall, there are enough reasons to affirm significant progress in the formation of the Banking Union, and to realistically expect its full launch in the near future (table “*EU Banking Union Formation*”).

³² See: Communication to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions on completing the Banking Union, COM(2017) 592 final. – European Commission, 11 October 2017, http://ec.europa.eu/finance/docs/law/171011-communication-banking-union_en.pdf.

³³ The share of such non-performing loans in the total portfolio of debt instruments has grown from less than 3% in 2008 to over 6% in the Euro area and almost 5% – in the EU at the end of 2014. And although it went down by March 2017 to 4.8% and 4.1% respectively, these levels are still considered too high to support stability in EU's banking sector. Source: Communication on completing the Banking Union. – European Commission, 2017, http://ec.europa.eu/finance/docs/law/171011-communication-banking-union_en.pdf. The overall percentage of banks' risk-weighted assets was steadily rising since 2009, amounting to 18% in the Euro area and 19.1% – in the EU in 2016, vs. USA – below 15%. See: Completing the Banking Union. – European Commission https://ec.europa.eu/info/sites/info/files/171011-banking-union-factsheet_en.pdf.

³⁴ Sovereign bond-backed securities (SBBS). – European Commission, https://ec.europa.eu/info/business-economy-euro/banking-and-finance/banking-union/sovereign-bond-backed-securities-sbbs_en. This instrument helps diversify banks' bond investments and helps relieve negative dependence on their country's respective government.

³⁵ EMU roadmap (as of December 2017) proposes to make the ESM a part of the new regulatory institution – the European Monetary Fund.

³⁶ See: European Commission Press-release, 25 May 2018. – European Commission, http://europa.eu/rapid/press-release_IP-18-3941_en.htm.

EU Banking Union Formation*

Already in place		In progress		New EC proposals
Single Rulebook for EU28	Mechanisms for Banking Union member states	Single Rulebook for EU28	Banking Union mechanisms applied to its member states	
Capital and liquidity requirements (to make banks more stable)	Banks supervised by the Single Supervisory Mechanism (SSM) at the ECB (operates since November 2014)	Further enhancements of capital and liquidity requirements (legislative proposal to be agreed by European Parliament and Council)	European Deposit Insurance Scheme (EDIS) (legislative proposal as of October 2017 to be agreed by European Parliament and Council)	Equipping banks better to reduce stock of non-performing loans
Governance rules (incl. on remuneration) to set the right incentives	Opportunity to get help in case of complications through the Single Resolution Mechanism (SRM) – in operation since January 2016		Common backstop for the Single Resolution Fund	Enabling banks to prevent accumulation of non-performing loans in the future
Strong supervision of banks	Banks pre-finance the Single Resolution Fund to avoid costs for taxpayers		Private-sector risk sharing through sovereign bond-backed securities (under consideration in EU agencies)	Clarifying supervisors' powers to address non-performing loans
Disclosure rules to improve transparency			Single Resolution Fund (SRF) to reach €55 bn until 2023	More transparency on non-performing loans
Improved protection for depositors through national deposit insurance systems				Large investment firms to be supervised by Single Supervisory Mechanism
Common rules for managing failing banks				

* Sources: Completing the Banking Union. – European Commission, https://ec.europa.eu/info/sites/info/files/171011-banking-union-factsheet_en.pdf; Banking Union: Progress on risk reduction. – European Commission, https://ec.europa.eu/info/sites/info/files/180118-non-performing-loans-factsheet_en.pdf.

3.3. CREATION OF THE CAPITAL MARKETS UNION

The idea to create a Capital Markets Union (CMU) belongs to the current EC President Jean-Claude Juncker. It is included in the corresponding EC Action Plan as of 2015,³⁷ and constitutes an initiative aimed at removing barriers on the way of transborder movement of investments and facilitating access to financial resources for investor companies and participants of infrastructural development projects, regardless of their location within the EU. Special attention is paid to sustainable finance, foremost its environmental component. This idea supplements EU's Banking Union and is a key element of one of the fundamental market freedoms in the single market – freedom of capital movement. Overall, the initiative aims to attract large investments in the EU through support of competition in financial markets, reducing the cost of access to financial sources on the long-term basis and reducing obstacles to investing in other member states, which is especially important for small and medium businesses, as well as innovation activity (start-ups, venture capital, crowd-funding³⁸ etc.).

Creating a CMU implies introduction of: European labels and passports for financial products; simplified and harmonised financial market operation rules; more effective and consistent supervision of markets, for which the EC has developed a number of legislative initiatives awaiting approval in 2019 (table “*Progress on Capital Markets Union*”³⁹). Among them, particular attention should be paid to the proposal of introducing a new class of pension savings – *Pan-European Personal Pension Product*. Another important financial innovation is issuing of European covered bonds.⁴⁰ It is estimated that the introduction of new rules for distribution of investment funds will save up to €444 million in annual investment-related costs.

³⁷ For more information, see: Action Plan on Building a Capital Markets Union, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, COM (2015) 468/2. – European Commission, 30 September 2015, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015DC0468>.

³⁸ Crowdfunding – funding a project or venture by raising small amounts of money from a large number of people, typically via the Internet or other means of mass communication.

³⁹ Sources: Delivering on the Capital Markets Union. – European Commission, https://ec.europa.eu/info/sites/info/files/180308-communication-cmu-factsheet_en.pdf; Capital Markets Union: Mid-term review. – European Commission, https://ec.europa.eu/info/sites/info/files/factsheet-cmu-mid-term-review-june2017_en.pdf; Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Mid-Term Review of the Capital Markets Union Action Plan, COM(2017) 292 final. – European Commission, https://ec.europa.eu/info/publications/mid-term-review-capital-markets-union-action-plan_en.

⁴⁰ Covered bonds are debt securities backed by a pool of assets, which cover the lenders' claims in the event the issuer's insolvency, but unlike asset-backed securities they remain as arrears on the balance sheet of the issuer.

Progress on Capital Markets Union

Measure	Description
<i>Approved by the European Parliament and the Council</i>	
Rules for simple, transparent and standardised securitisation (adopted in 2017)	Broaden investment opportunities and boost lending to Europe's households and businesses.
New Prospectus Regulation (adopted in 2017)	Facilitate access to financial markets for companies, particularly small and medium-sized enterprises
Review of European Venture Capital Fund Regulation (EuVECA) and European Social Entrepreneurship Funds Regulation (EuSEF) (adopted in 2017)	To stimulate venture capital and social investments in the EU
Solvency II adjustments to EU Directive that regulates the size of insurance company capital to ensure its solvency (entered into force in 2016-2017)	To foster insurers' investments in infrastructure projects and corporate projects
<i>Under consideration of EU governing bodies</i>	
Legislative proposal on business insolvency (submitted for consideration in November 2016)	Concerns preventive restructuring and second chance (possibilities to save businesses)
Capital requirement adjustments (CRR) (submitted for consideration in November 2016)	Rules to foster banks' infrastructure investment
European Commission proposal for a Pan-European Personal Pension Product (PEPP) (submitted for consideration in June 2017)	New rules to provide pension providers with the tools to offer a simple and innovative pan-European personal pension product
European Commission proposal for a review of the European Supervisory Authorities (submitted for consideration in September 2017)	Reform of the EU's supervisory architecture for stronger and more integrated financial markets
A legislative initiative for more proportionate and effective rules for investment firms (submitted for consideration in December 2017)	A more targeted regime to reduce risks in investment firms' activities
Action Plan on sustainable finance (submitted in March 2018)	EU strategy to encourage green and sustainable investments with regulatory measures
Action plan on financial technology (FinTech) and a legislative proposal for an EU framework on crowdfunding and peer-to-peer lending * (submitted in March 2018)	EU strategy to promote financial innovation while protecting consumers and investors. New EU rules to boost and facilitate cross-border activity in the crowdfunding sector

* The practice of lending money (usually, on better conditions) to individuals or businesses through online services that match lenders with borrowers as equal market participants.

Measure	Description
New EC initiatives	
European covered bonds	New rules to promote covered bond markets as a source of funding for banks thereby increasing lending to the economy
Legislative initiative for cross-border distribution of investment funds	To facilitate easier EU-wide distribution of investment funds
Clear rules on ownership of securities and claims	Measures to enhance legal certainty in cross-border transactions in claims and securities
More proportionate rules on SME listing	Reducing the cost of listing for SME and increasing the volume of initial public offerings (IPO) on European stock markets
EU strategy to support local and regional market development	Broaden the geographical reach of capital markets; promote local solutions for SME funding

At the very beginning of this initiative, in 2015, one of the top companies in finance and business consulting *Pricewaterhouse Coopers (PwC)*⁴¹ highlighted in its report that CMU contains not just opportunities, but different potential *risks* as well, as changes in market conditions may cause an *increase of systemic risks*, reduce the ability of small and local market players to access financial resources, while harmonisation of investor protection measures could lead to actually weaker protection in some countries (like, for instance, in the UK).

In its report, this reputable institution stressed the over-ambitious nature of the proposed goals, given the general underdevelopment of capital markets in the EU and heavy reliance on bank loans and deposits. Loan liabilities in the EU account for 212% of EU's GDP, assets of debt securities are worth 171% of GDP, and listed shares issued in the EU represent 60% of GDP, while in the USA these figures are 147% of GDP, 220% of GDP and 115% of GDP, respectively.⁴² The share of non-financial corporations in the total value of debt securities in the EU is only 7.6%, with obvious domination of government debt securities. Alternatives to traditional methods of financing are limited (private equity and venture capital, business angels and crowdfunding combined represent a mere 0.5% of GDP).⁴³

⁴¹ Capital Markets Union: Integration of the Capital Markets in the European Union. – PwC, September 2015, <https://www.pwc.com/gx/en/banking-capital-markets/pdf/cmu-report-sept-2015.pdf>.

⁴² Ibid.

⁴³ Ibid., p.4.

Securitisation has been in steady decline since 2009, and EU capital markets are heterogeneous and concentrated in the largest economies: the UK, France and Germany. And although integration of EU capital markets is indicating positive trends (namely, stock markets are showing signs of convergence, cross-border capital flows are growing), the EU loan market remains highly fragmented.

The report identifies eight main barriers that are preventing the emergence of CMU:

(1) high costs to enter into market-based financing solutions (especially for SME); (2) households' aversion to risk and financial markets prevents market-based finance development; (3) the cost of securitisation is high, especially for SMEs' loans; (4) crowdfunding is still embryonic; (5) asymmetric information persists in EU capital markets; (6) uneven playing field regarding fiscal consideration, in particular different tax regimes between residents and nonresidents; (7) supervision and regulation are not sufficiently strong; (8) non-involvement of some EU member states in the Monetary Union.

Meanwhile, German stock market trade experts in their study of CMU creation⁴⁴ indicate that the *issue of CMU creation was raised amidst a shift in political priorities and a transition from crisis solving towards growth and job creation*. While acknowledging the existence of complicated problems on the way to CMU, authors state that the union itself will be the solution to these problems – through development of alternative, non-bank funding sources, restoring trust and confidence in capital markets, enhancing the stability and efficiency of these markets through transparency, liquidity and neutrality of market mechanisms, as well as harmonisation of rules and standards for market operations. Thus, experts proposed the following principles to achieve a functioning CMU:

1. *revive investor trust* in order to restore demand for new sources (instruments) of funding;
2. *improve non-bank funding* through ensuring a choice for investors and companies;
3. *promote financial stability* through ensuring safety of operations and market integrity;
4. *increase transparency* to avoid investment risks and additional costs for investors and supervisors;
5. *foster harmonisation and remove barriers* to reduce complexity for investors and introduce a harmonised framework for market regulation;
6. *shape the supporting regulatory and supervisory environment* and reduce the overall regulatory burden.

⁴⁴ See: Principles for a European Capital Market Union. Strengthening capital markets to foster growth. – Policy Paper, Deutsche Börse Group, January 2015, https://deutsche-boerse.com/blob/2532340/a1ae3aad16f3c04ad0e27ee55a7a4ba8/data/principles-for-a-european-capital-markets-union_en.pdf.

A research on CMU formation performed by the European Capital Markets Institute (ECMI),⁴⁵ allowed to conclude that the key aim in the process of CMU creation is improving capital markets themselves (increasing transparency, making capital markets more accessible to smaller businesses, incentivising long-term private investment in listed equities, encouraging the development and use of disruptive technology and creating jobs), rather than making it easier for large institutions to invest more and extend their product and services offers. Given the current environment of political instability and uncertainty in the EU, and the fact that the latter is at a crossroads, the official goal – the completion of CMU by 2019 – “is moving backwards and farther away”, according to the author.⁴⁶

In one of the studies by a reputable think tank Bruegel (Belgium),⁴⁷ authors note that integration of capital markets is a *long-term structural* endeavour, rather difficult to achieve. Despite the difficulties, CMU formation is worthwhile, as purely bank-based financial systems are more prone to crises and produce lower growth performance.⁴⁸ At the same time, the authors note that *actual progress has been limited*. Significant progress will be feasible if *clear priorities are set*, which should include: *strengthening and expanding the role of the European Securities and Markets Authority (ESMA)*, which should ensure financial stability and prevent negative effects of capital market integration; introduction of harmonised *regulatory framework on business insolvency and on new pension products*.

Summarising the above, we can conclude that the current EC course of accelerating CMU formation is ***not only unrealistic, but also rather dangerous for the EU***. It is founded on the overly optimistic appreciation of institutional capacity of the current EU that, we believe, stems from overestimating the role of formal institutional arrangements and underestimating the influence on institutional formats exerted by available market structure (which cannot be altered quickly) and established informal institutional norms deeply rooted in national cultural stereotypes.

⁴⁵ For more information, see: Thomadakis A. How close we are to a Capital Market Union? – ECMI Commentary, №44, 17 March 2017, https://www.ceps.eu/system/files/How%20close%20to%20a%20CMU_%20ECMI%20Commentary_%20A%20Thomadakis.pdf.

⁴⁶ Ibid., p.6.

⁴⁷ Source: Sapir A., Véron N., Wolff G. B. Making a reality of Europe's Capital Markets Union. – Policy Contribution, Issue №7, April 2018, <http://bruegel.org/wp-content/uploads/2018/04/pc-07-2018.pdf>.

⁴⁸ Relevance of this policy is increased by the UK's exit from the EU, as the UK is Europe's main financial centre.

Overall, our suggestion is to narrow down the CMU formation process and focus on a limited number of priorities with the potential to boost long-term structural changes in EU's financial markets. It is unacceptable to give priority to market liberalisation over creating effective market regulation mechanisms, and the “top-down” approach (processes initiated by governing EU agencies) – over using grassroots processes coming from local financial markets.

3.4. CREATION OF THE FISCAL UNION

Harmonisation of fiscal policy and formation of the Fiscal Union of member states has an extremely important role in the complex of measures aimed at EMU completion. This issue is directly aimed at resolving one of the most complicated EMU controversies – simultaneous implementation of centralised monetary and decentralised fiscal policy.

With this purpose, the *Integrated budgetary framework* of 2012 proposed, as a component of policies to complete a fully-fledged EMU, supplementing the existing mechanisms of budgetary policy surveillance and coordination with longer-term coordination instruments, and, ultimately, creating a full “integrated budgetary system” to ensure sound budgetary policies at the national and European level.

Moving in this direction meant that it was required to strengthen government regulation of economy, in particular through: (1) use of effective fiscal policy frameworks of the European monetary union (the so-called “*Six-Pack*”⁴⁹) and the *Treaty on Stability, Coordination and Governance* to prevent budget imbalance and focus attention on debt issues; (2) amending these mechanisms with the so-called “*Two-Pack*”⁵⁰ to coordinate annual budgets of the Euro area member states and increase supervision over member states that face financial difficulties.

⁴⁹ Made of five EU regulations and one directive that reinforce the Stability and Growth Pact for EU member states through fiscal and macroeconomic monitoring as part of the Macroeconomic Imbalance Procedure and stronger correction procedures for major deviations from medium-term objectives in this area.

⁵⁰ Consists of two legislative acts: (1) regulation for monitoring and assessment of draft budgetary plans, and correction of excessive deficit in the Euro area; (2) regulation for stronger supervision over Euro area member states threatened with, or experiencing, serious difficulties regarding their financial stability.

In the context of the integrated budgetary framework, fiscal capacity had to be increased, including the use of additional financial functions not foreseen in the long-term financial perspectives, through:

- introduction of mechanisms to *mitigate the influence of country-specific shocks through their absorption on the central level* – in the form of limited fiscal solidarity (sharing of fiscal risks without permanent transfers across countries);
- *promotion of structural reforms to increase competitiveness and growth potential*, which is based on contractual arrangements outside the integrated economic policy framework. It was indicated that the well-functioning mechanism of shock-absorption will require further convergence of member states' economic structures and policies.

An important direction of the budgetary integration has been the declared introduction of a **financial asset for the Euro area with a high degree of reliability and liquidity** (euro area fiscal capacity) that would help limit negative effects of linkages between the banking sector and public finances, and would facilitate adaptation to economic shocks. This was supposed to be a demonstration of fiscal solidarity within cyclic development and a reduction of financial expenditure and production losses resulting from macroeconomic adjustment, thus complementing the already existing functions of the European Stability Mechanism (ESM).

Lastly, a fully integrated budgetary framework will require, at the final stage of EMU completion, the creation of a *Treasury function* with clearly defined fiscal responsibility.

The prospects of Fiscal Union formation are most tightly connected with member states' **tax policy harmonisation** in the following areas: fight against tax evasion and tax fraud through automatic exchange of corresponding information; adopting a directive on taxation of savings, strengthening control over relations between parent companies with foreign subsidiaries and strengthening mechanisms of the Code of Conduct on Business Taxation, as well as taking measures to prevent money laundering.

A key precondition for Fiscal Union formation is strengthening of budget discipline. This is why the so-called Fiscal Compact⁵¹ of 2012 revised the rules set in the Stability and Growth Pact of 1997 to provide stronger fiscal discipline and convergence in the Euro area. This was ensured through the introduction of the **balanced budget rule**, which entails a balanced budget or a budget surplus of general government.

⁵¹ Shortened name of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

This rule requires that the annual structural deficit of government finance⁵² shall not exceed 0.5% of GDP at market prices, and for countries with a low level of general government external debt (significantly below 60% of GDP), the lower limit can be 1%. Member states shall achieve convergence according to medium-term goals as quickly as possible, taking into account specific risks in each country. Deviations from these guidelines are admissible in exceptional cases. These budget rules are to be included in the national legislation of member states, preferably as *constitutional* provisions.

In case the set limit is exceeded, a correctional mechanism shall be automatically launched, as determined by each member state individually based on EC-proposed principles. Observation of this rule is supervised by the European Court of Justice that is entitled to impose fines in case of its violation up to 0.1% of the country's GDP, payable to the European Financial Stability Facility for Euro area member states and to the EU Budget – in other cases.

If a country exceeds its government debt limit (60% of GDP), the excess debt has to be reduced at an average rate of one twentieth per year, according to excessive deficit procedure defined by EU Council regulations dated 7 July 1997 and 8 November 2011.

The Fiscal Compact stipulated that countries facing excessive deficit shall approve mutually agreed *budgetary and economic partnership programmes*, which would include a detailed description of structural reforms drafted for effective correction (reduction) of excess deficit. Such programmes need to be approved by the Council, the European Commission and undergo monitoring as defined in the Stability and Growth Pact.

To improve better problem detection, *early Council and EC notification procedure* was introduced to inform about national plans for government bond placement.

Overall, application of these instruments and political guidelines meant that each member state had to “tighten its fiscal belt” and implement a ***strict budget restriction policy***.

However, as it turned out later, this policy produced not only positive but also pronounced negative effects for a number of states. According to some experts⁵³, *strict fiscal austerity policy increases divergence among member states*. Despite the

⁵² Structural budget balance – a nominal budget balance adjusted by the cyclical component, excluding one-off and temporary policy measures.

⁵³ Source: Storm S. How a Flawed Structure is Hurting the Eurozone. – INET Conference “Reawakening” Edinburgh, 21-23 October 2017, <https://www.ineteconomics.org/uploads/papers/STORM-INET-2017-Storm-Panel-Future-of-the-Eurozone.pdf>.

relaxation of the budgetary rules in the Euro area – from restrictive (after the fiscal rules of the Stability and Growth Pact strengthened during the recession of 2012) to more neutral⁵⁴, even these “more relaxed” fiscal rules are still a barrier on the way to sustainable economic development in a number of countries, which increase structural disproportions in the Euro area.

RESULTS OF AUSTERITY MEASURES IN THE EURO AREA

To resolve problems in the Euro area countries, the ECB introduced austerity measures that had to ensure economic growth. Yet, the ECB policy did not account for divergent economic conditions in various countries, which caused instability of the balance of payments, growth of government debt and reduction of GDP in a number of member states. Most affected countries included Greece⁵⁵, Portugal and Spain; France and Germany – less so (although, their economic growth rate did go down).

Austerity measures resulted in the growth of unemployment rate in the Euro area to 12% (2013), in Portugal – to 16.42%, Italy – to 12.1%, Greece and Spain – to over 25% (27.5% and 26.1%, respectively).

The unemployment problem was especially severe among youth, in particular, percentage of unemployed 15-24-y.o. in 2013 in the Euro area was 24.4%, in Greece – 58.21%, Spain – 55.6%, Italy – 42.67%, and Portugal – 38.15%.⁵⁶

These measures also eroded the system of social security, caused a decrease in real pensions, reduction of the volume of services provided in healthcare and education, increase in unemployment and emergence of non-standard forms of employment. In 2014, 122 million persons in EU-28 (24.4% of its population) were at risk of poverty or social exclusion.⁵⁷

Nobel Prize winner J. Stiglitz notes that austerity measures in the Euro area suppressed economic growth and caused deep social problems (decrease in income and increase in unemployment).⁵⁸ He stresses that the “policies in many ... ways were counterproductive... They were intended to bring the countries closer together. But when you look at the design of the whole eurozone system, it has led, inevitably...to divergence: the rich got richer, the poor got poorer, the poor got more indebted to the rich and the creditor-to-debtor relationship got exacerbated”. Ireland and Spain are a good example – they were plunged into a deep crisis with government budget surplus and comparatively low level of government debt as to GDP. Thus, it was the anti-crisis policy that caused the exacerbation of the situation, not vice versa.

⁵⁴ For more information, see: Towards a Positive Fiscal Policy Stance for the Euro Area. – European Commission, https://ec.europa.eu/info/sites/info/files/2017-european-semestercommunication-fiscal-stance_en_1.pdf.

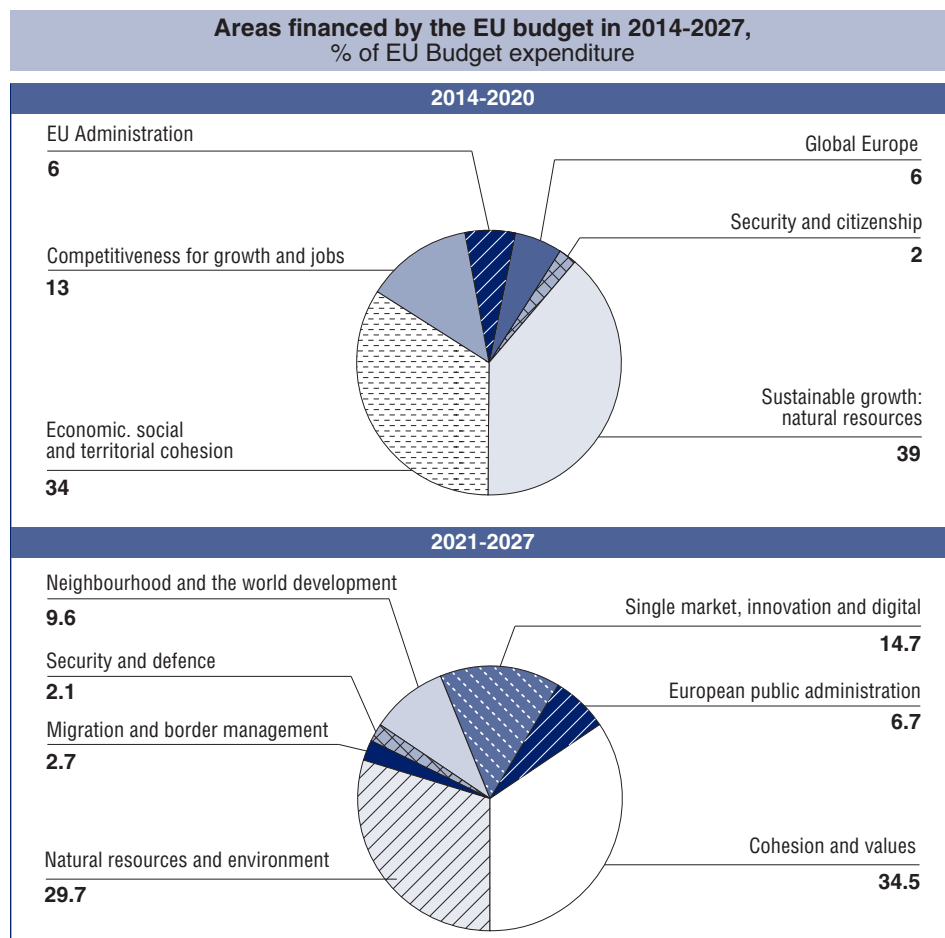
⁵⁵ Greece became the centre of the debt crisis in Europe. The country was deprived of the opportunity to borrow at financial markets and in early 2010 faced bankruptcy. To avoid a disaster, the IMF, the ECB and the European Commission provided financial assistance of €110 bn. But the crisis quickly proliferated to Italy, Spain and Portugal, exposing the EMU's weaknesses. We should understand that with Euro being the common currency in Euro area countries, the interdependence principle takes effect in a force majeure situation, which leads to the possibility of negative events in one country spilling over to others.

⁵⁶ Source: Unemployment, total (% of total labor force) (modeled ILO estimate), World Bank Indicators. – World Bank, <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?view=chart>.

⁵⁷ Source: Antropov V. European Social Model and Austerity Measures. – Global Economy and International Relations, 2017, vol.61, No.3, p.45-54 (in Russian).

⁵⁸ Source: Flawed at Birth: Why the Eurozone Faces Endless Division – The Wharton School, 24 Aug. 2016, <http://knowledge.wharton.upenn.edu/article/how-the-euro-threatens-europes-future>.

Note that discussions, which took place in the context of debating different scenarios of further EU development and were laid out in the above-mentioned document – “Reflection Paper on the Future of EU Finances”,⁵⁹ revealed the necessity to *focus on the long-term strategic approach* in this sector based on ***EU Multiannual Financial Framework*** 2021-2027 (MFF). Already MFF 2014-2020 stipulated the possibility of joint financing of EU development (diagram “Areas financed by the EU budget in 2014-2027”, table “Areas financed by the EU budget in 2014-2020”, p.90).⁶⁰



⁵⁹ See: Reflection Paper on the Future of EU Finances. – European Commission.

⁶⁰ Source: Reflection Paper on the Future of EU Finances: Facts and Figures. – European Commission, https://ec.europa.eu/commission/sites/beta-political/files/future-eu-finances-facts-and-figures-factsheet_en.pdf.

Areas financed by the EU budget in 2014-2020

Financial commitments	Priority areas	Total volume, € bn	% of EU Budget expenditure
Sustainable growth: natural resources	<ul style="list-style-type: none"> ➤ Agriculture ➤ Rural development ➤ Fisheries ➤ Environment and others. 	420	39
Economic, social and territorial cohesion	<ul style="list-style-type: none"> ➤ Research and innovation ➤ Information and communications technology ➤ Small and medium enterprises ➤ Low-Carbon Economy ➤ Climate change and risk ➤ Environment and resource efficiency ➤ Transport and energy ➤ Employment ➤ Social inclusion ➤ Vocational training ➤ Other 	371.4	34
Competitiveness for growth and jobs	<ul style="list-style-type: none"> ➤ Education ➤ Energy ➤ Industry and small and medium enterprises ➤ Networks and technology ➤ Research and innovation ➤ Transport ➤ Others 	142.1	13
Управління в ЄС		69.6	6
Global Europe	<ul style="list-style-type: none"> ➤ Development and international cooperation ➤ Humanitarian aid ➤ Neighbourhood and enlargement ➤ Foreign policy instruments ➤ Others 	66.3	6
Security and citizenship	<ul style="list-style-type: none"> ➤ Migration and home affairs ➤ Health and food safety ➤ Culture ➤ Justice ➤ Others 	17.7	2
Total		1 087.1	100

On 7 May 2018, EC presented new **MFF for 2021-2027**⁶¹ (table “*Areas financed by the EU budget in 2021-2027*”⁶², p.92-93). In particular, it is noted that the EU Budget, being an instrument of socio-economic governance in the EU, as earlier, will have limited influence on socio-economic processes, because most public spending will be done at different levels of national fiscal systems. At the same time, there are some changes in the relative shares of certain positions in common budget allocations, among which – largest increase of allocations is for stimulation of socio-economic development and territorial cohesion within the EU (+5.1 p.p.), regulation of migration, border management and security (combined +3.2 p.p.), as well as implementation of EU’s neighbourhood policy and global development (+3.5 p.p.). These allocations are increased mainly due to significant reduction of spending on “Natural resources and environment” (–8.9 p.p.), which is largely due to a decrease in spending on support of agricultural sector in the framework of EU’s new agricultural policy (in particular, redistribution of payments in favour of small and medium farms and agricultural development goals).

Overall, it is planned to increase allocations for a number of new and to strengthen the existing EU priorities for the total amount of €109 bn, increasing spending on climate goals and protection of environment 1.7 times, youth programmes – 2.2 times, migration and border management – 2.6 times, European security – 1.8 times, CFSP – 1.3 times.⁶³ Yet, despite a reduction of allocations in the “Single Market, Innovation and Digital” category, the overall funding of research, innovation and digital technologies in the EU Budget will significantly increase (64%). Moreover, it will be funded with additional money from European structural and investment funds. Also, the EU intends to allocate up to 25% of total global spending on climate change policy goals determined by the UN through an increase of corresponding allocations 1.6 times – from €206 bn to €320 bn, or from 20% of EU Budget appropriations in 2014-2020 to 25% in the new 2021-2027 Budget.⁶⁴

⁶¹ See: Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions. A Modern Budget for a Union that Protects, Empowers and Defends: The Multiannual Financial Framework for 2021-2027, COM(2018) 321 final. – European Commission, 2 May 2018, https://eur-lex.europa.eu/resource.html?uri=cellar:c2bc7dbd-4fc3-11e8-be1d-01aa75ed71a1.0023.02/DOC_1&format=PDF; Proposal for a Council Regulation laying down the multiannual financial framework for the years 2021 to 2027, COM(2018) 322 final. – European Commission, 2 May 2018, https://eur-lex.europa.eu/resource.html?uri=cellar:f5965d24-4ed6-11e8-be1d-01aa75ed71a1.0002.02/DOC_1&format=PDF.

⁶² Source: Annex to the Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions. A Modern Budget for a Union that Protects, Empowers and Defends: The Multiannual Financial Framework for 2021-2027, COM(2018) 321 final, Annex. – European Commission, 2 May 2018, https://eur-lex.europa.eu/resource.html?uri=cellar:f5965d24-4ed6-11e8-be1d-01aa75ed71a1.0002.02/DOC_2&format=PDF. Also, Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions. A Modern Budget for a Union that Protects, Empowers and Defends: The Multiannual Financial Framework for 2021-2027, COM(2018) 321 final. – European Commission, 2 May 2018, https://eur-lex.europa.eu/resource.html?uri=cellar:c2bc7dbd-4fc3-11e8-be1d-01aa75ed71a1.0023.02/DOC_1&format=PDF.

⁶³ Source: A Modern Budget for a Union that Protects, Empowers and Defends: The Multiannual Financial Framework for 2021-2027. – European Commission, p. 9, 14, 23.

⁶⁴ Ibid.

**Areas financed by the EU budget in 2021-2027,
(2018 prices)**

Financial commitments	Priority areas	Total volume, € bn	% of spending in the EU Budget in 2021-2027	% of spending on similar areas ¹ in the EU Budget in 2014-2020	Change in MFF 2014-2020 (p.p.) ²
Single market, innovation and digital	<ul style="list-style-type: none"> ➤ Research and innovation ➤ European strategic investments ➤ Single market (including SME competitiveness) ➤ Space 	166 303	14.7	13.1	−1.6
Cohesion and European values, incl. <i>Economic, social and territorial cohesion</i>	<ul style="list-style-type: none"> ➤ Regional development and cohesion ➤ Economic and Monetary Union ➤ Investing in people, social cohesion and European values 	391 974 330 642	34.5 29.1	 34.2	 +5.1
Natural resources and environment, incl. <i>Market-related expenditure and direct payments</i>	<ul style="list-style-type: none"> ➤ Agriculture policy (incl. direct payments to farmers and development of agricultural territories) and maritime policy (fisheries) ➤ Environment and climate action 	336 623 254 247	29.7 22.4	38.6	−8.9
Migration and border management	<ul style="list-style-type: none"> ➤ Migration, incl. Asylum and Migration Fund ➤ Border management, incl. Integrated Border Management Fund 	30 829	2.7	1.1	+1.6

¹ Comparison of allocations is approximate, as allocation sectors in the budgets for the two seven-year periods are not a full match.

² Razumkov Centre experts' calculations.

Areas financed by the EU budget in 2021-2027,
 (2018 prices)

(continued)

Financial commitments	Priority areas	Total volume, € bn	% of spending in the EU Budget in 2021-2027	% of spending on similar areas ¹ in the EU Budget in 2014-2020	Change in MFF 2014-2020 (p.p.) ²
Security and defence	<ul style="list-style-type: none"> ➤ Security, incl. Internal Security Fund ➤ Defence, incl. European Defence Fund ➤ Crisis response, incl. Union Civil Protection Mechanism 	24 323	2.1	0.5	+1.6
Neighbourhood and the world	<ul style="list-style-type: none"> ➤ External action, incl. Neighbourhood, Development and International Cooperation Instrument; humanitarian aid; CFSP ➤ Pre-accession assistance 	108 929	9.6	6.1	+3.5
European public administration, incl. Administrative expenditure of EU institutions	<ul style="list-style-type: none"> ➤ Administrative expenditure ➤ Pensions ➤ European schools 	75 602 58 547	6.7 5.2	6.4	−0.3
Total, incl. as a % of gross national income		1 134 583 1.11	100,0	100,0 1.13	

Note. Outside the MFF ceilings, the following expenditure is planned: Emergency Aid Reserve – €4.2 bn, EU Solidarity Fund – €4.2 bn, European Globalisation Adjustment Fund – €1.4 bn, Flexibility Instrument – €7 bn, European Investment Stabilisation Function (amount not determined yet), and European Peace Facility – €9.223 bn (2018 prices). In particular, European Defence Fund expenditure is planned to increase 22 times.

Clearly, the current budgetary spending structure does not match the challenges faced by the EU and thus – will need to be adjusted after 2020. In particular, expenditure in the Security and Defence sector will have to increase, and technological progress spending should grow amidst the Fourth Industrial Revolution, whereas the funding of natural resources sectors (in the EU, this is primarily agriculture) should be rationalised via more efficient use of the Union's limited resources.⁶⁵

New approaches require a wider range of instruments, so the new roadmap for EMU completion issued in 2017⁶⁶ proposed *new budgetary instruments to ensure stability* in the Euro area within the Union framework,⁶⁷ which focus on four “specific functions”, specific mechanisms to be developed in 2018-2020:

- **support structural reforms** through: (1) *reform delivery tool* approved by member states; (2) *technical support* as requested by member states;
- **dedicated convergence facility** for member states on their way to joining the euro;
- **common backstop instrument** for the Banking Union, provided through ESM/EMF;
- **stabilisation function**: EU and Euro area funds and financial instruments at different levels to be used to protect investment and preserve their levels in the event of large asymmetric shocks.

In May 2018, the EC approved proposals for regulations aimed at creating the *Reform Support Programme* with the total budget of €25 bn and a *European Investment Stabilisation Function* providing opportunity to mobilise up to €30 bn in loans on condition of abiding by strict macroeconomic and fiscal policy terms. The Reform Support Programme includes the *Reform Delivery Tool*, the Technical Support Instrument and the *Convergence Facility* for states on their way to joining the euro.⁶⁸

⁶⁵ Total resources of EU Budget equal less than 1% of the total income of EU member states and approximately 2% of their total government expenditure. Yet the percentage of European structural and investment fund spending within total government investment of less developed member states in 2015-2017 was rather significant: Croatia – up to 80%, Portugal – over 70%, Latvia and Lithuania – approximately 70%, Poland, Slovakia, Bulgaria and Romania – over 50%. For more information, see: Reflection Paper on the Future of EU Finances: Facts and Figures. – European Commission, p.2-3.

⁶⁶ See: Further Steps towards Completing Europe's Economic and Monetary Union: a Roadmap. – European Commission, 6 December 2017.

⁶⁷ For more information: Communication from the Commission to the European Parliament, the European Council, the Council and the European Central Bank. New Budgetary Instruments for a Stable Euro Area Within the Union Framework, COM(2017) 822 final. – European Commission, 6 December 2017, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017DC0822&from=EN>.

⁶⁸ For more information, see: Proposal for a Regulation of the European Parliament and the Council on the establishment of the Reform Support Programme, COM(2018) 391 final. – European Commission, 31 May 2018, https://eur-lex.europa.eu/resource.html?uri=cellar:02e3ae29-64af-11e8-ab9c-01aa75ed71a1.0001.03/DOC_1&format=PDF; Proposal for a Regulation of the European Parliament and the Council on the establishment of a European Investment Stabilisation Function, COM(2018) 387 final. – European Commission, 31 May 2018, https://eur-lex.europa.eu/resource.html?uri=cellar:c9301291-64b1-11e8-ab9c-01aa75ed71a1.0001.03/DOC_1&format=PDF.

In addition to these “specific functions”, it is planned to implement in 2018-2020 a number of measures aimed at supporting structural reforms and economic capacity building, including:

1) amending the **Common Provisions Regulation** (Regulation laying down common provisions for European Structural and Investment Funds)⁶⁹ to mobilise performance reserves provisioned for in European Structural and Investment Funds⁷⁰ in support of national reforms;⁷¹

2) building up the **Structural Reform Support Programme**⁷², introduced in May 2017, to increase (double) technical support for member states, as well as non-Eurozone members that plan to join the euro and follow convergence policy in public administration, public finance management, financial sector, labour markets, and product markets. Overall, in 2017-2020, the volume of this technical support will amount to €300 mln.⁷³

Proposing new instruments to member states to support implementation of required structural reforms, the EC aims to ensure medium-term fiscal discipline and fiscal responsibility in all member states.⁷⁴ Its cornerstone principle is maintaining a safe level of government debt.

⁶⁹ See: Regulation (EU), №1303/2013. – Official Journal, L 347, 20 December 2013, p.320-469.

⁷⁰ See: European Commission. Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 as regards support to structural reforms in Member States, COM(2017) 826 final. – European Commission, 6 December 2017, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017PC0826&from=EN>.

⁷¹ Reforms determined in the framework of the so-called European Semester for the coordination of economic policies and embedded in corresponding national reform programmes.

⁷² Regulation (EU) No 2017/825 on the establishment of the Structural Reform Support Programme for the period 2017 to 2020 and amending Regulations (EU) No 1303/2013 and (EU) No 1305/2013 (Official Journal, L 19.05.2017, p.129). This Programme is coordinated by the Structural Reform Support Service created in 2015, which provides technical support to member states for planning and implementation of reforms and overall capacity-building to conduct reforms.

⁷³ See: Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2017/825 to increase the financial envelope of the Structural Reform Support Programme and adapt its general objective, COM(2017) 825 final. – European Commission, 6 December 2017, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017PC0825&from=EN>.

⁷⁴ See: Proposal for a Council Directive laying down provisions for strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States, COM(2017) 824 final. – European Commission, 6 December 2017, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017PC0824&from=en>.

Thus, new approaches to Fiscal Union formation represent three important interconnected focal points, which are supposed to ensure higher efficiency of integration measures:

- focus on *long-term approaches* and ensuring that short-term action is in line with long-term strategic development prospects;
- pronounced emphasis on *diversification* of fiscal and financial instruments to ensure higher flexibility and efficiency in resolving specific tasks;
- significantly stronger support for structural reforms, which demonstrates the realisation of the deep structural nature of many problems experienced by the EU and the Euro area.

We would like to stress once again that the current fiscal regulation system in the EU has a very high level of complexity. Not coincidentally, the 2017 EMU roadmap outlines prospects of reviewing EU's fiscal rules and simplifying them before 2025.

3.5. INTRODUCTION OF COMMUNITY MECHANISMS FOR MACRO-ECONOMIC POLICY HARMONISATION (THE ECONOMIC UNION)

Formation of increasingly more diversified regulation mechanisms for the European economy is impossible without their effective integration into the economic regulation system of each member state. This is especially true in relation to national fiscal systems, which continue being the dominant source of accumulation and distribution of public financial resources, despite the ongoing Fiscal Union formation. Thus, this integrated regulatory system objectively requires *convergence of national regulatory systems and a high level of synergy between them*. This is extremely relevant at the moment, given the coordination of long-term reform plans, which directly determine the prospects for sustaining integrity of Europe's socio-economic environment.

To this end, the envisaged EMU completion included a **mechanism for economic policy coordination (European Semester)** as a key component. This mechanism aims to ensure the sound state of public finances (incl. through avoiding excessive public debt), prevent macroeconomic imbalances, coordinate necessary structural reforms to achieve higher levels of employment and economic growth, and harmonise EU investment stimulation measures. In the framework of this process, with participation of the EC and on the annual basis, an analysis of each member state's plans for their budget, macroeconomic regulation measures and structural reforms is performed, and recommendations are provided (approved by the Council) for ensuring conformity with EU plans and development strategies (in particular, the Europe-2020 Strategy).

A key European Semester element is the so-called **Macroeconomic Imbalance Procedure (MIP)** introduced back in 2011 for timely identification of potentially dangerous macroeconomic imbalances that can negatively affect economic stability in certain countries or the entire EU/Euro area. Countries showing signs of such imbalances are subject to enhanced surveillance (*Excessive Imbalance Procedure*) and may become subject to sanctions. A comprehensive multiaspect approach is used to analyse the economic situation, which is based on the system of 14 headline macroeconomic indicators and indicative thresholds that can indicate the presence of a macroeconomic imbalance (average of the current account balance, net international investment position, export market shares, nominal unit labour cost, real effective exchange rates, private and general government sector debt, changes in house prices, unemployment rate, etc.).⁷⁵ The relevant analysis performed in November 2017⁷⁶ showed that government debt ratios in 16 member states exceeded the threshold, net international investment position ratios rose above the threshold in 15 member states, private debt ratios – in 12 countries, house prices changes – in 10, although the overall number of such negative deviations went down compared to previous years.

In order to improve common macroeconomic regulation, a number of new institutions have been created over the past years (since 2015):

- **The European Fiscal Board** is an independent advisory body of the European Commission, whose mandate includes fiscal regulation in the EU and the Euro area, preparation of corresponding recommendations, and cooperation with national fiscal councils in individual member states;

- A network of **National Productivity Boards** (with all Euro area countries invited to have such boards and other EU countries – also encouraged) to provide independent analysis of economic productivity and competitiveness, as well as challenges in these areas. According to EU's Council recommendations,⁷⁷ independent expertise of the boards can be used in the context of the annual policy monitoring process, i.e. the European Semester, and Macroeconomic Imbalance Procedure.

⁷⁵ For more information, see: Scoreboard: Information on headline and auxiliary indicators included in the macro-economic imbalance procedure scoreboard. – European Commission, https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/macro-economic-imbalance-procedure/scoreboard_en.

⁷⁶ For more information, see: Report from the Commission to the European Parliament, the Council, the European Central Bank and the European Economic and Social Committee "Alert Mechanism Report 2018", COM(2017) 771 final. – European Commission, 22 November 2017, <https://ec.europa.eu/info/sites/info/files/economy-finance/com-2017-771-en.pdf>.

⁷⁷ See: Council Recommendation of 20 September 2016 on the establishment of National Productivity Boards (2016/C 349/01). – European Commission, 24 September 2016, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32016H0924%2801%29>.

The new roadmap for EMU completion approved in December 2017 included a number of new proposals for institutionalisation of member states' economic and financial policy harmonisation and formation of a full Economic Union on this basis. These proposals included:

- ✓ Establishing (possibly, already in November 2019) a new European authority – **European Minister of Economy and Finance**, to be combined with positions of EC Vice-President and Eurogroup Chair. Establishing this authority is meant to strengthen coordination, efficiency, transparency and democratic accountability in developing EU and Euro area economic policy (insert “*A European Minister of Economy and Finance: Proposed Functions and Powers*”⁷⁸).

A EUROPEAN MINISTER OF ECONOMY AND FINANCE: PROPOSED FUNCTIONS AND POWERS

Main functions of the Minister:

- ✓ ***Pursuing the general interest of the EU and euro area economy and representing it at global level.*** The Minister helps promote the general interest of the Union and the euro area economy, both internally and on the global level. The Minister will be a key interlocutor at EU level in the areas of economic, fiscal and financial policies vis-à-vis the EU institutions and bodies, the States, social partners and the general public.
- ✓ ***Strengthening policy coordination and overseeing economic, fiscal and financial rules.*** The Minister helps further strengthen economic policy coordination and ensure consistency across policy areas. Working in close bilateral and multilateral dialogue with national authorities and the European Parliament, the Minister also promotes the coordination and implementation of reforms in the Member States.
- ✓ ***Pronouncing on the adequate fiscal policy for the Euro area.*** The Minister helps in the identification and pursuit of an adequate fiscal policy for the Euro area. As a member of the Commission, the Minister will coordinate the surveillance of Member States' fiscal policies, ensuring fiscal sustainability and applying the Stability and Growth Pact with the economic reading that the rules foresee.
- ✓ ***Overseeing the use of relevant EU and Euro area budgetary instruments.*** The Minister coordinates the use of EU and Euro area budgetary instruments and maximises their impact in support of shared priorities.

Institutional setting:

- ✓ ***Vice-President of the Commission.*** A Vice-President of the Commission could take over the role as European Minister of Economy and Finance. This would allow for the creation of a visibly mandated and unified representative of the economic and fiscal interests of the whole EU and the Euro area.
- ✓ ***Chair of the Eurogroup.*** The Eurogroup could agree to elect the Minister as its President for the whole duration of the Commission's mandate.
- ✓ ***Chairing the Board of the European Monetary Fund.*** The President of the Eurogroup currently chairs the Board of Governors of the European Stability Mechanism. As President of the Eurogroup, the Minister would also chair the Board of Governors of the European Monetary Fund in the future.
- ✓ ***Accountability towards the European Parliament.*** The Minister, as a member of the Commission, would be accountable towards the European Parliament on all issues related to its functions and would also be available for dialogues with national Parliaments.

⁷⁸ Source: A European Minister of Economy and Finance. Completing Europe's Economic and Monetary Union. – European Commission, https://ec.europa.eu/commission/sites/beta-political/files/european-minister-economy-finance_en.pdf.

However, we should note that *this proposal is taken rather sceptically by finance ministers of some Euro area countries* that do not wish to transfer certain powers in this sector to Brussels (in March 2018, Sweden, Denmark, Finland, Estonia, Latvia, Lithuania, Ireland and the Netherlands rejected this idea).

- ✓ Establishing a **European Monetary Fund (EMF)**⁷⁹ on the basis of the existing European Stability Mechanism (ESM).⁸⁰ It is planned that EMF will use the ESM architecture, preserving its financial and institutional structure, and will provide assistance to Euro area member states that face financial difficulties. The fund will allocate finances to the Single Resolution Fund (part of the Banking Union) and will act as common backstop while restructuring of crucial banks, which will ensure proper problem resolution within the banking system.
- ✓ Creating an *official external representation body of the Euro area*.
- ✓ *Integrating Fiscal Compact into the legal framework of the EU*, which will simplify the regulatory framework and ensure a more reliable monitoring mechanism for member states' financial and economic systems, including government debt monitoring.

Note that the current EC President pays a lot of attention to promote investment. One step towards stimulating strategic investment processes in the EU was the introduction of an **Investment Plan for Europe (or the Juncker Plan)**⁸¹ according to a recommendation in the above-mentioned Five Presidents' Report.

The plan set three objectives: (1) remove regulatory barriers to investment; (2) provide technical assistance and greater visibility of investment opportunities; (3) smarter use of financial resources. The plan is built on three pillars:

- ✓ **The European Fund for Strategic Investments (EFSI)**, which provides guarantees to mobilise private investment;

⁷⁹ See: Proposal for a Council Regulation on the establishment of the European Monetary Fund, COM(2017) 827 final. – European Commission, 6 December 2017, https://eur-lex.europa.eu/resource.html?uri=cellar:050797ec-db5b-11e7-a506-01aa75ed71a1.0002.02/DOC_1&format=PDF.

⁸⁰ In recent years, the ESM played an important role in ensuring the Euro area stability, helping member states restore or maintain access to sovereign bond markets.

⁸¹ For more information, see: What is the Investment Plan for Europe? – European Commission, https://ec.europa.eu/commission/priorities/jobs-growth-and-investment/investment-plan-europe-juncker-plan/what-investment-plan-europe_en.

- ✓ **The European Investment Advisory Hub (EIAH)** within the European Investment Bank system and the **European Investment Project Portal (EIPP)**, which provide technical assistance and greater visibility of investment opportunities, thereby helping proposed investment projects become a reality;
- ✓ Improving the business environment by removing regulatory barriers to investment both nationally and at EU level.

In its Multiannual Financial Framework for 2021-2027, the EC proposed to use the European Fund for Strategic Investment to create a new integrated structure – **InvestEU**, which will work together with the European Investment Bank (EIB) Group and national investment banks and international financial institutions (e.g. EBRD) to trigger additional €650 billion in total investment, as expected by the EC, while receiving only €15.2 billion allocation from EU budget.⁸²

In the context of further developing Economic Union institutions, the EU continues to discuss the idea of creating in 2019-2025 a **Euro Area Treasury** – the idea originally proposed by EC President Jean-Claude Juncker back in the fall of 2015 (State of the Union 2015 address).⁸³ According to EC President, this institution is meant to operate a special financial instrument for countering external shocks in the Euro area and promoting structural reform. At the moment, this idea is in its early stage, despite the EP Resolution adopted on the matter in 2017.⁸⁴

It seems like *Europe in general and the Euro area in particular are not yet ready (and are unlikely to be ready in the near future) for such an ambitious step as the introduction of a supranational fiscal institution (Treasury)*. This is confirmed by the significant opposition of many member states. According to information on EP website, 12 countries (Netherlands as the initiator, joined by Austria, Finland, Sweden, Denmark, Lithuania, Latvia, Estonia, Ireland, Belgium, Luxemburg, and Malta), after adoption of the Meseberg Declaration⁸⁵ in June 2018, have spoken up *against creating a Euro area budget* and expressed doubt as to its benefits, efficiency and possible

⁸² Source: A Modern Budget for a Union that Protects, Empowers and Defends: The Multiannual Financial Framework for 2021-2027. – European Commission, p.8.

⁸³ For more information, see.: State of the Union 2015 by Jean-Claude Juncker, President of the European Commission. – European Commission, 9 September 2015, https://ec.europa.eu/commission/sites/beta-political/files/state_of_the_union_2015_en.pdf.

⁸⁴ For more information, see: Budgetary capacity for the Euro area: European Parliament resolution of 16 February 2017 on budgetary capacity for the euro area (2015/2344(INI)). – European Parliament, <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+P8-TA-2017-0050+0+DOC+PDF+V0//EN>.

⁸⁵ For more information, see: Section 2 of this Report.

funding sources (e.g., introduction of a European tax on financial transactions).⁸⁶ Not coincidentally, in his State of the Union address on 12 September 2018, EC President refrained from advancing this idea.

Improvement of macroeconomic regulation in the EU and the Euro area *does not necessarily imply creation of new regulatory institutions at the EU level*. In this context, a number of researchers of macroeconomic stabilisation in the Euro area have proposed several measures that *focus on the quality of regulatory functions*⁸⁷:

- ✓ Make debt policy a priority, namely – limit the amount of sovereign debt that banks can keep on their balance sheets, shrinking their stock of bad loans, and completing the deposit guarantee scheme (EDIS);
- ✓ Reform the system of rules for macroeconomic imbalance regulation. The current system of fines for countries violating the Stability and Growth Pact is not credible. Since the beginning of the Euro area crisis, countries often violated the Pact requirements, and corresponding fines were not enforced as disciplinary measures. Abidance by the rules should be controlled by independent bodies and the penalty would come in the form of issuing so-called junior debt (i.e., with higher interest rates) that would be automatically restructured if the country later needed assistance from the ESM;
- ✓ Introduce an overt legal mechanism for national debt restructuring to avoid a repetition of the Greece situation since 2010;
- ✓ Make monetary policy work for people. The ECB's quantitative easing programme, and particularly its corporate securities purchasing programme, is pumping billions in to banks to the benefit of large corporations, without providing genuine stimulus to the real economy. Quantitative Easing for banks and corporations should be replaced by the direct transfer of newly created money to governments so they can engage in green investment, and by QE for people, with payments to individual households;

⁸⁶ See: Legislative Train Schedule. Deeper and Fairer Economic and Monetary Union: Creation of a Euro Area Treasury. – <http://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-economic-and-monetary-union/file-euro-area-treasury>.

⁸⁷ Sources: Briançon P. France and Germany agree on eurozone reform. – Politico, 17 January 2018, <https://www.politico.eu/article/french-german-economists-launch-their-own-eurozone-plan/>; Clancy E. The Future of the Eurozone. An economic discussion document. – Matt Carthy MEP, <http://www.mattcarthy.ie/wp-content/uploads/The-future-of-the-Eurozone.pdf>.

- ✓ Expand the ECB's mandate, which must cover not only inflation but also employment and economic growth;
- ✓ Introduce a real investment plan. The Juncker Investment Plan and the European Fund for Strategic Investments (EFSI) are insufficient. The Euro area and the EU need a new, genuine investment plan based on public investment in infrastructure and green energy. The role of the European Investment Bank could be re-cast and bolstered as a major investment instrument to direct needed investment into deficit countries;
- ✓ Set rules to limit the size and length of trade surpluses, and discourage chronic and large current account surpluses by the use of penalty fines which can then be used to lower trade imbalances;
- ✓ Separate investment and trading activities from deposit channel, and raise capital requirements for systematically important banks in the EU.

Overall, we would like to note that *the EU is approaching the moment, when final systematic decisions will be made as to the format of further development of European integration. It will finalise the discussions started in 2015, determine the new EU development strategy and its updated institutional structure.*

The informal meeting of the European Council on 9 May 2019 in Sibiu, Romania adopted the Sibiu Declaration, which postulated 10 commitments to be observed on the way towards a stronger Union.⁸⁸ They put emphasis on unity, joint solutions, protection of European values, democracy, and the rule of law, safeguarding fairness and protection of citizens as well as Europe's responsible global leadership. Despite its symbolic political significance, the Declaration did not give the much-expected



answer to the basic question: which scenario of EU's future development is chosen. It looks like EU member states and different social groups inside them have rather diverse visions of a strong Europe when they depart from general principles and move to practical political solutions. Thus, it is a challenge – to reconcile all the differing visions, merging them into a common practically applicable vision enshrined in the EU's Strategic Agenda 2019-2024 to be adopted on June 21 after the 2019 European Parliament election on May 23-26.

⁸⁸ See: The Sibiu Declaration, <https://www.consilium.europa.eu/en/press/press-releases/2019/05/09/the-sibiu-declaration>.

4. REFORMATTING THE EUROPEAN INTEGRATION PROCESS: PROSPECTS OF THE UKRAINE-EU ASSOCIATION

As laid out in previous sections of this report and articles herein, European integration mechanisms have been undergoing extensive transformations. They have modified the EU system to the point that we can confidently speak about the *full-scale reformatting of European integration*. Clearly, this process will strongly affect the future of member states, as well as EU partner states, to speak nothing of those, who tie their future to integration into EU structures. Ukraine, which belongs to the latter, must be aware that *today's fundamental changes in European integration represent both new opportunities and new challenges*. In this context, key political objective is to make the best of new opportunities and find adequate ways to respond to emerging challenges and risks.

4.1. REFORMATTING OF THE EU AND UKRAINIAN REFORMS: POSSIBLE INSTITUTIONAL CONFLICT

Adoption and entry into force of the EU-Ukraine Association Agreement has definitely become the core of the course of socio-economic transformations that Ukraine committed to in 2014 – the de facto “European Choice” course.¹ The over thousand pages long document that regulates EU-Ukraine relations became the ideological foundation for socio-economic and political changes, the strategic vision of the country's future, as well as a specific plan for systemic reforms.

However, crises that engulfed the EU at the end of the first decade of the 21st century and fundamental changes in the process of European integration caused by the search for answers to these new challenges cannot but raise complicated and politically sensitive issues for Ukraine.

First of all, they are connected with the fact that perception of the EU in 2018 is quite different from that of 2004 – the year of unprecedented enlargement of the Union, which seemed to be on a straight course towards swift EMU completion and creation of a political union – actually a sort of European Federation.

¹ “European Choice” is the title of a coalition of deputy factions in the Verkhovna Rada of Ukraine of 7th convocation created on 27 February 2014 by 250 MPs from political party factions of “Batkivshchyna”, “Svoboda”, UDAR, “Economic Development” and “Sovereign European Ukraine” groups.

At that time, the EU was full equivalent of the notion “European civilisation”, so accession to the Union was perceived as becoming an integral part of Europe. The EU was a model of socio-economic system that successfully combined economic efficiency, technological development, high social and environmental standards, as well as successful international integration policies.

In 2018, the situation around the EU is not as perfect anymore, and in some aspects – causes serious concerns. The EU, as a historically determined institutional entity, is no longer an absolute synonym of the notions of “Europe” and “European civilisation”, which, by the way, had been established in the context of development of *nation states* long before international integration originated. Although severity of external crisis manifestations in the EU has somewhat reduced compared to the 2015 crisis peak, its underlying factors persist: they still influence the Union and manifest themselves, from time to time, as different conflicts regarding institutional development, with Brexit being the most vivid and destabilising example.

At the moment, it is impossible to define the historical context of the EU crisis – *whether it will be a transient problem that will make the EU stronger in the long run or a precursor to disintegration (or at least decreasing importance of the EU in the global system, given the faster pace of development in East Asian countries.*

It is also impossible to determine the strength and duration of *the spread of nationalistic political trends in Europe: whether this is a temporary “populism disease” that will be undoubtedly overcome in the process of EU reformation, or a new long-lasting trend, inseparable from today’s global shifts?* This is why there is no clear answer as to the future EU format at the moment. Despite major effort of EU leaders, EC President and heads of leading member states, in particular, France, real events can take a different turn.

This situation gives the country a chance *to re-evaluate its European integration course that is based on far-reaching institutional adaptation to the Union’s standards and rules.* It is one thing to use model institutional structure as guidance, and quite another – when this structure shows major imperfections and insecurities as to further development. In addition, there is uncertainty as to the real meaning for Ukraine of socio-economic policies in *different evolution scenarios of the EU and European integration* – in the general political and specific pragmatic sense. We should consider here not only the scenario that will be *formally* approved by member states’ leaders, but also the one that will be implemented *de facto*, under the influence of real socio-economic and political circumstances in Europe and in the world.

There are sufficient reasons to state that systemic changes in EU mechanisms can lead to ***a conflict between the new institutional formats and the EU-Ukraine***

Association Agreement (hereinafter – Agreement) – from the standpoint of both formal and informal institutional arrangements.

From the point of view of *formal compatibility of institutional formats*, the Agreement contains mechanisms and instruments prevalent at the moment of its formalisation. Intensive changes in EU mechanisms are causing a *progressive lag of the Agreement content behind the regulatory system of the EU*. Although Agreement provisions are not invariable and can be changed and amended, *the opportunities for such adjustment are limited*. They greatly depend on Ukraine's *institutional maturity and the pace of transformations, people's ability to adjust to institutional changes and view new opportunities and risks with optimism*.

In this regard, there is a *real threat that the pace of institutional changes in the EU will by far exceed the pace of institutional changes in Ukraine*. This is not just due to the fact that the EU and its member states possess much greater financial resources to support institutional changes.² The main problem areas are: (1) *ability to establish a connection between new institutional mechanisms and previous development experience* and (2) *ability to ensure integration of new institutional formats into the national environment*.

In Europe – taking into account different approaches and political views – institutional transformation is done through an open dialogue with society. Even considering some obvious issues with democratic legitimacy (democracy deficit) in the work of EU institutions mentioned in the previous sections of this Report, it is easy to agree that the extent of these problems is much smaller than in Ukraine.

Ukrainian reforms, judging by their *achieved results*, are quite questionable. On the one hand, we can hardly deny that institutional changes that have taken place in Ukraine over the past five years are the most extensive by their scale and impact on the society. But on the other – we need to understand that reforms are carried out not for the sake of institutional changes themselves or to conform to a certain template – even if provided by the “centre” that is obviously better developed in the institutional sense. The main criterion to evaluate any reforms is whether they really unveil development potential of society, create new resources and, ultimately, *achieve strong positive results*.

From this point of view, Ukrainian reforms proved objectionable as far as their real social effect goes. These problems become even more apparent in the comparison

² Any reform demands expenditure: to dismantle old and create new structures, train and retrain staff, conduct necessary education and awareness measures, ensure territorial and sectoral employee mobility, research aimed at finding answers to new questions, permanent monitoring of reforms, etc. Before reforms can yield results in the form of higher efficiency and quality of development, it is necessary to invest in the institutional transformations themselves.

of reform outcomes assessment by Ukrainian reformers and their European partners, and those of the Ukrainian society (table “*Comparison of assessments of Ukrainian reforms: official Ukraine-EU opinion and opinion of Ukrainian society*”).

**Comparison of assessments of Ukrainian reforms:
official Ukraine-EU opinion and opinion of Ukrainian society**

Joint statement following the 20 th EU-Ukraine Summit (9 July 2018) Areas of reforms considered successful (p.4 of the Statement) ³	Public opinion ⁴ , % of the total number of respondents			
	Do not know anything about this reform	Influence of reforms on citizen's personal well-being [*]		
		Positive	None	Negative
Healthcare reform **	77	10	33	57
Pension reform **	–	–	–	–
Public administration reform	36	6	74	20
Decentralisation of state administration	58	23	58	20
Reform of public procurement	–	–	–	–
Environmental reform	–	–	–	–
New laws on privatisation** and governance of state owned enterprises	31	3	76	20
Improvement of national security legislation	46	17	63	19
Energy sector reform and adoption of the Energy Strategy up to 2035	41	6	61	32

* There were a number of other reform areas with rather poor results, which were not defined as successful in the Joint Statement, but are foreseen in the Agreement and corresponding implementation action plans. In particular, 55% of people believe that the education reform did not influence their personal well-being, and 32% – that this influence was negative. For the judicial reform, these rates are 68% and 27% respectively, law enforcement reform – 65% and 25%, tax reform – 69% and 28%, deregulation and development of entrepreneurship – 74% and 21%, financial sector reform – 76% and 21%. None of the 16 reform areas included in the survey showed positive transformation outcomes above 23% (decentralisation), while the reform of state owned enterprise governance, tax reform and financial sector reform had the lowest percentage – 3%.

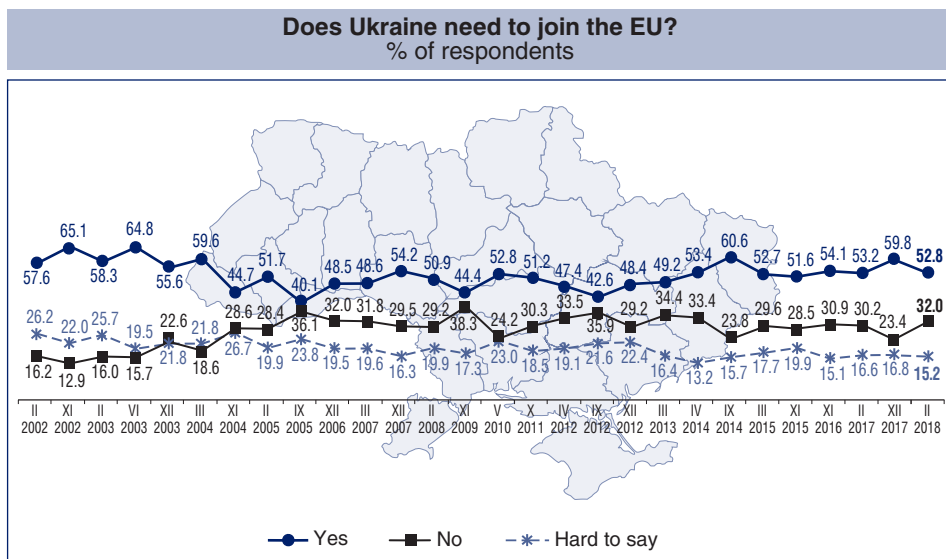
** As part of this sociological survey, we also asked questions regarding people's attitude to reforms in Ukraine. Thus, 13.6% respondents had positive attitude regarding the healthcare reform, 10.9% – pension reform, 7.5% – scheduled mass privatisation of state owned enterprises, percentages with negative attitude – 66%, 62.1% and 44.6%, respectively.⁵

³ Source: Joint statement following the 20th EU-Ukraine Summit Brussels, 9 July 2018. – <https://www.consilium.europa.eu/media/36086/joint-statement-eu-ua-summit-2018.pdf>.

⁴ Source: Press release of the Razumkov Centre “Level of awareness of Ukrainian population about reforms, assessment of the impact of reforms on citizens' personal well-being”, http://razumkov.org.ua/uploads/socio/2018_10_reformy.pdf. The Sociological Service of the Razumkov Centre conducted a national survey on 21-27 June 2018. The survey included all regions of Ukraine, except Crimea and the temporarily occupied territories of Donetsk and Luhansk regions. Number of respondents – 2,021, age – from 18 y.o. Theoretical error of the sample does not exceed 2.3%.

⁵ For more information, see: Press release of the Razumkov Centre “Level of awareness of Ukrainian population about reforms, assessment of the impact of reforms on citizens' personal well-being” (in Ukrainian), <http://razumkov.org.ua>.

As we can see, there are *pronounced discrepancies between official evaluations of reform efficiency and their perception by Ukrainian citizens*, who, in the best case scenario, do not see any reform results. And as reforms are closely associated with the country's pro-European course, their failure to identify positive change may lead to *discreditation of Ukraine's European integration goals* in the public eye. In this situation, the conflict originating from formal divergences in EU's and Ukraine's institutional formats, can turn into a conflict of informal institutional foundations (mentality and values) that define the presence or absence of trust in regard to different policies.



In this context, it is important to pay attention to Ukrainian citizens' attitude to the idea of EU integration (diagram "Does Ukraine need to join the EU?"⁶).

Thus, the rate of public support to EU accession is rather high, coming close to 60% in December 2017, and yet still below the 2014 level and below the maximum rate recorded in the early 2000s. And this is given the fact that most Ukrainians do not know much about EU mechanisms, its development trends and have a vague idea about real potential outcomes of joining this union. Over the past year, Ukrainian citizens' support for EU integration has gone somewhat down – to the level of 2015.

⁶ Source: Results of sociological studies of the Razumkov Centre for corresponding years, <http://razumkov.org.ua/napryamki/sotsiolohichni-doslidzhennia>.

In this context, we should look at *changes in attitudes to European integration in countries that joined the EU in 2004*: initial euphoria here later gave way to a more balanced, and at times sceptical attitude. Ivan Krastev, a Bulgarian researcher well-known for his support of liberal ideas and pro-European choice, gave a concise and expressive description of this attitude in his distinguished work, published by University of Pennsylvania Press (USA).⁷ In particular, he characterises the transformation of East Europeans' attitude to Europe in the following way (pp.49 and 58):

“What followed communism and the raft of liberal reforms was a pervasive cynicism. Central Europe may lead the world in the level of mistrust of public institutions... Faced with an influx of migrants and haunted by economic insecurity, many eastern Europeans feel betrayed by their hope that joining the European Union would jumpstart prosperity and end their crisis-filled existence...”

In the first generation of Central European leaders, politicians like Vaclav Havel made integration into the EU their life's cause and tried to prove that central Europeans could be more European than the Westerners. But the new generation of leaders experiences the constant pressure to adopt European norms and institutions as a humiliation and build their legitimacy around the idea of a national identity in opposition to Brussels”.

Is it possible that Ukraine will undergo a similar ideological transformation, as immersing ourselves deeper in the fulfilment of agreed commitments we start realising that reforms based on European standards may cause not only benefits, but also substantial losses and disappointment?

Ukraine's pace in implementation of the Agreement will hardly surprise anyone. The main reason is not the “lack of political will”, as European leaders and some pro-European political figures in Ukraine sometimes hint. As a matter of fact, in its current state of *informal institutional arrangements* (foremost, the culture of public administration and business, level of people's confidence in basic social institutions, extremely high level of mental propensity to corruption and rent-seeking), Ukraine's institutional structure is *simply unable to assimilate* all commitments on the association agenda. Moreover, with attempts to adapt this agenda to recent transformations of evolving EU mechanisms or ones scheduled in the near future, – *this conflict of institutional structures may grow even more.*

⁷ Source: Krastev I. After Europe. University of Pennsylvania Press, 2017.

We should understand, that *as our agenda starts to include objectives not backed by necessary preconditions, there is a risk of potential discreditation of the entire political course, loss of society's trust in it, and thus – we may find ourselves on a path ultimately leading to a forced revision of strategic priorities.*

The “pro-European” approach currently prevalent in Ukrainian mindset is based on unstructured, rather simplified emotional understanding of European integration and is often a result of unawareness of what European integration mechanisms really are. It contains a plethora of mottos and ideological rhetoric, rather than real ideas about possible effective algorithms of joining the European integration space, which is extremely dangerous from a political standpoint. Unfortunately, Ukraine lacks fruitful expert discussions and fundamental scientific research on key aspects of European integration. Instead, we have a lot more over-simplified propaganda. This has to change, if the country expects to achieve any success in its European integration.

Ukraine needs to *conduct in-depth professional research, hold expert discussions on the issues of the EU agenda, and adjust its own European integration action plan accordingly.* Most likely, it will be necessary to define priorities more precisely, possibly drop some non-priority measures and focus resources and effort on ensuring more effective policy in key areas. *Instead of mechanical transposing of European institutions* (as currently done by our European integrators), the new fundamental philosophy of the country's strategic development should focus on *creating conditions for progressive enhancement of the cultural level of socio-economic and political processes within Ukraine, which is impossible without following imperatives deeply rooted in the national culture.* Modernised on the basis of this idea, the country has much stronger chances of becoming a part of Europe and developing relations with European partners in different areas.

At the same time, we must raise the issue of Ukraine's *possible participation in some new EU mechanisms* (proposed recently or being developed as EU policy evolves), including the newly created *Banking Union, promotion of investment and capital market development, foreign debt regulation, as well as programmes for priority financing by the EU budget, and extra-budgetary resources of EU institutions, new migration regulation mechanisms, and European security policy.* Concentrating our European integration measures in these areas will support modernisation of Ukraine's European integration mechanisms and will ensure a much bigger return for the country's development, even in the situation of limited funding that Ukraine finds itself in at the moment.

4.2. POTENTIAL FRAGMENTATION OF THE EU'S INTEGRATION PROCESS: RISKS FOR UKRAINE

Thinking about the future relations between Ukraine and the EU, we need to take into account differentiation within the Union. Under certain conditions, it can grow into fragmentation of a single space with emergence of different areas with variable level of integration.

Although this scenario is not politically desirable, as there are boundaries, crossing which will cause disintegration of the single space into two or more integration blocs (although still under one name), – it appears quite realistic⁸, if one group of member states keeps persisting in EMU and political union formation, and another – sticks to focusing on national development policy.

Such internal institutional break-up of the EU will most likely emerge along the “Euro area – other EU members” line, as firstly, the Euro area is already de facto singles out within EU's single economic space (map “Europe's Economic and Monetary Union today”,⁹ p.112), and secondly, the single monetary policy format dictates formation of single fiscal policy, to which a lot of EU member states are not likely to agree. Prospects of integrating regulatory institutions and fiscal mechanisms contain possible emergence in the EU of what could be termed a “premier league” (or, in other words, “business class”), while most other EU member states will remain in the “second league” (“economy class”).

Along with separation of the Euro area, other aspects of fragmentation can also become systemic. Thus, major differences of opinion on the matter of migration¹⁰ may cause some countries to *exit the Schengen agreement or not participate in new agreements on joint border security and joint mechanisms to control migrant inflow or asylum granting*. In this case, free movement of people will essentially cease to exist, and the single set of rules will be partially substituted with corresponding bilateral agreements with countries that stopped participating in common mechanisms.

It is also possible that the same destiny will befall mechanisms of *joint foreign and security policy*¹¹, if some member states decide to determine their own political priorities on a number of key issues, for instance, on extending sanctions against

⁸ A good example of disintegration of this kind gives the case of the Commonwealth of Independent States, which divided into two blocs – Eurasian Economic Community and GUAM.

⁹ Based on: Further Steps towards Completing Europe's Economic and Monetary Union: a Roadmap. – European Commission, https://ec.europa.eu/commission/sites/beta-political/files/further-steps-completing-emu_en.pdf.

¹⁰ For more information, see article by Viacheslav Holub “EU Migration and Asylum Policy Reform” in this publication.

¹¹ See article by Viacheslav Holub “EU security and defence reform” in this publication.

Russia or their own position on the real prospects of deployment of US intermediate-range and shorter-range missiles in Europe (which becomes a reality after US President Donald Trump and Russia's President Vladimir Putin announced intention to suspend the Intermediate-Range Nuclear Forces Treaty).

Break-up lines are also already visible in the policy regarding different options of energy supply to Europe, where different projects are competing: supply of Russian gas via "Nord Stream" vs supply of shelf LNG (insert "*EU Energy Policy Dilemmas*"¹², p.113-114).

If these prospects become real, Ukraine will face a tough choice regarding formulating its intentions for EU accession. For example, we will need to ask ourselves: "*Which EU do we join: "premier league" or "second league"?*" Of course, in terms of prestige and ambition, the choice would be in favour of the "premier league". But will the country be able to meet the level of institutional and financial requirements that this format of integration entails?

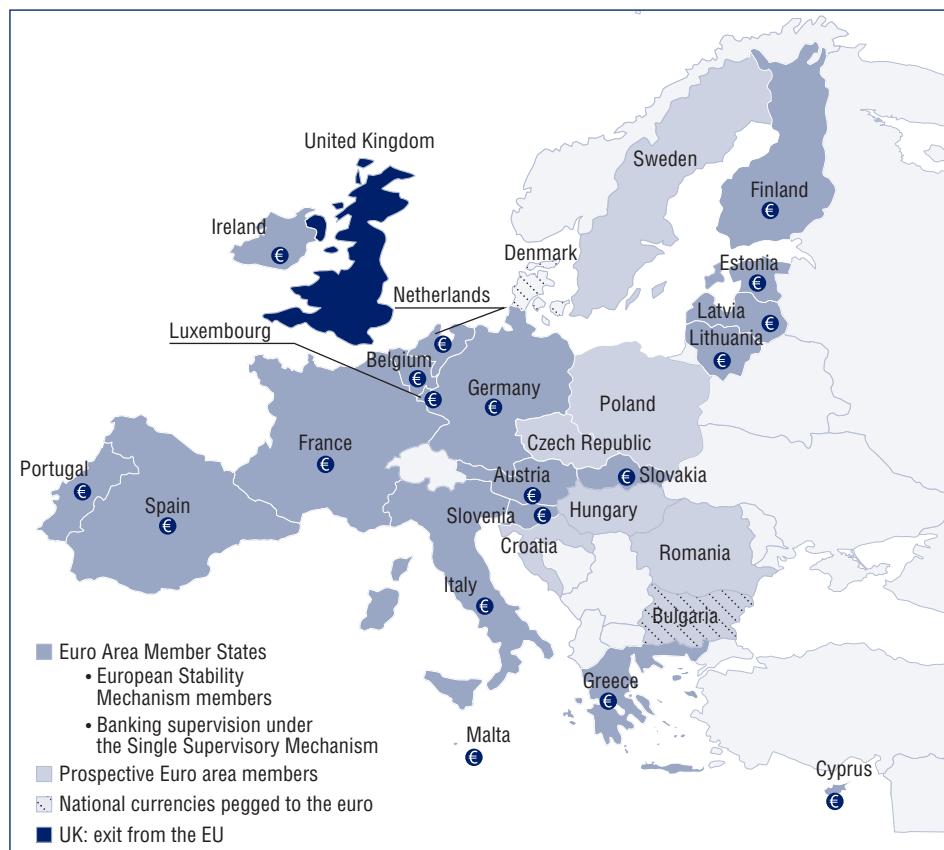
At the same time, *choosing EU area with fewer requirements involves certain risks*. Global experience of regional unions shows that *with two competing integration structures in a region the one with looser commitments is likely to develop rather slowly or fall into stagnation*. For example, this happened in early stages of European integration development, when the EEC and the European Free Trade Association competed between themselves, and the latter was later left by a number of members (Austria, the UK, Portugal, Sweden, Denmark and Finland) that intended to join the EEC. Similarly, two structures emerged in the CIS space – the Eurasian Economic Community and GUAM (called "Organisation for Democracy and Economic Development" today) – with rather unimpressive evolution of the latter and the first one turning into the Eurasian Economic Union with strong ambitions for a much deeper integration. Clearly, finding itself in this situation is not a very lucrative prospect for Ukraine.

We should also take into account that fragmentation of the European space (economic, social, political, security) *may complicate cooperation mechanisms, make their support more expensive* due to the need for additional coordination and, if necessary, creation of additional institutions to ensure coordination of different mechanisms inside the European space. To a certain extent, these differences in the format of participation of some member states can be resolved, as it has been done until now (map "*Europe's Economic and Monetary Union today*", p.112). Yet, we are

¹² Based on materials: Markevych K., Omelchenko V. Global Energy Trends through the Prism of National Interests. – Razumkov Centre, 2016, http://razumkov.org.ua/images/broshura/2016_ENERGY-S.pdf; Energy Sector of Ukraine: 2016 Results. – Razumkov Centre, 2017, <http://razumkov.org.ua/uploads/article/2017ENERGY-FINAL.pdf>.

uncertain as to the EU's ability to consolidate parts with different level of integration after the divergence has passed over certain threshold and various areas of the European space have grown so different that developing more or less coordinated policies becomes "Sisyphean labour". This generates the risk of a major drop of efficiency of these mechanisms, with significant administrative effort absorbed by

Europe's Economic and Monetary Union today



ALL EU MEMBERS:

- Coordinate policies and adhere to common economic and fiscal rules (European Semester, Stability and Growth Pact, Macroeconomic Imbalance Procedure)
- Adhere to common rules in the financial sector (Single Rulebook)
- Participate in the Treaty on Stability, Coordination and Governance (except the Czech Republic, Croatia and the UK)

EU ENERGY POLICY DILEMMAS

EU is one of the largest energy importers in the world, and a number of its member states are dependent on a limited number of energy suppliers, especially natural gas. Thus, the biggest energy policy issue of the EU is **security of energy supply**, in particular, supporting diversification of natural gas supply to Europe.

Creation of the **EU Energy Union** in 2015 was an attempt to reform the European energy space and eliminate energy policy differences between EU member states in relations with Russia. Polish Prime Minister Donald Tusk¹³ proposed a rather radical concept of Energy Union based on creating a single body responsible for procurement of natural gas for EU member states, as well as standardisation of energy supply contracts between EU member states and third countries. This would have allowed to strengthen EC's position in negotiations with Russia and change the rules of the game in the natural gas market in favour of importers. But the **Energy Union programme document**¹⁴ marked a departure from Donald Tusk's main ideas. It stipulated the following in the area of energy security: transparent rules for natural gas supply, implementation of the *Southern Gas Corridor*, project, access to Caspian area resources, use of LNG (in particular, from the USA¹⁵ and Australia), development of a network of hubs and voluntary demand aggregation mechanisms for collective purchasing of gas during a crisis by neighbouring EU member states.

Natural gas plays an important role in energy consumption structure of most EU member states (its share in the total primary energy supply for EU-28 in 2016 was 23.3%)¹⁶ and will likely retain this role in the future. EU's ambitious plans to reduce CO₂ emissions by 80% in 2050, as compared to the 1990 level, mean that natural gas may become the bridge fuel.

One of the largest natural gas exporters to EU countries is Russia. It provided 37% of all natural gas supplies to EU countries in 2017 (39.5% in 2016)¹⁷, which demonstrates extremely high level

¹³ He believed that the Energy Union should focus on: (1) significant strengthening of the solidarity mechanisms for EU member states in case there is an embargo on energy supply; (2) investment in energy infrastructure to increase the number of inter-containers connecting the gas networks between the particular EU countries to diversify energy supply; (3) increasing internal production of energy resources; (4) intense search for alternative energy suppliers; (5) more efficient management of internal European energy resources and expanding the Energy Community created in 2005 with the goal of implementing EU norms and rules in new EU member states to boost energy security in Europe in general. For more information, see: Lenkowski B. The Pressing Need for Energy Union. – 4Liberty.eu, <http://4liberty.eu/the-pressing-need-for-energy-union>.

¹⁴ For more information, see: Communication on A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy, COM(2015) 80. – European Commission.

¹⁵ Deloitte analysts calculated that American LNG supplies to Europe could substitute about 22% of natural gas supply from Russia to the EU. For more information, see: Exporting the American Renaissance Global impacts of LNG exports from the United States. – Deloitte, 2013, https://www2.deloitte.com/content/dam/Deloitte/fpc/Documents/secteurs/energie-et-ressources/deloitte_global-impact-exports-american-renaissance_en_janv2013.pdf.

¹⁶ Source: Energy balance sheets 2016 DATA, 2018 edition. – Statistical Book, Eurostat 2018, <https://ec.europa.eu/eurostat/documents/3217494/9172750/KS-EN-18-001-EN-N.pdf/474c2308-002a-40cd-87b6-9364209bf936>.

¹⁷ Source: EU imports of energy products – recent developments. – Eurostat, April 2018, <http://ec.europa.eu/eurostat/statistics-explained/pdfscache/46126.pdf>.

of EU dependence on this supplier. According to the German Institute for Economic Research that calculates the so called Broader Supply Security Indicator, countries that are most dependent on Russian gas (apart of CIS countries) include East European countries (Czech Republic, Poland, Slovakia, Hungary, Bulgaria, and Romania), as well as Finland and Estonia¹⁸, moreover, in some countries this dependence reaches 100%.

A joint policy approach of EU member states encounters barriers here because different countries consume different volumes of this resource and have different infrastructure capacity for transporting and storing natural gas, different capacities to substitute gas and develop spot markets for natural gas, etc. This pushes some EU member states to placing national interests regarding natural gas procurement from Russia above common European interests.

Thus, Russia is able to implement geopolitically motivated, albeit technologically and economically risky, natural gas transportation projects that aim to reduce or even eliminate transit via Ukraine. This is foremost the Nord Stream-2 project¹⁹ that may undermine EU's energy security. This project is being implemented with active political support of some influential groups, although Baltic countries, Poland, Moldova and Denmark oppose it. Another project that has been revived by the Presidents of Russia and Turkey is the TurkStream, the content of which violates the EU's competition law and is similar to the South Stream pipeline project that Russia had to abandon in 2014.

According to some experts²⁰, the threats of the Nord Stream-2 project for Europe arise from the following: (1) it is not in conformity with EU energy legislation (e.g., the Third Energy Package) and competition legislation as regards natural gas transportation and sales requirements; (2) it is not a new natural gas supply route as it does not provide access to new natural gas sources; (3) creates a precedent of ignoring the interests of most EU countries in favour of Russia and financial interests of project lobby groups; (4) undermines EU unity, plans and priorities regarding pipeline development strategies aimed at natural gas supply from alternative sources (Caspian Sea region, Middle East, and the USA), increasing LNG supply to European markets, and development of alternative energy facilities; (5) creates excess capacities in Europe solely for Russian gas; (6) increases EU's dependence on Russian gas; (7) entails high costs ultimately paid by European consumers as part of gas tariffs.

¹⁸ Source: Franziska Holz, Hella Engerer, Claudia Kemfert and others. European Natural Gas Infrastructure: The Role of Gazprom in European Natural Gas Supplies – Deutsches Institut für Wirtschaftsforschung, 2014, https://www.diw.de/documents/publikationen/73/diw_01.c.465334.de/diwkompakt_2014-081.pdf.

¹⁹ The second line of the stream will be 1,200 km long, with total capacity of two lines – 55 bn cu.m/year. The project was initiated on 4 September 2015 with New European Pipeline AG (later renamed as Nord Stream 2 AG) established for its implementation. Its shareholders are: Gazprom – 50%, E.ON (Uniper), Shell, BASF/Wintershall, OMV, ENGIE (former GDF-Suez) – 10% each.

²⁰ For more information, see: Laktionov A. European “Locomotive” Running on Russian Gas: Nord Stream-2 and Its Team (Part Two). – Finance.UA, 9 September 2016 (in Russian), <http://news.finance.ua/ru/news/-/383909/evropejskij-lokomotiv-na-rossijskom-gaze-severnoy-potok-2-i-ego-komanda-chast-vtoraya>.

futile attempts to coordinate the growing circle of disagreements. In this situation, *disintegration may become a self-supporting process*.

For Ukraine, an EU fragmentation scenario would mean also a risk of *weakening political support in the issues most important for the country*. Fragmentation of foreign policy and security policy, which is already occasionally attempted by some EU member states (although, these attempts are not yet very obvious, except for Hungary that is overtly blocking Ukraine-EU and Ukraine-NATO cooperation) can result in disintegration of the sanctions policy against Russia and abandoning European values-based policy in favour of pragmatic pursuit of material interests. Here, we may witness the same processes already taking place in Europe's energy security sector.

Similarly topical is the issue of *potential destruction of EU's single migration policy*, which has already manifested itself as Hungary's and Austria's refusal to take part in the new UN's Global Compact for Migration.²¹ Moreover, given the fact that the US is not participating either, other EU countries may also follow this path. These prospects are a *double risk* for Ukraine. First of all, gaps in common migration policy are bound to complicate general regulation of migration in Europe. In this situation, Ukraine may turn into a main area for reception of illegal migrants. The EU is likely to be interested in this, as it would help it get rid of migrant overflow using neighbouring countries bound by EU readmission agreements. Secondly, large-scale illegal migration is surely a time bomb placed under the Schengen mechanisms of free movement of people. Inability to find an effective solution to this issue now could eventually challenge the very existence of the Schengen in its current form.²² This, in turn, would *undermine one of Ukraine's most important Eurointegration policy achievements to date*. It would be damaging to the general line of support for Ukraine's European integration course.

It is important to remember that the general rule "reforms require money" is also effective regarding transformation of European integration and EU mechanisms. Even withdrawal from this process, as EU-UK negotiations demonstrated, entails major financial expenditure. This means that the EU will need to consolidate resources targeted at resolution of key development and transformation issues. Given rather

²¹ See: EU regrets Austria's backing out of global migration pact, by David Walsh, Euronews, 31/10/2018, <https://www.euronews.com/2018/10/31/austria-follows-us-and-hungary-in-withdrawing-from-un-migration-pact>.

²² This would not necessarily require a formal withdrawal from this agreement or its termination. It would be enough to introduce additional mechanisms of control, e.g. restore "on a temporary basis" border posts on national borders between the states or introduce burdensome "proof of good intentions" mechanisms on entering the Schengen territory, to turn visa-free travel guarantees into fiction.

limited common budget resources,²³ the EU will be looking for ways to cut its spending. In this context, it may lose interest in countries that are unable to be a real partner and contribute to resolution of European problems. The EU is not likely to be interested in countries that constantly require external support (especially, financial). Ukraine has all chances to be included in this group because of its failure to develop efficiently and inability to move out of the circle of the poorest European countries.

Thus, ironically, *either significant deepening of European integration or possible disintegration processes will both be a challenge for Ukraine, and for its socio-economic transformations and cooperation in the framework of the EU-Ukraine Association Agreement.* Depending on the type of scenario the EU follows, these challenges will have a different impact, but if we are unable to find an effective response, the ultimate result will be the same. Realising the reality of losing the results expected from European integration would be important for the Ukrainian society – not just in terms of further policy, but also for the general mindset and values of the society.

4.3. POSSIBLE WAYS OF UKRAINE'S ADAPTATION TO THE NEW FORMATS OF EUROPEAN INTEGRATION DEVELOPMENT

Adapting to the new reality of European integration development, the country will likely need to tackle two groups of tasks: (1) how to respond optimally to changes in European integration mechanisms and (2) how to make it in the most efficient way. This will require specific measures in line with these two tasks.

The first group of measures has to *adjust our priorities in integration interactions with the EU.* In this context, we first need to work on provisions of the EU-Ukraine Association Agreement, as well as a number of agreements and arrangements arising from it, and regarding which European integration reformatting creates most significant risks, on the one hand, and most considerable opportunities, on the other. In particular, this would include:

1) A joint research by Ukrainian and European experts regarding Ukraine's *potential participation (association) in the EU Banking Union mechanisms*, where the EU has achieved good progress. For Ukraine, the creation of Banking Union mechanisms is especially relevant, as this is the most intensively developed EMU component at the moment, with many aspects of it valid not merely for the Euro area, but the entire EU; moreover, because Ukraine's current banking system situation *requires new solutions for banking system revitalisation.*

²³ As shown in the analysis of EU's Multiannual Financial Framework for 2021-2027 in Section 3 of this Report.

Ukraine's banking system has suffered major cuts in the process of its restructuring since 2014. Certain general improvements in commercial banks' balance sheets were achieved through liquidation of a large number of small and medium banks and transferring the resolution costs related to the largest private Ukrainian bank (*PrivatBank*) over on taxpayers. Overall, these "resolution" measures have greatly undermined people's trust in the banking system and have had questionable impact on its ability to carry out large-scale funding of modernisation and development of Ukraine's economy.

Thus, Ukraine's participation (at least partial) in the EU Banking Union mechanisms and implementation of stronger mechanisms to prevent banking crises and protect depositors' interests, could become a real way to resolve problems in Ukraine's weak banking sector.

2) A joint research by Ukrainian and European experts regarding the possibility of Ukraine's implementation of a number of *financial mechanisms to support investment and national economic development programmes*, as foreseen by different EMU components – the Banking Union, the Capital Market Union and the Fiscal Union. In this context, it is important to study the possibility of direct participation²⁴ in the work of the European Investment Stabilisation Function and the Reform Support Programme that are being created, or at least introduction of similar national mechanisms in Ukraine with EU support. Another subject for research is the possibility of operation of the Union's structural and investment funds in Ukraine.

This issue is very topical as it is the weak investment activity in Ukraine that is one of the main reasons for slow structural transformations and unimpressive innovation processes in the national economy. Ukraine still lacks an efficient investment stimulation mechanism, in particular, infrastructure investment. We need structural and investment fund mechanisms to boost the creation of new components of the economic system and build-up competitiveness.

These measures should be viewed in the more general context of retargeting EU's financial assistance to Ukraine from the current focus on macroeconomic assistance meant to overcome the *consequences* of inefficient economic policy – to supporting structural transformations eliminating the *roots* of economic inefficiency.

3) Given the EU's leading role in implementing measures to tackle climate change, Ukraine should study together with European partners the opportunities in

²⁴ However, the fact that Ukraine is not officially an EU acceding country greatly inhibits this opportunity.

intensification of EU-Ukraine cooperation on energy and climate policy, including the European policy of accelerated green energy development. Within this approach, we should focus on the prospect of making climate policy and RES development measures a key component of a new policy targeted at promotion of innovation-based structural change in Ukraine's economy.

In this context, it is particularly important to consider the issue of *introducing higher taxes on carbon emissions*. Significant growth of these payments in Ukraine will not only stimulate the development of new technologies, but will also become a source of state budget replenishment and compensate the temporary loss of revenues caused by tax incentives to boost investment and innovation. At the same time, Ukraine should be more active in adapting best EU practices in the funding of corresponding climate and green energy measures, including establishing modern financial institutions and market instruments to serve this purpose.

4) Institutional bodies established under the Association Agreement need to create a task group to work on the topic of *intensifying and diversifying international migration regulation mechanisms*, taking into account corresponding future development of these mechanisms in the EU.

We need to define clearly Ukraine's attitude to these matters, given the country's proximity to main migration routes to Europe, as well as the fact that some migrant routes go directly through Ukrainian territory. Our country must not become a part of illegal migration network leading to Europe or a country that accumulates migrants deported from European countries.

At the same time, *our agenda needs to incorporate issues of Ukrainian youth and qualified specialists emigrating from Ukraine*, keeping in mind that some EU member states incentivise such outflow, e.g. to fill positions that are left vacant as a result of their own specialists moving to EU countries with a higher level of income. In this context, we could raise the issue of proportional compensations (in various forms) for expenditures of Ukraine's budget for educating specialists that later leave Ukraine for a long time.

5) Institutional bodies established under the Association Agreement also have to *take additional action to strengthen cooperation in the security sector* in the context of the new opportunities provided by EU's new approaches outlined in its Multiannual Financial Framework for 2021-2027, which provides for significant increases of funding for these purposes. Relevant Ukrainian agencies need to research these matters and hold consultations with European partners, with a view that cooperation

in this sector has to focus not only on getting financial support to build defence capacities, but also on prospective integration of the entire defence system into the European space.²⁵

The second group of measures deals with *existing mechanisms for shaping European integration policy in Ukraine*, which contain major problems.

To develop efficient action plans in response to arising challenges, we first need to become aware of them. There are doubts as to Ukraine's ability to see these challenges, as the country is focused on its own current problems and is not inclined to think about issues outside short-term perspective. As a result, the Ukrainian society knows little about processes underway in the EU, despite a large volume of information received, in particular, in the media. This large volume of information, not properly analysed and processed, creates a feeling of disorder and confusion instead of an understanding of what is going on. There is a risk that we will find out about the real scale of the brewing issues in our priority direction (Europe) too late, when these issues become impossible not to notice due to their magnitude.²⁶

Given this, it is necessary to create preconditions for continuous systemic analysis of European issues in Ukraine. Unfortunately, even though the country has declared its European course, it still does not have a powerful specialised think tank for systemic research of European issues, including issues in the EU and other regional European associations, as well as economies and policies of key EU member states. Neither the National Academy of Sciences of Ukraine²⁷, nor higher education establishments²⁸, or non-government think tanks²⁹ currently have the potential required to deal with various analytical and scientific issues in this area. There is also no permanent *network* of Ukrainian centres for European integration studies, and numerous think tanks that do study certain aspects in this area are rather competing for limited financial resources than cooperating on major research projects.

²⁵ For more information, see Appendix 2 "Ukraine-EU cooperation in the security sector" in this publication.

²⁶ By the way, this is exactly what happened with the global financial crisis that spread to Ukraine in the fall of 2008, while experts had warned about such possibility back in 2007, but hardly anyone paid attention.

²⁷ In fact, over the years of independence, Ukraine managed to get rid of a leading centre for international research (the Institute of World Economy and International Relations of the National Academy of Sciences of Ukraine).

²⁸ Separate specialised departments created at Ukrainian universities are very local in their missions and provide methodological support for the educational process rather than intellectual support for state policy.

²⁹ They mostly structure their activity within the framework of short-term grants they receive, which prevents them from undertaking continuous comprehensive studies of various European integration and EU member states' development issues.

Thus, Ukraine needs to *create a powerful permanently operating system for comprehensive analytical support of European integration and European development, at least in the form of independent think tank network*. Without this, our policy will lack a solid foundation and will be influenced by judgments generated outside – by foreign experts and think tanks.

In this regard, top Ukrainian think tanks that study different European integration issues could *create a consortium for European integration studies, inviting representatives of reputable European think tanks*, with possible project proposals in the framework of the Horizon 2020 programme and its successor for the period after 2020, or other international funds.

Adjustment to new formats of European integration requires *significant changes in the patterns used by Ukrainian business*. The latter, as shown by Ukraine's experience of WTO accession and EU-Ukraine Association Agreement preparations, was *extremely passive* during the development of conditions to be included in corresponding international documents. Notably, business representatives were very critical of negotiations' participants after imperfect decisions have been made, became effective and started influencing the economy, whilst forgetting that they themselves had not done anything to make these conditions better. And although Ukrainian business unions and associations have been creating certain structures with names that reference European integration³⁰, there is hardly any real influence exerted by them on the overall conditions of Ukraine's European integration. Unfortunately, their actions are only aimed at resolving *short-term and small-scale* issues.

In this context, Ukrainian business could be *more active in funding* research of strategic issues of the country's development and ways to optimise its positioning in Europe. It could propose a relevant long-term research initiative to be implemented through an *open competition*.

Finally, we need to *adjust our mechanisms of government decision-making in the area of European integration*. Unfortunately, Ukraine is lagging significantly behind the "problem-laden" EU, especially in the following areas:

- *Government web-platforms* with information on Ukraine's European integration, despite the large number of IT specialists, are significantly weaker

³⁰ E.g. the Ukrainian League of Industrialists and Entrepreneurs has created its EU Representative Office in the EU (Brussels).

than internet resources of EU agencies by the volume of provided information and the depth of its analysis, as well as form of presentation.

- There is a major gap between Ukraine and the EU and its member states in society's involvement in discussions on European integration issues. While the EU has had powerful *internet platforms for discussing key issues of EU development and reform* for almost two decades, there have been no developments in this area in Ukraine.
- While top EU governing bodies use a *powerful network of independent think tanks* with a multi-year record of experience in research and political consulting, which ensures detailed analysis of decisions being prepared, *Ukraine has been working mostly in the closed mode*, allowing only "select ones" in on decision-making processes.

All of this negatively affects the *quality* of decisions made in the field of European integration. ***Ukrainian business could undertake a joint funding initiative to support improving governance related to Ukraine's European integration***, aiming to bring governance structures and procedures in this area closer to the EU level.

It is extremely necessary for Ukraine to ***create a multi-level governance system related to European integration***, which would involve representatives of government agencies that shape European integration policy, representatives of leading national business unions and associations, non-government organisations (civil society organisations) and different academic institutions (the National Academy of Sciences of Ukraine, universities, non-government think tanks). This should not be a mere political declaration or a forum for lectures by top officials moderated by media representatives, but a ***carefully designed permanent mechanism for mutual communications on drafted key European integration decisions***.

Developing Ukraine's European integration policy, we should rest on multi-variant assessments and calculations that take into account ***different scenarios of EU's future development***. Under the high level of uncertainty determined by factors out of Ukraine's control, we have to be ready for different scenarios and have a corresponding set of political tools and preventative measures for each of them to avoid potential large-scale negative effects. This is an aspect of national security, which should be among the state's priorities.

CONCLUSIONS AND PROPOSALS

The research arrived at the following **main conclusions**:

1. The crisis processes in the development of European integration and the EU, which hit them in the second decade of the 21st century, were born by deeply enrooted internal factors closely linked with the objectively wave-like nature of socio-economic and technological development. They are not unique to the EU experience, as crises accompanied, from time to time, the development of the European integration process. The unambiguous multidimensional nature of the crisis processes and their complex nature should not be misleading: in fact, we are dealing with various aspects (facets) of a general crisis process in the development of European integration.

2. The main primary sources of current crisis processes are significant contradictions and asymmetries in the mechanisms of the Euro area and the declared policy of the EMU completion. The mechanisms already implemented in the Euro area do not take into account the existing differences among member states regarding the level of economic development, the maturity of regulatory economic institutions and competitiveness potential. European integration is in urgent need of reshaping, which would breath-in new energy into it. However, nowadays, the EU in its Euro-zone “core” have no single strategic vision of further development of the integration community mechanisms. The elaboration of such common vision is hampered by significant differences between member states, which are fundamental, and in some cases even conceptual.

3. Advancing to higher stages of the EMU cannot take place outside the formation of a political union of states, which should ensure an appropriate level of unity in economic policy. However, the plans to build up a political superstructure over the EMU have largely failed, which has become an important pro-crisis factor. This problem has been complicated by important political changes on a global scale and in Europe, related to the revival of nationalism and protectionism, and the intensification of de-globalisation tendencies. The emphasis on the policy based national value systems and life principles based on national experience creates prerequisites for slowing down the process of European integration and even for disintegration trends as demonstrated by the UK’s exit from the EU.

4. The severe migration crisis that hit Europe also aggravated problems within the EU, creating extraordinary tensions in social security systems within the EU, and together with Russian foreign policy efforts challenged the European security as a whole.

5. The overlapping in time of the policies aimed at deepening and enlarging the European Union also contributed to the emergence of the crisis in the development of the EU, as it created an extraordinary burden on the entire system of institutions of the European integration bloc.

6. The prospects for further evolution of the EU and the possibility of its advance on the path to positive development are endangered by a number of adverse long-term trends, including negative demographic processes in Europe and a tendency towards a relative reduction in the EU's global weight due to the progressive strengthening of emerging market economies, especially Asian countries. These prospects will be adversely affected by the possible increased differences in the scientific and technological potential among EU member states and their ability to effectively seize the achievements of the Fourth Industrial Revolution, which can create new technological frontiers in Europe and substantially enhance the fragmentation of the European economic and technological space.

7. Partial reforms implemented in recent years in the EU and the Euro area are incomplete and leave room for different trajectories in the future. In this case, established mechanisms and formats of interaction, which are not sufficiently flexible and diverse, have ceased to correspond to the realities of modern development and therefore do not work properly.

8. None of the five scenarios proposed by the European Commission in March 2017 about further EU development do not look flawless: all contain certain risks. Politically, three of them seem to be rather realistic. These scenarios are named: "Those Who Want More Do More", "Doing Less More Efficiently", and "Doing Much More Together". However, the first of them is rather risky and requires compliance with certain limits to avoid transformation of differing speeds into substantially differing integration structures. The scenario "Doing Much More Together", to which the European Commission and the leaders of France and Germany adhere, is viable only in case of overcoming the public mistrust of supranational structures and a significant levelling-out of economic development for the majority of member countries. The results of this study, however, provide more arguments to support the "Doing Less More Efficiently" scenario, which appears to be the most acceptable in terms of the balance of interests of different participants of the European integration and, as a result, is the most viable among the mix of different scenarios.

9. Important political impetus for a decision on the future format of European integration and the EU were acquired from different political statements of the recent period. Among them are the political priorities indicated by Jean-Claude Juncker, President of the European Commission, in his 2018 "State of the Union" address. Another breaking pro-European initiative was put forward by Emmanuel Macron, President of France, in his speeches at the Sorbonne University (26 September 2017) and the European Parliament (17 April 2018). Finally, the leaders of France and Germany outlined a set of priorities in the Mezeberg Declaration dated 19 June 2018. However, the practical feasibility of implementing these approaches are not unquestionable. In particular, they do not take into account that the creation of an increasing number of new regulatory institutions at a community level does not guarantee improvements in their regulatory efficiency. They do not pay attention to the excessive complexity, and hence the vulnerability of the European regulatory system which requires a significant "unloading" of the European agenda to make it functionally more suitable for effective community regulation.

10. There is a clear disruption between the range of assessments and proposals of the European Commission and some top European integration champions and the assessments made in discussions outside government offices, inter alia, those originating from independent scientific research. The latter predict a number of possible pessimistic scenarios for the EU integration process.

11. The initial format of the EU's EMU appeared to be incomplete and imbalanced. The complete integration of the monetary policy while maintaining a significant autonomy of the banking system and fiscal and budgetary spheres generated a serious structural distortion inside the Euro area regulatory system, which weakened its resilience to external shocks and caused its increased vulnerability to the effects of global instability. Theoretically, there are only two possible outcomes of this situation: (1) significant deepening of integration and the completion of a fully-fledged EMU; and (2) a controlled partial disintegration and a partial return of previously centralized monetary powers to nation states and the actual transformation of the role and functions of the common currency.

12. The completion of the EMU, initiated in 2012 by the adoption of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, has become a complex process to comprise the Banking Union, the Fiscal Union of the member states and the introduction of an integrated economic policy framework with a single European system of macroeconomic regulation ("European Semester"). Subsequently, it received the fourth element – the Capital Markets Union, and together with the Banking Union, they are now officially referred to the Financial Union while the single European system of macroeconomic regulation makes the basis of the Economic Union.

13. The process of EMU completion is contradictory because it strengthens the functions of macroeconomic regulation at the community level in the absence of the necessary political preconditions for this at the level of a nation state. It does not fully take into account the special political and ethno-cultural aspects of development, as well as the factor of significant technological complexity of the proposed regulatory mechanisms.

14. The formation of the Banking Union is the least controversial issue enjoying the greatest support among all the EMU components: the further development of integration in the banking sector is an imperative not only for the countries of the Euro area but also for the whole of the EU. At the same time, the course targeted at accelerated formation of the Capital Markets Union appears unrealistic and even dangerous, as it proceeds from an overly optimistic assessment of the EU's institutional capacity. This course should rather focus on a small number of priorities capable of facilitating longer-term structural changes in the EU financial markets. However, the most problematic issue is the formation of the Fiscal Union: Europe and the Euro area do not show signs of readiness for the introduction of a supranational fiscal institution (treasury).

15. For Ukraine, the dramatic changes in the European integration system represent both new opportunities and new challenges. It is necessary to take into account

the possibility of a conflict between new institutional formats and the Association Agreement between Ukraine and the EU both in formal and informal aspects. An intensive process of change in the EU mechanisms can lead to a progressive lagging of the content of the Agreement from the EU regulatory system caused by the situation where the pace of institutional change in the EU significantly exceeds the pace of institutional change in Ukraine.

16. The main risks for Ukraine arising from reforming of the European integration process are related to possible fragmentation of the European space and, consequently, the emergence of difficult political dilemmas and additional costs, a restricted access to EU funds, aggravation of the migration problem, the possibility that Schengen regime will fall apart, as well as complicated security conditions through the erosion of EU support policies. Both the substantial deepening of the European integration process and possible disintegration phenomena will be a challenge for Ukraine, its process of socio-economic transformation and its interaction within the framework of the Association Agreement with the EU.

17. In the process of adaptation to changes in the EU system, it is necessary to take into account both own experience of reforms based on adaptation to the EU norms, and similar experiences accumulated by the Central and East European countries that have already joined the European Union. They suggest that putting these objectives on the agenda, not having the sufficient preconditions, can create the risk of possible discrediting of the entire political course, the loss of public trust and the forced review of strategic priorities. It is necessary to exclude any mechanical transposition of European institutions to the Ukrainian system, and to create conditions for the progressive elevation of the level of civilisation of socio-economic and political processes within Ukraine based on imperatives inherent in national culture.

The results of this research made it possible to formulate the following **policy recommendations** regarding Ukraine's European integration:

- ✓ To make a joint study by Ukrainian and European experts of the issue of possible Ukraine's accession (on association terms) to the mechanisms of the EU's Banking Union, in order to find new solutions to make the Ukrainian banking system healthier.
- ✓ To organise joint research by Ukrainian and European experts on the possibility of Ukraine's accession to a number of financial instruments that have been introduced in various EMU sectors to promote investment and support implementation of national economic development programmes. This issue should be considered in a wider context of the need to reorient the mechanisms of providing the EU's financial assistance to Ukraine – from the current emphasis on macroeconomic assistance to overcome the negative effects of economic inefficiency towards structural reforms designed to tackle the main causes of inefficient activities.
- ✓ In cooperation with European partners, to investigate the opportunities for strengthening the EU-Ukraine interaction in the field of energy and climate policies. i.e. in the context of the European green energy policy. Special

emphasis should be made on coordination in implementing higher carbon taxation and adapting EU best practices in funding climate policy and green energy, including the spread of modern financial institutions and market financial instruments serving this purpose.

- ✓ Within the Association's governing bodies, a working group should be established to deal with the issues of activation and diversification of the mechanisms for regulating international migration. The "brain drain" (migration of young people and highly qualified specialists from Ukraine to the EU) should be added to the Association's agenda. There is a need to discuss the possibility of introducing compensatory mechanisms for the partial reimbursement of the budgetary expenditure in Ukraine for the education of those professionals who leave the territory of Ukraine for a long-term engagement abroad.
- ✓ Association bodies should also take additional measures to enhance security cooperation in the context of new opportunities that arise from the new approaches within the EU Financial Perspectives for 2021-2027, focusing, first of all, on integrating the entire system of Ukraine's defence capability into the European space.
- ✓ Ukraine needs to create a permanently operating and powerful system of integrated scientific and analytical support relating to European development and European integration. This goal could be reached through the creation of a network of independent think tanks on these issues, or the creation of a consortium of leading think tanks engaged in the study of European integration issues, and inviting the representatives of high rank European research centres.
- ✓ Ukrainian business should be invited to actively fund the relevant research on strategic issues of the country's development and ways to optimize its place in Europe, in particular through the launch of a long-term Ukrainian research initiative on these issues that could be implemented via open competitive procedures.
- ✓ It is necessary to strengthen the quality of mechanisms for shaping governmental decisions on European integration issues, paying particular attention to: the quality of web portals of the governing bodies related to European integration process; creation of a platform for public discussions over key issues of European integration; expanded involvement of independent think tanks with prolonged experience in political advisory activities for detailed decision drafting in the field of European integration policy.
- ✓ It is extremely necessary to create in Ukraine a multi-level system of governance to manage the process of European integration. It should involve representatives of government structures, leading all-Ukrainian business unions and associations, non-governmental organisations (civil society) and various academic sectors (the National Academy of Sciences of Ukraine, universities, non-governmental research organisations), providing the basis for a functioning communication mechanism in preparing key decisions regarding the development of European integration.

THE MAIN DILEMMAS OF REFORMING THE INSTITUTIONAL FRAMEWORK OF THE EU¹

Euro area crisis and a surge of migrant crisis in 2015-2016 have affected the very foundation of the European project and brought to light the deficiencies in legitimacy and effectiveness of the existing EU democracy model. EU legitimacy crisis was accompanied by a drop of citizens' trust in traditional political parties. EU citizens blamed financial and political elites in economic recession and unemployment, their inability to prevent crisis in time and use of painful solutions to resolve it. As a result, populist parties and movements that skillfully manipulated citizens' growing discontent with the economic situation and mass migration from the Middle East and Africa gained its momentum.²

However, populism should not be treated as an anti-democratic phenomenon. Rather, it is a consequence of an inefficient democratic system that is lingering "in the shadows of democracy". Populist leaders are often current or former representatives of the Establishment. There are two types of populism: reactionary and grassroots.

Reactionary populism is aimed at restoring the former (lost) *status quo*: it is represented by Donald Trump, Matteo Salvini, Marine Le Pen, Geert Wilders, Nigel Farage. Whereas the grassroots type, represented by the Italian "Five Stars Movement", Greek party "Syriza" and Spanish party "Podemos", – aims to ruin the existing status quo to create a kind of political-economic renaissance in the interest of ordinary people. For the European democracy, however, the biggest threat is a combination of populism and nationalism (national populism). It appeals to national identity and contrasts it to globalisation failures, offering fast and simple solutions to complicated issues.

On the other hand, there are also forces that see possible answers to democratic system legitimacy crisis in strengthening supranational governing through further delegation of national sovereignty on the EU level in such spheres as macroeconomic, social, fiscal, foreign, security and migration policy.³

Yet, will the EU have enough courage to reform its own structure in order to overcome the numerous crises? Does the European project fit to respond to current challenges?

As we know, the founding fathers of post-World War II European integration did not have a single vision of the European project. Christian Democrats Konrad

¹ Prepared by Viacheslav Holub, Razumkov Centre Expert for Foreign Policy and International Security Programmes.

² Bertoncini Y. Democratic Crises in the EU: Towards "New Frontiers". – Jacques Delors Institute, 14 November 2017, <http://institutdelors.eu/wp-content/uploads/2018/01/democraticcrisesintheeu-bertoncini-oct17.pdf>.

³ Colombo A., Magri P. ISPI Report for 2017. The Age of Uncertainty. – Global Scenarios and Italy, ISPI, p.58-59, 69.

Adenauer, Alcide de Gasperi and Robert Schuman saw united Europe as a confederation that ensures peace, works on several strategic issues and has full respect for national and regional autonomy according to the principle of subsidiarity. They had respect for identity and traditions of European nations and regions, and did not trust the purely technocratic approach to integration.

In contrast, Jean Monnet and his followers in European institutions supported the transfer of powers to European technocrats, who would make non-political decisions. According to this approach, European integration progress would be determined by technocratic necessity, not political choices.⁴

Finally, Altiero Spinelli and his followers in socialist and liberal circles elaborated a plan for a federal Europe. According to this plan, federal Europe had to have a federal government accountable to the European Parliament (elected through the general voting procedure), federal Parliament's chamber consisting of member states' representatives, Court of Justice and other institutions to represent common European interests. It is worth noting that federalism was the first among the different concepts of theoretical and ideological justification of European integration. It was developed in the interwar period by Austria's Richard von Coudenhove-Kalergi in his book *Pan-Europa*.⁵

For a long time, the European project was developing according to Christian Democrats' logic. Federalism was considered as an overambitious idea that gained no support from either the population or the national governments. Having just regained their national sovereignty, post-war European countries were not ready to give it up. So, in the beginning, integration encompassed a narrow area of several neighbouring states' economy, and was practically implemented as the European Coal and Steel Community. It was planned to start convergence from the less sensitive areas – economic, social, cultural, which was supposed to gradually expand into security and foreign policy.⁶ Yet, the latter remained the weakest areas in European integration, with member states having the final say and a limited role of the supranational institutions.

The nature of this approach to European integration is well presented in a famous statement by Robert Schuman as of 9 May 1950: “Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements which first create a *de facto* solidarity”.⁷ Thus, European integration was designed to be a process, not a steady structure. Also, there has never been a full agreement on

⁴ Ottavio Reho F. For a New Europeanism. – Wilfried Martens Centre, <https://martenscentre.eu/sites/default/files/publication-files/future-europe-new-europeanism.pdf>.

⁵ Sydoruk T. Integration Processes in Modern Europe. – Lviv: LA “Piramida”, 2010, p.22-21 (in Ukrainian).

⁶ Ibid., p.28-27.

⁷ White Paper on the Future of Europe. Reflections and Scenarios for the EU27 by 2025. – European Commission, https://ec.europa.eu/commission/sites/beta-political/files/white_paper_on_the_future_of_europe_en.pdf.

the ultimate result of this process. Even the vague formulation of a “tighter Union” spelled out in the 1957 Treaties of Rome is quite debatable at the moment.⁸

As a result, the European project now is an ambiguous doctrine with an undefined final scope of powers and constitutional structure. In contrast to federation, which provides for centralisation in a limited number of sectors (foreign policy, defence, four freedoms, single market) and full decentralisation in other areas, today’s EU is leaning towards excessive centralisation, harmonisation and regulation. In many aspects, the EU is already more centralised than most of the world’s federations. Thus, EU member states’ citizens see the EU as a technocratic structure trying to limit national states’ sovereignty. The existing European idea is seen as outdated and unacceptable in many member states, which means it is high time to update and adapt it to the current situation.⁹

From the very beginning, development of the institutional structure in the context of European integration was associated mainly with EU founding treaties adjustment. Yet, over the past two decades, the conceptual link between reform of European institutions and adjustment of treaties has been lost. Since 1990s, when European integration started affecting sensitive issues, e.g. monetary policy and internal security, ratification of new treaties in national states’ parliaments or in national referenda became increasingly more problematic. A strong confirmation of this trend were the negative results of referenda – Danish on Maastricht Treaty approval, Irish – on Treaties of Nice and Lisbon, French and Dutch – on European Constitution approval. As a result, there appeared an opinion that current discussions on EU reforms cannot aim to change the founding treaties, and EU upgrading has to be done under existing legal framework.¹⁰

In order to make discussions on EU reform more practically oriented, on 1 March 2017, the European Commission proposed five scenarios for Europe’s development until 2025. They contain a broad range of ways for Europe to follow in its integration: from returning to nation states to creating a federal European state.

While the second and fifth scenarios (“Nothing but the single market” and “Doing much more together”) involve fundamental reform of the EU, including the founding treaties change, the third and fourth scenarios (“Those who want more do more” and “Doing less more efficiently”) are modifications of the first one and an attempt

⁸ Lehne S. EU Reform: Does Everything Have to Change for Things to Remain the Same. – Carnegie Europe, 19 July 2018, <http://carnegieeurope.eu/2018/07/19/eu-reform-does-everything-have-to-change-for-things-to-remain-same-pub-76871>.

⁹ Ottavio Reho F. For a New Europeanism. – Wilfried Martens Centre, <https://martenscentre.eu/sites/default/files/publication-files/future-europe-new-europeanism.pdf>.

¹⁰ Lehne S. EU Reform: Does Everything Have to Change for Things to Remain the Same. – Carnegie Europe, <http://carnegieeurope.eu/2018/07/19/eu-reform-does-everything-have-to-change-for-things-to-remain-same-pub-76871> <http://carnegieeurope.eu/2018/07/19/eu-reform-does-everything-have-to-change-for-things-to-remain-same-pub-76871>.

to boost EU development. They develop the concept of differentiated integration that can serve as an instrument for implementing a pragmatic integration strategy without the need to review the founding treaties.

“Differentiated integration” scenario is currently considered as the EU’s chance. Although various forms of differentiation were being introduced in European communities from the start of European integration in the 1950s, now this concept is gaining popularity. It is being considered as a possibility to compensate for the heterogeneous structure of EU member states and overcome differences in their ability and political will to delegate more sovereignty to the supranational level. Differentiated integration format can be used to achieve a balance between a deeper integration and expansion of the EU. It has already proven its efficiency as a tool to manage European diversity (e.g. Schengen, Euro area, where not all EU members are included). At the same time, differentiated integration can lead to opposite consequences: on the one hand, it will facilitate better management of the member states’ diversity, overcoming integration impasses, and on the other – it can trigger disintegration processes. Thus, it is important not to associate differentiation with fragmentation.¹¹

Differentiated integration can be implemented in the form of different approaches – “multi-speed Europe”, “core Europe”, “variable geometry Europe” or “Europe à la carte”. The concept of a multi-speed Europe means that integration-related goals have been defined for all member states, and only one group of member states is moving ahead, while the others can follow in time. Member states, which are less interested in deeper integration don’t oblige to follow suit while also not being excluded from these processes. Multi-speed Europe could turn into a core Europe, however, if the lagging member states are no longer able to or no longer willing to join the progressive group either over the long term or permanently, and this core group decides and implements its own integration steps and goals. A transformation of this kind is currently being discussed in the scope of Economic and Monetary Union (EMU). In the case of the variable geometries concept, integration goals are not predefined for all member states. This means that member states with the intention to integrate can advance without the approval of the others. This results in a variety of integration groups with varying memberships. Europe à la carte concept offers a wide range of policy areas and single measures from which every member state can put together their preferred menu on an individual basis and form groups with other member states accordingly. In terms of future alternatives to the traditional enlargement process of the EU, the concept of Associate Membership is being discussed.¹²

Among all available differentiation forms, preference should be given to the one with the least risk of EU fragmentation. Implementation of “multi-speed Europe”,

¹¹ Tekin F. Differentiated Integration. – Institute for European Politics, March 2017, <http://iep-berlin.de/wp-content/uploads/2017/03/Funda-Tekin-Differentiated-Integration-Online-Paper2017.pdf>.

¹² Ibid.

“variable geometry Europe” or “Europe à la carte” concepts poses a risk of intensified disintegration processes, despite the fact that there were no precedents in the past.¹³

The legal instrument for intensified cooperation between EU member states entails the least risk of fragmentation. It doesn’t create a division between different groups of states involved in various forms of such cooperation. This mechanism first appeared in the 1999 Treaty of Amsterdam and developed in all subsequent treaties. The main problem was its non-application.¹⁴ Intensified cooperation instrument matches the fourth scenario of the White Paper on the Future of Europe. It was implemented, in particular, during the establishment of Permanent Structured Cooperation on Defence (PESCO). It can be a compromise between the supporters of stronger supranational structures and supporters of national sovereignty. Under intensified cooperation mechanism the determined integration priority sectors come under the EU rule when other sectors return under the management of nation states.

Sectors under exclusive EU jurisdiction like trade and competition, single market operation and institutional structure of the EU have to be excluded from differentiated integration. This is equally important for migration, common foreign and security policies. Thus, the third and fourth scenarios are a continuation of EU’s current development, plus the broad application of Lisbon Treaty opportunities. Despite the announced intentions, the government and population of member states are not ready for a deeper political integration in the sectors of migration, foreign and security policy.

Along with the differentiated integration concept, academics and experts across the EU are discussing the possibility of building the bloc in the format of federation. This approach matches the fifth scenario in the White Paper. However, we would like to note that there exists wrong interpretation of the federalism notion, which associates it with merely transferring the excess amount of powers to supranational institutions. In reality, federation means strengthening the EU in specific areas: foreign and security policy, economic management in the Euro area and the Single Market, border protection and asylum policy. In case of the federal approach implementation, it can help the EU to overcome governance challenges and weaken the pressure of long-term crises, as the EU will face transnational challenges and threats under new institutional and functional unity.¹⁵

In Europe, federalism has to be different from the form it takes in the USA. Since its foundation, the USA was based on the “competitive federalism” model, where autonomous governance entities competed between themselves and disciplined

¹³ Martonyi J. Differentiation, not Disintegration. – Wilfried Martens Centre, <https://martenscentre.eu/sites/default/files/publication-files/differentiated-integration-disintegration-future-europe.pdf>.

¹⁴ Tekin F. Differentiated Integration. – Institute for European Politics, <http://iep-berlin.de/wp-content/uploads/2017/03/Funda-Tekin-Differentiated-Integration-Online-Paper2017.pdf>

¹⁵ Ottavio Reho F., Rohac D. The Case for a Federal Europe. – Wilfried Martens Centre, May 2017, <https://www.martenscentre.eu/sites/default/files/publication-files/case-for-a-federal-europe.pdf>.

each other. However, after the Civil War this model evolved into such kind of “cartel federalism” with a much stronger federal level. This is why the US is an inappropriate example for the possible federalisation of Europe. Europe needs an authentic, decentralised and competition-based federalism, in which common European institutions would uphold common values of the European civilisation, strengthen the common market, oversee federal monetary, foreign and defence policy, protect equal rights of all citizens. All other functions should be returned to the national level, harmonisation would be brought to a minimum, and decentralisation – encouraged on all levels.¹⁶ As a result, the EU would be better adapted to modern challenges and threats.

However, in general, federalism is not on the EU reform agenda at the moment. This alternative is rarely discussed at the sessions of European institutions. EU leaders are looking at differentiated integration as the future way of the bloc’s development. The idea of turning the EU into the United States of Europe with a central government is supported only by 30% of citizens in EU member states, while 41% reject this idea, and 28% remain neutral.¹⁷

Thus, it appears that **numerous crises in the second decade of the 21st century have revealed weak institutional capacity and resilience of the EU in the face of this type of challenges and threats. With the low level of citizens’ trust and the overarching legitimacy crisis, the bloc is in dire need of reforms. The five options of future development proposed by the European Commission mean different prospects: from moving towards a European superstate to limiting integration to the Common Market. While the first option looks utopian and enjoys low level of citizen support, the last one practically eliminates all the 60-year achievements of the European project. Elites and citizens in member states are relatively supportive of the “multi-speed integration” and tighter cooperation options, which are already implemented in the current EU architecture to a different degree (e.g. Schengen area and the Euro area). It is unknown whether they will be successful in the future or will boost the disintegration, however, it is already clear that the EU has to reestablish solidarity between members and restore its citizens’ trust. This will largely define either the EU will survive this crisis and become stronger, or member states follow the UK example. The current situation is similar to the post-war period, as the war-devastated European states had no choice but to unite to oppose the influence both of the USSR and the USA. Today the EU has to be reborn in order to counter potential domination of Russia and China on the European continent in the face of the possible US disengagement. This will determine the fate of the EU and peace on the continent, as well as the liberal model of global development, on which, as of lately, Brussels has lost its grip.**

¹⁶ Ibid.

¹⁷ Raines T., Goodwin M., Cutts D. The Future of Europe. Comparing Public and Elite Attitudes. – Chatham House, p.38.

UKRAINE-EU COOPERATION IN THE SECURITY SECTOR¹

CHANGES IN EUROPEAN SECURITY POLICY

For many centuries, the European continent has been the territory of almost never-ending war. After two world wars, Western and Central Europe, using successful integration projects, came into the 21st century as one of the safest and most prosperous regions in the world. However, security changes that took place in Europe and around it in recent years prompted European leaders to critically re-evaluate the dependability of the existing mechanisms and available capacities of responding to traditional and new security threats.

While European Security Strategy 2003 started with the words “Europe has never been so prosperous, so secure nor so free”,² the present-day evaluation is more pessimistic: “...peace and stability in Europe are no longer a given”.³ Over the past years, there have been more than enough strong reasons for this, especially in connection with the annexation of Crimea, the ongoing military conflict in Eastern Ukraine and Russia’s increasingly aggressive foreign policy not only towards its neighbours but globally.

The security system, as formed at the end of the 20th century, has proven unfit for effective counteraction against comprehensive threats of the early 21st century. The 2008 financial crisis, large-scale terrorist attacks, new conflicts in Europe, the uncontrolled flow of migrants from neighbouring regions have drastically changed the situation. Cooperation and partnership were substituted with nationalism and confrontation not just in relations with Russia, but also with the USA – a strategic ally, as well as among EU member states themselves.

It should be noted that despite regular updates of strategic documents on foreign and security policy, the EU seems still to be looking for such strategies, ways and implementation instruments. It would be overly optimistic to state that a consensus has been reached on many sensitive issues, including threat priority assessment, use of military instruments, allocation of necessary resources for joint security and defence.

¹ Prepared by Oleksiy Melnyk, Razumkov Centre Co-Director for Foreign Policy and International Security Programmes.

² European Security Strategy – A Secure Europe in a Better World. – European Union, 12 December 2003, <https://europa.eu/globalstrategy/en/european-security-strategy-secure-europe-better-world>.

³ Shared Vision, Common Action: A Stronger Europe, A Global Strategy for the European Union’s Foreign and Security Policy, EEAS: Brussels, June 2016, p.33, http://eeas.europa.eu/archives/docs/top_stories/pdf/eugs_review_web.pdf.

Analysing EU policy, we should consider not only Brussels' policy, but also specific interests of member states. Many common threats have a different degree of relevance for individual nations. The threat of international terrorism is equally topical for all the states, so it is logical to expect common consensual action against terrorism. Meanwhile, illegal migration, which affected European nations differently, became one of the top challenges to European unity in 2015.

Ukraine has directly experienced the different perception and interpretation of national minority rights in its neighbouring EU countries. Look at, for example, the Hungary's angry reaction to the Ukraine's education bill.

It is also important to account for differences in global security approaches of Washington D.C. and European capitals that have become more pronounced during Donald Trump's presidency.

The special feature of EU's security policy is that it looks at security in a much broader sense than defence issues, which is, in fact, not a key function of the EU. At the same time, given the presence of new threats and challenges at European borders, as well as their global character and the diminishing military role of the USA in Europe, the EU has to pay increasingly more attention to its own capacities for defending itself from military threats. Brexit is an additional stimulus for the EU to develop its own defence capacities, as Britain leaving the EU means loss of one of the strongest military powers.

Association Agreement as the Basis for Cooperation and Development of National Security Policy

Having signed the Association Agreement, Ukraine and the EU have proclaimed their mutual interest in deepening political dialogue and developing cooperation in the security sector. One of the goals of the association is "Ukraine's ever-deeper involvement in the European security area" and "practical cooperation between the Parties for achieving peace, security and stability on the European continent".⁴

For Ukraine, integration in EU's political and economic structures is a foreign and domestic policy priority, including national security policy. To achieve this, the country intends to "promote gradual convergence in the area of foreign and security policy" and develop cooperation in the framework of Common Security and Defence Policy, in order to build security and defence capacities, and support international security and stability.⁵

⁴ Association Agreement between the EU and Ukraine, p.4.

⁵ Decree of the President of Ukraine "On the Decision of the Ukrainian National Security and Defence Council as of 6 May 2015 'On Ukraine's National Security Strategy' No.287 as of 26 May 2015.

Security levels in Ukraine and the EU are inseparably connected, and the high level of common security cannot be achieved without joint efforts and mutually beneficial cooperation. In the near future, domestic and international security issues will clearly be among the top priorities of EU policy, including the EU-Ukraine relations.

The Association Agreement has determined the *principles, goals and forms* of cooperation in foreign and security policy. Although only a small portion of the Agreement's text covers these areas (Articles 7, 9-13, 462), joint security issues – national, regional and global – are equally as important as cooperation in economy, trade and environment. Moreover, modern concepts of peace and security stress the importance of tight and inseparable connection between security issues (including, conflict prevention and resolution) and socio-economic, legal and environmental aspects of development policy.⁶

Talking about Association Agreement provisions that directly or indirectly involve security, it is important to mention the following mutual obligations of the Parties that are meant to be the foundation of policies and plans of EU-Ukraine cooperation in this area:

- intensify dialogue and cooperation and promote gradual convergence in the area of foreign and security policy, including the Common Security and Defence Policy (CSDP), and address in particular issues of conflict prevention and crisis management, regional stability, disarmament, non-proliferation, arms control and arms export control;
- reaffirm commitment to the principles of respect for independence, sovereignty, territorial integrity and inviolability of borders, and address in a timely and coherent manner the challenges to these principles at all appropriate levels of the political dialogue;
- intensify joint efforts to promote stability, security and democratic development in common neighbourhood area, and in particular work together for the peaceful settlement of regional conflicts based on commonly shared principles for maintaining international peace and security as established by the UN Charter, the Helsinki Final Act of 1975 of the Conference on Security and Cooperation in Europe and other relevant multilateral documents;
- enhance practical cooperation in conflict prevention and crisis management, in particular with a view to increasing the participation of Ukraine in EU-led civilian and military crisis management operations as well as relevant exercises and training activities, including those carried out in the framework of the Common Security and Defence Policy;

⁶ See, for example: Milante G. Peace and Development. – SIPRI Yearbook 2017, p.213-219.

- establish close contacts to discuss military capability improvement, including technological issues;
- cooperate and contribute to countering the proliferation of weapons of mass destruction, related materials and their means of delivery through full compliance with international treaties and undertaken obligations, by:
(a) taking steps to sign, ratify or accede to, as appropriate, and fully implement all other relevant international instruments; (b) further improving the system of national export controls, as well as effective sanctions for violations of export controls;
- develop further cooperation on disarmament, including in the reduction of stockpiles of redundant small arms and light weapons, as well as dealing with the impact on the population and on the environment of abandoned and unexploded ordnance;
- work together at bilateral, regional and international levels to prevent and combat terrorism in accordance with international law, international human rights standards, and refugee and humanitarian law.

It is stressed that cooperation will be based on common values and mutual interests, conditions and agreements between Ukraine and the EU reached in the course of consultations. Each Party has the right to take any measures, which are:

- (a) necessary to prevent disclosure of information, when such disclosure is contrary to its essential security interests;
- (b) connected with the production of or trade in arms, munitions or war material, or related to research, development or production indispensable for defence purposes, provided that such measures do not impair the conditions of competition in respect of products not intended for specifically military purposes;
- (c) essential to its own security, in the event of serious internal disturbances affecting the maintenance of law and order, in time of war or serious international tension constituting threat of war, or in order to carry out obligations it has accepted for the purpose of maintaining peace and international security.

Given the above, Ukraine should make the most of the possibilities coming from EU's obligations under the Agreement in developing and implementing its own security policy. Also, we should not forget about the country's sovereign right to take measures that are not necessarily supported or even criticised by the partner, but are "related to essential security interests" (Art.472).

Key Provisions of EU Security Policy Documents and their Role in Ukraine's Security Policy

In the context of developing cooperation with the EU, as well as gradual integration into the European community, it is important for the national government to have a correct understanding of key aspects and priorities of EU security policy, as well as Ukraine's place in Europe's security expectations. It is equally important to understand that dynamic changes in the domestic and foreign security situation are reflecting on how citizens and political elites perceive security, which requires regular adjustment of political decisions as part of the overall strategy.

Europe's current approach to ensuring common, collective and indivisible security is based on a tight combination of military-political, humanitarian, economic and environmental aspects. This approach is documented in corresponding European and Euro-Atlantic security policies and structures (the EU, the Council of Europe, NATO, and the OSCE). Consequently, Ukraine has to take into account provisions of corresponding documents in developing and implementing national policies.

First of all, it is crucially important to take into account the fundamental principles and priorities of the EU security policy.⁷

Principles guiding EU's External Action:

- unity (across institutions, states and peoples);
- engagement (active participation in resolving global issues);
- responsibility (for resolving issues not just within the EU and at its borders);
- partnership (with states, regional bodies and international organisations, civil society and the private sector).

Priorities of EU's External Action:

1. **Security of the Union.** Recognising the importance of NATO for most of its members, the EU needs to develop its own defence capacities to respond to external and internal threats (terrorism, cyber threats, economic volatility, climate change and energy insecurity);

2. **State and societal resilience** to EU's East and South (Enlargement, Neighbourhood, and Migration policies);

3. **An integrated approach to conflict and crisis resolution.** Priority is given to prevention and saving people's lives, ensuring lasting peace and stability after conflict resolution;

⁷ Shared Vision, Common Action: A Stronger Europe, A Global Strategy for the European Union's Foreign and Security Policy, EEAS: Brussels, June 2016.

4. **Cooperative Regional Orders.** Active support of regional initiatives for peace and development, as well as stronger cooperation with regional organisations;

5. **Global Governance for the 21st Century.** The EU declares its commitment to global norms and rules, fulfilment of international obligations, and support to the UN as the bedrock of the multilateral rules-based order.

Each of these priorities opens a breadth of opportunities for cooperation, both bilateral and in the form of joint participation in regional and global initiatives. It is always stressed that the overall focus is on Sustainable Development Goals and protecting human rights, peace and security, and gender equality. Considering different ways to implement its policy, official Brussels is always paying attention to the importance of cooperation and joint action with its partners, indivisibility of internal and external security. Creating a “safe perimeter” is a goal of EU security policy and a factor of strengthening security at the same time.

In this context, Ukrainian defence capabilities could become an additional factor for positive resolution of European security issues and a valuable part of the future European military force.

Regardless of the format of current relations, Ukraine has to do its utmost to be treated as an inseparable element of European security, not as a source of security challenges and threats. To achieve this goal, national government’s work should be shaped by the following internal and external priorities.

Internal dimension:

- restore peace and stability within Ukraine’s borders;
- develop national security system to ensure justice and order on the entire territory of the country, as well as protection from a wide range of external threats;
- implement a complex of reforms to ensure sustainable development and, accordingly, stability, peace and security in the country.

External dimension:

- achieve such level of “self-sufficiency in security” that would allow the EU to treat Ukraine as a neighbour that does not endanger European security;
- develop security and resource capacities that allow for making an active contribution to EU’s security policy priorities (fight against terrorism, response to illegal migration, arms control, and mitigation of climate change effects);
- implement a balanced and coordinated external policy aimed at consistent European and Euro-Atlantic integration.

EU SECURITY AND DEFENCE REFORM



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For seven decades after the end of World War II, three generations of Europeans lived in peace and security, economic prosperity and democracy. These also became the cornerstones of the EU, which brought the longest period of peaceful co-existence in the history of Europe. But already in June 2016, in the newly adopted Global Strategy for the European Union's Foreign and Security Policy (EU's Global Strategy), High Representative of the Union for Foreign Affairs and Security Policy Federica Mogherini said: "The purpose, even existence, of our Union is being questioned. Yet, our citizens and the world need a strong European Union like never before. Our wider region has become more unstable and more insecure. The crises within and beyond our borders are affecting directly our citizens' lives."¹

Over the past years, a number of factors have caused rapid deterioration of global security situation. Among them is the growing threat of Russia's actions, foremost connected with the annexation of Crimea and support of pro-Russian separatists in Donbas, terrorism and migration crisis, conflicts and instability in the Middle East and North Africa, demographic crisis, as well as climate change and resource scarcity. Furthermore, Donald Trump's Presidency in the USA has affected the very nature of Transatlantic partnership. Under the new President, the USA is actively insisting on increasing defence expenditures by European allies, making the execution of their obligations in NATO dependent on it, while Europe is becoming more aware of its own responsibility in the security sector.² All of this made it necessary to intensify cooperation on common security and defence, which has been the weakest field of European integration prior to this.

¹ Shared Vision, Common Action: A Stronger Europe. A Global Strategy for the European Union's Foreign and Security Policy. – European Union External Action Service, June 2016, http://eeas.europa.eu/archives/docs/top_stories/pdf/eugs_review_web.pdf.

² Reflection Paper On the Future of European Defence. – European Commission, 7 June 2017, https://ec.europa.eu/commission/sites/beta-political/files/reflection-paper-defence_en.pdf.

Integration of Defence: The Lessons of History

In the history of European project there were two attempts at deepening integration in security and defence, both of which ultimately failed. The first proposal to create a European army was made by French Prime Minister Rene Plevien on 24 October 1950. On 27 May 1952, an agreement on establishing the European Defence Community was signed and ratified by the parliaments of Germany, Netherlands, Belgium and Luxembourg. Along with this, efforts on establishing the European Political Community continued. However, after France's refusal to ratify the European Defence Community treaty, both initiatives failed. Thus, military-political integration suspended for many years to come.³

The first failure of military-political integration was caused by next factors such as France's fear that Germany might grow stronger with possible distancing of the USA; technocratic nature of the European Defence Community; creation of NATO as an alternative security agency on the continent, as well as UK's refusal to support this initiative.⁴

This issue was raised for the second time already after the disintegration of the USSR. After the adoption of the Maastricht Treaty in 1992, European integration, which had mostly focused on economy, spread to political issues. The three-pillar structure of the EU was introduced: the European communities; common foreign and security policy; and cooperation in justice and home affairs. Common Foreign and Security Policy (CFSP) included Common Security and Defence Policy (CSDP). CSDP was implemented most actively in 2003-2008, when 26 EU crisis management missions were deployed in 15 countries on 3 continents.

Yet, efficiency of these missions in achieving peace was questionable. Post-2010 events demonstrated the ultimate decline of CSDP in its current form. CSDP functions to support peace, in particular, during the war in Libya in 2011 and at the beginning of the Donbas conflict in 2014, were delegated to NATO. Both NATO and the EU were ignored by France when it interfered in the Northern Mali conflict in 2012. Thus, in case of a serious threat to international peace and security, EU countries turn to collective defence mechanisms in the framework of NATO, or act single-handedly (like France). EU mechanism is being employed selectively and in less important cases.

There are four reasons for CSDP inefficiency. *The first* is significant differences in EU member states' strategic cultures, resulted in very different perceptions of the threats involved, levels of military ambition and defence spending,

³ Sydoruk T. Integration Processes in Modern Europe. – Lviv: LA "Piramida", 2010, p.46.

⁴ Howorth J. For a True European Defence Union. – Wilfried Martens Centre for European Studies, <https://www.martenscentre.eu/sites/default/files/publication-files/european-deefence-union-future-europe.pdf>.

⁵ Ibid.

willingness to participate in overseas operations and definitions of strategic objectives. *The second* problem derived from the tensions between EU defence-related institutions (the European Council, Council Secretariat, Political and Security Committee, European Union Military Staff, European Union Military Council and European Defence Agency) and the member states, most of which remained wedded to a firm belief in national sovereignty in this area. *The third* problem is that of leadership (leadership of the USA or shared leadership – Franco-British, Franco-German). *Finally*, there is a factor of the very existence of NATO. As long as the US, despite the rhetoric, remains committed to transatlantic partnership, there is little motivation for Europeans to step up and take responsibility for their own defence.⁶

EU Defence Reform: Possible Scenarios

Despite unsuccessful attempts at military-political integration in the past, Europeans started discussing this topic once again in search for acceptable ways to resolve it. In *EU's Global Strategy adopted in June 2016*, the main focus is on taking more responsibility for the EU's own security via achieving Union's true strategic autonomy. It says: "The EU has to be strengthened as a security agency, which will allow it to act independently. Deeper defence cooperation provides for interoperability, effectiveness, efficiency and trust. EU cannot rely on soft power anymore. To respond to external crises, build partners' capacities and protect Europe, Member States must deliver a sufficient level of expenditure to defence, make the most efficient use of resources, and meet the collective commitment of 20% of defence budget spending on procurement of equipment and Research & Technology".⁷

The next phase in EU's effort to boost CSDP was the publication of the Reflection Paper on the *Future of European Defence* by the European Commission on 7 June 2017. The paper analysed three scenarios of defence cooperation between member states until 2025: security and defence cooperation (Scenario 1), shared security and defence (Scenario 2) and common defence and security (Scenario 3).

In *Scenario 1 (security and defence cooperation)* – member states cooperate in security and defence sectors mostly on a voluntary basis, and decisions will depend on a specific threat. They would not be bound – politically or legally – by a common policy in security and defence. The European Union would continue to be able to deploy civilian missions and relatively small-scale military missions and operations aimed at capacity-building to strengthen the security and defence apparatuses of partner countries. The European Union would facilitate more

⁶ Howorth J. For a True European Defence Union. – Wilfried Martens Centre for European Studies, <https://www.martenscentre.eu/sites/default/files/publication-files/european-deefence-union-future-europe.pdf>.

⁷ Shared Vision, Common Action: A Stronger Europe. A Global Strategy for the European Union's Foreign and Security Policy. – European Union External Action Service, June 2016. http://eeas.europa.eu/archives/docs/top_stories/pdf/eugs_review_web.pdf.

intelligence sharing between Member States. The EU would establish a *European Defence Fund* to ensure efficient spending and avoid duplications in defence spending.⁸

Scenario 2 (shared security and defence) enhances cooperation between EU Member States, including through: *increasing the role of supranational institutions* in countering hybrid and cyber-threats, terrorism; strengthening border control and energy security. EU civilian and military missions would be scaled up, helping to make countries in surrounding regions more resilient. Member States' intelligence would be systematically shared and merged.

Scenario 3 (common defence and security) provides for the *creation of a full security and defence union* under the guidance of the EU. This is based on par.2 of Article 42 of the Treaty of Lisbon, which includes the progressive framing of a common Union defence policy, leading to common defence, if approved by the European Council. Complementing NATO, Europe's common security and defence would enhance Europe's resilience and protect against different forms of aggression. The EU would be able to deploy high-end missions abroad, potentially including independent operations against terrorist groups, naval operations in hostile environments or cyber-defence actions. Security threats would be systematically monitored and assessed jointly, in close cooperation with national security and intelligence services. Contingency planning would be carried out at European level. Member States' defence forces will have a greater level of integration; they would engage in regular joint military exercises, and prompt decisions on their development will be made on the supranational level. *The European Border and Coast Guard Agency* would rely on standing European maritime forces and on European intelligence assets. A *European civil-protection Agency* would be established to rapidly react to natural or man-made disasters, alongside with a *common European defence market* protected from hostile external takeovers.⁹

As in the case with the White Paper on the Future of Europe, the European Commission has proposed to member states a number of options for cooperation in defence and security: from pure interstate cooperation to a defence union fully integrated into the EU. The EC document analyses the current situation in the defence sector, yet does not dwell on the possible risks contained in the different scenarios. On the one hand, the Commission offered a wholesome vision of different ways to tackle the issue, on the other – created an uncertainty as to which scenario is better. *The scenario that matches the Global Strategy best is No.3*, as EU's strategic autonomy can be achieved on condition of tight integration of member states in the military-political area. Yet given that the previous attempts failed, is it possible that the same destiny will also befall new EU initiatives?

⁸ Reflection Paper On the Future of European Defence. – European Commission, 7 June 2017, https://ec.europa.eu/commission/sites/beta-political/files/reflection-paper-defence_en.pdf.

⁹ Ibid.

Apart of official EU programme documents, security and defence reforms are also in the focus of statements made by some EU leaders. EC President Jean-Claude Juncker and French President Emmanuel Macron are among the most active. In September 2017, in his 2017 State of the Union address to EP deputies, *Jean-Claude Juncker made a call to create a full European Defence Union until 2025*, with first steps including the *establishment of a European Defence Fund and Permanent Structured Cooperation (PESCO)*.¹⁰

Emmanuel Macron presented similar ideas to Sorbonne students in September 2017. According to him, Europe can achieve strategic autonomy, in complement to NATO. Through *PESCO*, member states will be able to undertake more responsibilities in the security sector, and ensure better coordination of joint action. The European Defence Fund will allow to invest money in defence capacities and research. In his ideas Emmanuel Macron went even further, talking about creating new European institutions to fight different types of threats: *European Intelligence Academy, European Public Prosecutor's Office for organized crime and terrorism, European civil protection force*. Note that Emmanuel Macron put the need to reform security and defence sector in the first place, as security is the foundation for any political union.¹¹

The New Start of EU Defence Reform

EU member states' leaders have not only outlined the ways to increase cooperation in security and defence, but have already started practical actions in this area. At the European Council summit on 22-23 June 2017, they approved ambitious and inclusive ***Permanent Structured Cooperation (PESCO)***. In the final press conference, President of the European Council Donald Tusk called the launch of the *PESCO* initiative a historic step, because such cooperation will allow the EU to move towards deeper integration in defence.¹² On 13 November 2017, ministers from 23 member states signed a joint notification on the Permanent Structured Cooperation (*PESCO*), marking the first step in the establishment of *PESCO*. It stated that “*PESCO* is an ambitious, binding and inclusive European legal framework for investments in the security and defence of the EU's territory and its citizens”. Binding commitments include regularly increasing defence budgets in real terms. Countries also identified 17 projects, participation in which is mandatory for the involved parties.

¹⁰ President Jean-Claude Juncker's State of the Union Address 2017. – European Commission – Speech, 13 September 2017, http://europa.eu/rapid/press-release_SPEECH-17-3165_en.htm.

¹¹ Initiative for Europe. Speech by M.Emmanuel Macron, President of the French Republic, 26 September 2017, <http://international.blogs.ouest-france.fr/archive/2017/09/29/macron-sorbonne-verbatim-europe-18583.html>.

¹² European Council, 22-23/06/2017. – European Council; Council of the European Union, <http://www.consilium.europa.eu/en/meetings/european-council/2017/06/22-23>.

MANDATORY PROJECTS IN THE FRAMEWORK OF PESCO¹³

Each of the 17 projects has the lead state and other participants (from 2 to 23). Lead states in most projects are West European EU's members, with only two of them coming from Eastern Europe – Lithuania and Slovakia.

Germany will be in charge of the European Medical Command, logistics hubs, European Union Training Mission Competence Centre, and will be working on creating crisis response services. European Medical Command will provide critical medical resources and contribute to harmonising national medical standards, and sanitary service principles. Network of logistics hubs aims at establishing cross-border logistics and mobility, and connection of existing European initiatives under one logistic umbrella. European Union Training Mission Competence Centre will improve skills and professionalism of personnel for EU training missions, while Crisis Response Operation Core will improve the crisis management capabilities of the EU.¹⁴

France will be responsible for safety of military communications through the development of joint technologies for European Secure Software Defined Radio. Also, Paris will be developing new systems of energy supply for camps deployed in the framework of EU's joint operations.

Italy will be leading four projects. In particular, Rome will be responsible for the following: standardisation of procedures among European Armies and ensuring that soldiers and civilian employees will work together in a simulated training environment, creating Deployable Military Disaster Relief Capability Package to work with consequences of natural and man-made disasters, conducting surveillance and protection of specified maritime areas, from harbours up to littoral waters, as well as building a prototype European Armoured Infantry.

Spain will lead the project aimed at enhancing military decision-making process, planning and conducting of EU missions, and the coordination of EU forces.¹⁵

Netherlands will be working to simplify cross-border military transport procedures across Europe.

Belgium will be responsible for the development of autonomous underwater technologies for maritime mine countermeasures.

Greece will lead two projects, one of which will work with sharing of intelligence received from surface, underwater and aerial surveillance platforms, and the other – on creating a platform for intelligence sharing in cyber-security.

Among East European EU members, *Lithuania* will be responsible for creating Cyber Rapid Response Teams, and *Slovakia* – for developing a mobile precision artillery platform, which aims to improve coordination and interoperability in multi-national operations.¹⁶

¹³ Defence cooperation: 23 member states sign joint notification on the Permanent Structured Cooperation (PESCO). – European Council; Council of the European Union, 13 November 2017, <http://www.consilium.europa.eu/en/press/press-releases/2017/11/13/defence-cooperation-23-member-states-sign-joint-notification-on-pesco>.

¹⁴ Overview of Permanent Structured Cooperation (PESCO) first collaborative projects. – European Council, <https://www.consilium.europa.eu/media/32079/pesco-overview-of-first-collaborative-of-projects-for-press.pdf>.

¹⁵ Ibid.

¹⁶ Ibid.

PESCO was established on 11 December 2017 by an EU Council decision. It included 25 participating EU member states. Ireland and Portugal, which had not signed the letter in November 2017, announced their decision to join *PESCO* right before its inception.¹⁷ The UK, Denmark and Malta refused to participate in *PESCO*.

On 6 March 2018, the EU Council adopted an implementation roadmap for *PESCO*, which determined the strategic direction of future joint efforts in security and defence, as well as joint implementation of projects. It also envisaged a mandatory assessment procedure for national implementation plans and timelines for each project.¹⁸



The possibility of creating *PESCO* was foreseen in the Treaty of Lisbon. In particular, its Art.42(6) states: “Those Member States whose military capabilities fulfil higher criteria and which have made more binding commitments to one another in this area with a view to the most demanding missions shall establish permanent structured cooperation within the Union framework”. *PESCO* procedures are regulated by Art.46, which, among other things, establishes that *PESCO* decisions are to be made unanimously¹⁹ – the condition that made this initiative structurally weak from the start.

To ensure efficiency of the newly created *PESCO*, it must be provided with proper tools. *PESCO* has a two-layer structure. EU Council is responsible for the overall policy direction and decision-making, including as regards the assessment mechanism to determine whether participating Member States are fulfilling their commitments. Each project will be managed by participating Member States. The *European Defence Agency (EDA)*²⁰ and the *European External Action Service*

¹⁷ Defence cooperation: Council establishes Permanent Structured Cooperation (PESCO), with 25 member states participating. – European Council; Council of the European Union, 12 November 2017, <http://www.consilium.europa.eu/en/press/press-releases/2017/12/11/defence-cooperation-pesco-25-member-states-participating>

¹⁸ Defence cooperation: Council adopts an implementation roadmap for the Permanent Structured Cooperation (PESCO). – European Council; Council of the European Union, 6 March 2018, <http://www.consilium.europa.eu/en/press/press-releases/2018/03/06/defence-cooperation-council-adopts-an-implementation-roadmap-for-the-permanent-structured-cooperation-pesco>

¹⁹ Consolidated versions of the Treaty on European Union and Treaty on the Functioning of the European Union (2010/C 83/01), http://zakon2.rada.gov.ua/laws/show/994_b06

²⁰ European Defence Agency was established in 2004 by 24 EU member states (excluding Denmark). The EDA supports cooperative European defence projects and defence capacity-building of member states. Also, the agency provides a forum for European ministries of defence interested in closer cooperation.

(EEAS),²¹ including the *EU Military Staff*,²² are jointly providing secretariat functions for all PESCO matters, with a single point of contact for the participating Member States.²³

Among *PESCO*'s main tasks is the removal of duplications of military capacities, achieving their interoperability across different member states, which will facilitate greater efficiency of defence spending. Today, total EU member states' defence spending equals 45% of US military budget, while the efficiency of European defence, according to expert assessments, is only 15% of that in the USA.²⁴ EU member states have 17 different types of tanks, 29 different types of naval ships and 20 different types of airplanes, while the USA has: 1 type of tanks, 4 – ships, and 6 – airplanes.²⁵ This situation encourages inefficient spending of available defence resources, and prevents member states from reaching NATO's 2% of GDP requirement for minimal defence spending.

Besides *PESCO*, EU package of defence reforms includes other innovations. In particular, on 8 June 2017, the EU Council adopted a Decision on establishing a Military Planning and Conduct Capability within the EU Military Staff, which would be responsible at the strategic level for operational planning and conduct of non-combat military missions. It was originally planned to establish true operational headquarters with full operational capacity and broad powers, yet at the UK's demand, the organisation's status was lowered. Despite the start of *Brexit* process, the UK still remains a full-fledged member of all EU agencies, and its defence minister regularly vetoes all initiatives on deeper military cooperation within the EU. Creation of this division does not really alter the current situation, as the EU can truly

²¹ European External Action Service is the EU's diplomatic service. It aids EU High Representative for Foreign Affairs and Security Policy in execution of his/her responsibilities and managing diplomatic relations with other countries outside the bloc. EEAS was established on 1 January 2011 according to the Treaty of Lisbon provisions.

²² EU Military Staff is a structural department of the EU External Action Service that performs early warning, situation assessment, strategic planning, concept development, as well as training and education functions.

²³ Permanent Structured Cooperation – PESCO. – European External Action Service, https://eeas.europa.eu/sites/eeas/files/pesco_factsheet_05-03-2018.pdf

²⁴ Dirk Vöpel. EU Defence Union: from Sleeping Beauty to Effective Bloc. – Yevropeiska Pravda, 27 December 2017, <https://www.eurointegration.com.ua/experts/2017/12/27/7075314>

²⁵ Reflection Paper On the Future of European Defence. – European Commission, https://ec.europa.eu/commission/sites/beta-political/files/reflection-paper-defence_en.pdf

²⁶ European Defence Fund was established by the European Commission on 7 June 2017. It has to coordinate and amplify national investments in joint defence research, development of prototypes and acquisition of defence equipment and technology.

²⁷ Numbers in brackets represent EU member states' defence spending, while European Defence Fund is meant to be funded from the EU budget.

reach strategic autonomy proclaimed in the Global Strategy only upon becoming capable of deploying real field missions. It is hoped that after the UK's final exit from the EU, it will be able to revive the old idea of creating operational headquarters.

Another decision addressed improvement of funding for *EU battlegroups*, which have not been used since their creation. According to the funding mechanism, money is provided not by member states participating in the battlegroup, but by the EU. Yet in case of successful operation of *PESCO*, both structures will be mostly duplicating each other. The recent initiative was the creation of the *European Defence Fund*,²⁶ aimed at investments in researching innovative defence products and technologies, as well as in the acquisition of new defence equipment and technologies. Although this structure is essential, its planned EU Budget funding is insufficient, compared to EU member states' defence spending in 2014-2015. Thus, in 2017, €25 million was allocated for research and technologies (compared to €8.8 billion in 2014²⁷), €500 million – for acquisition of weaponry (compared to €38 billion in 2014).²⁸ Given how ambitious the idea of the European Defence Fund is, lack of funding will make it impossible to execute its tasks efficiently. Refusing to allocate sufficient funds for defence on the level of the EU, member states will continue to invest in their national defence systems, which will largely offset the reforms started in the defence sector.

EU Defence or European Defence: a French Perspective

Along with strengthening of security and defence cooperation on the EU level, France is proposing to strengthen defence cooperation between nation states outside the EU. In his Sorbonne speech on the EU reform, Emmanuel Macron talked about establishing a *European Intervention Initiative*.²⁹ In contrast to *PESCO*, instead of capacity-building and improving the functioning of existing EU mechanisms, the main focus will be on operational readiness of member states to get involved in military operations led by France mainly outside of Europe. Given the interstate nature of this initiative, it will be functioning independently from the EU and NATO, which will increase its efficiency. The European Intervention Initiative will include less member states that are ready to contribute to joint operations.

²⁸ Howorth J. For a True European Defence Union. – Wilfried Martens Centre for European Studies, <https://www.martenscentre.eu/sites/default/files/publication-files/european-defence-union-future-europe.pdf>

²⁹ Initiative for Europe. Speech by M. Emmanuel Macron, President of the French Republic, 26 September 2017, <http://international.blogs.ouest-france.fr/archive/2017/09/29/macron-sorbonne-verbatim-europe-18583.html>

³⁰ France Moves from EU defence to European defence. – Claudia Major, Christian Molling, Carnegie Europe, <http://carnegieeurope.eu/strategieurope/74944>



There are some reasons that made Paris turn to a defence mechanism alternative to *PESCO*. *First*, France considers the Mediterranean region as the greatest challenge to its security, and security of the EU, and thinks that it receives insufficient support in this direction. *Second*, Paris cannot run operations in Africa on its own and needs reliable partners to share the responsibility. *Third*, France is worried that *PESCO* might fail and is preparing a backup plan.³⁰

Differences of opinion on this matter between France and Germany undermine the prospects of European defence and may lead to the loss of recent positive dynamic connected with *PESCO* launch and establishing of the European Defence Fund. This also creates a dilemma for the other Union members regarding further choices: strengthening security in the framework of the EU or choosing interstate cooperation. *While Germany is inclined to strengthen EU mechanisms, France is advocating for a more pragmatic approach that considers EU to be just one of several possible cooperation options.* The ability of the two states to reach a consensus determines the future of joint security and defence, as together Paris and Berlin hold 50% of Europe's defence potential.³¹ This will be a test of EU solidarity and a pointer for reforms in other areas, as focus should be not on technical details of a plan, but on the ability to find common ground and reach a consensus. Both states have this experience.

Overall Assessment of EU Security and Defence Reform Prospects

Having realistically evaluated today's challenges and threats, EU leaders acknowledged the need to revive the idea of strengthening EU defence component. Despite previous failures in this sector, in 2017 practical steps were made towards establishing *PESCO* and European Defence Fund. It was decided to reform EU security and defence within the current EU's legal framework. As a result, the *institutional conflict* embedded in the Treaty of Lisbon has its impact on the course of reforms. This conflict is connected with the fact that the EU's legal framework allows for the possibility of developing joint EU defence policy, preservation of the special nature of national security and defence policy, as well as joint defence in

³¹ Franco-German Differences Over Defence Make Europe Vulnerable. – Claudia Major, Christian Molling, Carnegie Europe, <http://carnegieeurope.eu/strategiceurope/75937>

the framework of NATO. Such three-fold approach to defence leads to *uncertainty, which transferred into programme documents of official EU institutions*. The EC paper “On the Future of European Defence” defined three scenarios for stronger cooperation in defence: from interstate approach to establishing a defence union, – without any clarification as to which scenario would be preferable. EC President Jean-Claude Juncker proposed creating a full defence union within the EU, showing his support for a specific scenario. While agreeing with the need to strengthen defence mechanisms in the EU, French President Emmanuel Macron insists on strengthening the inter-state component as well. Despite this, the creation of *PESCO* testifies to EU leaders’ intention to move on with the second scenario in the EC’s document, – strengthening defence cooperation without creating a full defence union.

Yet, the following questions remain unanswered: is it possible that the new initiative will meet the same fate as previous attempts? Won’t *PESCO* compete with the European Intervention Initiative proposed by France? Future developments will give an answer to these questions, yet certain negative trends are already visible at the moment. *First*, the large number of *PESCO* members and the principle of unanimity in decision-making will affect the efficiency of its operation. In addition, European Defence Fund’s limited funding may prevent *PESCO* from carrying out its main function – achieving interoperability across different member states’ armaments and greater efficiency of defence spending. *Second*, if the European Intervention Initiative is established, it will definitely be competing with *PESCO*, which will create a dilemma for other member states – which format to choose. *Third*, differences between Germany and France on the issue that finds broad public support, is a serious test of EU’s solidarity. This is another sign of a gap between citizens and elites, as the latter ones fail to respond to the demand of the former to strengthen defence cooperation on the EU level.

To sum up, we would like to note that **existing security and defence reform projects do not offer a balanced answer to current challenges. They are partial and contain a number of controversies.** The 70 years of peace enjoyed by Europe, as stressed in key EU documents, were possible due to the security umbrella of the United States. **If the EU truly wants to achieve strategic autonomy and strengthen NATO’s European base, it should seek to create a full defence union. This might require a change of EU’s founding treaties. The lack of a common vision on EU defence reform coupled with chaotic decisions may aggravate the already complicated situation in this sector.**

EU MIGRATION AND ASYLUM POLICY REFORM



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In her speech on 7 June 2016 on the day of adoption of the **Migration Partnership Framework**, High Representative of the Union for Foreign Affairs and Security Policy Federica Mogherini said: "Migration is a positive thing for the world, but we need to do it in a regulated way. It is a global, complex phenomenon, it concerns the EU as much as countries of transit or origin... Our approach is a new one, based on a win-win partnership".¹ Yet, in her speech she did not mention interests of migrants, who have become an independent actor of international policy over the past years. Will the EU's win-win strategy also meet the interests of asylum seekers, or will it be implemented at their expense? These questions can be answered after a comprehensive analysis of the current state of the migration issue, its root causes, current EU policy and its future prospects.

Compared to previous years, in 2017 we saw a decline of migrants' activity on the way to Europe. They continued to use three main migrant routes: Central Mediterranean, Eastern Mediterranean and Western Mediterranean. In 2017, the total number of illegal migrants crossing the EU border dropped to 204,719 persons, which is 60% less than in 2016 (511,047 persons) and 89% less than in 2015 (1.8 million persons) at the peak of the migrant crisis.

¹ Migration Partnership Framework. A New Approach to Better Manage Migration. – European Commission, https://eeas.europa.eu/sites/eeas/files/factsheet_ec_format_migration_partnership_framework_update_2.pdf.

Migration Trends along the Main Routes

The number of migrants that came to the EU in June 2017 through the *Central Mediterranean route* (23,461) was similar to that in June 2016 (22,344). In July 2017, the number of migrants reduced almost twice (11,460) compared to June, and in August 2017 – three-fold (3,914). In 2017, a total of 118,962 migrants were recorded coming through this route, which is 34% less compared to 2016. Most migrants came from Nigeria (18,163), Guinea (9,714) and Côte d’Ivoire (9,509).² This data indicates that in 2017 migrants preferred to use the Central Mediterranean route as a main gateway to Europe.

A 50% drop of the total number of migrants that came to Europe in 2017 was possible largely due to the *EU-Turkey migration agreement* concluded in March 2016, which facilitated a significant reduction of illegal border-crossings along the *Eastern Mediterranean route* (as well as the *Western Balkan route* linked to it). In 2017, 42,305 persons entered the EU through this route. Most migrants came from Syria (16,395), Iraq (7,193) and Afghanistan (3,985). Strengthened controls on the Western Balkan route and both the number of people stuck on the Greek islands and the Greek mainland and/or their waiting time meant that the amount of document fraud detections at Greek air borders to Western Europe, as well as the smuggling activity via the Ionian Sea increased. Istanbul Atatürk Airport remained the top departure airport for detections of fraudulent documents from third countries.³ The side effect of the EU-Turkey statement was the large number of migrants being stuck in Greek islands in the Aegean Sea, without an opportunity to move either to the EU, or to Turkey, while their asylum applications were being reviewed. As a result, fights became a common occurrence in the overcrowded migrant camps and the overall crime situation got worse.

Instead, the number of illegal border-crossing along the *Western Mediterranean route* doubled. In 2017, 23,143 persons entered the EU through this route. Among them: 4,809 – from Morocco, 4,219 – Algeria, 3,345 – Côte d’Ivoire.⁴ Unstable domestic political situation in Morocco, the main transit country for migrants heading to Spain, created an opening for more departures from Morocco’s western coast in particular, using high-capacity boats able to transport large numbers of migrants. The feature that makes this migrant route different from others is that migrants mostly plan their travels to Spain independently without using carriers’ services.⁵ This is due to Morocco’s geographic proximity to Spain, the narrowness of the Strait of Gibraltar, which makes it easier for migrants to reach the European continent.

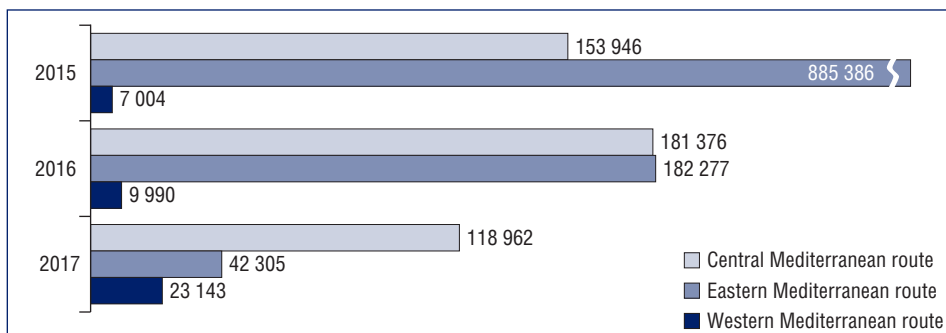
² Frontex Risk Analysis for 2018. – Frontex European Border and Coast Guard Agency, February 2018, https://frontex.europa.eu/assets/Publications/Risk_Analysis/Risk_Analysis/Risk_Analysis_for_2018.pdf.

³ Ibid.

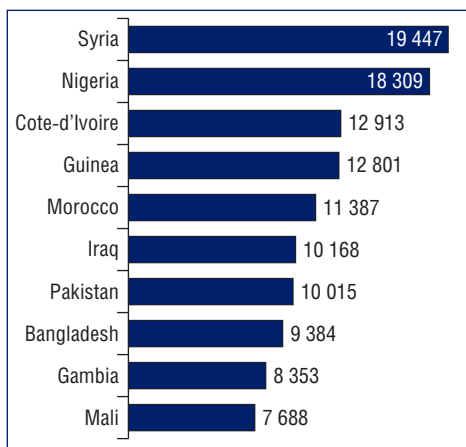
⁴ Ibid.

⁵ Ibid.

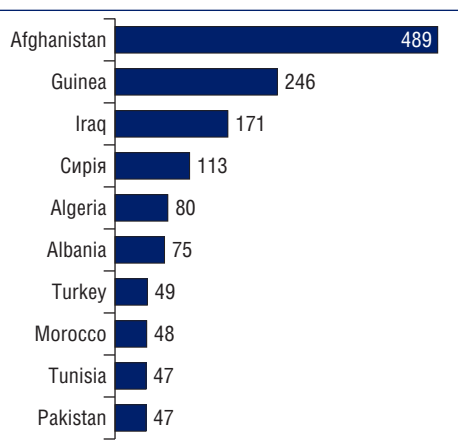
Illegal EU border-crossings (by key migration routes) 2015-2017, persons



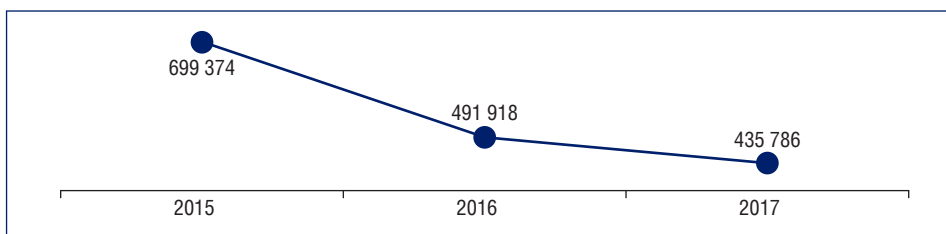
Top 10 countries of origin of migrants in 2017*, persons



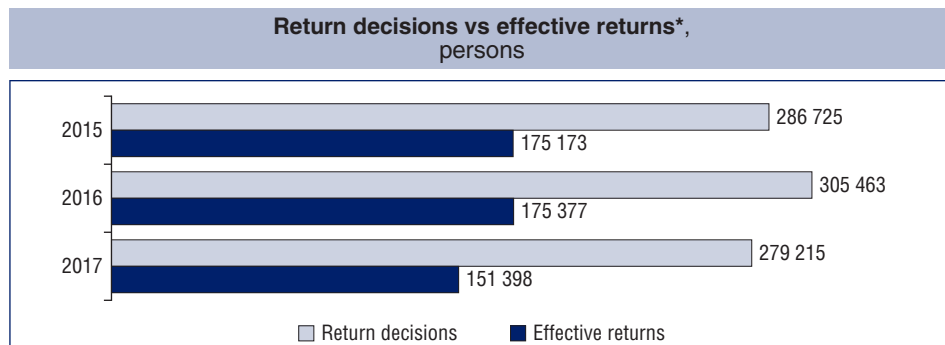
Clandestine EU border-crossings (top 10 nationalities)*, persons



Illegal stay on the EU territory during 2015-2017*, person



* Source: Frontex Risk Analysis for 2018. – Frontex European Border and Coast Guard Agency, February 2018, https://frontex.europa.eu/assets/Publications/Risk_Analysis/Risk_Analysis/Risk_Analysis_for_2018.pdf.



* Source: Frontex Risk Analysis for 2018. – Frontex European Border and Coast Guard Agency, February 2018, https://frontex.europa.eu/assets/Publications/Risk_Analysis/Risk_Analysis/Risk_Analysis_for_2018.pdf.

As seen in the diagrams, compared to migration crisis peak in 2015-2016, the number of illegal EU border-crossings through the Eastern and Central Mediterranean routes significantly decreased. Instead, the number of migrants on the Western Mediterranean route grew and this trend continues. *Top-3* nationalities responsible for illegal EU border-crossings, as recorded by official border-crossing points (BCP), are migrants from Syria, Nigeria and Côte d'Ivoire, and clandestine border-crossings (not recorded by BCP) – Afghanistan, Guinea and Iraq. Illegal EU stay numbers have also gone down from almost 700 thousand persons in 2015 to almost 400 thousand in 2017. There are still significant disproportions between decisions to return migrants to their country of origin and effective returns, due to bureaucratic obstacles as well as the incomplete list of safe countries (return decisions issued imply return of persons to third countries considered to be safe).

Phenomena that Accompany the Migration Crisis

Massive inflow of migrants to Europe contributed to *easier access for terrorists*, as well as *increased volume of drugs and arms smuggling*. After ISIL's territorial losses in Iraq and Syria, terrorism threat became decentralised. Terrorist leaders put an emphasis on fighters permeating Europe with the purpose of committing terrorist attacks. In July 2017, 30% of 5,000 foreign fighters living in Europe and traveling to Syria or Iraq returned to Europe.⁶

Mediterranean Sea is a drugs and arms trafficking crossroads. It is estimated that approximately 125 tonnes of cocaine worth €27 billion are consumed in Europe each year.⁷ Cocaine smuggling networks have been diversifying the routes using transshipment hubs in Western Africa (e.g. Guinea-Bissau, Guinea, the Gambia, Senegal, and Nigeria) and the Caribbean. About 80 tonnes of Afghan heroin are

⁶ Frontex Risk Analysis for 2018. – Frontex European Border and Coast Guard Agency, February 2018, https://frontex.europa.eu/assets/Publications/Risk_Analysis/Risk_Analysis/Risk_Analysis_for_2018.pdf.

⁷ Ibid.

smuggled to Western and Central Europe each year through the Islamic Republic of Iran, Turkey and South-Eastern Europe. Albanian and Kosovo-based criminal groups, play a key role in the smuggling of heroin to Europe.⁸ The main destination countries for firearms trafficking are: France, Germany, Greece, Ireland, Italy, the Netherlands, the Scandinavian countries, Spain, and the United Kingdom.⁹

The migration crisis created a new phenomenon – people smuggling. Given the high demand for illegal travels to the EU, as well as high levels of unemployment in African countries, a profitable business of voluntary people smuggling across the Mediterranean sprung up. Smuggler bands consist of leaders and recruiters (agents) looking for potential migrants. Other roles include safe house managers (or owners) and middlemen (or brokers), boat operators, drivers, document forgers, money collectors and security providers. The majority of migrants travelled to the EU by rubber boats unfit for long-distance travel. The top ranking nationalities of facilitators were Libyan, Syrian, Iraqi, Turkish and Afghan.

Along with smuggling of human beings (based on a voluntary agreement between smugglers and migrants), there is also active trafficking in human beings (one of the most profitable forms of cross-border crime). Trafficking in human beings takes the form of sexual exploitation, forced labour, exploitation of criminal activities, begging and illegal adoption. West Africa currently represents one of the main source regions of victims of human trafficking in the EU. Victims mainly come from Nigeria, Cameroon, Ghana, Guinea, Côte d'Ivoire and Sierra Leone.¹⁰

As we see, in the past years, the EU has faced unprecedented security challenges due to a massive inflow of migrants. Large numbers of migrants are staying inside the EU, waiting on the decision on their asylum application; meanwhile, there are continued attempts to enter the EU illegally from the outside. To find efficient ways to respond to these threats, the EU needs to analyse the reasons that caused this situation, both in the international context and in the EU's internal structure.

Causes of the European Migration Crisis

The Arab Spring of 2010, accompanied by the decline of viable states in Libya and Syria, opened a freeway to Europe for migrants. Prior to that, Muammar Qaddafi's and Bashar Assad's dictatorships in Libya and Syria prevented the massive inflow of migrants through their countries.

Using the power vacuum in *Libya* after Qaddafi's regime was toppled in 2011, terrorists, smugglers and human traffickers flourished in the country and benefitted

⁸ Frontex Risk Analysis for 2018. – Frontex European Border and Coast Guard Agency, February 2018, https://frontex.europa.eu/assets/Publications/Risk_Analysis/Risk_Analysis/Risk_Analysis_for_2018.pdf.

⁹ Ibid.

¹⁰ Ibid.

from the country's transit opportunities.¹¹ After 2011, the power was transferred to the National Transitional Council, recognised by the international community as the legal representative of Libyan people, and in 2012, the country held its first free parliamentary election and formed a government. Yet, in May 2014, the country split into two opposing governments and parliaments in the west (Tripoli) and in the east (Tobruk). Also, Derna province was seized by ISIL fighters, who proclaimed the Islamic State of Derna Province. Later, Qaddafi's hometown Sirt was added to it. In Tripoli, the Government of National Accord led by Fayeze al-Sarraj was established, officially recognised by the UN. Besides the capital, the Government of National Accord also controls the town of Misrata, which is the military base of the regime. In Tobruk, the power is held by general Khalifa Haftar, who captured a number of oil terminals on the coast of the Mediterranean Sea. Haftar's regime has the support of Russia, Egypt and the UAE.

Large-scale migration was also fuelled by the situation in *Syria*. An uprising against Bashar Assad's regime that started in 2011 in the south-western province of Daraa, gradually turned into a civil war. Since then, the previously stable Syria became the arena of different battles: between opposition and Assad; ISIL, opposition and Assad; infighting between opposition groups – with interference of outside players (USA, Russia, Turkey, Iran).¹²

Thus, the EU's intentions to establish democracy and the rule of law in neighbour states have caused an opposite effect. ***Failing to create a belt of stable and successful states outside of its borders, the EU is now forced to defend itself from massive movement of people searching for a better life inside the Union.*** Yet, what also contributed to the current migrant crisis is the EU's *wrong migration policy in the previous period, which was focusing on prevention of illegal migration.*

Since early 1990s, the EU was building a comprehensive system for external management of migration. In the framework of its **2005 Global Approach to Migration and Mobility** (GAMM), the EU was developing close partnerships with third countries, where it clearly underlined the importance of migration control. GAMM was intended to find a balance between EU's interests (encouragement of legal migration and well-controlled mobility), interests of third countries (encouragement of legal migration and maximising the positive influence of migration on development) and migrants' interests (guarantees of international protection). However, in reality this resulted in an *imbalance due to excessive attention to fighting illegal migration. In third country partnerships, the EU did not account for specific interests and prospects of these countries, nor for the rights and interests of migrants.* As a result of EU's policy, migrants got stuck in transit countries, where their rights were massively

¹¹ Novotny Vit. The Refugee Crisis in Focus: Towards better cooperation between Europe's national governments. – Wilfried Martens Center, October 2015, <https://www.martenscentre.eu/sites/default/files/publication-files/refugee-crisis-coordination-european-governments.pdf>.

¹² Colombo A., Magri P. ISPI Report for 2017. The Age of Uncertainty. – Global Scenarios and Italy, ISPI, p.75-87.

abused. GAMM's limited efficiency was also due to the *lack of horizontal and vertical coordination* (between different policies of the Union: migration and asylum, development policy, humanitarian aid, neighbourhood policy, CFSP; and between EU officials and national elites). Structural deficiencies of GAMM were transferred to all subsequent regulatory documents of the EU on external migration management.¹³

Treaties and Laws Underlying EU Migration Policy

Date	Name of Normative Act	Main Provisions of the Normative Act
2005	Global Approach to Migration and Mobility ¹⁴	<p>Key priorities:</p> <ol style="list-style-type: none"> 1) encouraging legal migration and good governance of mobility; 2) preventing illegal migration and trafficking in human beings; 3) maximising the development impact of migration and mobility; 4) providing guarantees of international protection and strengthening the external dimension of asylum policy. <p>Main forms of cooperation with third countries:</p> <ol style="list-style-type: none"> 1) Mobility Partnerships; 2) Common Agendas on Migration and Mobility. <p>Common features of the above two forms:</p> <ol style="list-style-type: none"> 1) Offer a political framework for comprehensive and intensified cooperation with non-EU countries in the context of key priorities; 2) Cover the issues of mobility, including visa issues; facilitate return and readmission of illegal migrants. <p>Different features of the above two forms:</p> <ol style="list-style-type: none"> 1) Mobility partnerships involve negotiations on visa liberalisation and readmission agreements; common agendas on migration and mobility do not have such provisions; 2) Mobility partnerships apply to neighbouring countries; common agendas on migration and mobility – to other non-EU countries.
October 2008	European Pact on Immigration and Asylum ¹⁵	<p>Key priorities:</p> <ol style="list-style-type: none"> 1) organise legal immigration to take account of the priorities, needs and reception capacities determined by Member States; 2) control irregular immigration and encourage voluntary returns to the countries of origin or transit of immigrants; 3) make border controls more effective; 4) build a common European asylum system; 5) conclude a comprehensive partnership with non-EU countries in order to encourage the synergy between migration and development.

¹³ Koenig N. The EU's External Migration Policy: Towards Win-Win-Win Partnerships. – Jacques Delors Institut, 6 April 2017, <http://institutdelors.eu/wp-content/uploads/2018/01/externalmigrationpolicy-nkoenig-jdib-april17.pdf>.

¹⁴ Global Approach to Migration and Mobility. – European Commission, https://ec.europa.eu/home-affairs/what-we-do/policies/international-affairs/global-approach-to-migration_en.

¹⁵ European Pact on Immigration and Asylum. – EUR-Lex, Access to European Union Law, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=LEGISSUM%3Ajl0038>.

Treaties and Laws Underlying EU Migration Policy

(continued)

Date	Name of Normative Act	Main Provisions of the Normative Act
28 November 2014	EU-Horn of Africa Migration Route Initiative (Khartoum Process) ¹⁶	<p>The Khartoum Process – is an established regional dialogue for enhanced cooperation on migration and mobility between countries of origin, transit and destination regarding the migration routes between the Horn of Africa and the EU.</p> <p>Key priorities:</p> <ol style="list-style-type: none"> 1) combating human trafficking; 2) combating migrant smuggling; 3) benefits of migration and addressing root causes of irregular migration and forced displacement; 4) encouraging legal migration and mobility; 5) providing international protection and asylum; 6) facilitating return, readmission and reintegration of migrants. <p>Countries participating in the Khartoum Process:</p> <p>28 EU member states;</p> <p>two states of the European Economic Area: Norway and Switzerland;</p> <p>11 African countries: Djibouti, Egypt, Ethiopia, Eritrea, Kenya, Libya, Somalia, South Sudan, Sudan, Tunisia, Uganda.</p>
7 June 2016	Migration Partnership Framework. A New Approach to Better Manage Migration ¹⁷	<p>New EC initiative “Migration Partnership Framework” is based on a mutually beneficial partnership between the EU and its member states, on the one hand, and partner states – on the other, and is focused on joint measures to deal with migration and development challenges.</p> <p>The key elements of the initiative are migration deals, in the following areas: assistance in development, trade, mobility, energy, security, digital policy.</p> <p>Priority countries: Mali, Nigeria, Niger, Senegal, Ethiopia.</p> <p>Short-term priorities:</p> <ol style="list-style-type: none"> 1) save lives at sea and in the desert; 2) fight traffickers and smugglers’ network; 3) return of migrants, whose asylum applications were rejected; 4) open up legal ways for immigrating to Europe. <p>Long-term priorities:</p> <ol style="list-style-type: none"> 1) address the root causes of irregular migration and force displacement by supporting partner countries in their political, social and economic development; 2) improve employment and development opportunities in countries of origin.

¹⁶ EU-Horn of Africa Migration Route Initiative (Khartoum Process). – International Organization for Migration, <https://www.iom.int/eu-horn-of-africa-migration-route-initiative-khartoum-process>.

¹⁷ Migration Partnership Framework. A New Approach to Better Manage Migration. – European Commission, https://eeas.europa.eu/sites/eeas/files/factsheet_ec_format_migration_partnership_framework_update_2.pdf.

Treaties and Laws Underlying EU Migration Policy

(continued)

Date	Name of Normative Act	Main Provisions of the Normative Act
2 February 2017	Italian Memorandum of Understanding ¹⁸	Key provisions: <ol style="list-style-type: none"> 1) completion of the border control system in Southern Libya to restrict migration; 2) provision of medicines and medical equipment for refugee centres in Libya; 3) training of the Libyan personnel within refugee reception centres; 4) support of broad Euro-African cooperation to eliminate the causes of irregular immigration, implement strategic projects for development in the countries of origin, improve life standards and contribute to the reduction of poverty and unemployment; 5) support international organizations working in the migration sector in order to continue the efforts aimed at returning migrants to their countries of origin, including through voluntary return.
3 February 2017	Malta Declaration ¹⁹	Key priorities: <ol style="list-style-type: none"> 1) training, equipment and support to the Libyan national coast guard; 2) further efforts to disrupt the business model of smugglers; 3) supporting the development of local communities in Libya, especially in coastal areas and at Libyan land borders on the migration routes; 4) seeking to ensure adequate reception capacities and conditions in Libya for migrants; 5) supporting the International Organization for Migration in significantly stepping up assisted voluntary return activities; 6) helping to reduce the migrant pressure on Libya's land borders through strengthening border controls.

Key Directions of EU's Current Migration Policy

EU policy towards the Central Mediterranean route

With the Balkan route being closed to migrants as a result of the EU-Turkey migration agreement, the Central Mediterranean route became the main route for migration. 90% of all migrants from sub-Saharan and North Africa come to Europe through Libya. Thus, the EU needs to maintain close cooperation with Libyan government to ensure control and management of migration flows through this country.

¹⁸ Italy-Libya agreement: the Memorandum text, <https://www.asgi.it/wp-content/uploads/2017/02/ITALY-LIBYA-MEMORANDUM-02.02.2017.pdf>.

¹⁹ Malta Declaration by the members of the European Council on the external aspects of migration: addressing the Central Mediterranean route. – European Council, Council of the EU, <http://www.consilium.europa.eu/en/press/press-releases/2017/01/03-malta-declaration>.

EU policy regarding Libya is focused on the following priorities: training of coast guards; protecting and assisting migrants and refugees; supporting local communities, improving border management.²⁰

Recognising the central role that the Libyan Coast Guard should play in managing the situation, building its capacity is a priority for the EU. The Libyan Coast Guard faces complex training needs, ranging from basic seamanship and an ability to operate safely at sea, to conducting the full range of law enforcement tasks expected of a coastguard, including effective control of Libya's international search and rescue zone.²¹ Operation Sophia has started training the Libyan Coast Guard in 2016. The main goal of training is improving safety in Libyan territorial waters and saving migrants' lives at sea. Due to EU actions, 213 Libyan coast guards were trained, who greatly improved their capacity to fight smuggling and human trafficking at sea, as well as to perform search and rescue operations.²²

EU policy in helping and protecting migrants and refugees takes the following forms: provision of humanitarian assistance and improving living conditions; enabling migrants to voluntarily return home and resettling people in need of international protection. In April 2017, the EU adopted a package of new measures worth €48 million to improve the living conditions of migrants in Libya, including those in reception centres. The measures include primary health care, psychological first aid, and access to food and non-food items. The EU supports the assisted voluntary return programme run by the International Organisation for Migration (IOM). 8,546 migrants from Libya have benefited from this programme in 2018. For refugees that cannot return voluntarily because their safety would be at risk in their home countries, the emergency transit mechanism was established, funded by the EU and run by the UN refugee agency (UNHCR). Up to now more than 1,609 refugees have been evacuated from Libya thanks to this mechanism.²³

In March 2018, the EU adopted a new programme worth €50 million to improve the living conditions of migrants in Libya and their host communities. The programme aims to provide access to basic and social services for vulnerable people and support

²⁰ Central Mediterranean route. – European Council, Council of the European Union, <http://www.consilium.europa.eu/en/policies/migratory-pressures/central-mediterranean-route>.

²¹ Migration on the Central Mediterranean route. Managing flows, saving lives. – Joint Communication to the European Parliament, the European Council and the Council, European Commission, https://ec.europa.eu/home-affairs/sites/homeaffairs/files/what-we-do/policies/european-agenda-migration/proposal-implementation-package/docs/20170125_migration_on_the_central_mediterranean_route_-_managing_flows_saving_lives_en.pdf.

²² Central Mediterranean route. – European Council, Council of the European Union, <http://www.consilium.europa.eu/en/policies/migratory-pressures/central-mediterranean-route>.

²³ Ibid.

local communities particularly exposed to migratory flows. Local community support programmes are implemented in partnership with the Italian Government, the United Nations Development Programme (UNDP) and the United Nations Children's Fund (UNICEF).²⁴

The EU's contribution to migration management to the South of Libya includes support to security and defence capacity building and to processes of regional security cooperation in the Sahel. The European Union Capacity Building Mission (EUCAP) Sahel Mali aims to contribute to improving border control in Mali through training and advice activities. Niger, as a main transit crossroad for migrants on their way to Europe, benefits from a stronger CSDP engagement, including a permanent presence of EUCAP Sahel Niger mission in Agadez. This is aimed at supporting the Nigerien authorities to address irregular migration and fight related trafficking in human beings and organised crime.²⁵

In the European Council summit on 28-29 June 2018, EU leaders agreed to: step up efforts to stop migrant smugglers; support Italy and other frontline EU countries; increase support for the Sahel region, the Libyan coastguard, coastal and Southern communities, humane reception conditions and voluntary humanitarian returns; enhance cooperation with other countries of origin and transit as well as voluntary resettlement.²⁶ Thus, in this European Council summit, the EU has demonstrated its commitment to its earlier illegal migration prevention policy in the framework of GAMM.

EU's development policy has two main instruments to overcome the root causes of illegal migration, in particular: the EU Emergency Trust Fund for Africa and the European External Investment Plan. ***The EU Emergency Trust Fund for Africa*** was launched in November 2015 to boost economic development and create jobs, provide better access to basic social services and tackle the root causes of migration. 147 programmes have already received a total of €2.5 billion in funding. The results have been successful so far, with: 200,000 jobs created; 5.4 million people receiving basic social services and 150,000 migrants protected or assisted. Trust funding is distributed in the following way: Sahel region (12 countries) – €1.3 billion; Horn of Africa (nine countries) – €833 million; North Africa (five

²⁴ Central Mediterranean route. – European Council, Council of the European Union, <http://www.consilium.europa.eu/en/policies/migratory-pressures/central-mediterranean-route>.

²⁵ Migration on the Central Mediterranean route. Managing flows, saving lives. – Joint Communication to the European Parliament, the European Council and the Council, European Commission, https://ec.europa.eu/home-affairs/sites/homeaffairs/files/what-we-do/policies/european-agenda-migration/proposal-implementation-package/docs/20170125_migration_on_the_central_mediterranean_route_-_managing_flows_saving_lives_en.pdf.

²⁶ European Council, 28-29/06/2018. – European Council, Council of the European Union, <http://www.consilium.europa.eu/en/meetings/european-council/2018/06/28-29>.

countries) – €285 million. *The European External Investment Plan* (EIP) aims to boost investment and job creation in Africa and in countries neighbouring the EU. The investment plan is expected to trigger public and private investments worth €44 billion. The *European Fund for Sustainable Development* (EFSD) is the main instrument for the implementation of the EIP.²⁷

The EU policy aimed at preventing illegal departures of migrants from North Africa is controversial and balances between interests and values. In reality, many migrants get stuck in transit, which transfers the financial and administrative burden of reception and protection of migrants to non-EU partners.

External migration control can negatively affect the biggest beneficiaries of foreign cash transfers. The World Bank estimates that cash transfers to African countries in 2017 exceeded \$440 billion. Stronger migration control would harm this basic and relatively stable factor contributing to developing economies. This further augments the uneven distribution of risks and benefits between the EU and its partners.²⁸

Overall, the practice of ‘offshoring’ asylum and search and rescue responsibilities to African countries presents deep challenges in terms of its practical feasibility as well as its respect for the rule of law. To return rescued people to unsafe environments, with the risk of arbitrary and inhumane detention, would incur liability for grave human rights violations before international and European courts. Such actions fall far short of securing a stable, long-term asylum policy and they make the EU highly vulnerable to and dependent on third countries.²⁹

Nearly half of the 35 African countries the EU prioritises for advancing migration controls have an authoritarian government and pose extreme or high risks for exercise of human rights. The EU provides largest assistance to the structures (Libyan Coast Guard and Libyan Department for Combating Irregular Migration) most responsible for violation of migrants’ human rights. In particular, a major decrease of migration pressure along the Central Mediterranean route in 2017 that was achieved through close cooperation between the EU and Libya became possible, among other things, due to an increase of the number of deaths at sea in the Mediterranean.³⁰ Migrants

²⁷ Central Mediterranean route. – European Council, Council of the European Union, <http://www.consilium.europa.eu/en/policies/migratory-pressures/central-mediterranean-route>.

²⁸ Nils F. Turning the Tide in the Mediterranean. Smart Tools For Effective EU Migration Management. – Jacques Delors Institut, 13 December 2017, <http://institutdelors.eu/wp-content/uploads/2018/01/turningthetideinthemediterranean-feller-dec17.pdf>.

²⁹ Carrera S., Lannoo K. We’re in this boat together. Time for a Migration Union. – Centre for European Policy Studies, June 2018, https://www.ceps.eu/system/files/SCandKL_PI2018_09_MigrationUnion.pdf.

³⁰ Akkerman M. Europe’s solution to migration is to outsource it to Africa. – EU Observer, <https://euobserver.com/opinion/141784>.

are reportedly placed at severe risk during search and rescue operations conducted by coastguards, and in other cases agencies have directly shot at or sunk migrant boats. Upon reception, migrants often face executions, torture and deprivation of food, water and access to sanitation at the hand of Libyan agencies. German diplomats have compared the situation in Libyan refugee reception centres to those in German concentration camps. In the country, there are ‘slave markets’, where sub-Saharan migrants are bought and sold by Libyans.³¹

The EU is attempting to introduce a similar policy (as in Libya) in Sudan. By providing assistance to Sudanese border authorities, the EU had been helping President Omar al-Bashir (removed from power during the April 2019 military coup), who is wanted by the International Criminal Court for war crimes during the Darfur war, come out of international isolation. As a result of this policy, more and more people were prompted to attempt to flee to Europe. And EU’s focus on external migration management will only strengthen the circle of authoritarian states in Africa.³²

Although EU’s cooperation with African countries poses many risks and challenges for the European Union, these countries get a number of benefits in its course. *First of all*, it facilitates the growth of international authority of these countries and legitimises their governing regimes (mostly, authoritarian). *Secondly*, they enjoy EU’s financial support aimed at strengthening border control and stabilisation of local communities. Such countries as Mali and Afghanistan largely depend on this assistance. Ethiopia hopes to attract European investment in its private sector and get preferential access to EU’s single market. *Thirdly*, African countries themselves share the EU’s interest of preventing illegal migration and building their countries’ security.

Readmission agreements are an effective measure against illegal migration, as they allow to return migrants to their countries of origin. Concluding readmission agreements is among EU’s priorities in this area. However, third countries are reluctant to sign such agreements, as they reap major benefits off money transfers from abroad. Mali’s experience showed that the financial aid offered by the EU in return for the readmission agreement was only one fifth of the annual income this country gets off money transfers from abroad, which is why Mali rejected this agreement. Readmission agreement negotiations with Morocco have lasted for years with no result, while in the case of Algeria – they failed. African countries refuse to get back their citizens, as they make a significant contribution to their countries’ GDP.³³

³¹ Nils F. Turning the Tide in the Mediterranean. Smart Tools For Effective EU Migration Management. – Jacques Delors Institut, 13 December 2017, <http://institutdelors.eu/wp-content/uploads/2018/01/turningthetidein-themediterranean-feller-dec17.pdf>.

³² Akkerman M. Europe’s solution to migration is to outsource it to Africa. – EU Observer, 10 May 2018, <https://euobserver.com/opinion/141784>.

³³ Ibid.

Thus, formulating the long-term migration policy goals, the EU is balancing between pragmatism, efficiency and its own values. Pragmatic focus on *illegal migration prevention can bring the EU a short-term relief, yet this approach will hardly bring stable results in the long run*. At the same time, upholding the EU's fundamental values in the implementation of migration policy would ensure foreign partners' trust. Overall, working on its migration policy, the EU should prioritise long-term effects.

To save lives at sea and target criminal networks, the EU has launched three operations in the Mediterranean: Sophia, Themis (formerly Triton) and Poseidon. Since 2015, they have rescued 375 thousand persons. At the same time, more than 6,000 people have died attempting to cross the Mediterranean to reach Europe.³⁴

Operations in the Mediterranean

Name	Mandate
Sophia ³⁵	Launched in June 2015. Its <i>goals</i> : identify, capture and dispose of vessels and enabling assets used or suspected of being used by migrant smugglers or traffickers; break the business model of smugglers in the South Mediterranean; prevent human deaths. 25 member states have allocated 1,800 staff and assets for the operation. The operation has so far resulted in the arrest of 101 smugglers and the destruction of 372 boats. In June 2016, the operation's mandate was extended to include two additional tasks: the training of the Libyan coastguards and assistance in implementing the UN embargo on arms smuggling in the high seas off Libya's coast. Operation Sophia is conducted in the high seas next to Libya's territorial waters, but is not implemented within Libyan territorial waters. Since 2015, 44,810 migrants have been saved as part of the Sophia operation.
Themis ³⁶ (replaced Operation Triton)	Launched by the European Border and Coast Guard Agency <i>Frontex</i> in November 2014 to protect EU's external border and provide assistance in search and rescue operations. In July 2015, the operation was extended further South. Operation's mandate extends to illegal border-crossing and related crimes (smuggling of people, drugs, illegal fishing and sea pollution), as well as registration of migrants. The operation is run by the Italian Ministry of the Interior. 28 European states are taking part in the operation through delegation of border guards and provision of equipment. In February 2018, operation Triton was replaced by operation Themis. Since 2015, 251,099 migrants have been saved as part of the operation.
Poseidon ³⁷	Operation Poseidon has been covering the eastern Mediterranean since 2006. Its <i>focus</i> : border surveillance along the Greek sea borders with Turkey in the Aegean. Since 2015, 82,080 migrants have been saved as part of operation Poseidon

³⁴ Saving lives at sea and targeting criminal networks. – European Council, Council of the EU, <http://www.consilium.europa.eu/en/policies/migratory-pressures/sea-criminal-networks/>.

³⁵ Migration on the Central Mediterranean route. Managing flows, saving lives. – Joint Communication to the European Parliament, the European Council and the Council, European Commission, 25 January 2017, https://ec.europa.eu/home-affairs/sites/homeaffairs/files/what-we-do/policies/european-agenda-migration/proposal-implementation-package/docs/20170125_migration_on_the_central_mediterranean_route_-_managing_flows_saving_lives_en.pdf.

³⁶ Ibid.

³⁷ Saving lives at sea and targeting criminal networks. – European Council, Council of the EU, <http://www.consilium.europa.eu/en/policies/migratory-pressures/sea-criminal-networks/>.

The EU is implementing decisive measures to fight smuggling of human beings. In February 2016, the **European Migrant Smuggling Centre** (EMSC) was established. 45 specialists provide assistance to police and border guards, and are involved in coordinating cross-border anti-smuggling operations. In March 2016, the EU Council called on all involved parties to strengthen their cooperation and information sharing, research the influence of social networks on migrant smuggling, step up private sector involvement and cooperation with countries of origin and transit. In November 2015, EU and African leaders agreed to share information and improve cooperation between police and judicial authorities on migrant smuggling issues.³⁸

EU Policy towards the Eastern and Western Mediterranean Routes

The migrant crisis peak of 2015-2016 has demonstrated that EU's south-eastern border is unprotected from the massive inflow of migrants from the war-torn Syria, Iraq and Afghanistan. In response, some EU member states started building physical barriers to stop migrants from getting to Europe. In particular, Hungary has built a border barrier on its border with Serbia and Croatia, Bulgaria and Greece – on the border with Turkey, Spain – on the border with Morocco (around Ceuta and Melilla – its enclaves in North Africa). Yet these measures were only a short-term solution. In order to achieve long-term results in restricting migration flows along the Eastern Mediterranean and the connected to it Western Balkan route, the EU started negotiations with Turkey, aiming to stop the unrestricted inflow of migrants from this country to the EU territory.

On 29 November 2015, a meeting of the leaders of EU member states and Turkey took place. It became an important step in the further development of bilateral EU-Turkey relations, as well as regulation of the migrant crisis. The main result of the meeting was the **EU-Turkey Joint Action Plan**. Its parties agreed to prevent illegal migration between Turkey and the EU, implement the provisions of the readmission agreement and return migrants that have been refused asylum to their countries of origin. The EU committed to allocate additional €3 billion to improve migrants' conditions for the duration of their stay in Turkey.³⁹

Since the beginning of the migrant crisis, Turkey has hosted 3.5 million Syrian refugees. To mitigate the burden of hosting, the EU established in November 2015 the **EU Facility for Refugees in Turkey**. The main focus areas are humanitarian assistance, education, management of migration, health, municipal infrastructure, and socioeconomic support. The operational funds of €3 billion have been allocated (€1 billion from the EU budget and €2 billion from the member states). EU's

³⁸ Saving lives at sea and targeting criminal networks. – European Council, Council of the EU, <http://www.consilium.europa.eu/en/policies/migratory-pressures/sea-criminal-networks/>.

³⁹ Meeting of the EU heads of state or government with Turkey, 29/11/2015. European Council, Council of the EU, <http://www.consilium.europa.eu/en/meetings/international-summit/2015/11/29>.

humanitarian assistance provided 1.3 million of Syrian refugees in Turkey with a package of basic social services, 266 thousand children gained access to education and 18 thousand pregnant women got necessary medical assistance. In the education sector, 5,500 teachers of Turkish language in 23 provinces were teaching 312 thousand Syrian children, 32 thousand children were using public transportation to get to their place of study, construction of 50 new schools was started. In health-care, 760 thousand persons got the package of basic health services, 217 infants were vaccinated and 12 migrant health centres were established.⁴⁰



Positive developments in EU-Turkey cooperation continued in 2016. On 18 March 2016, the parties signed a migration statement aiming to stop the influx of refugees to the continent. According to this deal, as from 20 March 2016, all irregular migrants crossing from Turkey into Greek islands and migrants not applying for asylum in EU member states or whose application has been found unfounded or inadmissible, will be returned to Turkey. For every Syrian being returned to Turkey from Greek islands, another Syrian will be resettled from Turkey to the EU. Priority will be given to migrants who have not previously entered or tried to enter the EU irregularly. Turkey will take any necessary measures to prevent any new illegal migration attempts.⁴¹

The EU-Turkey migration statement also contains a number of policy provisions unrelated to migration control. In particular, the parties committed to accelerate the fulfilment of the visa liberalisation roadmap with a view to lifting the visa requirements for Turkish citizens at the latest by the end of June 2016, provided that all benchmarks have been met. The EU and Turkey reconfirmed their commitment to re-energise Turkey's EU accession process and welcomed the ongoing work on the upgrading of the Customs Union.⁴² Yet, due to excessive power centralisation in Turkey as a result of a failed military coup in June 2016, mass persecution of coup suspects and a long-lasting martial law, further political alignment between the EU and Turkey was terminated.

⁴⁰ The EU Facility for Refugees in Turkey. – European Commission, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/frit_factsheet.pdf.

⁴¹ EU-Turkey statement, 18 March 2016. – European Council, Council of the EU, <http://www.consilium.europa.eu/en/press/press-releases/2016/03/18/eu-turkey-statement>.

⁴² Ibid.

2.5 years of the EU-Turkey Statement implementation brought significant results. Daily irregular arrivals got 97% lower than in the period before the Statement became operational – from 10 thousand persons in October 2015 to 80 persons in March 2018, while the number of deaths in the Aegean Sea decreased from 1,175 to 130. In strict conformity with the statement provisions, 12,476 Syrian refugees have been resettled from Turkey to EU Member States. At the same time, the rate of returns of irregular migrants from Greek islands to Turkey remains low: only 2,164 refugees were evacuated from Greece since March 2016. Since the beginning of 2016, a total of 12,569 migrants have returned voluntarily to Turkey from both the Greek islands and mainland through the EU Assisted Voluntary Return and Reintegration Programme.⁴³

Despite its major advantages, the EU-Turkey Statement contains a number of disadvantages and threats for the EU. The combination of provisions on migration control and prospective political alignment with the EU in a single document gave Turkey political means to influence Brussels. President Erdogan threatened to exit from the migration deal on numerous occasions, if the EU does not support progress in visa liberalisation and accession negotiations. There are also reputational costs for the EU due to the negative impact of the Statement on human rights. Since early 2017, an estimated 15,000 migrants were stranded on the overpopulated Greek islands, living in inhuman conditions at reception centres for refugees. In the absence of solidarity between its member states, the EU remains vulnerable to blackmail by third countries.⁴⁴ It should also be taken into account that Turkey as of 2016, with which the EU has made the migration deal, and Turkey as of 2018 – are essentially two different states. After a failed military coup in July 2016 and a referendum in April 2017, President Erdogan centralised all the power in his hands, further being strengthened by the presidential and parliamentary election results in June 2018. In response to strengthening of authoritarian regime in Turkey, Brussels has been trying to distance itself from its promises on the country's EU accession. In the absence of political incentives in the form of visa liberalisation and accession guarantees, execution of the migration deal became voluntary for Turkey. The situation cannot stay like this for a long time, and the EU needs to build a new form of relations with its eastern neighbour given the current reality.

Meanwhile, Frontex border agency director Fabrice Leggeri turns EU leaders' attention to the Western Mediterranean migration route.⁴⁵ Today, the number of

⁴³ EU-Turkey Statement. Two years on. – European Commission, https://ec.europa.eu/home-affairs/sites/home-affairs/files/what-we-do/policies/european-agenda-migration/20180314_eu-turkey-two-years-on_en.pdf.

⁴⁴ Koenig N. The EU's External Migration Policy: Towards Win-Win-Win Partnerships. – Jacques Delors Institut, 6 April 2017, <http://institutdelors.eu/wp-content/uploads/2018/01/externalmigrationpolicy-nkoenig-jdib-april17.pdf>.

⁴⁵ Illegal migration to Spain likely rise further in 2018: EU agency. – Reuters, 19 January 2018, <https://www.reuters.com/article/us-europe-migrants-spain/illegal-migration-to-spain-likely-rise-further-in-2018-eu-agency-idUSKBN1F8192>.

migrants entering the EU through the Central and Eastern Mediterranean routes is much bigger than the corresponding number along the Western Mediterranean route, yet it will keep growing in the coming years. Problems in Morocco's northern Rif region, together with the improvement of Spain's economic situation will stimulate the increased arrival of illegal migrants to the Iberian peninsula. Also, sub-Saharan Africans crossing to Libya through Niger can change their route to reach Spain via Morocco or Algeria, this route posing far less risks during the crossing of the Mediterranean. *Frontex* is finalising plans to make a border operation in the west Mediterranean and increase the use of air surveillance.⁴⁶



Yet it seems that the EU is underestimating threats potentially arising along the Western Mediterranean route. Conclusions of the European Council summit on 28-29 June 2018 contain just two sentences on this matter: “EU leaders agreed to support efforts to prevent illegal migration in the Western Mediterranean where irregular arrivals are on the rise. This includes efforts by member states as well as countries of origin and transit, in particular Morocco”.⁴⁷

Thus, having faced the unprecedented influx of migrants, the EU opened its borders for almost a million persons and then set a course to restrict irregular migration and ensure a more controlled situation. Upon achieving success in restricting new entries of migrants to Europe through the migration deal with Turkey, the *EU has essentially placed itself at Turkey's will, allowing it to decide whether to stick or not to stick to the agreement, and damaged its image of a global human rights defender*. Despite the financial aid and ability to stay in Turkey, many migrants cannot fully use their right to international protection guaranteed by the 1951 Refugee Convention. The EU seeks to establish a similar practice in Libya which, unlike Turkey's precedent, will be extremely difficult given the de facto diarchy in the country, most of the country being uncontrolled by the central Tripoli government, activity of human traffickers and smugglers, as well as terrorists. *This policy could result in the opposite effect in the long run, as increasingly more migrants decide to undertake a dangerous journey to Europe pushed by human rights violations in their countries of origin, where the EU supports authoritarian regimes aiming to prevent migration from these countries.*

⁴⁶ Illegal migration to Spain likely rise further in 2018: EU agency. – Reuters, 19 January 2018, <https://www.reuters.com/article/us-europe-migrants-spain/illegal-migration-to-spain-likely-rise-further-in-2018-eu-agency-idUSKBN1F8192>.

⁴⁷ European Council, 28-29/06/2018. – European Council, Council of the European Union, <http://www.consilium.europa.eu/en/meetings/european-council/2018/06/28-29>.

Implementation of the measures focused on overcoming the root causes of this phenomenon could be effective to prevent migration. In order to achieve this, the *EU needs to significantly increase the existing funding for socioeconomic development and creating jobs in the countries of origin. If the economic situation in their home countries improves, migrants will be less incentivised to leave them. Current EU funding is far from being enough.*

Reform of the Common European Asylum System

The migrant crisis has vividly demonstrated the disadvantages of EU's current institutional decision-making architecture in the migration sector and the lack of solidarity between member states on the issues of migrant and refugee reception. The Treaty of Lisbon contains only three provisions on migration, regarding the general political declarations. According to Art.78 of the Treaty "The Union shall develop a common policy on asylum, subsidiary protection and temporary protection with a view to offering appropriate status to any third-country nationals requiring international protection and ensuring compliance with the principle of non-refoulement. In the event of one or more member states being confronted by an emergency situation characterised by a sudden inflow of nationals of third countries, the Council, on a proposal from the Commission, may adopt provisional measures for the benefit of the member state(s) concerned".⁴⁸

Measures for a common European asylum system comprise:

- 1) a uniform status of asylum for nationals of third countries, valid throughout the Union;
- 2) a uniform status of subsidiary protection for nationals of third countries who, without obtaining European asylum, are in need of international protection;
- 3) a common system of temporary protection for displaced persons in the event of a massive inflow;
- 4) common procedures for the granting and withdrawing of uniform asylum or subsidiary protection status;
- 5) criteria and mechanisms for determining which Member State is responsible for considering an application for asylum or subsidiary protection;
- 6) standards concerning the conditions for the reception of applicants for asylum or subsidiary protection;
- 7) partnership and cooperation with third countries for the purpose of managing inflows of people applying for asylum or subsidiary or temporary protection.⁴⁹

⁴⁸ Consolidated versions of The Treaty on European Union and The Treaty on the Functioning of the European Union (2010/C 83/01). – Official Journal of the European Union, http://zakon2.rada.gov.ua/laws/show/994_b06.

⁴⁹ Ibid.

Thus, the Lisbon Treaty calls for a common European asylum policy and joint efforts of member states in this area. In reality, the situation is very different. Due to differences of stances between member states, common European migration and asylum institutions are weak. *EU's migration, foreign relations, trade and development policies are poorly coordinated between themselves.* Migration and asylum policy is jointly regulated by the EU and member states, which further increases its complexity. Without stable national obligations and regular contributions, the EU has no adequate financial resources or powers to implement its mobility initiatives. Thus, instead of a joint European asylum system mentioned in the Lisbon Treaty, *there are 28 national asylum systems.* European migration and asylum institutions – the **European Border and Coast Guard Agency, Frontex** (headquartered in Warsaw, Poland), and the **European Asylum Support Office** (headquartered in Valletta, Malta), – are underdeveloped and underfinanced. EC's influence on EU migration policy is largely limited by the Lisbon Treaty, while the EP has indirect influence on the decisions made by national governments on the daily basis. The only authority with real powers in the migration sector is the EU Council, which represents member states. There is qualified majority voting on immigration and asylum matters. On the operational level, there is also *low institutional capacity and poor coordination between relevant authorities.* In particular, Frontex suffers from the lack of personnel and equipment. Europol, the EU's law enforcement agency with an indispensable role tackling human traffickers that bring people into the EU, depends on member states to share information, with a number of governments not sharing the required information. In addition, *Frontex* and Europol are not allowed to share data due to EU data protection rules. The lack of equipment, personnel and readiness, is the main reason that the much-vaunted hotspots, or reception centres, are taking long to be established.⁵⁰

Major structural deficiencies are also present in the common European asylum system. The ***Dublin Regulation that establishes the criteria and mechanisms for determining which EU member state is responsible for the examination of an application for asylum, submitted by third-country nationals or stateless persons seeking international protection***,⁵¹ placed the responsibility for processing asylum applications and reception on the member state through which the asylum seeker first entered the EU. This placed *excessive burden on two EU countries – Italy*

⁵⁰ Novotny Vit. The Refugee Crisis in Focus: Towards better cooperation between Europe's national governments. – Wilfried Martens Center, October 2015, <https://www.martenscentre.eu/sites/default/files/publication-files/refugee-crisis-coordination-european-governments.pdf>.

⁵¹ Regulation (EU) No 604/2013 of the European Parliament and of the Council of 26 June 2013 establishing the criteria and mechanisms for the determining the Member State responsible for examining an application for international protection lodged in one of the Member States by a third-country national or a stateless person. – EUR-Lex Access to European Union Law, <https://eur-lex.europa.eu/legal-content/EN/ALL/?sessionId=jHNITp3HLjqw8mqGbQSpZh1VWpjCyVQq14Hgcztw4pbfSQZffrn!557467765?uri=CELEX:32013R0604>.

and Greece, which received most migrants through the Mediterranean routes. Unable to deal with the mass influx of migrants, Rome and Athens allowed migrants to keep moving further to northern Europe, which resulted in over 1 million refugees being stuck on the Austrian and German borders. Guided by humanitarian considerations, in September 2015, German Federal Chancellor Angela Merkel opened the borders for migrants. At the same time, the European Commission approved a quota system for relocation of migrants from Italy and Greece to other member states. It was planned to relocate 160,000 asylum seekers across the EU within two years. In 2016, the EC amended the Dublin Regulation, establishing an automatic relocation mechanism across the EU territory in case of an excessive influx of migrants to a small number of member states, based on the principle of solidarity⁵² and the Lisbon Treaty (p.3 of Art.78).⁵³

Angela Merkel's decision and the *quota system for migrant relocation caused a chasm in Europe*. The EU divided into opposing camps. Member states in western and northern Europe, such as Austria, Belgium, the Netherlands and Sweden supported Germany in its migrant assistance policy. France's and the UK's responses were somewhat more reserved, with these countries accepting significantly less migrants. Central European states (Poland, Czech Republic and Hungary) spoke categorically against these decisions. Warsaw, Prague and Budapest thought that stronger protection of EU's external borders to prevent irregular migration was a better solution. They believe that the EU should help migrants in their countries of origin, not giving them access to the EU territory. Central European countries' strong position regarding this matter is explained by the particular course of their historical and civilisational development. For the former communist states with homogenous population, accepting migrants from another cultural and religious backgrounds is a much more sensitive issue, than for Western European countries that have had large foreign communities from the former colonies for a long time.⁵⁴

On 4 May and 13 July 2016, the EC made *seven legislative proposals to reform EU asylum rules*.⁵⁵ The reform of the common European asylum system aimed to make the system more efficient and more resistant to migration pressure; eliminate secondary movements; and ensure better support for the most affected member states.

⁵² Lehne S. The EU Remains Unprepared for the Next Migration Crisis. – Carnegie Europe, 3 April 2018, <http://carnegieeurope.eu/2018/04/03/eu-remains-unprepared-for-next-migration-crisis-pub-75965>.

⁵³ Consolidated versions of The Treaty on the Functioning of the European Union, https://eur-lex.europa.eu/resource.html?uri=cellar:41f89a28-1fc6-4c92-b1c8-03327d1b1ecc.0007.02/DOC_1&format=PDF.

⁵⁴ Lehne S. The EU Remains Unprepared for the Next Migration Crisis. – Carnegie Europe, 3 April 2018, <http://carnegieeurope.eu/2018/04/03/eu-remains-unprepared-for-next-migration-crisis-pub-75965>.

⁵⁵ Reform of EU asylum rules. – European Council, Council of the EU, <http://www.consilium.europa.eu/en/policies/ceas-reform>.

Seven Legislative Proposals to Reform Common European Asylum System		
	Innovation	Description
1)	A revised Dublin system	<ul style="list-style-type: none"> • Better determination of a single member state responsible for examining the asylum application. • Ensuring fair sharing of responsibilities between member states with a corrective allocation mechanism. • Prevention of secondary movements of applicants within the EU.
2)	Update of EU fingerprint database	<ul style="list-style-type: none"> • Improve the system by collecting more data such as facial images. • Expand its scope by including data on third country nationals irregularly staying in the EU who did not seek asylum. • Simplify access for law enforcement authorities.
3)	A new EU asylum agency	<p>This proposal aims to turn the existing European Asylum Support Office (EASO) into a fully fledged EU asylum agency.</p> <p>This agency will be responsible for:</p> <ul style="list-style-type: none"> • ensuring convergence in the assessment of applications for international protection; • providing operational and technical assistance to member states.
4)	A common asylum procedure	<ul style="list-style-type: none"> • Replacing different member states' procedures with a simpler procedure. • Ensuring better safeguard of applicants' rights and better protection of vulnerable individuals. • Introduction of stricter rules to prevent abuse. • Establishing faster application examination procedures.
5)	Uniform rules of asylum applications	<ul style="list-style-type: none"> • Common criteria for the identification of persons genuinely in need of international protection. • Common rights for those persons in all member states.
6)	Better reception conditions for refugees	<p><i>First objective:</i> provision of standard reception conditions to all asylum seekers through:</p> <ul style="list-style-type: none"> • a common definition of reception conditions for all asylum seekers; • the right to work for asylum seekers no later than 9 months after lodging their application; • education rights for minors. <p><i>Second objective:</i> reduce secondary movements of asylum applicants by setting up geographical limitations, namely:</p> <ul style="list-style-type: none"> • restrict access to reception conditions to the member state responsible for their asylum application; • limit the provision of travel documents except on serious humanitarian grounds; • allow member states to restrict the applicant's presence to a specific geographical area.
7)	A new EU resettlement framework	<p>The Commission proposed to establish a permanent EU resettlement framework that would replace the EU's existing ad-hoc resettlement schemes.</p> <ul style="list-style-type: none"> • Provide for legal and safe pathways to the EU and reduce the risk of massive irregular arrivals in the long term. • Provide common rules for resettlement and humanitarian admission. • Support third countries hosting many persons in need of international protection.

Thus, *having announced ambitious goals for creating a common EU asylum system in the Lisbon Treaty, EU member states failed to actually use them as a guidance. Due to weakness of EU's institutional structure, its migration governing authorities were largely unprepared for the arrival of so many migrants and the need to relocate them fast and in line with international standards. The situation was further complicated by the lack of solidarity within the Union itself. Institutional capacity-building of the EU and achieving internal solidarity on the issues of migration could become the necessary safeguards in case similar challenges arise in the future. EU's integrity and future development largely depend on its ability to respond to migration challenges.*

EU Migration Policy Challenges of Today

In the middle of June 2018, Germany experienced a government crisis, which threatened to break up the ruling coalition. The disagreement between Chancellor Merkel and Interior Minister Seehofer was regarding secondary movements to Germany of the refugees already registered in other EU member states. Given the increasing number of irregular Austria–Germany border crossings, and also in preparation for Bavarian elections (with CSU dominating Bavarian politics since World War II), Seehofer threatened to turn away at the border asylum seekers already registered in other countries or those whose application has been rejected. Instead, Angela Merkel warned against unilateral actions on the part of Germany, insisting on seeking a common solution. Germany's head of Government was asking her colleague to wait for the decision of the European Council summit on 28-29 June 2018. Situation looked quite tense, as in his dispute with Angela Merkel Horst Seehofer had the Austrian Chancellor Sebastian Kurz's support, known for his hard-line stance on immigration.⁵⁶ It seemed like the longstanding German Chancellor Angela Merkel was a step away from losing her power and potential snap elections as a result of disintegration of the ruling coalition.

Ultimately, the compromise was achieved at the European Council's summit on 28-29 June 2018. EU member states' leaders agreed to *create special controlled reception centres*, where asylum applications would be reviewed through an accelerated procedure, and migrants would be divided into those who have no reason to be in the EU and will be returned to the county of origin, and refugees that match all the criteria and are guaranteed international protection. These centres would be established in those member states that agreed to it voluntarily.⁵⁷ This compromise satisfied the leaders of Visegrad Group countries, who thus approved a *common*

⁵⁶ Bondarieva Kh. An Ultimatum for Merkel: New Migrant Crisis Breaking Up German Government. – Yevropeiska Pravda, 15 June 2018, <https://www.eurointegration.com.ua/articles/2018/06/15/7083158>.

⁵⁷ European Concil, 28-29/06/2018. – European Council, Council of the European Union, <http://www.consilium.europa.eu/en/meetings/european-council/2018/06/28-29>.

EU decision, on which Angela Merkel had insisted from the very beginning. As a result of these agreements, the Merkel-Seehofer dispute gradually subsided and the coalition as well as political stability in Germany was preserved.

On 1 July 2018, Austria took over the EU Council Presidency. In its presidency programme, Austria prioritised external management of migration, confirming its commitment to EU's previous line of migration policy. Austria proposed close and cooperative partnerships of the EU with relevant countries of origin and transit to restrict irregular migration across the Mediterranean. Specific measures include preventing illegal immigration and human trafficking, creation of the Border and Coast Guard Agency *FRONTEX*, closing of Eastern and Central Mediterranean illegal migration routes, dismantling illegal immigration networks. In asylum policy, Austria stresses the importance of a clear distinction between refugees and migrants, creation of a resilient and strict European asylum system, strengthening of the common return policy.⁵⁸ Thus, *Austria's main objective is to fight illegal migration and prevent it in the future, with much less attention paid to internal reforms.* Programme provisions on migration do not contain any information on financial aid for the countries of origin and transit, which is one of the measures to deal with the root causes of illegal migration. Such an imbalance in priorities may freeze up the situation, with all the negative consequences, which would only become more severe in the long run.

In line with June 2018 European Council summit decisions, on 24 July 2018 the EC presented its concept on ***Controlled Centres and Regional Disembarkation Platforms***. The announced primary aim would be to improve the process of distinguishing between individuals in need of international protection, and irregular migrants with no right to remain in the EU, while speeding up returns. The centres would have full operational support from the EU agencies and would ensure rapid, secure and effective processing of asylum applications. Member states refusing to establish controlled centres on their territory, volunteer to contribute financial support to member states accepting transfers for those disembarked (€6,000 per person to cover the cost of resettlement or return to the country of origin). In addition to the establishment of the controlled centres, the Commission proposed to introduce regional disembarkation platforms with the objective of providing quick and safe disembarkation of migrants on both sides of the Mediterranean in line with international law.⁵⁹ These initiatives are in harmony with EU's overall migration

⁵⁸ Programme of the Austrian Presidency of the Council of the European Union 1 July – 31 December 2018. – The Austrian Presidency of the Council of the European Union, <https://www.eu2018.at/agenda-priorities/programme.html>.

⁵⁹ Managing migration: Commission expands on disembarkation and controlled centre concepts. – European Commission, Press release, 24 July 2018, http://europa.eu/rapid/press-release_IP-18-4629_en.htm.

policy and enjoy the support of EU member states. Yet, their efficiency may be compromised as they deal with the consequences of the mass inflow of migrants to Europe, without affecting its root causes. Much less attention is being paid to overcoming the causes of irregular migration with limited funds allocated for this purpose.

Final Conclusions

Since 2015, the growing economic inequality between different parts of the world caused by globalisation, as well as a fast deterioration of security situation around the world, forced millions of people from Africa and the Middle East stricken by long-lasting military conflicts to undertake a risky journey to Europe in search of a better life. In the face of the unprecedented influx of refugees at its borders, *the EU proved unprepared to deal with this situation in terms of institutional capacity and unity within the Union*. German Chancellor Angela Merkel's open door policy for migrants supported by Western European states, met with strong opposition in the Eastern post-socialist states, which had no desire to accept migrants with a different cultural background. Thus, the EU had to start balancing and looking for a compromise between different centres inside the Union. EU's policy primarily focused on the following: helping refugees already registered and granted asylum in EU member states; preventing new movements to the continent and returning migrants that have been refused asylum to their countries of origin; reforming EU's institutional capacity and implementing measures aimed at overcoming root causes of irregular migration. Given the scale of migrant crisis and its direct influence on the sociopolitical situation in member states, the EU paid particular attention to the first two objectives, making the latter ones secondary.

In addition, the EU decided to *overcome the consequences of the migrant crisis using the very same methods that caused it*. EU's prior migration restriction



policy was one of the reasons that caused the 2015 situation. Thus, if this policy is continued, the EU is likely to face a mass influx of refugees again. A policy of forced restriction of migration in close partnership with authoritarian African states will prove inefficient in the long run, and will result in major reputation losses for the EU and its image of a global human rights defender. By restricting

migrant inflows and returning the rescued people to unsafe environments, the EU violates international legislation standards that guarantee them the right to asylum in any country of the world. This *damages EU's legitimacy and increases the legitimacy of authoritarian regimes, which are getting further support through EU funding*. Thus, in order to avoid the undesirable scenarios, *the EU should gradually shift its focus from restricting migration to overcoming the root causes of this phenomenon*. This would be possible through creation of safe conditions and economic opportunities in the countries of origin, which greatly reduce the incentives for migrants to undertake long and risky trips to Europe. Deciding to take such a trip, migrants risk their main right – the right to life. The current EU funding, especially in African countries, is insufficient for comprehensive resolution of existing problems. These countries need *much more funds* to radically change the current situation. To accomplish this, the EU requires *restored solidarity between its member states*. Given this fact, neglecting the common asylum policy reform might not be the best option.

Main recommendations, developed by top European think tanks, including the Jacques Delors Institute, Wilfried Martens Centre and Centre for European Policy Studies, focus on:

- *opening up new routes for legal immigration to the EU*, controlled exclusively by EU member states. This will legalise migration, which is in the Union's interest, given the shortage of skilled labour, and in the interest of non-EU countries whose budgets will be replenished with money transfers from abroad;
- *significantly increasing financial assistance for countries of origin and transit*;
- *institutional reform of the EU with more powers for EU migration authorities, potentially creating a full migration union*. The existing EU and member states' architecture for common management of migration is inefficient. The reform would be a possible option upon amending the basic Treaty of Lisbon, taking into account that such amendments currently are being rejected by leaders of EU member states.

EU migration policy discussions also raised radical ideas on ensuring security and controlling migration in third countries by creating "safe zones", which essentially meant occupying a part of these countries' territory. Such a policy could be effective, but would be completely against EU's fundamental principles and values. *Values and principles that formed the EU foundation at the time of its creation must be the basis for new answers to complex challenges of the migrant crisis.*

BREXIT: A WHIM OR NECESSITY?

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The challenges encountering the EU nowadays have slowed down and somewhat destabilised integration processes within the Union, hampering its progressive development. One of such challenges is Brexit – the United Kingdom’s exit from the EU – with potential consequences that are hard to predict at the moment. Among possible pessimistic scenarios: the EU will stop accepting new members, “chain reaction” will spread to liberal and prosperous countries in Northern Europe or radically-minded Eurosceptical governments in Eastern Europe, which have repeatedly spoken out on the possibility of similar referendums in their countries.

The Brexit issue – its consequences and impact on different areas of social life in the EU and the UK – is extremely topical, and that is why at the moment it is being thoroughly researched and discussed by many scientists and analysts, as well as commented upon in the media. Experts’ opinions differ:¹ some consider that Brexit is the beginning of the EU’s end, others see it as an important step towards further “unification” of states and deeper integration. Taking into account various possible Brexit scenarios, to prevent destabilisation in the EU, the establishment must stand united, develop coordinated policies and implement them.

¹ Namely: Sampson T. Brexit: The Economics of International Disintegration. – Journal of Economic Perspectives, Vol. 31, No.4, Fall 2017, p.163-184, <http://personal.lse.ac.uk/sampson/BrexitDisintegration.pdf>; Martill B., Staiger U. Brexit and Beyond: Rethinking the Futures of Europe. – <http://discovery.ucl.ac.uk/10041784/1/Brexit-and-Beyond.pdf>; Bickerton C. Brexit and the British Growth Model. Towards a new social settlement. – Policy Exchange, <https://policyexchange.org.uk/wp-content/uploads/2018/07/Brexit-and-the-British-Growth-Model.pdf>; Grauwe De Paul. What Future for the EU After Brexit? – Forum, 2016, Leibniz Information Centre for Economics, https://www.ceps.eu/system/files/IEForum52016_1.pdf.

Historical Context of Brexit and Contributing Factors

Since the very beginning of integration, there have been difficulties in the UK-EU relations: the United Kingdom viewed itself as a world power, with Europe being just one area of its influence. The country's participation in a number of proposals and initiatives, as well as full-fledged membership in different associations has been perceived as "the end of the United Kingdom as an independent state" and "the end of the thousand-year British history".²

Since the beginning of integration on the European continent, the UK had no intention of giving up its sovereignty in favour of any supranational administrative bodies³ or through implementation of a number of directives and rules. Despite the fact, that the country has always supported integration, it had no desire to participate in any institutional changes and was taking part only in select policies.⁴ Namely, the UK government refused to support the Schuman Declaration of 9 May 1950, which proposed to control coal and steel production in Germany and France, and which created the European Coal and Steel Community. In November 1955, the country exited the Spaak Committee,⁵ which was working on the establishment of European Economic Community (EEC), and in 1957 – refused to sign the Treaties of Rome.

In the early 1960s, when the country did declare its desire to join the EEC, President of France Charles de Gaulle spoke against its membership, and vetoed the country's accession twice – in 1963 and 1967. From his perspective, the UK and continental Europe were "incompatible" and had fundamentally different priorities and values. The UK was characterised by: (1) inability to make a decision on integration as a political project; (2) support for Atlantic cooperation as opposed to European; (3) "competing" with the EU, instead of building a strategic alliance with it. Among other things, there were mutual disagreements regarding conditions, on which the UK participated in the EU Budget,⁶ and conditions for adapting EU's common agricultural policy.

² See: Bulmer S., Quaglia L. The politics and economics of Brexit. – Journal of European Public Policy, 2018, Vol. 25, No.8, p.1089-1098.

³ In one of his speeches in 1988, EC President Jacques Delors stressed the fact that by 1992 national governments would need to transfer their rights to the European level. Yet, British Prime Minister Margaret Thatcher called this idea an illusion and said she hoped this would never come true, as she believed that each decision had to be approved exclusively by EEC member states' governments.

⁴ The country has always had a rather strong opinion on its integration into the monetary union and was ambiguous as for migration policy (as we know, the country is not a part of the Schengen area), and has also maintained a firm stand on social policy (in 1989, Margaret Thatcher's government refused to sign the Community Charter of the Fundamental Social Rights of Workers).

⁵ The Committee was named after Paul-Henri Spaak, Belgian politician and statesman considered one of the founding fathers of European integration.

⁶ In 1984, Margaret Thatcher's government achieved a reduction of the country's payments to the EU Budget.

The UK was able to become EEC member only in 1973. According to results of the referendum held on 23 April 1972, 68.3% of the French population supported UK, Denmark, Ireland and Norway's membership in the Community. Yet, two years later, on 5 June 1975, the UK brought further participation in the EEC to the national referendum.⁷

Many times the UK repeatedly reviewed its position on participation in economic integration. Since the adoption of the Single European Act in 1986, which introduced fundamental changes to the Treaty of Rome about EEC establishment and paved the way to establishing a full-fledged union, the country had to find a compromise on reconciling national and European interests. Complexity of integration triggered active discussions among political elites – the most impressive one was “The Bruges Speech” by Margaret Thatcher on 20 September 1988 to the College of Europe in Bruges (Belgium) (insert “*Excerpts from Margaret Thatcher’s Bruges Speech*”⁸).

EXCERPTS FROM MARGARET THATCHER’S BRUGES SPEECH

Margaret Thatcher’s speech represented a position that was opposed to federalism and was being upheld by the UK throughout the entire history of united Europe. Prime Minister emphasised the importance of preserving national identity of each nation along with developing European integration. Correspondingly, *her main message was to protect national interests and deny the creation of a unified federal Europe.*

Key ideas of the speech:

- ✓ ensure prosperity and security of each Community member;
- ✓ create a confederation based on the principle of preserving state sovereignty. Prime Minister emphasised: “*To try to suppress nationhood and concentrate power at the centre of a European conglomerate would be highly damaging...*”;
- ✓ resolve issues within the Community through democratic discussion procedure;
- ✓ ensure development of free entrepreneurship and capital movement, free market for financial and banking services, insurance and investment. Wavering of the idea of creating a European Central Bank and introduction of exchange controls.

⁷ The question on the voting ballot was: “*Do you think that the United Kingdom should stay in the European Community (the Common Market)?*”

⁸ For more information, see: Full text of Margaret Thatcher’s speech to the College of Europe: “The Bruges Speech”. – The Telegraph, Personal view by Margaret Thatcher, 19 September 2008, <https://www.telegraph.co.uk/comment/personal-view/3562258/Full-text-of-Margaret-Thatchers-speech-to-the-College-of-Europe-The-Bruges-Speech.html>.

In the years that followed, the UK governments had a different attitude to deepening the economic integration. For instance, in 1992, the then Prime Minister John Major signed the Maastricht Treaty, yet in September of that year the country left the European Exchange Rate Mechanism (notably, some scientists consider this the first Brexit⁹). Efforts of the next Prime Minister Tony Blair – a proponent of European integration – were focused on gradual convergence with the EU. He achieved significant results, but was unable to radically change public opinion, as at the moment the country was debating the issue of joining the monetary union, which contradicted the country's key political principle – national sufficiency and complete independence.

In general, the UK is considered one of the most eurosceptic EU members: the country's political leaders, as well as the majority of the population appears to be cautious about Brussels' policy. Euroscepticism grew under Prime Minister David Cameron, who spoke in favour of reviewing the country's EU membership at the World Economic Forum in Davos (23-27 January 2013) in order to win votes and to prevent fragmentation of the Conservative Party. He insisted that the UK should be granted better conditions and spoke about a potential referendum on the country's exit from the EU.

“I know the British people and they are not passengers – they are drivers”¹⁰
(D. Cameron)

Following the Conservative Party's victory in the parliamentary elections of 2015, on May 28 David Cameron's new government brought the issue of holding a referendum on further EU membership by the end of 2017 to the House of Commons, and on November 10 in an open letter to President of the European Council Donald Tusk¹¹ – outlined main requirements for EU reforms, including: (1) UK's non-participation in the “ever closer” political union; (2) rolling-out of the “red card” mechanism that would allow national parliaments to cancel or veto decisions made by Brussels; (3) expanding the Single Market and reducing bureaucracy; (4) introducing an “emergency braking” – a mechanism to cut social benefits for migrants from other EU countries;¹² (5) preserving the national currency; (6) obtaining the right to

⁹ See: Keegan W., Marsh D., Roberts R. Six Days in September: Black Wednesday, Brexit and the Making of Europe. – London: OMFIF Press, 2017, 176p.

¹⁰ David Cameron's speech at the Conservative Party conference. – The Guardian, 6 October 2010, <https://www.theguardian.com/politics/2010/oct/06/david-cameron-speech-tory-conference>.

¹¹ Source: Prime Minister's speech on Europe. – European Commission, 10 November 2015, http://ec.europa.eu/dorie/fileDownload.do?sessionId=GTPvxMWPdf20f8z4f1B9xH1mC1U8I64C4H-47kMFcWFS_Mztcq4E!-2142749860?docId=2381004&cardId=2381003.

¹² Emigrants from other EU countries coming to the UK have to work in the country at least four years in order to receive financial aid and social housing.

veto monetary decisions made in the Eurozone; (7) guaranteeing that monetary union measures will not be imposed on countries outside the Eurozone; (8) guaranteeing that the UK's obligation to provide emergency financial assistance to euro area countries will be lifted.

On 19 February 2016, the EU and the UK signed an agreement on the special status of the latter,¹³ which allowed David Cameron to announce that the country remained an EU member, and set a referendum on 23 June 2016. So far, referendum results showed that most British citizens saw their future outside the EU: exit was supported by 51.9%, and 48.1% – were against it. Disconcerted by the referendum outcome, David Cameron resigned as Prime Minister and Conservative Party leader. At the moment, he advocates for preserving the country's membership in the EU, insisting on retained participation in the European Economic Area.

REASONS THAT GAVE THE IMPETUS TO LEAVE THE EU

1. **EU migration policy**, that caused an uncontrolled inflow of migrants.¹⁴ The migration issue was not very topical until 2004, when Tony Blair's government "opened up" the labour market for eight CEE countries that joined the EU that year. It was expected that the number of new migrants will range from 5 to 13 thousand people, but already in the first year their number reached a record 129 thousand.¹⁵ The European migrant crisis became the "trigger" before the vote. Despite the fact that many European politicians consider providing assistance to migrants and refugees as a moral duty, the leader of the UK Independence Party (UKIP) Nigel Farage at the time emphasized that the uncontrolled inflow of migrants deprived the British of jobs, reduced their salaries, increased crime rate and became dangerous in the context of terrorism.¹⁶

¹³ The Agreement: (1) restricts access to social security system for labour migrants from the EU for the period of four years since the day of their arrival; (2) formalises independence of British financial system from the ECB, however, the UK was not granted the right to veto monetary decisions of the Eurozone; (3) allows the UK to opt out of separate integration mechanisms, if it is inconsistent with its national interests. For more information, see: Outcome of the European Council of 18-19 February 2016. – Briefing Post-European Council Briefing, European Parliament, February 2016, [http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/573303/EPRS_BRI\(2016\)573303_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/573303/EPRS_BRI(2016)573303_EN.pdf).

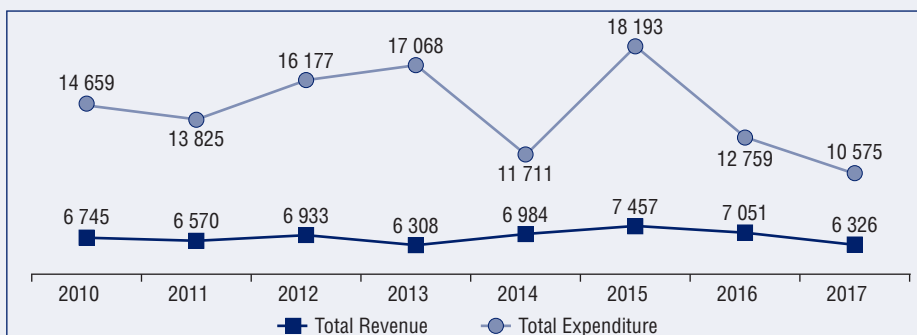
¹⁴ On the eve of the Vilnius Eastern Partnership Summit in November 2013, British Prime Minister proposed to review EU migration policy and insisted on reinforcing measures that regulate European migrants' stay in the country (reducing their social security, as well as adopting stricter economic sanctions against countries that fail to prevent their citizens' illegal migration to the EU). In turn, the EU refused to support the British Prime Minister's proposal, sharply criticised and declared it discriminatory. EU's top officials obliged the UK to abide by the established rules – fundamental European principles, including citizens' right to free movement.

¹⁵ See: Jack I. Who do I blame? Eight reasons we ended up in this Brexit mess. – The Guardian, 3 March 2018, <https://www.theguardian.com/commentisfree/2018/mar/03/brexit-immigration-jobs-eton-europe>.

¹⁶ For more information, see: Farage: Migration has made parts of UK "unrecognisable". – BBC News, 28 February 2014, <https://www.bbc.com/news/uk-politics-26376026>.

2. **Unwillingness to renounce the “UK rebate”¹⁷ in the EU Budget for 2014-2020**, as well as to be one of the largest contributors to the Budget (diagram (“*Total UK Expenditure and Revenue in the EU Budget*”¹⁸).

Total UK Expenditure and Revenue in the EU Budget, € million



3. **Disagreement with a number of powers of the Single Supervisory Mechanism.**¹⁹ The ECB attempted to implement mechanisms of bank resolution and liquidation that would extend beyond the Euro area to the Single Market, which in most cases uses qualified majority vote that denied the UK's right to veto. In addition, the EC was actively advancing the concept of Banking Union establishment for all EU member states, while the UK was against it, as it did not support the idea of its banks making contributions to the Single Resolution Fund.

4. **Unwillingness to introduce “Tobin Tax”²⁰** due to fears that it might weaken London's position as a global financial centre. The tax would be imposed on operations between two parties, one of which was based in the tax jurisdiction, or when one of the companies represented interests of a client responsible for paying this tax. The proposed tax rate specified 0.1% for securities, and 0.01% for derivatives (futures, options and swaps).

5. **Disappointment in the effectiveness of supranational bodies.** Despite a number of summits and many “rescue measures”, as well as a significant amount of funds allocated to resolve certain issues, EU leaders were unable to fully stabilise the situation in Euro area's “crisis countries”. Such issues as unemployment, especially among young people, a significant gap between the economic development of “new” and “old” members and a large debt of Euro area countries remain unresolved since 2008.

¹⁷ “UK rebate” is a financial mechanism that has been in effect since May 1985 (approved in June 1984). Margaret Thatcher successfully negotiated the United Kingdom's right to receive a rebate on its contribution to the EU Budget. The “rebate” is a compensation for the fact that the UK gains insufficient funding in the framework of European programmes. For more information, see: Sydorova E.A. Budget Policy in the European Union. – M.: IMEMO RAN (Institute of World Economy and International Relations of the Russian Academy of Sciences), 2012, 129p. (in Russian).

¹⁸ Source: Financial Programming and Budget: EU expenditure and revenue. – European Commission, http://ec.europa.eu/budget/figures/interactive/index_en.cfm.

¹⁹ On 28-29 June 2012, the European Council approved (with UK's support) the decision to establish single Euro area Banking Supervision Mechanism built around the ECB.

²⁰ In March 1999, the EP prepared a report on “The Feasibility of an International ‘Tobin Tax’”. See: Economic Affairs Series: The Feasibility of an International “Tobin Tax”. – European Parliament, March 1999, http://www.europarl.europa.eu/workingpapers/econ/107_en.htm.



Regarding referendum results, we cannot underestimate the role of the powerful British media conglomerate, as it fuelled particular sentiment and increased polarisation in the society. Media instantly picked up community trends in social networks, dividing people into EU membership proponents and opponents. They attracted people's attention with explosive speeches, controversial mottos and tricks. Print media also had made a big contribution through

publishing strong headlines, in particular concerning migration:²¹ *"Kick out Foreign Crooks"*, *"You Pay for Roma Gypsy Palaces"*, *"Migrant Crisis will Kill off EU"*, *"EU Migrants Grab Our Jobs"*, etc.²² This was the media's way to motivate politically passive citizens to come to polling stations and determine the UK's destiny, compelling its leaders hear their voice and offer an "alternative". Thus, with the help of media, Brexit became an example of skillful use of facts and data, successful "cooking" and spreading of unverified information.

The referendum on the UK's exit from the EU became the "bifurcation point" in the history of European integration. Brexit raised a number of important issues: (1) What are the consequences for the EU's future policy and relations between member states? (2) What are the consequences for the UK, politically and economically? (3) What is the impact on the future of EU integration and will the UK's official exit change the balance of power between key member states?

Brexit Negotiations' Results

After David Cameron's resignation, Brexit became a challenge for Theresa May – Britain's new Prime Minister, who, on the one hand, had to reach agreement with the EU on a number of important issues, and on the other – stick to her party's principles.

²¹ See: The Media, National Identity and Brexit Politics. – AlbionMill, 27 June 2016, <http://www.albionmill.org.uk/?p=1912>.

²² It is important to note that former UK Brexit Secretary David Davis stated in the early 2017 that the UK is not about to "shut the door" on low-skilled EU migrants. He stressed: *"It is not plausible that British citizens would immediately take jobs in the agriculture, social care and hospitality industry once the UK had left the EU. We're a successful economy, largely or partly at least because we have clever people, talented people come to Britain"*. See: UK not about to 'shut the door' on low-skilled EU migrants, says David Davis. – The Guardian, 22 February 2017, <https://www.theguardian.com/politics/2017/feb/22/uk-not-about-to-shut-the-door-on-low-skilled-eu-migrants-says-david-davis>.

STAGES OF BRITAIN'S EXIT FROM THE EU²³

2016	July 23: Referendum on the UK exit from the EU was held.	
2017	<p>March 29: The UK Prime Minister informed the European Council about the country's intention to exit the EU by initiating the two-year exit period according to Art. 50 of the Treaty on European Union.</p> <p>April 29: Heads of state and government of European Council countries adopted key principles for Britain's exit from the EU.</p> <p>June 19: Start of Phase 1 of the negotiations between the EU and the UK.</p> <p>July 13: UK Government submitted legislative act on the country's exit from the EU (EU Withdrawal Bill), which was aimed to revoke the European Communities Act of 1972.²⁴</p> <p>December 8: The EU and the UK reached provisional accords on citizens' rights and the Brexit financial settlement.</p> <p>December 15: Start of Phase 2 of the negotiations between the EU and the UK.</p>	COORDINATION OF POSITIONS
2018	<p>March 19: The EU and the UK reached a provisional agreement on a transition period.</p> <p>November: Deadline for reaching an final agreement on the United Kingdom's exit from the EU.</p>	RATIFICATION PROCESS
2019	<p>March 29: The UK had to withdraw from the EU. Given the fact that the withdrawal agreement has not been reached and transition period – extended only till 31 October (depending on conditions) – there is a possibility of political and legal chaos.</p> <p>March 30: Transition period had to begin, provided a withdrawal agreement has been reached.</p>	TRANSITION PERIOD
2020	December 31: The transition period will have to be ended, provided a withdrawal agreement has been reached that has been approved by the EU member states, the European Parliament and the UK Parliament.	
2021	January 1: The new relationship between the EU and the UK will have to begin, provided a withdrawal agreement has been reached. Special agreements have to be signed in such areas as security, defence and research.	

²³ Created with the use of data from: Brexit: where do we stand? – Government of the Netherlands <https://www.government.nl/topics/brexit/brexit-where-do-we-stand>.

²⁴ For more information, see: European Union (Withdrawal) Bill Explanatory Notes <https://publications.parliament.uk/pa/bills/cbill/2017-2019/0005/en/18005en.pdf>.

Theresa May interpreted referendum results as voters support for a “hard” exit concept, when in her speech on 17 January 2017 in the Lancaster House she outlined the goals (as approved by the country’s Government) of further UK-EU cooperation (insert “*Britain’s Main Objectives for Brexit*”²⁵), ruling out the country’s participation in the Single Market, Customs Union,²⁶ and terminating the jurisdiction of the Court of Justice of the European Union in the UK.

BRITAIN’S MAIN OBJECTIVES FOR BREXIT

1. EU law will initially continue to apply as national law after Brexit.
2. The laws applicable in the United Kingdom will be made in the UK and interpreted only by UK courts.
3. The governments of England, Scotland, Northern Ireland and Wales will work closely together on implementing Brexit.
4. The freedom to travel between Northern Ireland and the Republic of Ireland will be maintained.
5. The United Kingdom intends to control the number of immigrants from the EU.²⁷
6. The rights of EU citizens who are living in Britain, and the rights of the British nationals living in the EU, will be guaranteed.
7. The protection for workers under EU law will be maintained and extended.
8. The United Kingdom is seeking the greatest possible access to the EU single market for goods and services²⁸, it is also willing to make financial contributions to the EU Budget.²⁹
9. The United Kingdom is aiming to conclude its own free trade agreements with third countries.
10. The United Kingdom is aiming to continue its collaboration with the EU in the areas of science, research and development.
11. The United Kingdom is aiming to continue to collaborate with the EU on combating crime and terrorism³⁰ as well as on foreign and defence policy.
12. The United Kingdom is seeking a transition period which will give government and businesses time to adapt to the new arrangements.

²⁵ Source: “Ukraine Plus” as a Model for Brexit. – CEPAdhoc, 24 January 2017, https://www.cep.eu/fileadmin/user_upload/cep.eu/Studien/cepAdhoc_Brexit/cepAdhoc_Ukraine_Plus_as_a_model_for_Brexit.pdf.

²⁶ Withdrawal from the Customs Union means reinstatement of border formalities, introduction of cumbersome control procedures and measures, which can inconvenience companies working in the precisely synchronised logistics mode. In particular, there will be new logistical problems – e.g. increased number of days for storage of goods in warehouses, as well as increased transportation costs.

²⁷ The country intends to control the number of EU immigrants and thus de facto cancel the free movement of people. At the same time, the UK is interested in receiving qualified employees from the EU. So the issue in question is the conditions that will determine these employees’ and their families’ rights to work and freely move between the UK and the EU in the future.

²⁸ The country does not intend to be a Single Market member, but seeks to have “greatest possible access” to it.

²⁹ The UK plans to keep making MFF payments after 2020 in the framework of individual projects to support its cooperation with the EU, apparently hoping to gain trade preferences. In particular, the country wishes to take part in key programmes in education and culture, as well as development of chemical, pharmaceutical and aerospace sectors.

³⁰ Given that in the past decades the country has blocked the common security and defence policy on repeated occasions, this goal is hardly realistic. Aware of this fact, Theresa May turns the European community’s attention to the UK’s possession of nuclear arms, its place in the UN Security Council and available intelligence potential.

On 29 April 2017, European Council heads of state and government adopted guidelines³¹ for the UK's exit from the EU and determined a number of stages for its execution,³² and in July – the EU and the UK started negotiations on their future cooperation in politics and economy.³³ On December 8, a number of decisions have been made (insert “*Agreements Reached in Phase 1 of Negotiations*”).³⁴ On December 15, following EC recommendations, EU-27 reached a conclusion that enough progress has been made to start Phase 2 – determining conditions of future relations between the EU and the UK, and transition mechanisms.

AGREEMENTS REACHED IN PHASE 1 OF NEGOTIATIONS

- ✓ *Citizens' rights*: parties agreed on reciprocal guarantees to safeguard the rights of EU-27 and UK citizens and their families derived from EU law after the United Kingdom's withdrawal from the Union. Such guarantees must include the right to free movement (exercised at the date of UK's withdrawal), employment, education and permanent residence.
- ✓ *Financial settlement*: parties approved a financial regulation methodology: components, principles for calculations and payment format. The UK will continue to make contributions to the EU Budget until 31 December 2020 and finance its share of EU liabilities incurred before this date.
- ✓ *The Republic of Ireland and Northern Ireland*: parties committed to support under any circumstances the peace process and uphold the Good Friday Agreement (or Belfast Agreement) signed on 10 April 1998, in particular, avoiding a hard border on the island. Failing to resolve specific issues regarding Northern Ireland, the UK commits to full alignment with EU rules that support all-island economy and North-South cooperation.

Other issues considered include: UK's exit from the Treaty establishing the European Atomic Energy Community; ongoing legal and administrative procedures; status of goods in the Single Market prior to the country's withdrawal from the EU; cooperation on police and justice issues.

³¹ Guidelines clearly state that a “non-EU country that has no obligations of a member state cannot have the same rights and enjoy the same preferences as a member state”.

³² In Phase 1 of negotiations, parties focused on: guarantees for the rights of EU and UK citizens, financial regulations, Northern Ireland situation.

³³ Source: Felbermayr G., Fuest C., Gröschl J., Stöhlker D. Economic Effects of Brexit on the European Economy. – Europe European Network of Economic and Fiscal Policy Research, EconPol Policy Report, Vol.1, No.4, November 2017, https://www.cesifo-group.de/DocDL/EconPol_Policy_Report_04_2017_Brexit.pdf.

³⁴ For more information, see: Sufficient progress in first-phase Brexit talks – At a glance Plenary. – European Parliament, December 2017, http://www.europarl.europa.eu/RegData/etudes/ATAG/2017/614635/EPRS_ATA%282017%29614635_EN.pdf.



On 28 February 2018, the EC published the first draft of the Brexit agreement,³⁵ which consisted of six parts: common provisions, citizens' rights, goods placed on the market prior to exit date, financial settlement, transition measures, institutional provisions, including the protocol on Republic of Ireland/Northern Ireland border. The latter contained a "backstop option" that aimed to avoid a hard border and determined the overall regulatory field for ensuring free movement of goods on the island and provided

guarantees that Northern Ireland will be included in the Single Market and Customs Union rules.

Certain progress was also achieved during Phase 2: namely, on 19 March 2018, EU leaders approved transition period structure and a number of instructions for coordinating future trade relations between parties. The transition period was scheduled to last from 29 March 2019 to 31 December 2020. During this period: (1) the UK is to continue to be a part of the EU Customs Union and the Single Market; (2) EU and UK citizens are to have the same rights and guarantees as before; (3) Jurisdiction of the Court of Justice of the EU is to apply in the UK; (4) the UK is to bear its share of financing all the budget commitments undertaken while it was a member of the Union; (5) the UK can conduct negotiations, sign and ratify new trade agreements without the EU approval, given that such agreements come into force after the transition period; (6) the UK not take part in EU decision-making process anymore. Overall, the transition period can be described as "time bought" to harmonise relations between the EU and the UK, and give the population and businesses a chance to prepare for Brexit consequences.

On 12 July 2018, UK Government published a White Paper on the relationship between the United Kingdom and the European Union (insert "*Excerpts of White Paper Provisions*"³⁶), which outlines the UK's vision on the principled, pragmatic and practical Brexit that will allow business to grow and regular people – to maintain relations with European citizens.

³⁵ Source: Brexit: European Commission publishes draft Article 50 Withdrawal Agreement. – European Commission, Press release, 28 February 2018, http://europa.eu/rapid/press-release_IP-18-1243_en.htm.

³⁶ Source: The Future Relationship Between the United Kingdom and the European Union. – Policy paper, 12 July 2018, <https://www.gov.uk/government/publications/the-future-relationship-between-the-united-kingdom-and-the-european-union>.

EXCERPTS OF WHITE PAPER PROVISIONS

Customs regulation

- The UK is leaving the Customs Union and intends to establish its own independent trade policy.
- As part of future relations with the EU, it is proposed to sign a new Facilitated Customs Arrangement, which will allow to ensure balanced and harmonised trade between the UK and its partners – the EU and the rest of the world.

Tariffs and Rules of Origin

For UK-EU trade in goods, the following is proposed:

- zero tariffs on goods (including agricultural products), with no quotas;
- no routine rules of origin requirements on UK-EU goods trade.

Free movement

- Free movement of people will end as the UK leaves the EU.
- The UK will make a sovereign choice in a defined number of areas to seek reciprocal mobility arrangements with the EU, e.g. to support business professionals, or to allow tourists to continue to travel visa-free.

Business

- The UK will seek reciprocal arrangements to allow the British people to visit the EU without a visa for short-term business reasons.
- As is the case with non-EU countries with whom the UK has a trading agreement, the UK also wants to agree reciprocal provisions on intra-corporate transfers that allow UK and EU-based companies to train staff, move them between offices and plants.

Tourism

- The UK proposes reciprocal visa-free travel arrangements to enable UK and EU citizens to continue to travel freely.
- The Government wants UK and EU nationals to continue to be able to use the European Health Insurance Card (EHIC) to receive healthcare should they need it while on holiday.

Students and young people

- The UK and the EU should continue to give young people and students the chance to benefit from each other's world leading universities, including cultural, scientific and academic exchanges.

Joint committees and institutional framework

Dispute resolution and consistent interpretation

- Court of Justice of the EU (CJEU) has no more jurisdiction over the UK. Disputes between two parties cannot be resolved by the court of one party.
- In areas, where parties have a common rulebook, it will be important for companies and citizens of both sides that these rules will be interpreted and applied consistently. Therefore, UK courts will pay due regard to CJEU case law in those areas where the UK continued to apply a common rulebook.

Cooperation and interaction with EU bodies and agencies

Future security partnership

- Participation in/or collaboration with key agencies and bodies that support Future Security Partnership, including:
 - Internal security: Europol and Eurojust.
 - External security: European Defence Agency (EDA), EU Intelligence and Situation Centre (INTCEN) and EU Satellite Centre (SATCEN).
 - International security: EU Agency for Network and Information Security (ENISA), European Centre for Disease Prevention and Control (ECDC).

European Medicines Agency (EMA) participation

- Provision of guarantees that EU and UK patients will have access to the best and most innovative medicines and will have confidence in their safety.
- The UK will want to secure access to relevant IT systems, ensuring the timely transfer of data between UK and EU authorities, with the purpose of monitoring all existing routes of the medicines and medical goods market.

European Chemicals Agency (ECHA) participation

- The UK would want to secure access to relevant IT systems (for chemical industry), ensuring timely transfer of data between EU and UK authorities.
- The UK would want to ensure UK businesses' ability to register chemical substances directly, without an EU-based representative.

European Aviation Safety Agency (EASA) participation

- Joint work on aviation space safety.

It was planned that the EU and the UK would agree on Brexit conditions (including all legal issues regarding citizen rights, parties' financial obligations, and Irish border) before 21 November 2018,³⁷ with reconciling the position between European Parliament and the UK Parliament. The agreement had to contain transition provisions and a separate "political declaration" that determines conditions for further trade relations between the parties, when the UK becomes "the third party". It was supposed that, if the agreement is not reached by the set deadline, the treaty itself cannot be ratified in time (scheduled for January 2019) and will not become effective on 29 March 2019. This poses a threat of a "hard" Brexit: breaking off agreements and termination of participation in legislative acts on the part of the UK, uncertainty as to further relations with the EU. At the end of September 2018, the UK Prime Minister noted that Brexit negotiations came to a standstill and "no deal" was better than a bad agreement (chart "*Possible Scenarios of UK's Withdrawal from the EU as of end 2018*",³⁸ p.190). However, at the time of writing this article the UK had no parliamentary majority that could vote for Brexit "without an agreement", thus, parties must make efforts to reach an agreement. Meanwhile, the time envisaged for adoption of agreement before the deadline has elapsed with no positive result achieved. The threat of a political chaos in UK-EU relations thus increased immensely.



In early November 2018, British media were publishing information on the feasibility of agreement between parties regarding issues that are rather important for the UK. In particular, according to information in the media, parties reached a compromise on controls at the Northern Ireland border: the EU has agreed to perform regulatory control of goods at plants and stores, not on the border.³⁹ Some publications highlighted that the Prime Minister had secured private concessions from Brussels that would allow her to keep the whole of Britain in a Customs Union, avoiding a "hard" border in Northern Ireland. Another news⁴⁰ was the granting to the British

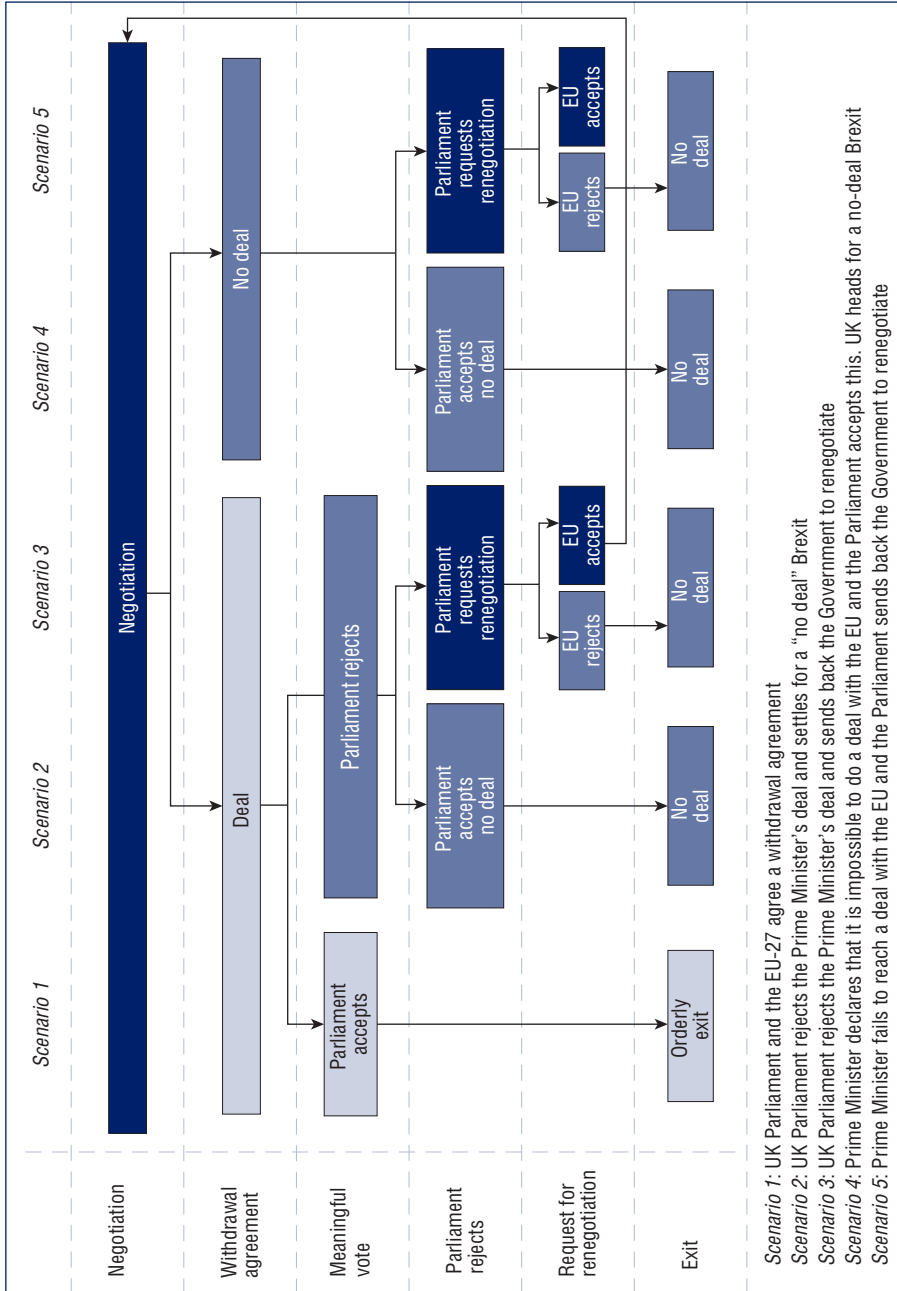
³⁷ This date was announced as the deadline for the agreement by UK Brexit Secretary Dominic Raab.

³⁸ Source: Rutter J., Owen J. Autumn surprises: possible scenarios for the next phase of Brexit. – Institute for Government, August 2018, https://www.instituteforgovernment.org.uk/sites/default/files/publications/brexit-scenarios-final_0.pdf.

³⁹ Source: Revealed: Theresa May's secret Brexit deal. – The Times, 4 November 2018, <https://www.thetimes.co.uk/edition/news/revealed-theresa-mays-secret-brexit-deal-3vvn3c0sf>.

⁴⁰ Source: Pound jumps on May's Brexit deal on financial services. – The Times, 1 November 2018, <https://www.thetimes.co.uk/article/pound-jumps-on-news-theresa-may-seals-brexit-deal-on-financial-services-79thmrzvk>.

Possible Scenarios of UK's Withdrawal from the EU as of end 2018



companies in financial services a continued access to European markets, as long as UK's financial regulations remain compatible with the EU.

At the moment, it is extremely difficult to predict the future course of events. Difficulties in negotiations with EU-27 regarding the Irish border, foreign policy and security, cooperation in internal affairs (police), as well as future trade relations, differences within the Conservative party, *etc.* showed that it will not be easy to find a compromise between the parties.

Brexit: the Economic Aspect

General economic assessments. There is an intensive scientific debate as to the potential economic consequences of Brexit. Referendum results became a “shock” for the British economy, weakened the British pound,⁴¹ and later caused a small decrease of GDP and growth of inflation, – all of which intensified the debate.

The most tangible changes are expected right after the country's withdrawal from the EU in 2020. According to OECD assessments,⁴² in 2020, Brexit will affect EU-27's GDP, which will go down 1%, while in the UK this drop will be 3.3%. In the medium term – in 2023 – the situation might somewhat improve, with a respective 0.8% and 2.5% fall predicted. Most significant consequence for the UK will be a sharp drop in imports, possible decrease of personal consumption expenditure and lower investment rate in the country's economy as a result of uncertainty and lack of confidence in the future. Britain's GDP might be affected by its leaving the Single Market without preferential access for service companies – a £25-36 bn/year decrease, as reported by the Centre for Economic and Business Research (CEBR).⁴³

Experts at the International Monetary Fund⁴⁴ have provided their assessment of the outcomes of different scenarios – “soft” and “hard” Brexit.

⁴¹ In the wake of referendum, negative dynamic was recorded for the British pound, as it hit its 30-year minimum with a 10% decrease. Just in several days at the end of June 2016, its rate went down from \$1.48/£ to \$1.32/£. The weakening continued and showed the rate of \$1.22/£ in October 2016. See: GBP to USD exchange rate. Online Forex chart. – ForexClub, <https://www.fxclub.org/markets/forex/gbp-usd>.

⁴² For more information, see: The Economic Consequences of Brexit: A Taxing Decision. – Policy Paper, April 2016, <http://www.oecd.org/economy/the-economic-consequences-of-brexit-a-taxing-decision.htm>.

⁴³ See: Zeffman H. Brexit without deal on services 'could cost £36bn a year'. – The Times, 22 May 2017, <https://www.thetimes.co.uk/article/brexit-without-deal-on-services-could-cost-36bn-a-year-5flvmkbrb>.

⁴⁴ For more information, see: Euro Area Policies. Selected Issues. – IMF Country Report, No.18/224, 19 July 2018, <https://www.imf.org/en/Publications/CR/Issues/2018/07/18/Euro-Area-Policies-Selected-Issues-46097>.



In the “soft” Brexit option, the level of certainty of market participants worldwide will decrease, additional uncertainty will negatively affect entrepreneurs’ trust in companies and economic environment of the UK, which will cause a drop in investment. A part of companies working in the financial services sector will gradually move to the EU (Frankfurt am Main or

Paris), which will be an additional factor in the decline of business activity in the UK.

The “hard” Brexit scenario means intensified economic instability and tensions in the UK and the EU. It is predicted that depending on the type of Brexit – “soft” or “hard” – production in EU-27 will decrease, respectively, from 0.06% to 1.5% in the long-term perspective.

It is not implausible that Brexit will also affect consumer prices. In an analytical report on the topic, its authors concluded that prices would go up most in transport (between 4% and 7.5%), alcoholic drinks (4% to 7%), food (3% to 5%) and clothing (2% to 4%).⁴⁵ It stems from the fact that these product groups depend heavily on imported intermediate inputs. By contrast, prices for services will rise the least. Growth of consumer prices can cause an increase of the gap between people’s incomes. For the poorest households, real income losses would be 1.7-3.6% in the short-run and 5.7-12.5% in the long-run. For the richest households, the short-run losses would be 1.8-3.9% and the long-run losses – 6-13.4%.⁴⁶

At the same time, these predictions are preliminary and provide only a glimpse of the long-term Brexit consequences. Only the final conditions of the country’s withdrawal from the EU and political response from EU-27 will determine the real outcomes.

Trade cooperation. The nature and potential of the EU-UK economic cooperation are far-reaching, universal and supportive to economic interests of both parties. Single market is characterised not only by duty free trade, but also by the ongoing elimination of non-tariff barriers. Before the UK joined the EEC in 1973, almost a third of the UK’s trade was with countries from this group. Now – almost

⁴⁵ Source: Dhingra S., Ottaviano G., Rappoport V., Sapmson T., Thomas C. UK trade and FDI: A post-Brexit perspective, <https://onlinelibrary.wiley.com/doi/epdf/10.1111/pirs.12345>.

⁴⁶ Ibid.

50 years after the country chose the path of integration – the EU remains its main trading partner. In the country's total international trade, EU percentage in 2017 was 49%, including 44.5% – in export of goods and services, and 53.1% – in import.

Currently, the UK's imports from the EU exceed its exports, in particular, in 2017 deficit of trade in goods was £67 bn. At the same time, with third countries (Americas, Asia and Africa) the UK had surplus in trade – £56.3 bn. Thus, the statement that the UK is trading more with EU countries than other countries worldwide due to “geographical proximity” is erroneous. Current account data (table “UK's Current Account Components in 2017”⁴⁷) shows that British extra-EU trade is more successful.



UK's Current Account Components in 2017,⁴⁷ £ million

	Trade in goods	Trade in services	Income	Transfers	Balance
World	-137 448	111 562	-32 058	-21 015	-78 959
EU-28	-95 056	28 032	-20 099	-9 085	-96 208
Americas	12 500	33 878	-12 734	625	34 269
Asia	-33 549	20 221	1 551	-4 282	-16 059
Australia and Oceania	2 640	3 880	6 658	-152	13 026
Other	-23 983	25 551	-24 624	-12 894	-13 987

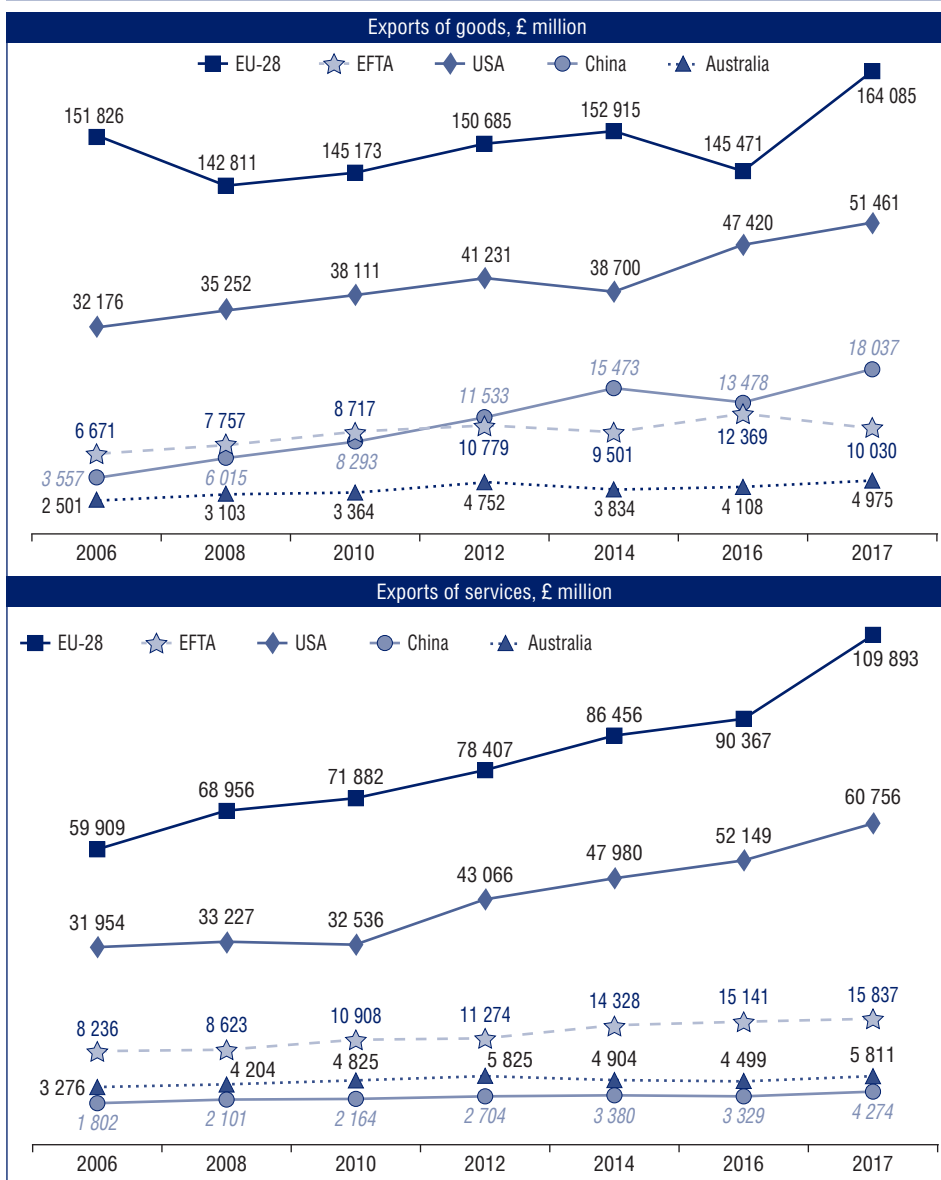
British exports are mostly concentrated in Western Europe and North America. At the same time, there has been a gradual increase of mutual trading with some countries of the British Commonwealth⁴⁸ (diagram “UK Exports of Goods and Services”⁴⁹).

⁴⁷ Source: Office for National Statistics, Balance of Payments, The Pink Book 2018, <https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/unitedkingdombalanceofpaymentsthepinkbook/2018>.

⁴⁸ The Commonwealth of Nations is an association of 54 states. Commonwealth countries have three characteristics that influence the UK's choice in the development of bilateral trade: (1) presence on five continents. Almost each country represents another large global association (EU, NAFTA, MERCOSUR, ASEAN); (2) most of these countries possess major deposits of natural resources; (3) favourable demographic trends – growth of young population and gradual increase of workforce.

⁴⁹ Source: Office for National Statistics, Balance of Payments, The Pink Book 2018, <https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/unitedkingdombalanceofpaymentsthepinkbook/2018>.

UK Exports of Goods and Services



The UK's withdrawal from the EU threatens to temporarily slow down the development of existing trade relations with European countries. It might be necessary to conclude new trade agreements with countries that have free trade agreements with the EU (at the moment, there are 37 such agreements, involving over 60 countries).

The UK is already trying to redirect its exports, yet at the moment, trade policy is shaped by the EU, and although the UK has the right to sign and ratify new trade agreements, they [agreements] will only enter into the force after the country's final exit from the EU.

It is assumed that the country might lose a significant percentage of its trade with the EU. First of all, this is connected with duties that will have to be paid, thus producing additional expenses for businesses. After the draft Framework for the Future Relationship (FFR) was published, EU Council President Donald Tusk said: *"Our agreement will not make trade between the UK and the EU frictionless or smoother. It will make it more complicated and costly than today, for all of us. This is the essence of Brexit"*.⁵⁰ Thus, EU and UK companies have to accept this reality and research all possible consequences that may stand in the way of future development.

It is expected that Brexit will have a slightly weaker impact on the EU-27 economy than on the UK's economy, as the latter has more uncertainties in its trade relations with the EU and the rest of the world. A number of EU member states have tight trade relations with the UK, e.g. Germany, Belgium and the Netherlands, whose share of exports coming to the UK is rather high. Consequently, the effect of Brexit on these countries is more likely to be stronger.

At the same time, Brexit will influence trade with third countries due to rules of goods origin. UK-manufactured components in the post-Brexit rules of period will be classified as third country goods, thus, the end product cannot be classified as originating from the EU-27, which leads to the loss of zero duty tariffs in countries that have free trade agreements with EU-27.

Investment activities. Despite the continued growth of FDI in the UK economy in recent years⁵¹ and the country's long-term status as investment-attractive (insert *"UK's Investment Attractiveness"*), its economy may face investment outflows.

Expert survey of 440 foreign investors conducted in early 2018 by British audit and consulting company E&Y⁵² showed that at the moment investors are still

⁵⁰ Source: Statement by President Donald Tusk on the draft guidelines on the framework for the future relationship with the UK. – European Council, Council of the European Union, 7 March 2018, <https://www.consilium.europa.eu/en/press/press-releases/2018/03/07/statement-by-president-donald-tusk-on-the-draft-guidelines-on-the-framework-for-the-future-relationship-with-the-uk/>.

⁵¹ According to UNCTAD's World Investment Report 2018, the country's FDI base is made by cross-border mergers and acquisitions (M&As). In particular, cross-border M&As attracted to the United Kingdom \$255 billion in 2016 (as compared to the average of \$45 billion over 2011-2015). Only the purchase of British SABMiller plc. by Anheuser-Busch Inbev (Belgium) valued \$101 billion. In 2017, the value of M&As was much lower, and most agreements were on the change of ownership without direct influence on FDI. As a result, UK's FDI inflows dropped by 92% in 2017 – down to \$15 billion. For more information, see: Investment and New Industrial Policies. – World Investment Report 2018, UNCTAD, https://unctad.org/en/PublicationsLibrary/wir2018_en.pdf.

⁵² For more information, see: Inward investment after Brexit. – EY's UK Attractiveness Survey, March 2018, [https://www.ey.com/Publication/vwLUAssets/EY-Inward-investment-after-Brexit/\\$FILE/EY-Inward-investment-after-Brexit.pdf](https://www.ey.com/Publication/vwLUAssets/EY-Inward-investment-after-Brexit/$FILE/EY-Inward-investment-after-Brexit.pdf).

UK'S INVESTMENT ATTRACTIVENESS

UK has retained its investment attractiveness, which is confirmed by the Foreign Direct Investment (FDI) Confidence Index⁵³, calculated by international consulting company A.T.Kerney. In 2017, according to the Index, the country was rated 4th after Germany, Canada, and the USA.⁵⁴ The country is popular among many “cash” investors in EU countries, who are seeking stability. In particular, the UK has the lowest barriers for doing business⁵⁵, compared to other countries of the world, while corporate management standards are among the most transparent. UK Government attempts to implement ambitious business policy, developing a competitive tax environment and attracting leading transnational companies. E.g. UK corporate tax rate for the past two years was at 19%, while in Italy, Germany and France it was 24%, 30% and 33.33%, respectively.⁵⁶

interested in investing in the UK economy, yet it is possible that investment activity will slow down or collapse in the future (table “*British Survey: “Have you changed your investment plans for the UK in the last 18 months?”*”). According to survey results, 21% of investors changed their investment plans after the referendum: surprisingly, that 7% increased their expected investment in the country’s economy, 6% – reduced, and 8% – put their plans on hold. Most notable differences were in the geographic distribution: Asian investors, as compared to Western investors, had a stronger reaction to Brexit.

British Survey: “Have you changed your investment plans for the UK in the last 18 months?”

	Geographical distribution			Company size			Sectoral distribution					
	Asia	Western Europe	North America	Small	Medium	Large	Consumer	Hi-tech	Business services	Financial services	Manufacturing	Chemical and pharmaceutical
Reduced investment	13	6	5	4	10	5	5	11	8	7	4	6
Increased investment	8	4	9	9	7	4	13	10	5	7	4	11
Paused investment	14	8	6	8	10	5	4	5	12	12	6	12
No change	59	76	72	74	66	77	74	63	70	66	77	64
Can't say	7	6	8	5	7	9	4	11	5	8	9	7

⁵³ The FDI Confidence Index takes into account the impact of political, economic and regulatory changes on FDI intentions and preferences of top business executives. It is based on a survey of over 500 business executives from foreign companies in 29 countries of the world and covers all sectors of economy. It is calculated as a weighted average of the number of responses indicating likelihood of direct investment in a market over the next three years. Higher Index values indicate more attractive investment environment.

⁵⁴ For more information, see: Foreign direct investment in UK could dry up post-Brexit, 14 June 2018, <https://www.consultancy.uk/news/17511/foreign-direct-investment-in-uk-could-dry-up-post-brexit>.

⁵⁵ According to the World Bank's Doing Business Index, the UK was ranked 7th among 190 world economies in 2018.

⁵⁶ Source: Corporate tax rate table, <http://www.kpmg.com/Global/en/services/Tax/tax-tools-and-resources/Pages/corporate-tax-rates-table.aspx>.

According to survey results, in the long-term perspective (beyond the three-year horizon), the situation is more complicated – approximately 50% of companies currently working in the country expect that Brexit will cause capital outflow from the UK. Thus, although the situation at the moment is stable, future FDI growth may be changed, if the UK fails to attract new investors on a consistent basis. In turn, FDI decrease will likely exert an adverse impact on the UK's long-term production potential.



Along with attracting investment, and more importantly – retaining existing investors, the issue of the future of a key global financial centre London City (*The Square Mile*) is becoming more topical.⁵⁷ For a long time, the UK's business centre has been open for the world's financial institutions. London gradual distancing will cause capital outflow, which will disrupt the region's financial stability and, again, will slow down economic growth. Officially, the problem is that to conduct operations in the EU without authorisation from each country, financial companies need an EU "passport" that guarantees conformity to EU rules and obligations. If a company is based outside the EU, it loses this privilege. As a result, banks and financial companies will have to bear additional costs of relocating operations from London. Thus, for instance, a number of financial institutions plan to move their offices to Frankfurt am Main, Dublin, Amsterdam, Luxembourg or Paris.⁵⁸

Economic consequences of the UK's withdrawal will depend on the policy that the country chooses afterwards. The long-term influence of Brexit will probably be different for each member of EU-27, as it will depend on the future bilateral cooperation, level of integration, sectoral specialisation, and sector positioning within the global supply chain. Germany's economy is most likely to suffer negative effects. In the case of "hard" Brexit, because of termination of integration processes and elimination of all benefits provided by EU membership, the UK itself will face the hardest consequences.

⁵⁷ According to the Global Financial Centres Index, London is ranked first. See: The Global Financial Centres Index 23, March 2018, <http://www.longfinance.net/Publications/GFCI23.pdf>.

⁵⁸ In 2017 this was announced by such American banks as Morgan Stanley, Citigroup, Goldman Sachs, JP Morgan, French BNP Paribas, Swiss Credit Suisse and UBS, top multinational financial company HSBC, as well as a number of other financial groups. For more information, see: McNulty L., Ahuja V. Bank Brexit plans: what we know so far. – Financial Times, 21 July 2017, <https://www.ftlondon.com/articles/bank-brexit-plans-what-we-know-so-far-20170717>.

Possible Forms of Economic Cooperation between the EU and the UK

New trade relations between the EU and the UK is one of the most important, topical and complicated issues. Post-Brexit cooperation is in the interest of both parties, which are trying to choose the best possible model of further collaboration. The fact that the EU has made a number of agreements (different in content, character and depth of integration) with third countries shows a rather wide room for manoeuvre in terms of creativity and depth of the future relations. Yet, during political discussions, there has been no true understanding of the key differences at the base of each cooperation model. Namely, that *these models represent two opposing paradigms: market integration and trade liberalisation*.⁵⁹

For example, models of EU cooperation with Norway, Switzerland and Ukraine are defined by market integration and characterised by a high rate of participation in the EU's internal market,⁶⁰ although they include some limitations compared to the full EU membership. These models are the product of many decades of negotiation, institution-building, aimed at deeper economic integration. They are implemented by EU's legislation aimed at harmonising domestic laws to the level required to ensure adequate convergence.

The trade liberalisation paradigm stands in stark contrast to the market integration paradigm. Its focus is trade, and it is through trade transactions that the economic exchange is facilitated. Its aim is not integration of markets, but rather liberalisation of trade between different markets. The major difference between them is the absence of harmonised regulations. This paradigm characterises both the WTO rules and the large majority of trade agreements concluded by the EU and third countries (table “*Characteristics of Possible Formats of Economic Cooperation Between the EU and the UK*”, p.204).

Norwegian model. Since 1992, Norway has been cooperating with the EU in the framework of the European Economic Area (EEA) Agreement. This model ensures wide access to the EU's internal market: EEA-based companies benefit from export of goods to the EU that is duty-free or subject to reduced tariff rates and can export services to the EU territory without establishing a branch (the country is eligible to EU “passporting”). This model does not have a requirement of mandatory contributions to the EU Budget. It allows the country to conclude free trade agreements with other countries (which meets the UK's purposes). At the same time, EEA countries have to accept all EU rules regarding the internal market without taking part in their

⁵⁹ For more information, see: Future trade relations between the EU and the UK: options after Brexit. – European Parliament, study requested by the INTA committee, March 2018, [http://www.europarl.europa.eu/RegData/etudes/STUD/2018/603866/EXPO_STU\(2018\)603866_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2018/603866/EXPO_STU(2018)603866_EN.pdf).

⁶⁰ The EU's internal market rests on the basic freedoms and covers the free movement of goods, services and factors of production (capital and labour).

**Characteristics of Possible Formats of Economic Cooperation
Between the EU and the UK⁶¹**

	Opportunities, benefits, privileges	Prohibitions, restrictions, obligations
Norwegian model (EEA member)	<ul style="list-style-type: none"> • Single Market privileges; • Can negotiate trade deals independently of the EU; • No requirements for mandatory contributions to the EU Budget (with participation in financing of a number of EU programmes). 	<ul style="list-style-type: none"> • Implements Single Market policies, without representation in EU decision-making process; • Must comply with rules of origin for exports to the EU and subject to EU anti-dumping measures; • Falls within EU Court of Justice jurisdiction; • Not part of the EU Customs Union and no access to intra-EU trade system; • Application of EU Regulations and Directives.
Swiss model (Bilateral agreements)	<ul style="list-style-type: none"> • Single Market privileges; • Can negotiate trade deals independently of the EU; • No legal obligation to abide by EU legislation; • Does not fall within EU Court of Justice jurisdiction; • No requirements for mandatory contributions to the EU Budget (with participation in financing of a number of EU programmes). 	<ul style="list-style-type: none"> • Application of EU Regulations and Directives; • Not part of the EU Customs Union and no access to intra-EU trade system; • No agreement with the EU on mutual trade in financial services.
Canadian model (Free Trade Agreement)	<ul style="list-style-type: none"> • Does not fall within EU Court of Justice jurisdiction; • No requirement to contribute to the EU Budget; • Independent trade policy. 	<ul style="list-style-type: none"> • No Single Market privileges; • Market access depending on the shape of the FTA deal (mostly, free access to the Single Market; goods exported to the EU must maintain EU product standards); • No guarantee on mutual opening of financial services market.
“Ukraine-plus”	<ul style="list-style-type: none"> • No requirement to contribute to the EU Budget; • Single Market privileges; • Independent trade policy. 	<ul style="list-style-type: none"> • Market access depending on the shape of the FTA deal (mostly, free participation in the Single Market; goods exported to the EU must maintain EU product standards); • No agreement with the EU on trade in financial services.
Turkish model (Customs Union)	<ul style="list-style-type: none"> • Free access to the Single Market, excluding financial services; • Access to intra-EU trade system for goods as part of Customs Union; • No requirement to contribute to the EU Budget; • Does not fall within EU Court of Justice jurisdiction. 	<ul style="list-style-type: none"> • No agreement with the EU on trade in financial services; • No Single Market privileges.
WTO legal framework	<ul style="list-style-type: none"> • No requirement to contribute to the EU Budget; • Independent trade policy; • Does not fall within EU Court of Justice jurisdiction. 	<ul style="list-style-type: none"> • No Single Market privileges; • Not part of the EU Customs Union and no access to intra-EU trade system; • Goods exported to the EU must maintain EU product standards; • No agreement with the EU on trade in financial services.

⁶¹ Based on: Brexit: Lighting the way Spring 2018 Update. – PWC, Issue 3, Spring 2018, <https://www.pwc.ie/publications/2018/brexit-spring-2018-report.pdf>; Brexit Update Walking the tightrope – a European view on Brexit, <https://www.pwc.de/de/finanzdienstleistungen/brexit-update-walking-the-tightrope.pdf>; Dhingra S., Ottaviano G., Rappoport V., Sapmson T., Thomas C. UK trade and FDI: A post-Brexit perspective, <https://onlinelibrary.wiley.com/doi/epdf/10.1111/pirs.12345>.

elaboration. In fact, the country is subject to the jurisdiction of the EFTA Court, which is to make its decisions with due regard to the EU Court of Justice practices.

Swiss model. Swiss-EU cooperation is based on bilateral agreements. According to this model, the country has access to the EU's internal market only in a number of sectors. Meanwhile, the sector of financial services, which is crucially important for the UK, remains here almost completely excluded from mutual market opening. Consequently, Swiss companies that wish to export financial services to the Single Market have to establish branches in the EU. Thus, the main pros of this model are: (1) opportunity to enter into free trade agreements with third countries; (2) absence of legal obligations regarding the implementation of EU legislation; (3) evading the jurisdiction of the EU's Court of Justice. The main argument against this model is the fact that the UK wishes to restrict free movement of people.⁶²

Some foreign experts argue⁶³ that a Ukraine-style Association Agreement (has taken effect since 1 September 2017) offers the UK a viable model for its future relationship with the EU, combining both “sovereignty” and close economic ties. This model (“*Ukraine-plus*”) offers new ideas as to the ways the UK can get access to the Single Market.

The EU-Ukraine Association Agreement⁶⁴ has been seen as innovative external action that offers a new type of integration without actual EU membership aiming to create a deep and comprehensive free trade area (DCFTA).

The “*Ukraine-plus*” model would offer a number of advantages in further trade relations between the EU and the UK in the domain of free trade of goods and services. Migration is regulated here through visa regime liberalisation and the system of labour permits. Countries, which have signed this type of Association Agreement,

⁶² From 2002, Switzerland and the EU have an agreement on the free movement of people, which can only be restricted in certain cases and with mutual agreement. In case Switzerland cancels the free movement agreement to implement popular initiative “*against mass migration*”, all bilateral agreements between sides will be automatically terminated (“*Guillotine Clause*”).

⁶³ Source: Oppenheim B. The Ukraine Model for Brexit: Is Dissociation Just Like Association? – Centre for European Reform, 27 February 2018, https://www.cer.eu/sites/default/files/insight_BO_27.2.18.pdf.

⁶⁴ EU-Ukraine Association Agreement was adopted by the Decision of EU Council on 17 March 2014. The Agreement aims to facilitate Ukraine's integration into the internal market of the EU. Ukraine has to introduce corresponding EU standards into national legislation. The Preamble clearly states: “... *political association and economic integration of Ukraine with the European Union will depend on progress in the implementation of this Agreement as well as Ukraine's track record in ensuring respect for common values, and progress in achieving convergence with the EU in political, economic and legal areas*”. Access to EU's internal market will be granted only upon thorough monitoring confirming that Ukraine has succeeded in approximation of its legislation to *acquis communautaire*.

can cooperate with Europol and Euratom, and take part in a number of programmes⁶⁵ like “Horizon 2020” (a major EU research programme), as well as in a broad range of common EU policies in the area of transport, environment, labour and consumer protection. The Agreement entails cooperation in justice and internal affairs, as well as aligning foreign, security and defence policies with those of the EU. However, the country cannot influence the EU’s foreign, security and defence policies.

The “*Ukraine-plus*” model will hardly be satisfying for the UK, as it contains numerous limitations,⁶⁶ especially in the part of service market access.⁶⁷ According to the Agreement, Ukraine does not yet have full access to most EU’s service sectors, and many of them are excluded from liberalisation completely. For instance, the EU and some member-states have put in place a total of 46 restrictions on Ukraine’s access to financial services markets.⁶⁸ There is also a broad prudential carve-out which means that market access can be unilaterally withdrawn by the EU if it is deemed to threaten the “integrity and stability of a Party’s financial system”.⁶⁹

In one of the analytical reports on this issue, authors concluded: “This agreement cannot serve as a blueprint for a Brexit-agreement. Firstly, the UK economy already matches EU standards. Secondly, contrary to the EU-Ukraine Association Agreement, a UK-EU agreement would rather be aimed at disengagement than at rapprochement”.⁷⁰ Later, both the EC and the European Council rejected this model as an option for future economic cooperation.

Among the most acceptable options at the moment is the *Canadian model* of economic cooperation, which is based on the free trade agreement between the EU and Canada – CETA (*Comprehensive Economic and Trade Agreement*), effective since 21 September 2017. According to this type of deal, the country does not pay mandatory

⁶⁵ Ukraine, for instance, can take part in 22 programmes. For more information, see: List of EU programmes and financial instruments open to Ukraine’s participation, http://www.mk.gov.ua/store/files/announce_1495192232.pdf.

⁶⁶ The Ukraine-EU agreement has to go a long way to liberalise trade in goods, eliminating 99.1 per cent of Ukrainian customs tariffs and 98.1 per cent of EU customs tariffs. But some tariff quotas remain on agriculture and metal products, that limit the quantity of Ukrainian products that can be exported duty-free. Non-tariff barriers are also a problem for Ukraine, as most products have to conform to European technical standards.

⁶⁷ The ability to trade services freely with the EU in post-Brexit period is a key concern of the UK, where services output comprises 71.1% of GDP as of the 1st quarter of 2018. Calculations based on data from: United Kingdom GDP from Services. – Trading Economics, <https://tradingeconomics.com/united-kingdom/gdp-from-services>.

⁶⁸ For more information, see: Deepening EU-Ukrainian Relations: What, why and how? – CEPS, August 2016, <https://www.ceps.eu/publications/deepening-eu-ukrainian-relations-what-why-and-how>.

⁶⁹ Source: Szyszczak E. A UK Brexit Transition: to the Ukraine Model? – Briefing Paper 11, November 2017, <http://blogs.sussex.ac.uk/uktpo/files/2017/11/Briefing-Paper-11.pdf>.

⁷⁰ Source: Oppenheim B. The Ukraine Model for Brexit: Is Dissociation Just Like Association? – Centre for European Reform, 27 February 2018, https://www.cer.eu/sites/default/files/insight_BO_27.2.18.pdf.



contributions to the EU Budget, while EU's four freedoms and EU's Court of Justice decisions are not applicable. The Agreement lifts most of the customs duties on European exports to Canada and on Canadian exports to the EU. By 2025, import tariffs of the industrial goods will be eliminated. Tariffs on certain agricultural products will also be cancelled. European companies have received the right to take part in national tenders in Canada, but

the Agreement does not guarantee EU "passporting rights" for Canadian companies. As per Agreement, the party retains control over its borders.

Also experts are analysing another model – "no deal" option, which would mean trade relations based on the WTO rules. In this case, the UK completely loses all of its economic privileges: limited access to the European market and no "passporting rights" for financial services. At the same time, this would mean customs duties of almost 10% on vehicle imports, an average of 19% on beverages and tobacco, and an average of 12% on lamb meat and also fish – these are the goods that constitute the bulk of British exports to EU.⁷¹ Despite the elimination of mandatory EU Budget contributions and the right to control migration, all of this makes this type of deal unacceptable.

The EU repeatedly insisted on UK's making choice between the above-mentioned models, while the UK wishes to have a "specific agreement". At the same time, the future agreement has to balance both parties' interests and cannot put the UK in a better position compared to other countries that have agreements with the EU.⁷² It is crucial that the parties should reach a compromise on their future cooperation, which would ensure maximum benefits and efficiency for both.

Given the arrangements reached in preliminary stages of negotiations and the limited time to reach a deal, we believe that new relations will be developing according to the *Canadian model*.

⁷¹ For more information, see: The European Committee of the Regions & the likely impact of the United Kingdom's intention to withdraw from the European Union for local and regional authorities. – European Commission, European Committee of Regions, 126th Plenary Session, 30 November 2017, p.23, <https://cor.europa.eu/Documents/Migrated/Events/brexit-survey-results.pdf>.

⁷² The EU has signed over 20 association agreements with non-members in order to provide a basis for cooperation with the latter. They take different forms and aim to facilitate political association and economic integration. They aim to liberalise trade and cover also security, defence and energy sectors.

Brexit and EU Budget

Experts noted on numerous occasions that Brexit is bound to influence EU Budget after 2020⁷³ (insert “*Characteristics of EU Financing*”).

CHARACTERISTICS OF EU FINANCING

The EU has a fiscal capacity in the form of an annual budget,⁷⁴ whose size and structure are largely predetermined by a Multiannual Financial Framework (MFF). The current MFF covers the 2014-2020 period and amounts to €1.09 trillion, or roughly 1% of EU GDP. The EU budget is financed by three categories of resources: “traditional own resources” – customs duties and sugar levies (€20.1 billion in 2016, or 14% of revenue); a percentage of the Member States’ estimated VAT income (€15.9 billion or 11.1%); fixed percentage of Member States’ gross national income (GNI)⁷⁵ (€95.6 billion or 66.6%). Other revenue includes: income taxes, contributions by non-EU countries to EU Budget-funded programmes, fines paid by companies in breach of competition law, and revenues from EU borrowing and lending operations.⁷⁶

EU financing is also done through other extra-Budget frameworks, e.g. through the intergovernmental European Development Fund – where member states’ commitments in 2014-2020 amounted to €30.5 billion. Other financial instruments and resources include loans or guarantees managed by the European Investment Bank or targeted funds.⁷⁷

It is planned that the UK will fulfill the entire scope of its financial commitments in the framework of MFF 2014-2020 undertaken as an EU member. In her Florence speech in September 2017, UK Prime Minister Theresa May announced that the country will not put MFF 2014-2020 at risk, noting that other member states should not have to suffer (namely, increase their contributions or receive less

⁷³ A number of analytical papers mention this: Körner K. Post-Brexit EU budget – the next hot button issue. – Deutsche Bank Research, 28 February 2018, https://www.dbresearch.com/PROD/RPS_EN-PROD/PROD000000000463628/Post-Brexit_EU_budget_%E2%80%93_the_next_hot_button_issue.pdf; Gordon N. The EU budget after Brexit Reform not revolution. – Centre for European Research, April 2018, https://www.cer.eu/sites/default/files/prbrief_mff_gordon_24.4.18.pdf; Darvas Z., Wolf G. Rethinking the European Union’s Post-Brexit Budget Priorities. – PolicyBrief, Issue 1, March 2018, http://bruegel.org/wp-content/uploads/2018/03/PB-2018_01_correction.pdf.

⁷⁴ Countries’ total commitments in the EU Budget for 2018 equaled €160.11 billion (approximately, 1.02% of the gross national income of EU-28), and total payments – €144.68 billion. For more information, see: Ten issues to watch in 2018. – European Parliament, [http://www.europarl.europa.eu/RegData/etudes/IDAN/2018/614650/EPRS_IDA\(2018\)614650_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2018/614650/EPRS_IDA(2018)614650_EN.pdf).

⁷⁵ Determined in 1988, total contributions of some member states (in percentage of GNI) may be partially reduced through “rebates” aimed at compensating for the “gap” between their contributions to the EU budget and their revenues in the government and private sectors.

⁷⁶ These sources of revenues make up a small percentage – less than 5%.

⁷⁷ Source: Economic and Budgetary Outlook for the European Union 2018. – European Parliament, January 2018, [http://www.europarl.europa.eu/RegData/etudes/STUD/2018/614655/EPRS_STU\(2018\)614655_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2018/614655/EPRS_STU(2018)614655_EN.pdf).

according to the current budget plan) because of the country's withdrawal from the EU:⁷⁸ *"The UK...will facilitate and take part in the implementation of 2019 and 2020 annual budgets of the EU. The country will fulfill its budget commitments until 31 December 2020"*. Currently, the UK is the second net EU "sponsor" after Germany, whose annual contribution is from €10 billion to €18 billion (in different years) (diagram "EU Budget Balance, as of 2017 (main recipients and contributors)"⁷⁹).

Along with this, in the light of different pending changes, the EU top officials have to reevaluate their expenditure priorities for the future already now: either EU Budget will have to be cut, which will lead to reduction of payments to member states, or the countries will have to increase their contributions (to compensate for the loss of British contributions)⁸⁰ and thus, increase the risk of possibly stirring up Euroscepticism in a number of countries.

In June 2017, the EC published an analytical report on EU finances based on the White Paper scenarios.⁸¹ This report proposed to simplify or even eliminate VAT-based contributions. The EC also talked about the possibility of introducing energy or environmental taxes to facilitate decarbonisation of the European economy,⁸² or a 3% corporate tax, or financial transaction tax, to stabilise the situation in the Single Market and in the euro area. The EC also considered the option of higher use of financial instruments, such as loans, guarantees and shared funding, both within the EU Budget and outside of it, as a part of the extended EU financial architecture.⁸³

EU budget Commissioner Günther Oettinger has proposed closing the Brexit gap (which, according to his estimations, equals €13 billion) with a 50/50 approach: 50% – "fresh money" (additional borrowed capital) and 50% – cuts to existing programmes, including "Smart and Inclusive Growth" and "Sustainable Growth:

⁷⁸ Source: PM's Florence speech: a new era of cooperation and partnership between the UK and the EU. – T.May Speech, 22 September 2017, <https://www.gov.uk/government/speeches/pms-florence-speech-a-new-era-of-cooperation-and-partnership-between-the-uk-and-the-eu>.

⁷⁹ Built using data from: Operating budgetary balance. EU expenditure and revenue 2014-2020. – European Commission, http://ec.europa.eu/budget/figures/interactive/index_en.cfm.

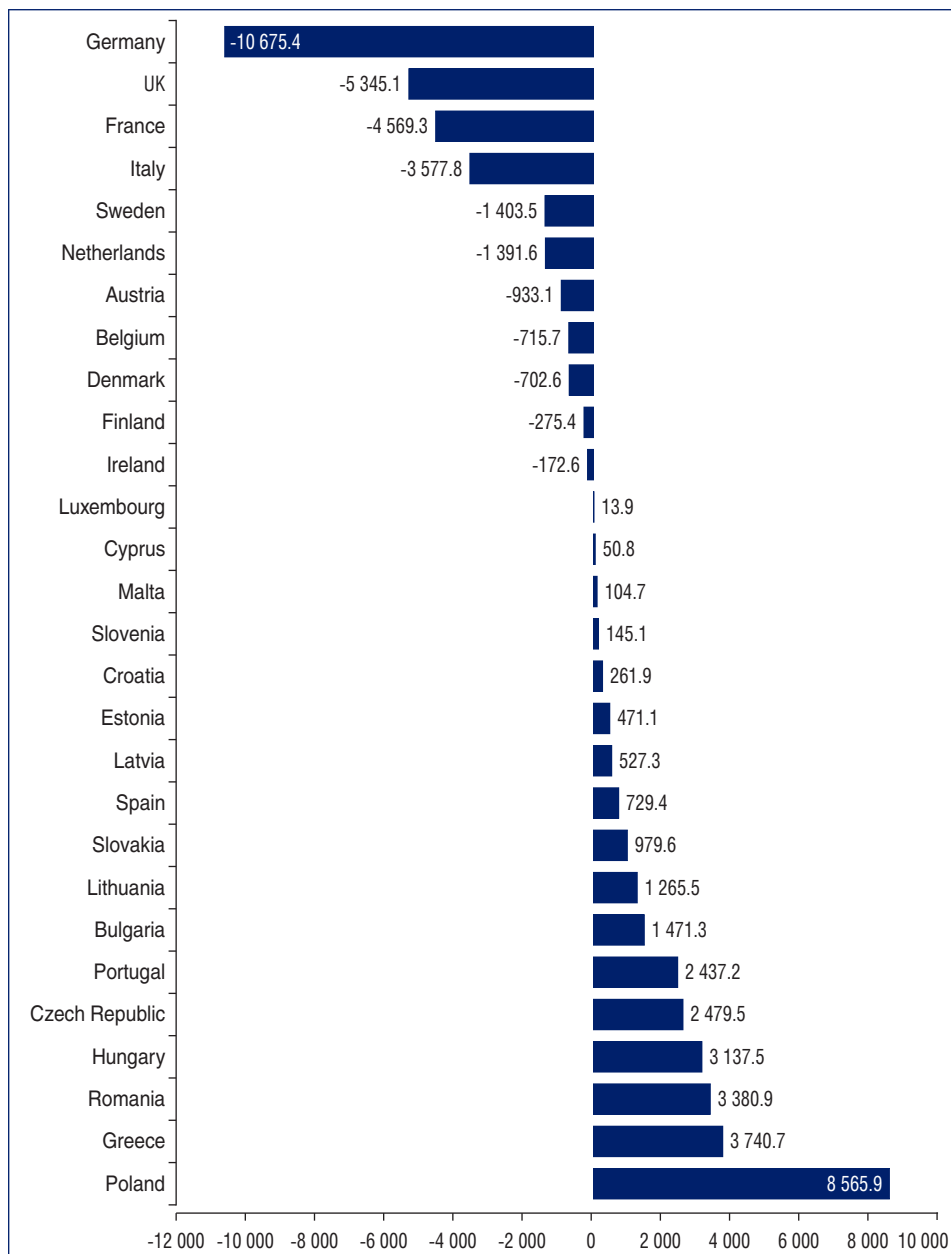
⁸⁰ Such countries as Austria, Sweden, Denmark, Finland and the Netherlands do not want to increase their GNI percentage contributions (they prefer the idea of a smaller budget). Germany, France, Greece, Spain and Ireland, on the opposite, are ready to increase contributions. Concerning the "new" EU members' considerations – Poland, Czech Republic, Hungary, Slovakia, Croatia, Slovenia, Bulgaria and Romania – they insist that a larger MFF in terms of percentage of GNI should be "taken into consideration". In particular, the countries supported an increase from 1% to 1.1-1.4% of GNI. For more information, see: Gordon N. The EU budget after Brexit Reform not revolution. – Centre for European Research, April 2018, https://www.cer.eu/sites/default/files/prbrief_mff_gordon_24.4.18.pdf.

⁸¹ Source: Reflection Paper on the Future of EU Finances. – European Commission, 28 June 2017, https://ec.europa.eu/commission/sites/beta-political/files/reflection-paper-eu-finances_en.pdf.

⁸² Aiming to decarbonise EU economy, the EC is working on projects that reduce dependence on the use of fossil fuels (in particular, in certain areas of Poland and Slovakia).

⁸³ During the current financial period, the European Fund for Strategic Investments has been one of these instruments.

EU Budget Balance, as of 2017
(main recipients and contributors), € million



Natural Resources”.⁸⁴ Along with this, he spoke in favour of boosting spending on student exchanges, the research and infrastructure.

In October 2017, the European Parliament adopted a resolution on EC’s Reflection Paper on the Future of EU Finances. The Parliament came to an understanding that any new priorities in EU policy have to be financed with additional funds, and stressed that the EU has to be funded with “genuine” own resources. The Resolution calls to develop the idea of EU’s added value as the basis for determining EU’s spending priorities. However, the EP expressed doubts as to the need to create additional financial instruments outside of EU’s Budget, as per EC’s proposal.

In May 2018, the EC proposed a way to modernise MFF, offering a broad range of proposals for its reform in both aspects – expenditures and revenues. After a number of consultations in early May 2018, the EC presented a MFF 2021-2027 draft (which did not include the UK).⁸⁵ In particular, the proposed budget totalled €1.135 billion (expressed in 2018 prices), equivalent to 1.11% of the EU-27’s gross national income.⁸⁶ The goal of the MFF is to resolve issues connected with the loss of UK’s contributions, as well as to use the chance to harmonise and restructure the budget and to adjust funding priorities. For instance, it is proposed to fund new and pressing priorities, such as research and innovation, young people, the digital economy, border management, security and defence.⁸⁷ Also, the EC has identified areas, where funding will be reduced: (1) Common Agricultural Policy (CAP) by around 5% (at the moment, CAP receives 38% of the EU Budget); (2) Cohesion Policy – by 7%; (3) Cohesion Fund – by 45%. It gave priority instead to the European Regional Development Fund, which will redirect funds directly to the poorest regions.

The Commission’s proposal also foresees modern sources of funding for the EU budget. Concretely, the Commission proposes to finance the new priorities through a combination of additional borrowed capital – “fresh money” (roughly 80%), redistribution and savings (roughly 20%). Overall, the Commission proposes:

- ✓ *a modern budget* where further cutting of red tape for beneficiaries and managing authorities is foreseen by making rules more coherent on the basis

⁸⁴ For more information, see: Gordon N. The EU budget after Brexit Reform not revolution. – Centre for European Research, April 2018, https://www.cer.eu/sites/default/files/prbrief_mff_gordon_24.4.18.pdf.

⁸⁵ Source: EU Budget for the Future. – European Commission, 2 May 2018, https://ec.europa.eu/commission/news/eu-budget-future-2018-may-02_en.

⁸⁶ EC’s proposal for the EU Budget is consistent with its political priorities set out in the agenda in EC President Jean-Claude Juncker’s EU address on 14 September 2016, approved by EU-27 leaders in Bratislava on 16 September 2016, as well as in the Rome Declaration dated 25 March 2017. Jean-Claude Juncker noted: “*Today is an important moment for the EU. New budget is our opportunity to shape the future: a new, ambitious Union of 27 countries united by solidarity. This proposal helped us present a pragmatic plan on how to do more from less...*”

⁸⁷ E.g., Erasmus+ and European Solidarity Corps budget will be doubled.

of a single rulebook. It also means setting clearer objectives and focusing more on performance;

- ✓ *a simple budget* with a clearer structure which is more closely aligned with the Union's priorities. The Commission proposes to reduce the number of programmes by more than a third (from 58 currently to 37 in the future), for example by bringing fragmented funding sources together into new integrated programmes and radically optimizing the use of financial instruments;
- ✓ *a flexible budget* within and between programmes, strengthening anti-crisis management instruments and creating a new "Union Reserve" to tackle unforeseen events and to respond to emergencies in areas such as security, defence and migration.

A major innovation in the proposed budget is the strengthened link between EU funding and the rule of law. Respect for the rule of law is an essential precondition for sound financial management and effective EU funding. The Commission is therefore proposing a new mechanism to protect the EU budget from financial risks.⁸⁸ These instruments are expected to allow the Union to terminate, reduce or limit access to EU funding for some member states depending on their deficiencies in the rule of law.

One country's intention to withdraw from the EU has brought up the task of harmonising current financial obligations of the other 27 member states. Given post-Brexit budget limitations, conflicts between net contributors and net beneficiaries are almost inevitable, and the risks of long-term failures in the future negotiations between member states and policy-makers are high. If mechanisms for resolving disagreements between those who support larger and smaller contributions are not found, different priorities in various sectors will make reaching a consensus increasingly difficult.

Conclusions

The issues of national and economic independence, fears of losing control over own development, spread of nationalistic trends in Europe and within the country, lack of trust in supranational administrative bodies and agencies, the migrant crisis, which became the result of irregular flow of illegal migrants, – are the leading causes of Brexit.

⁸⁸ Source: Sound Financial Management and the Rule of Law. – European Commission, https://ec.europa.eu/commission/sites/beta-political/files/budget-proposals-financial-management-rule-law-may2018_en.pdf.

After 48 years of membership, the UK was going to leave the EU in 2019. Yet (at the time of writing), current statements and agreements on this issue were still preliminary. On 25 November 2018, at the EU summit the agreement on Brexit was approved. Yet the document wasn't ever ratified.⁸⁹ Meanwhile, UK citizens have divided into two "camps" – in a public gathering on 21 October 2018, a hundred thousand people rallied in support of UK's EU membership. There was a risk that the UK will leave the EU with no deal, which will lead to deterioration of both parties' social and economic situations, tensions in a number of crucial issues: UK and EU citizens' rights, possible border between Northern Ireland and the Republic of Ireland. If the agreement is made, the UK would enter a transition period, to last until 2020. Consequently, the country will have this time to agree all aspects of its future relations with the EU.

On March 20, Prime Minister Theresa May sent a request to the EU to postpone Brexit until June 30. Yet, on March 22, the EU leaders agreed to postpone the UK's exit from the Union until May 22 upon condition that the British parliamentarians approve the draft agreement proposed by Prime Minister Theresa May. If the House of Commons will reject the draft agreement again, the UK will have to inform about its further actions by April 12⁹⁰.

It is important, that on March 27 deputies rejected all alternatives proposed by the Conservative Party: (1) leaving the EU without a deal on 12 April 2019; (2) proposing UK membership in the European Free Trade Association and the European Economic Area; (3) remaining within the European Economic Area and rejoining the European Free Trade Association, but remaining outside the Customs Union; (4) negotiating a "permanent and comprehensive UK-wide customs union with the EU" in any Brexit deal; (5) developing a close economic relationship with the EU; (6) abandoning Brexit completely and retaining EU membership under existing conditions; (7) holding of a second referendum on Brexit;⁹¹ (8) agreeing a "preferential" trade arrangements with the EU.

⁸⁹ The UK Parliament twice (in January and March) rejected Theresa May's deal proposals, which led to a government crisis. Also, on March 13, the House of Commons voted against "no-deal" Brexit, abandoning the scheme when both parties resolve contentious issues as they arise.

⁹⁰ Thus, the House of Commons of the UK voted to postpone the country's withdrawal from the EU: 441 deputies supported the suggestion of Brexit postponing, while 105 parliamentarians were against it.

⁹¹ In addition, on March 25 an electronic petition to parliament demanding to cancel British withdrawal from the EU and remain in the European Union gathered more than 5.3 million signatures.

The situation with Brexit is far from being finalised. One can not foresee its outcome today and it can hardly be predictable for both parties (the UK and the EU) in the coming months or even years.

At the same time, the UK's decision to exit the Union has stirred up the entire continent, and placed in jeopardy the "EU project".⁹² Brexit may (1) cause the EU to cease accepting new members and drop further integration for an indefinite period; (2) stimulate further spread of Euroscepticism within the EU; (3) intensify uncertainties in EU's development, which can undermine the EU's strength on the international arena; (4) deprive the EU of its most powerful business centre – London; (5) strengthen barriers in bilateral trade, investment (possible exit of global investors from the UK) and labour force movement, for the UK and the 27 EU member states. UK's exit from the EU will affect the distribution of costs among EU-27 members, and will also influence the volume of payments of each of them to the EU Budget. Despite the expectations that the UK will continue with its contributions to the EU Budget (in case an agreement is reached), in the future these payments (if they are actually be made) will be much smaller compared to the current ones.

Even though the country is leaving the EU, there is potential for future cooperation not only in trade relations, but also in science, education, culture, as well as foreign and security policy. In early September 2018, President of the European Commission Jean-Claude Juncker in his "State of the Union 2018. The Hour of European Sovereignty" address stated:⁹³ *"After 29 March 2019, the United Kingdom will never be an ordinary third country for us. The United Kingdom will always be a very close neighbour and partner, in political, economic and security terms"*.

From a purely economic standpoint, Brexit will have minimal impact on Ukraine's economy, as the volume of bilateral trade between the countries is small and does not really depend on EU's trade preferences. Yet, overall, Brexit is not beneficial for Ukraine, as it may weaken the EU's political stand in relation to Russia. Besides, the UK has always been among EU members that support Ukraine's integration aspirations. Thus, Ukraine will have to compensate for this loss with more active and rational actions on its way to European integration in all areas of social life.

⁹² For more information, see Section 1 of the Analytical Report in this publication.

⁹³ Source: State of the Union 2018. The Hour of European Sovereignty Authorised version of the State of the Union Address 2018, https://ec.europa.eu/commission/sites/beta-political/files/soteu2018-speech_en_0.pdf.

REFORMATTING THE EUROPEAN INTEGRATION: OPPORTUNITIES AND RISKS FOR THE UKRAINE-EU ASSOCIATION

On 15 November 2018, the Razumkov Centre and the Ukraine & Belarus Office of the Friedrich Naumann Foundation for Freedom organised and conducted an expert discussion on “Reformatting the European Integration: Opportunities and Risks for the Ukraine-EU Association”.

The participants discussed current crisis processes in the EU economy and politics, further EU development scenarios, as well as Ukraine’s potential to adjust to new formats of European integration.

Below are the opinions of participating experts in the order they were presented during the discussion. Texts have been prepared using discussion transcripts and are presented in an abridged form. Some presentations include references made by editors.



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The EU is being reformatted and France is gradually taking over the leadership. So let us consider opinions of French economists. In one of his recent articles, a high-profile European economist Jacques Sapir says: “If the EU fails to achieve budget centralisation, its prospects may be very bleak”. The EU is facing serious challenges at the moment and it is unclear how it will manage to centralise budget issues given the increasing level of self-awareness and cultural diversity.

Another aspect of the issue is economic policy of the USA. At the end of 2016 – early 2017, a group of American economists headed by Jeff Faux prepared a report titled “U. S. Trade Policy – Time to Start All Over”, which, by the way, was published in the “Economy of Ukraine” journal (No.5-6, 2017) with supplementary comments of different experts (in English and Ukrainian). By understanding the actions of the leader of global economic policy, we can understand where the situation in question is going.

Another important issue that also concerns Ukraine is the North American Free Trade Area. After several years of its operation, Canada, which was part of it, realised that its hopes for transnational capital bringing new technologies into the country and stimulating economic growth failed: transnational capital ceased all R&D and associated work at production entities under its control and liquidated corresponding engineering and technical units. Essentially, Canada saw the threat of becoming in future an economy with complete technological dependence on abroad. Therefore, this highly developed *G7* country started building its own national innovation system to prevent Canadian economy's transnational dependence and loss of its own capacity to influence economic and other aspects of social life.

The above-mentioned ideas make one reconsider, from the standpoint of national economic interests, everything that Ukraine has agreed to. At the moment, there is no hope for a "Marshall Plan for Ukraine" – an issue of continuous discussions for several years. Of course, we will be getting some assistance, but it is clear that it will not be sufficient for all the needed transformations and acceleration of processes fostering economic growth. That is why it is high time we prioritised our national economic interests and started reconsidering all of the above-mentioned issues given current transformations in the EU.

France could be a good example here. Why this country is so keen on creating a European army and promoting the issue of European security? It happens because France has its own interests: it has the most developed defence industry in the EU, which could produce a broad range of weapons to be used by the European army. So this political decision is based on economic goals that French leadership is trying to achieve. In this context, Ukraine has to think how it can participate in this cooperation, making use of its own defence industry capacities. For example, if production of tanks or similar machines is involved, Germany (which traditionally manufactures this equipment on a rather high level) would be a serious competitor. Yet, if Ukraine intensifies research and development in a broad range of sectors, they can become the foundation of future decisions aimed at achieving national interests. Then we can take part in this competition as equals and achieve good results.

It has been said on numerous occasions that our cooperation with the EU boils down to either greater openness or greater isolation policy. What do I mean? Any cooperation is to be institutionalised. The EU is an open access order. Our state is the so-called natural state¹ that has the signs of fragility. It has been proven both in

¹ A concept developed by Nobel Prize laureate Douglass North together with John Wallis and Barry Weingast in their book "Violence and Social Orders: A Conceptual Framework for Interpreting Recorded Human History" (Cambridge University Press, 2009, reprinted 2010–2013). According to this concept, natural states appeared 5–10 thousand years ago and are using political systems to regulate economic competition and create economic rents; these rents regulate social relations, control violence and establish social cooperation. Most of humanity (175 countries and 85% of the world's population) still lives in natural states. Open access order has developed since the early 19th century and currently exists in 25 countries with 15% of the world's population. They regulate economic and political competition in a way that helps manage social relations. In open access orders, access to economic and political organisations is open for all citizens, whereas in natural states – it is limited.

theory and in practice that open-access institutions are a worse match for such natural states than the ones they have had before. And if we fail to uphold our national interests as we institutionalise our cooperation with the EU, we will be losing our Europeanness.



Viktor CHUZHYKOV,
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Economic University named
after Vadym Hetman

Current EU trends prove that macroeconomic indicators do not necessarily provide an adequate picture of what is happening in the world's largest integration group. The truth is that at the moment the EU is consumed by a totally different sentiment. Thus, when Europeans are asked: "Where are the Eurooptimists, if there are so many pessimists around?", they joke: "They work in the European Commission".

The EU, especially its new members, is suffering from what is often called "Eurosclerosis". The previous seven-year term of *cohesion policy* implementation resulted in Poland receiving 20% of total cohesion policy budget – more than France and Germany together. Was Poland happy about it? They laugh about it: "Money is not something foreseen by the cohesion policy, but what is actually in the pocket".

I support the idea of joining effort to research various aspects of European integration. One of these aspects is EU's regional policy, and how we can direct Ukraine-EU association-related processes at our regions. Obviously, the reaction of regions, depending on their specialisation, presence of innovative enterprises (which are few in number) – will be different. Might this incite regional confrontation? And if it does, what will be our contingency plan?

This problem also exists in the EU. A research by *Andrés Rodríguez-Pose* from the London School of Economics shows that despite the large sums of grant money allocated for modernisation of Greek regions, these disbursements were not always efficient; and in five regions – the situation got even worse. Thus, we are left with an anti-economic binary law: investment improves the situation, and investment aggravates the situation. In the EU, this sort of regional confrontation is rather serious on the level of *NUTS 2*² classification units, which are comparable with Ukraine's basic regional unit called *oblast*. For example, the gap in GDP per capita between the Grand Duchy of Luxembourg and the most depressed region of Romania is eight-fold. This creates strong stimuli for one-way internal migration from Romania to Luxembourg.

² EU's 2016 Nomenclature of Territorial Units for Statistics (NUTS 2016 Classification), which became effective on 01.01.2018, identifies three levels of regions, with level 2 that includes 281 European regions considered the main target of EU's regional policy. – Nuts – Nomenclature of Territorial Units for Statistics – <https://ec.europa.eu/eurostat/web/nuts/background>.

We often ignore forecasts developed by prominent scientists in the past decades, although some of them are quite relevant nowadays. I would like to attract attention to the work of American economist *M. Storper*, Professor at the University of California in Berkeley, who described a model of the world's future, including its regional aspect, back in the 1990s³. He predicted that in the early 21st century rich regions will revolt against the poor ones. At first, this looked like a fantasy, but later the prediction started to come true.

Talking about Brexit, for instance, we need to pay attention to the response of some of UK regions. It mostly threatens Wales, the Isles of Scilly and other depressed regions (of course, depressed by British standards, not Ukrainian). These regions are against exiting the EU, as Wales has been receiving significant resources from the EU in the form of regional development funding. After Brexit, a neoliberal economic model will take effect, which might cause a situation similar to the one in the US, where we see the decline of Michigan, formerly the car-manufacturing leader.

Today we can speak of a change of the regionalisation concept. The model is changing as no one wishes to pull along the depressed *NUTS 2* regions. The attention is focused on highly innovative businesses located in certain territorial loci. Clusters, technoparks, technopoles and similar entities exemplify this new approach.



I approve of the wording of our subject matter – “reformatting”, not “disintegration processes in the EU”, as it is sometimes presented today. We see Eurosceptical sentiment not just within the EU, but in Ukraine as well. We need to clearly determine our position and understand what lies ahead. This is an important factor that impacts the development of Ukrainian society. We all know that until we resolve the broad issues, we will keep stumbling on the smaller ones. At first, we need to become aware of global trends and processes. And then, project this knowledge onto Ukraine's issues.

There are two main current trends in the global economy. First, is the intensive development of international economic integration, massive increase in the number of international economic integration agreements. In particular, the WTO has received notifications about 600 international economic integration agreements, while 15 years ago – there were only 142. I.e. over the past 15 years, their number increased fourfold. This first trend is related to the second one: creation of global production systems. There is a huge amount of different products produced in the world, and no country is able to produce everything on its own – computers, airplanes, tanks, wheat, etc.



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³ See: Storper M. *The Regional World: Territorial Development in a Global Economy*, The Guilford Press, 1997.

We should clearly determine our place. How we respond to this question will define our future participation in these outsourcing-based international production systems. The connection is quite simple: if we want to be included in the new stage and new form of international division of labour, we need to simplify the movement of production factors, remove barriers, simplify flows of capital, services, goods, intellectual property and labour movement as much as possible. Thus, signing these agreements, we are creating a platform for more efficient use of resources.

The problem of Ukraine's economy is that at the moment we are exiting production systems based on cooperation with Russia. Essentially all of them are being closed down, with only a small share of them remaining. At the same time, Ukraine is not a part of European production systems yet. The Association Agreement was meant to do the same thing that had been done for Central Europe. It had to establish the same climate and ensure the same conditions for production factors movement as exist in Europe, which were expected to form international production systems in Ukraine, and make Ukraine a part of these systems, thus ensuring its relatively stable economic development. Yet nothing of the kind is happening in Ukraine – and this is a serious problem. In my opinion, the Association Agreement is failing to achieve its main objective: help Ukraine become a part of European and global production systems. The country possesses only limited resources and its range of potentially competitive manufacturing – is also very limited: these are usually called *upstream goods* – products in the early stages of production process, or essentially raw materials.

Today there are no two similar integration mechanisms in the world: all 600 of the above-mentioned agreements have their individual features. For instance, the agreement reformatting the North American Free Trade Agreement (NAFTA) is different from another NAFTA – involving New Zealand and Australia. The EU-Ukraine Association Agreement has a totally different mechanism, and there are many other examples of such divergences. This shows that modern theory and practices of international integration development do not equip us with a homogenous economic mechanism. These are differentiated integration processes. The Association Agreement allows Ukraine to use the concept of differentiated EU integration.

This is a concept that allows a trade-off between different local resource patterns and the efficiency of their use in each country. At the start of Brexit, minister *Boris Johnson* noted that the country would have to change 12 thousand legislative acts in the context of resuming full or partial sovereignty over issues previously handled by the EU. As Central European countries entered the EU in 2004-2007, they had to “import” almost 3 thousand EU directives. The Association Agreement references 400 EU regulations, which allow to adjust to opportunities provided by European integration.

Should EU accession be the key goal of Ukraine's development? We should rather consider it as a tool for increasing efficiency. If there is no prospect of accession, we need to think of the ways to use European integration as a development tool, which may not guarantee EU membership, or envisage it as a distant prospect.

Let us cast a glance on some aspects of the development of differentiated economic integration. Today, the EU uses a “wider Europe” concept, which includes not just EU-28, but 41 European countries connected by free trade agreements with the EU. And while the share of intra-EU trade in the aggregate EU’s foreign trade is 65%, the share of trade between wider Europe states (41 countries) makes up 80%. In some countries (Baltic States and Central Europe countries), the volume of EU-bound trade amounts to 80% of total foreign trade. So we witness a self-sufficient cluster here. Of course, we cannot state that Europe is becoming an isolated island in the global economy, yet it appears self-sufficient.

So, I believe that Ukraine needs to use European integration mechanisms, but account for the differentiated integration in the EU. In fact, Ukraine needs to have its own policy of differentiated integration into the EU.



Today we are losing opportunities and there is no hope that our government authorities will do something about it. There is hope that civil society and think tanks will take initiative. They have to lead Government and Parliament by the hand. With 27 years of my experience in this field, I have an understanding of what our leaders can and cannot do, and we need to be realistic in assessing our capabilities.

Ukraine borders on the largest economy in the world, as the EU’s GDP exceeds US GDP by 15-16%. We are bordering on the world’s largest market and are still hesitating whether or not we should be in business with this market. Of course we should! The question is – how, if our government is unable to achieve this cooperation with good pace and precision?



Oleksandr SAVCHENKO,
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Why do we need to look at Europe and why should we not abandon this course? Let us consider China – in what direction is it looking? It is not the US, rather the EU: China’s Silk Road leads to the EU. China sees the EU as its main economic partner, and, I think, future political partner as well. If we were a practical nation, we could become a strong partner in foreign trade and have the following advantages: trade with China, whose economy will remain the third largest, even in 10 years, and with the EU, which regrettably is likely to move to the second place following the US in the next 10 years.

A more complicated question: will Ukraine manage to become a member of the EU, or rather – will it be accepted in the EU? We have no answer to this question yet, as in 27 years we have not been able to form a government based on European values (post-Soviet values still dominate our society). If we do manage to form a government based on European values, principles and behaviours, it will instantly become clear, whether Europe is interested in us or not. I believe this will happen, if Europe sees a powerful and capable neighbour in us. If we fail to form such a government (hardly anyone believes that after the upcoming elections

we can form a European government that will start implementing reforms, like, for instance, Poland or Hungary performed 15 years ago), we should start thinking about less ambitious unions and associations.

What should we put on the agenda? I would make priority use of Ukrainian citizens' intellect. Europe is apprehensive of migrants and Russia's actions on the international arena. We should propose measures to address these fear factors and have EU allocate funds for this purpose. We are to do something useful for the EU in these areas. For example, Turkey was promised €3 billion for hosting refugees, but Ukraine is promised only €2 million, given the fact that we have a common border with the EU. We can make a proposal for creating a trust fund of at least €1-2 billion (not €10 million) in order to ensure normal living conditions for internal migrants. At the same time, if we come forward with the trust fund proposal together with Moldova and Georgia, instead of acting alone, we are more likely to be successful.



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Processes currently taking place in the EU are important not just for Europe, but for the entire world. I would refer to three main directions of EU reformatting.

First – the five scenarios of the European Commission mentioned in the report. Overall, they pave the way towards a two-speed Europe.

Second – Brexit. This is the first time a country is exiting the EU. Although, we are to remember that officially Greenland had been in the EU as a part of Denmark, and later exited the EU. Of course, Greenland is not the same as UK, although what is important here is precedent. And no less important is that Greenland wants to come back to the EU. Here we can also mention Iceland that (re)started and ceased on several occasions negotiations on EU accession. Among other Northern European countries, Norway, which did not become part of the EU but has special relations with it, has occupied an intermediate position. Denmark became an EU member, but as opposed to others (except the UK), stipulated from the very start its refusal to introduce the euro, whereas all other accession agreements contained provisions on eventual transition to the euro. These divergences in the format of relations are not just a matter of geography, not simply specific feature of North Europe's policy. This is determined by differences laid down in economic models: Anglo-Saxon capitalism, Swedish model and other development models.

Third – Balkan states joining the EU. Montenegro, and in the future – Serbia, would mean not only geographical extension of the Union (to the entire Balkans), but also an enlargement of the sector of states in the domain of the Orthodox Church (currently represented by Romania, Bulgaria and Greece).

Thus, on our way to Europe we should take into account these three directions of necessary transformations. In addition, we should be aware of *what* will be Europe when we reach it. Europe is changing, and when we are finally accepted to the EU, we may find it completely different from its current shape. Today, the EU is experiencing major shifts and tectonic changes that are causing “rifts”: one rift is along the UK & Northern Europe – continental Europe line, another – between countries with old democratic traditions and post-totalitarian states (Spain, Portugal, Greece, and to some extent, Italy), and along the Old Europe – New Europe line. In the EU’s eastern camp (post-socialist states), there is also no stability. Another rift has a religious background, which means a rift in mentality, as religious issues are not just about believing in God, they are essentially about believing in oneself, one’s own capacity.

I support the idea that Ukraine should choose a differentiated integration model. Whether we want it or not, it will undergo differentiation anyway, and we need to define, which part we would wish to join.



Speaking about conceptual meanings, I am worried about the widespread use of the word “populism” by politicians and media. It is already hard to define who is a populist and what populism really is. The danger is that social orientation of our economic policy might be caught in the fight against populism. Nowadays, any actions related to increasing pensions or salaries, social security or consideration of people’s interests are being labelled as populism. I believe this is dangerous and erroneous from the political standpoint, as things that are happening in different European countries, current problems Europe is facing, ongoing *Brexit* – all of these are grass roots processes. For example, after latest elections in Italy, when analysts started examining people’s choices and why people made them, it turned out that votes were cast “against” things people were dissatisfied with, and not “for” a clear programme or prospective vision.



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While being a visiting professor at George Washington University (USA), I asked a political scientist the following question: What is the voting algorithm in the US presidential election? How do people choose their priorities, evaluate different complex options? – I got a clear and simple answer to them: on the eve of election, each American family asks itself whether life has become better or worse in the past four-year period. If worse – they do not vote for those in power during this period. If better – they re-elect them. When I saw the voting map from the latest presidential

election in the USA and compared it to the map of the ten-year changes of average salaries on a state-by-state basis – I revealed that this was actually the same map.

We have to receive an answer to the questions: what will be the result of all of these processes undergoing in our country? How will they influence our people? These questions are very important. Choosing among the options of our future policies, we have to realise that according to theoretical principles of economic efficiency there could be no absolute efficiency: we cannot give a reliable assessment for any option. So in our case, to choose the best course of action we should base our assessment of efficiency on comparison – to the basic situation and across possible alternatives. Thinking along these lines, I believe there is no alternative to moving towards Europe. That being said, we should be able to choose our course of action based on our interests. We have to think of what must be done and how can we build a system of integrating with Europe in a way that would benefit us, providing foremost social benefits.

I believe that we need to adopt priorities from the “Europe-2020” programme. There are three clearly defined points. The first is smart growth, meaning development of education and science. The second relates to environment protection. And the third refers to inclusive growth, meaning growth for everyone. It should be borne in mind, the Europe-2020 programme is mandatory for all accession candidates. Why are we not implementing it then? Why are science and education missing among our strategic priorities? Why are we evading inclusive growth policy? I am convinced that we need these priorities to solve many of our pressing issues.



Oleksandr SUSHKO,
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This is possibly a historic moment, as we are talking about more practical, profound things, although not as flashy as in the East vs. West discussions. Clearly, the dilemmas did not disappear. They transformed and instead of the East vs. West dilemma, we now have another one: more integration or more isolationism, more openness or more focus on our own interests. It is obvious that this is not just a Ukrainian dilemma – many countries of the world are currently debating these issues. We will probably not get a final answer to these questions, as the world is very dynamic and this answer requires ongoing re-estimation and responding to changes. I believe that in the next several decades the openness vs. isolationism dilemma is likely to remain topical. In the context of Ukraine’s international positioning, be it economic or social, this will be a megadilemma. However, in political positioning, traditionally called geopolitics, Ukraine has no alternative to choosing Europe.

Over the past years, we have been hearing increasingly more about the crisis of the global open and integrated world, and we have been seeing certain signs of this crisis. It is said that traditional integration projects are not experiencing the best of times, with people's preferences going in a different direction. At the same time, given the numbers that demonstrate a steady growth of the number of integration projects, and looking at free trade agreements dynamics, as well as other objective factors related to global dynamics, we see that there is no turning back. Possibly, there is a gap between how the world views itself and where it is actually moving.

Talking about the above-mentioned dilemmas, there are certain factors that make European integration a very different process for Ukraine as compared to other countries. The main aspect is that European integration is a powerful modernisation incentive for Ukraine. This aspect will remain effective in the future. In the case of the UK, Europe is not giving it anything new in terms of development of its internal institutions, and so it is only natural that British nationals have more trust in their national institutions that work better than the European ones (at least according to those, who voted for Brexit). Situation in Ukraine is the exact opposite. If at a certain stage we allow our national self-interest to take over, this will mean that we lose a powerful modernisation incentive that allows us to transform those areas that lack internal motivation, lack the quality of political elites and relevant competencies.

Here are the two challenges. First, there are factors that prevent us from using the full scope of opportunities provisioned by the Association Agreement and other documents, to say nothing of the new opportunities that could be created. This concerns foremost our mentality. Here we can talk about the sources of Ukrainians' euroscepticism: where it comes from, what forms it takes. This euroscepticism is based on the comprehension by most political elites of the really painful change imbedded in a truly European choice, which means a real change of the ways things to be done. This became clear in the past 3 to 5 years. Earlier, Ukraine's European integration was nothing more than a set of slogans, but as it started coming to life, the elites felt how painful it can be. It became clear, what habits would have to be abandoned, and it generated even more euroscepticism among the ruling elites. The deeper we go in this process, the more noticeable is the resistance.

The second factor concerns broad public. The problem is that those who benefit from European integration make up the active part of society – those who value visa liberalisation and opportunities to study in Europe, those who are ready for communication on equal footing, have partners and are ready to develop these relations. But this segment will never be the majority. Politicians, who seek people's votes, will naturally look for support in wider social circles. It would be naive to expect 90% of the population to value European integration. Thus, there might form a gap between the active minority that benefits from European integration, and the majority that is indifferent to the European choice. Politicians will be playing with this

wing that consists of people hardly involved in European processes, will be looking to gain their support through manipulating their stereotypes and phobias, as is currently done in Hungary and other countries. So our task today is to bridge the divide in the society and facilitate the inclusion of the general population in the processes related to our European choice. I.e. increasingly more people have to feel included in this process. It is important to have most Ukrainians feel like they are a part of the country's European choice.



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Several thoughts on the numbers presented in the report. Most interesting are the numbers currently discussed by the European community and presented in the Multiannual Financial Framework for 2021-2027. Prior to *Brexit* it was 1% of 28 countries' gross national income (GNI). In 2021-2027 – 1.11% of the GNI of 27 EU members, which is €1.13 trillion. Where does the EU budget money go? On the average – 46% is spent on common agricultural policy, and while for Slovakia it is 21%, for Germany– 63%, for France – 65%, and for Bulgaria – 43%. In the second place – measures aimed at reducing regional disparities: 49% in Bulgaria, 9% in France, and 39% in Italy. The third place is occupied by common spending on research and development, which is most significant in Germany – almost 20%. At the same time, the EU spends 6%

of the common budget on its administrative apparatus. Bureaucratic procedures take a lot of time in the EU. This bureaucracy seems to have played its role in shaping the UK's position regarding the EU, as the UK has always been a liberal economy.

I am sure that national state as a mode of society organisation has come into conflict with accelerated internationalisation of production. A good testimony of this is provided, for example, in a Elon Musk's biography book, which describes his experience in building factories in the US and placing then orders across the world. It paints a vivid picture of today's level of internationalisation and what a nation state means in the post-Westphalian world. Academic community has to turn to the following issues: what types of nation states should exist in the modern society of the 21st century? What kind of state should it be and what functions should it execute?

Talking about possible changes in Ukraine's policy or in issues related to the Association Agreement, I have a number of questions: why are we not using the funds allocated to Ukraine by international banks? For example, the European Investment Bank allocated €5 billion for Ukraine, of which we used only €2 billion. Hence the question: why do we keep going there asking for money that we are not using afterwards? If this is caused by the lending conditions set for us – we need to understand that all international financial institutions set "political tasks". We need to think in advance whether we are ready to execute them.

In the process of its development, the EU realised that its centralised hierarchical model is limited in its capacity. The inertial and slowly developing EU's model is in conflict with the dynamic network model that proliferates everywhere today – both in developed and developing countries. This is the basis of the growing Euroscepticism. So, looking for a new model for reformatting European integration, we need to find new points of unity in areas different from monetary and fiscal policy. Fiscal convergence based on macroeconomic imbalance models that is happening now is not a good point of unity, especially after the global financial crisis of 2008-2009. In the context of the network model, as I believe, unity may arise when each member state and essentially each European national is enabled to make the full use of its potential.

The concept of “Euroidentity” can be reset as each European citizen finds his new Euroidentity, which can only be done through his new self-identification: discovering how he can develop his potential within the EU, find his place, his opportunities for self-fulfilment, for communication. If European citizens realise that European integration as a wider integrated space creates better conditions for their personal fulfilment, new self-identity will be born. Different factors of this self-identification have been mentioned, in particular, religion. During the 28th Economic Forum in Poland, Christianity was mentioned as a possible foundation for re-consolidation of Europe.

I believe that this identification has to happen on the basis of networking. And EU reformatting has to happen along the transition from the model of hierarchy to subsidiarity. This means developing local agents, local communities, new businesses and delegating relevant powers to a higher level to ensure most efficient networking. In this context, I would like to mention several areas that are universal in today's European discourse and are important to Ukraine.

The first area, where Europe is trying to find its identity in forming new network economy, includes topics connected with Europe's re-industrialisation, new industrialisation, or the so-called Industrial Renaissance. These topics do contain immense potential of inclusivity, yet with one major “but”. European economy today is rather rigid: this means that this renaissance has a tendency to be localised in high-tech areas and does not really spread across the entire economy. Here is where countries on the periphery of Europe (including Ukraine) may come in handy with their more flexible economic models. These countries can be the recipients of modern network and digital technologies, introducing them into standard economic processes.



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This is the ultimate common ground that benefits, on the one hand, the producers of new technologies – through a major expansion of the market for their products, and on the other, the recipients – as their productivity would grow.

The second area – rethinking the notion of periphery. Currently, Poland feels like a country on the EU's periphery because it is the Union's eastern border, and the country is trying to remedy this situation. A possible solution for Poland is to make itself an agent of EU's influence for the countries outside EU's borders. This includes cross-border cooperation, as well as transit functions and other strategic measures – in trade, investment, etc. Transforming the periphery in a way that it stops being a fringe or rimland, and instead becomes a frontline – this would be good for the countries on the EU's periphery as well as Ukraine.

The EU has the problem of old industrial regions. “Older” EU member states were solving it back in the 1970s – early 1980s, the UK – in the 1980s, meanwhile, for the new members this problem is still topical and they are just beginning to deal with it: this includes a number of regions in the Czech Republic, Polish Silesia, etc. This problem is also relevant for Ukraine, in particular, in the context of rediscovering the identity of Donbas. Thus, this is a prospective area for effective cooperation, involving existing capacities, potential and approaches of the EU, and their proliferation outside the EU. This should include not just the so-called creative industries, but the introduction of a new inclusive model across all areas.

Development of agricultural territories is also topical for the EU. Europe is starting to resist the urban-centred model that is being implemented according to UN recommendations and Sustainable Development Goals. This model might be relevant for underdeveloped countries, where cities can become the agents of civilisation, but in the already urbanised Europe there is another problem: support of urban-centred development leads to segmentation of regional development, with rural segment falling out of focus. Ukraine has a similar problem, so rural development, i.e. based on different models of decentralisation, has good prospects. Notably, the EU is taking active part in Ukraine's decentralisation and formation of unified territorial communities through a number of different programmes.

Migration is another important issue. Europe is dealing with the migrant crisis, but at the same time some countries (including, Poland) see potential in the inflow of necessary human resources, in particular from Ukraine and other countries. We are interested in having these people become agents of change who come back with new knowledge, experience and money, instead of them being refugees, running from our economic and political model.

Conclusions: we need to rethink our euromotivation. After visa liberalisation, we essentially lost our vision of practical priorities – how we can effectively use eurointegration. Moving on to specific areas of self-identification, through practical things, we can regain new motivation, which, coming from the people, will overcome opposition to eurointegration.

I would like to attract attention to the gender aspect of EU governance. This factor is likely to be one of the main influences on the future European policy. Women are coming to power in many European countries, they form governments, and this process has spread to Ukraine as well.

In politics, women tend to make simple and specific decisions. By 2025 almost all European countries will have had their elections, and populism (both in good and bad sense) will be taking over politics in Europe, particularly because many women are populists. They are populists, because this is the easiest way to reach their audience – formulating simple and clear messages. This is also true for Ukraine. So Europe 2025 is seen as a community of countries, where populists and women are taking over.



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The second aspect of the issue: if populists are winning, problems are simplified, which may possibly lead to a stronger role of the national factor. At the moment, there is a major threat of division in Europe, mainly, in Eastern Europe. I think that Hungary is among the countries heading towards this division. And if countries are heading towards division, exit, then Ukraine is becoming more important for Eastern Europe. What can we do to help the united Europe hold together?

First, military security. The hybrid war is far from being over, and Ukraine can fill the security void that currently formed in Europe. NATO is not that powerful. And possibly, the entire concept of European security is about to undergo a change.

Second, energy. Ukraine is a country that could unite Europe's energy networks, which would guarantee sustainable energy security for the entire Union. *ENTSO-E*⁴ has to be promoted, as it facilitates stability and ensures security of energy supply to Europe.

Third, logistics. I believe that when populists come to power in Europe, it will lead to intensification of cooperation with Russia and China. In the context of the Silk Road, Ukraine can play an important role, as logistics will be important for European economy.

Fourth, human resources, migration of intellectual and labour capacities to Europe. On the one hand, migration creates an outflow of human resources from Ukraine, but on the other – it creates a presence of Ukraine's agents of influence in the heart of Europe. Meaning that Ukrainians living in Europe influence European politics and economy.

⁴ European Network of Transmission System Operators for Electricity. In July 2009, ENTSO-E united ATSOI, BALTSO, ETSO, NORDEL, UCTE and UKTSOA electricity networks. Overall, it includes 43 system operators from 36 countries. ENTSO-E was given legal mandates by the EU's Third Energy Package.

Last, but not least is the issue of Orthodox religion. Ukraine could become the Orthodox hub for European and Balkan states. Moving the centre of Orthodox religion to Ukraine as the largest (alongside Romania) Orthodox country, and separating Moscow from European Orthodox church, gives Ukraine a chance to use this idea to help unite Europe.



Halyna YAVORSKA,
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NISS, Professor*

I agree that Ukraine's European integration mostly concerns internal transformations taking place in our country. Gender issues are the result of our progress, although we do not always take note of it.

However, I would like to highlight another aspect – euroscepticism. It was repeatedly mentioned today that Ukraine gave in to the euroscepticism trend growing in Europe. I think this is somewhat exaggerated. This is not so much about euroscepticism, as about reducing political tensions in our relations with the EU. There is less talk of Europe, but this has nothing to do with euroscepticism. Our country's European choice is not a question anymore.

Substituting our European choice with another one means a choice between isolationism and integration. There is a key difference: when we talked about choosing the European direction, this was a choice between Europe and Russia, our future ability to determine our own foreign policy. Today, when the choice has been made, we are discussing our own foreign policy, how we decide to build our relations with the world. We may decide to take a more isolationist stand for a while, but integration is not fading away, as globalisation is still on track anyway, and the observed deviations are temporary.

Regarding defence and security, in particular, PESCO. Obviously, we have no chance of being its part (even the UK is being rejected). I think that this area of cooperation with the EU is not very promising. There is NATO and our cooperation with NATO. We should be solving our security issues in this plane. Also, the EU is connected with NATO anyway and coordinates its efforts with this organisation.

EU's foreign policy does not look very promising at the moment. A part of the Union's foreign policy is the so-called Eastern Partnership and the EU is doing its best to hold together something that has long fallen apart. We heard today that Ukraine needs to act together with Georgia and Moldova. I have nothing against Georgia or Moldova, but I do not support these formats, through which we keep trying to hold together this post-Soviet space.

Coming back to the issues of the banking and monetary unions, I would like to note that there are different points of view regarding their further development. The sceptical opinion is that because the Economic and Monetary Union is incomplete, the EU is on the verge of disintegration. There are also more optimistic assessments. This is a major problem in perceiving the EU in Ukraine: many aspects of it are rather technocratic by their character. In particular, the banking and monetary unions are hypertechnocratic and often incomprehensible even to their participants (e.g. overly complicated mathematical formulas for calculating national debt etc.) So we often see as dogma something that actually appears as just the next technocratic step towards Economic and Monetary Union completion. Nevertheless, we have to see that each EU discussion ends in a rational step forward, not the final breakdown. We have at least two examples to demonstrate this.



Taras KACHKA,
Deputy Director
of the International
Renaissance Foundation

First of all, it relates to Greece. No matter how sceptical the country is in regarding the EU, no matter what its social sentiment is, they have found a solution: it is complicated and will take time to implement, but it fits in EMU formation logic. Thus, all sceptical and optimistic discussions regarding EMU are being carried out on the basis of established EU terminology. It means that if we want to cooperate with the EU, we also have to speak this language.

Emmanuel Macron, who is more optimistic towards EMU, and Angela Merkel with her more technocratic approach, are both saying that they believe in rational solutions, in the ability to calculate future outcomes. But their stumbling block is the lack of trust. At the moment, they need to solve the issue of public confidence in order to make a step forward. If we performed reverse engineering of this situation for Ukraine, we would see that all technocratic proposals coming from Ukraine to the EU and from the EU to Ukraine also stumble upon the issue of lacking trust. Ultimately, apart of calculating the composition of our export and finding where we earn more, eventually, we will have to deal with the issue of trust – and this is the most critical moment, as we often retreat in crucial moments.

Secondly, there is the regional aspect of this issue, with the infrastructural gap constituting a major problem in our relations with the EU. We can talk about efficiency or inefficiency of EU's cohesion policy, various structures and funds supporting it, but we can see a much higher level of infrastructure development in our neighbouring EU member states, which they have attained during the last ten years. This infrastructure gap keeps widening. Thus we have to think of the ways to bridge it. This is possible through either internal mobilisation or tighter integration with the EU to achieve a *spillover* effect, as existing EU programmes extend to Ukraine.

All the discussions about ambitions, benefits and disadvantages of Ukraine's integration are often based on the assessment of benefits and flaws of the Association Agreement. However, this agreement was negotiated under permanently changing

circumstances. What we should remember is that there are no agreements on free trade or economic integration shaped once and forever. The best current example is NAFTA, which its participants have renegotiated and even renamed as USMCA. Please pay attention that dissatisfaction with NAFTA was expressed and resolved in the same legal language, i.e. in terms of the rules of origin, legal procedures, agreed mutual access to markets and so on. So speaking about modifying our agreements with the EU, we need a strategic vision expressed specifically in this language.

At this point, we find out that we (our government and political environment as a whole) lack a serious understanding of the Association Agreement. Currently, the opportunities created by the Association Agreement are used mainly by our agricultural sector, which succeeded in translating its strategic goals into the practical language of market access opportunities, getting permits for animal products export, etc. Our industry is regrettably lacking the understanding of how to link its development goals with making use of specific instruments of international agreements. And we see that here the Association Agreement is not being used at all, starting from the Agreement on Conformity Assessment and Acceptance of Industrial Goods (ACAA). Summing up, every research should translate into practical recommendations expressed in terms used in the language of the EU and its international relations.



Volodymyr FESENKO,
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Studies "Penta"*

A while ago, Ukrainians have excessively focused their attention on the romantic side of European integration. Today this is already familiar and is thus being pushed to the background. No one is discussing what to do with European integration in post-visa liberalisation period and how to treat the controversial processes inside the EU.

Today, taking into account the developments in the EU, we need to move from euroromanticism to europragmatism. Our politicians and government have to take account of these processes, as European integration policies can be flexible and we have to evaluate our actions keeping in mind various options of EU's further development.

I will focus on two issues.

First: scenarios of EU's further development. Internal differentiation in the EU is unavoidable. I believe that there will be the issue of a multi-speed Europe, not just the two-speed version. This trend may find its way not merely in the area of economic and monetary integration, but also in relations with Russia and in defence policy – a subject of current active discussions in connection with Emmanuel Macron's initiative. I am afraid that there will be discussions and the de facto development of a multi-speed – not two-speed – Europe. This may not be obvious, but it might be our chance. We can join those parts of the union that are moving slower, with less tight economic and political integration, undergo needed adjustment, and then – move on. This can reduce the risks of internal opposition against European integration.

I think we should not abandon the topic of Ukraine's EU membership, but the search for the best future tactics adaptable to different scenarios requires a debate. Different speeds of the Union's development and EU's decreasing internal political cohesion might not be the most appealing aspects to us, but this is objective reality.

I would like to highlight the importance of the EU's unity in the issues of sanctions imposed on Russia. This might look like an issue that has nothing to do with EU's internal cohesion and further development, but it is very important to us. At the same time, it is possible that after a while EU member states will be implementing diverging approaches towards the policy of sanctions. Some countries are likely to preserve a stable course in sanctions policy, while others may abandon it. What should Ukraine's reaction be in this case – it is a subject to think over.

The *second* topical issue is our European integration policy. I think that Ukraine needs to adjust it: not abandon it altogether, but adjust. We need to think not merely in terms of the grand ultimate goal, but about gaining benefits from the process, about the efficiency of eurointegration. European integration should not be an abstract goal in itself but rather an instrument of modernisation and development. Here, we have to pay attention to the following.

First, let us be objective: we cannot reproduce the eurointegration path of Poland and the Baltic states, to say nothing of Hungary and the Czech Republic. Let us be realistic: Europe will not be helping us as much as the Baltic countries and a number of Eastern European states in the process of their European integration.

Another aspect of the issue: we may be kept in the waiting room for an indefinite period of time without hearing either “yes” or “no”. This is also a problem and a challenge. So what can we do? Obviously, we should not abandon the EU membership as a publicly and officially proclaimed goal. We need to adhere to it, reiterate it periodically (similarly to the issue of NATO membership), keep knocking on the door, so that Europe does not forget about us. At the same time, our focus should move to specific practically significant intermediate objectives that can help us reap eurointegration benefits in the near future. President Poroshenko's latest agreements with EU leaders have defined a number of such intermediate objectives. We need to work on them, make them more specific, identify our next steps, formulate tasks for the government, and not waste time on abstract conversations.

Another important issue is existing infrastructural gaps. In the process of European integration, we need to be thinking in terms of precisely identified spots where the EU can help us. EU assistance in developing our infrastructure can be relevant, at least in the border regions. There can be more of such specific objectives. Thus, we need not only to make research on urgent issues but also to propose specific ways to achieve these intermediate objectives.

As regards reviewing and amending the Association Agreement, I do not support this idea. I think this would be a wrong path fraught with multiplying problems. A more relevant and practical option would be to negotiate additional agreements on sectoral cooperation, and possibly, on increasing access to the European market for certain sectors of Ukrainian economy.

CLOSING REMARKS



Volodymyr SIDENKO,
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I have to make four short remarks.

First. I think that in all of our discussions we need to differentiate between two concepts: Europe as a civilisation and Europe as a specific and historically determined institutional format of regulating international relations. In this sense, the EU should not be turned into an icon for prayers. This is a pragmatic tool for developing the European civilisation. It has to be altered, undergo changes of format according to internal and external changes in the development of the European civilisation.

Second. We have to realise that where there is integration, there can also be its alternative – disintegration, which similarly to an economic crisis can clear the way for the new. Partial disintegration that clears away excessive elements of development can be treated as a natural part of moving forward. Talking about reformatting, we are accepting these disintegration elements as part of a process that clears the way for the development of key priorities. Because of the information policies followed by Ukrainian media, almost no one in our country is aware that such important union as NAFTA is about to disappear as a result of corresponding agreements recently concluded between the USA and Mexico, joined later by Canada. Next to this, we do not pay attention to a the proliferation of a truly new generation of regional, macroregional, and transcontinental formations based on cooperation of nation states (instead of the supranationality principle), with an extensive range of various coordination mechanisms and creation of broad spaces for free movement of resources and production factors.

Third. Processes that are a part of the Fourth Industrial Revolution are drastically changing cooperation mechanisms through the change of the very perception of economic spaces. New means of communication allow for being global whilst sitting in one's room. There is no more juxtapositioning of global and local. Instead of thinking in dichotomies: integration vs disintegration, global vs national, global vs local, – a new system of perceptions is being formed, which includes all of these levels and provides for their balance and interaction. A new system of multi-level interaction, multi-level governance is being formed. And this is the path we should take – this is the essence of reformatting.

Fourth. What we have presented here is by no means the end of the research, because we are dealing with a process under intensive development. So we will be returning to these evaluations many times. This is why we proposed the idea of creating a cooperative discussion platform for think tanks and experts. It is very important that we stay involved in this process. It is rather sad that our authorities are not taking time to pay attention to these things. I think it is very dangerous for us and for them to be thinking only about today and not about the future.

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