PART 1:
EU ECONOMIC GOVERNANCE: LEVERAGING EUROPEAN INTERESTS ON THE GLOBAL SCENE

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SYNTHESIS

1. External and internal challenges

For several years now, the European Union has been facing two simultaneous challenges: the first internal, dealing with the crises in the euro area, and the second, interrelated, external challenge, dealing instead with the declining role of the EU in the world economy. Within Europe, the ongoing sovereign debt crisis has put the euro area under strain. In a low-growth-high-unemployment environment, most Member States are implementing substantial structural reforms and budgetary consolidations. At the same time, the euro zone area is creating a banking union, and has made progress with reforms for fiscal and economic governance, but has yet to move towards a meaningful fiscal and political union, which are necessary conditions for the economic and political sustainability of the euro. **Given the urgency for crisis management and the ongoing need to improve banking, economic and fiscal governance structures, political attention has been mostly concentrated on EU internal developments.** This inward orientation urgently needs to be rebalanced in order to tackle the second, interconnected, challenge the EU faces: **that of maximising its external influence in a rapidly changing world in which Europe is rapidly losing relative power and influence.**

2. The decline of the EU's economic influence

The rise of new players on the world scene, notably China and other emerging countries, is reflected in the evolution of the institutions of global economic governance. In 2008-2009, the G20 summit took over from the G7/8 as the most important forum for the discussion of global economic and financial developments and potential international coordination efforts. One out of five G20 members is European. In the G8, half of the members were European. Also the EU's presence in the International Monetary Fund (IMF) has been relatively reduced: the European governments had to give up two of their eight seats in the Executive Board. Europe's voice has further been weakened by the fact that several European states have become recipients of IMF aid. **Together, the relative loss of economic weight and the visibly poor performance in terms of growth, debt and banking stability have accelerated the decline of Europe's normative power.** Neither EU countries nor the US are today necessarily considered as 'models' and Western liberal preferences have less weight in shaping the debate on the future organisation of global economic and financial affairs.

One could expect that its weakened role on the global level would have pushed EU Member States closer together in their appearance on the global scene in order to defend joint interests more effectively. For instance, given that the EU is the largest trading block in the world and that trade policy is an area where Europe speaks with a single and powerful voice, one could thus expect an influential role for the EU. **Quite the contrary, the EU is not doing particularly well in handling the external dimension of trade. And the same could be said about economic, financial and monetary issues.**

Moreover, the **fragmentation of its external representation, in particular in macro-economic policy fields, and its troubles influencing the global regulatory agenda and the reform of the international monetary system are striking.** Most problems can be traced back to the unwillingness of some Member States to transfer more power to unified representations in multilateral institutions or the fragmented ways in which European Member States exercise power when dealing with external partners.

This applies to the EU's attempts to leverage its economic performance abroad and, in particular, to its strategy in dealing with traditional and new partners. New initiatives need to be taken in order to once again move closer to the EU's traditional American partner and promote western values in global economic governance. Europeans also need to find their own way of engaging with the new economic powers in the construction of a new global economic order. The problem is less in itself the rise of new powers like China or India, than it is Europeans' lack of an accurate assessment of new demographic and economic realities at the political level and the absence of a clear understanding of EU interests.

3. Ways ahead

3.1. The EU's trade strategy: crisis-driven competition versus long term EU competitiveness

Member States pursue commercial diplomacy in a way that is increasingly undermining to a common EU approach. Competition between Member States for market access is rising as they desperately seek sources of growth in exports to make up for slow domestic growth, as consumers are weighed down by debt and governments cut spending. This strategy is unlikely to make Europe richer. Besides moving forward with the banking, the fiscal, the economic and the political union, **the EU has to fuel domestic demand by promoting policies that boost consumption and investment in those Member States** that are not as harshly hit by the debt crisis. **In the long term, Europe has to improve its slow rate of productivity growth. The EU needs new efforts to boost trade among the EU Member States by knitting Europe's markets closer together** and by increasing competition between European firms, especially in services. This is more likely to be successful than current attempts by Member States to try to emulate emerging economies' 'geo-economic' strategies. *(J. Springford, CER & R. Youngs, FRIDE – p. 39)*

3.2. Engaging with China

With regard to the BRICs, and especially with regard to China, Europe needs to redefine its strategy in order to ensure that both parties benefit from an increasingly close and diversified relationship. So far, **Europe's approach to the BRICs has been fragmented and essentially based on trade and competition policy.** With China, the EU recently became more assertive, notably on public procurement, reciprocity, and anti-dumping issues. China chose to retaliate, slowing down investment in developed countries where China was not welcome. **The EU needs to clearly define European priorities in the strategic partnership, to match Chinese 'core interests'** and consistent demands on the arms embargo, Market Economy status and the One-China policy. Regarding Chinese bond holdings, foreign country purchases of sovereign debt in Europe should be made public so that opacity cannot be employed to enhance political influence. Joint European messages should be delivered at bilateral visits to ensure that sovereign debt purchases do not affect policy. Europeans should moreover create a system of incentives for co-operating with reformers in China. Thus, the EU could leverage already existing insider demands for liberalisation in order to achieve its economic goals. With regard to rising Chinese FDI in Europe, the EU should make a special effort to welcome Chinese private enterprises, which will also strengthen the position of Chinese private capital at home. But it is essential to ensure reciprocity and the protection of European investments in China. Finally, Europe should encourage a 'second opening' of the Chinese economy, one that increases domestic consumption and acts as a new source for global growth. Company ownership and IPOs, intellectual property rights, the financial and service sectors, and public procurement are all areas of pressing interest for Europe in this context. *(J. Parello-Plesner, ECFR & A. Kratz, ECFR – p. 58)*

Besides China, the EU needs to develop comprehensive strategies to deal with other key emerging powers like India and, particularly with middle powers like Mexico, Brazil, Indonesia, South Africa or – closer to the EU – Turkey: economies that may have an increasing influence in the world over the next decades.

3.3. Reinventing the transatlantic economic partnership

The EU should work towards a major initiative to advance the recently launched transatlantic trade and investment agenda. Eliminating tariffs would make companies from the US and the EU more competitive. Removing existing trade barriers could increase the EU's GDP by 0.7% and the US's GDP by 0.3% per annum and promote common standards, especially in trade in services, that could later be adopted by third parties or included in WTO negotiations. On macroeconomic issues, the EU and the US should engage in a regular strategic economic dialogue in order to explore mutual challenges and interdependencies, and coordinate policies more effectively. Other important areas of dialogue include energy and climate change, within the ambit of which the US shale gas and oil revolution has improved the country's position fundamentally. In the field of climate change, research collaboration on major technologies across the energy mix would be a promising perspective. Creating a Transatlantic Innovation and Research Space and a joint EU-US Research Energy Council would greatly help to bring new technologies to the market. Finally, Europe should seek cooperation with the US in its efforts to strengthen the normative framework for the international economic and monetary system. *(P. Świeboda, DemosEUROPA – p. 50)*

3.4. A single voice for the euro in monetary, financial, and regulatory affairs

Europe could increase its influence in global macroeconomic issues if it is capable of creating a single voice for the euro area in global financial and economic affairs in general and in the IMF in particular. Increasing coordination among Member States for the representation of the euro area within international organisations can be pursued in two ways. The first option would be to simply improve coordination in the use of voting rights currently allocated to euro area members, which are today split in two individual memberships and six different coalitions. This could be done through the creation of a euro area committee. The second option would be the creation of a single chair for euro area countries. Membership would need to be officially handled by an institution that has control on budget and fiscal policies, since the voting rights are immediately linked to the effective quota held within the Fund. This institution could be potentially represented by the European Stability

Mechanism, which may increase its importance in the future economic governance set up of the euro area if it becomes central in the coordination of fiscal policies. An alternative would be a euro area economic government, if the EU was willing to embark on a major treaty change. This option requires a reform, or at the very least a reinterpretation, of IMF Articles of Agreement, since officially only 'countries' can be part of the IMF. The second impediment to such a proposal concerns the re-calculation of the formula. By removing intra-EU flows from the calculation of the quota, the Euro area total quota may fall well below 21%, making the first option more attractive if no major reform of the formula is going to be undertaken in the coming years. However, this option would make more sense (for the benefit of having an integrated framework of external representation) if the IMF was to modify this formula and reduce the weight of euro area countries that are currently overrepresented. *(D. Valiante, CEPS & D. Schwarzer, SWP & F. Steinberg, Elcano – p. 66)*

In the field of financial governance, the EU's current process of internal financial and banking reform should be used to strengthen the EU's voice. The task is to promote a more unified and cohesive external representation of its positions. However, this potential may not be realised unless its design takes into account the institutional characteristics of global financial governance, which is composed of a variety of organisations often transcending the traditional public-private dichotomy. The EU should build on its own experience from international accounting harmonisation by turning its ad hoc governance initiative with the International Accounting Standards Board into a full-blown strategy in all areas of financial regulation. The generalisation of this strategy consists in extending the recently established European Supervisory Authorities (ESAs) as institutional platforms to coordinate and represent European views in global financial regulatory negotiations. More specifically, in order to strengthen the EU's regulatory capacity and ensure its institutional compatibility and complementarity with global financial regulatory fora, the newly established ESAs should act as institutional platforms to coordinate and represent European views in global financial regulatory negotiations. Moreover, it should be ensured that the design of the new European banking supervisory authority takes into account both the dimension of the EU's external representation in global banking regulation as well as the new agency's relation to the European Banking Authority (EBA), thus avoiding further fragmentation in the European financial regulatory landscape. To complement the ESAs, appropriate governance structures compatible with the global financial regime are needed. *(F. Chatzistavrou, Eliamep & D. Katsikas, Eliamep & Y. Tirkides, CCEIA – p. 76)*

A well formulated deepening of integration is the only solution to both internal and external European challenges. The EU needs to solve its internal economic problems (low growth and productivity and incomplete governance of the euro) in order to be able to exercise more influence globally. The internal crisis is an opportunity. The internal changes, required to make the monetary union sustainable and the European economies more competitive, require a higher level of political integration, and further integration in turn could facilitate the construction of a single European voice in foreign economic policy.