The Future of the European Union

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A political narrative framed by frustration

Despite better prospects for the eurozone, big gains are expected for populist anti-EU parties in this month's elections, says *Peter Spiegel*

Judging by the eurozone's bond markets, which just 18 months ago served as the most important globally watched gauge of the European project's health, the EU should be cruising through its most contented period in years.

Spain and Italy have seen borrowing costs on their benchmark bonds fall to levels not seen since the heady days before Lehman Brothers collapsed. Ireland – the first eurozone member officially to exit its international financial rescue programme – is borrowing in the private market at the cheapest rates on record. Portugal auctioned its first 10-year bond in three years. Even the eurozone's perpetual problem child, Greece, has been able to dip into the private markets and raise €3bn on its own.

Reza Moghadam, head of the European department at the International Monetary Fund, said last month: "There are improving economies, lower spreads and a return of market access."

Despite the unabashedly good news coming from what was once ground zero of an EU existential crisis, however, government leaders are bracing for Europe-wide elections that are expected to see a rash of anti-EU parties reach unprecedented heights.

Although this month's European Parliament elections will see these populist groups fall well short of a majority – even those predicting a huge groundswell forecast no more than a third of the chamber going to such parties – in some of the EU's biggest and oldest members, they are poised to make unprecedented gains.

Worlds apart: Greek protesters against EU-imposed austerity measures compare the eurozone to the brutal Galactic Empire from 'Star Wars' Milos Bicanski/Getty

Half of the EU's six founding members – France, Italy and the Netherlands – are expecting populists or far-right parties to finish first or second in the vote. In the UK, Denmark, Austria, Greece and Finland, similar parties are also near the top two slots.

Even in Germany, where anti-EU sentiment has historically played almost no role in political campaigns, the anti-euro Alternative for Germany party is expected to attract enough votes to win seats.

Mujtaba Rahman, head of European analysis at the Eurasia Group risk consultancy, says: "Despite the positives, voters have yet to experience the benefits of the pain they have endured over the past few years.

"Voter frustration and political populism will therefore continue to define political narratives in the periphery until living and social conditions improve on the ground."

Supporters of further European integration are hoping the sudden rise of such anti-EU sentiment is a protest vote that will subside once Europe's economies return to pre-crisis growth rates. The eurozone, after two years of recession, is expected to grow sluggishly this year.

But some fear that anti-EU sentiment is no longer a temporary phenomenon tied to economic cycles.

Even the EU's greatest supporters note that the movements are emerging as long-dormant nationalist and sectarian frictions are on the rise in Ukraine, the Middle East and Iraq.

José Manuel Barroso, the European Commission president, said during his final address to the European Parliament last month: "Now that some of our old demons are reawakening, we should not forget that those who defend ultranationalism and xenophobia are also attacking the European Union and the values which we hold dear."

He added: "We must never – I repeat, never – take peace and stability in Europe for granted. We need to defend [the EU in order] to defend peace and stability in Europe."

Some analysts had hoped Russia's assertiveness in Ukraine, where

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Fresh powers add spice to election battle

European Parliament

The new MEPs will be keen to nominate the next commission leader, says *James Fontanella-Khan*

European Parliament elections have rarely been about the future of the EU. Since 1979, when the first elections were held as the democratisation process began, they have been more of a mid-term test of national governments' strength or weakness than a contest for leading Europe.

However, "this time it's different". Or at least this is what outgoing EU parliamentarians claim under a new slogan they launched in February.

For the first time, European parties have nominated their candidate to lead the next European Commission. Effectively, this will give about 400m Europeans a chance directly to select who becomes president of the EU's executive body, which has the power to initiate and implement legislation.

It is unclear whether this will actually be the case, as national governments have traditionally selected the person for the top job at the commission.

However, MEPs are keen to flex their increasing political muscle.

The 2009 Lisbon treaty says that national governments must take into account the EU election results and then hold appropriate consultations among themselves before selecting the new head.

Interpretation of "must take into account the EU election result" will lead to a tough negotiation between the European Council, representing the states, and the parliament.

If the MEPs win that negotiation, it could have radical implications for the future of Europe and its direction.

EU parliamentarians have had little power over the running of Brussels since parliament's inception in 1979, as it has been squeezed by the European Council, which represents national governments, and the commission, which is run by eurocrats.

But since the Lisbon treaty came into force, the elected body has become more influential, thanks to a series of new powers it was awarded by member states.

Over the past five years, the parliament has churned out more than 400 laws, attracting the attention of a wide range of business lobbyists, who have been trying to influence MEPs on anything from easing financial regulation on big banks to watering down the EU's data protection rules in favour of US tech giants.

> Feelings of anger over the poor handling of the eurozone crisis are running high

This year's election is also different from previous ones because it comes at a time when support for the EU project is at an all-time low. Feelings of discontent and anger over the poor management of the sovereign debt crisis that brought the bloc to the verge of a break-up are running high across all 28 members.

According to a Pew Research survey in eight of the largest EU countries – including Germany, France, Italy and the UK – the popularity of the EU has fallen from a median of 60 per cent in 2012 to 45 per cent in 2013.

EU citizens are angry with Brussels for a variety of contrasting reasons.

In southern European countries, such as Greece, Italy, France and Spain, it is blamed for imposing punitive austerity measures that have left millions out of work.

Northern countries such as Germany, the UK, and the Netherlands complain the EU has been too lax with highly indebted member states. They also want to claim back more powers from Brussels over immigration and social welfare policies.

A number of anti-EU parties have emerged, promising voters anything from reducing Brussels' powers to determine national policies, to exiting the euro, the bloc's single currency or quitting the EU.

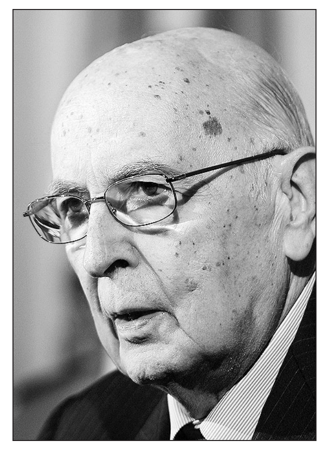
These are led by Marine Le Pen in France, Geert Wilders in the Netherlands and Nigel Farage in the UK. Together with other populist and anti-establishment parties, they are expected to win 218 out of 751 seats, according to Open Europe estimates.

However, counterintuitively, this is likely to produce a stronger pro-integration parliament.

Pawel Swidlicki, an analyst at Open Europe, says "The main effect of the rise in populist parties' representation could, ironically, be to make the next European Parliament even more integrationist by crowding out the reformist middle."

If Mr Swidlicki is right, it means that the European People's Party and the Socialists – the two largest political groups, which have selected Jean-Claude Juncker and Martin Schultz as their respective nominees for the top job at the commission – could form some sort of grand coalition to revive the integrationist dream.

As Giorgio Napolitano, Italy's head of state, said recently, the May election is "a moment of truth for the unity and future of Europe". It will also be the moment that the commission finally becomes a more political, rather than just a bureaucratic, institution.



Giorgio Napolitano: 'moment of truth for unity'

Foundations laid but bricks still to fall in place

Banking union

The new structures have yet to show they can live up to billing, reports *Alex Barker*

It was a step so bold even the original architects of the EU's single currency club did not think it realistic: persuading eurozone countries to give up national control over their banking systems.

That surrender of sovereignty – at least on paper – has now happened, allowing a European banking union to arise from the wrenching political and economic upheaval of the 2012 eurozone crisis.

Given that the talks took less than two years from start to finish, it is an extraordinary feat in political terms alone.

But even its champions admit it is an imperfect construct, perhaps closer to the "timber-framed" first phase described by Wolfgang Schäuble, Germany's finance minister. And it is not clear that the fledgling institutions of the union will live up to their billing.

Of the three parts to a fully fledged banking union – involving one bank supervisor, one resolution authority, and one insurance system for depositors – perhaps half are complete, according to Nicolas Véron of the Peterson Institute in Washington.

The European Central Bank has the potential to become a powerful single supervisor – that element is in place. The common system for handling struggling banks, by contrast, is still to a degree beholden to national interests and national purses; joint deposit guarantees, meanwhile, are not even being attempted.

Even so, Mr Véron speaks of "regime change for European banks".

Yet one of the main purposes of banking union – to reverse the fragmentation of the eurozone financial system – remains unfinished.

Banks have retreated behind borders and increased their appetite for their sovereign's debt, reinforcing the weaknesses the banking union is supposed to remedy.

"The foundations of a banking union have been laid, but changes in the financial landscape are yet to come," says Andre Sapir of the Brussels-based Bruegel think-tank.

The "doom loop" between weak banks and their weak sovereigns is reduced by rules forcing creditors to pay for bailing out banks in difficulty – a so-called bail-in – but it is a lingering vulnerability, say analysts.

Huw van Steenis, banking analyst at Morgan Stanley, says: "The link has been loosened slightly through timid steps towards a banking union, the new bail-in regime for bank liabilities, and the European Central Bank's OMT [Outright Monetary Transactions] announcement [in 2012].

"But, all in all, the political promise made in June 2012 to break the link between banks and sovereigns has not been heeded."

One of the most important immediate results of the banking union – and its first big test – is the ambitious health check and stress test of bank balance sheets. Although seemingly just a routine (and somewhat overlooked) line of the regulation describing the steps to establishing the single bank supervisor, the ECB-led exercise has turned into much more.

Thomas Huertas, a partner at EY and former regulator, says the exercises "should ensure that banks enter the banking union in robust condition".

Mr Veron says the clean-up is "the key to economic recovery in the euro area".

On the line, too, is the credibility of the ECB. Overseeing a tough clean-up process will be vital to burnishing its credentials as the euro area's top supervisor.

The way the potential capital gaps exposed by bank health checks is dealt with will also be important, as it will set the standard for how struggling banks will be treated, once the single resolution mechanism comes into effect from next year.

At present, the tools to handle any shortfalls will primarily be deployed at national level, enforcing EU competition rules that require junior bondholders to pay towards rescues before taxpayers are involved. An open question is whether such bail-ins will be strictly and uniformly applied.

From 2015, common bail-in rules should apply, so that senior creditors are treated in roughly the same way, wherever the bank is based. But if, in the transition period before this, senior creditors are spared in wealthy countries that can afford taxpayer bailouts, but are punished in poorer states that cannot, it would be an inauspicious welcome to a banking union supposedly free of national bias.

> '[The clean-up] should ensure that banks enter banking union in robust condition'

The treatment of banks will also set the tone for another looming debate: whether big, complex eurozone banks should be restructured so they are easier to handle and wind up in a crisis.

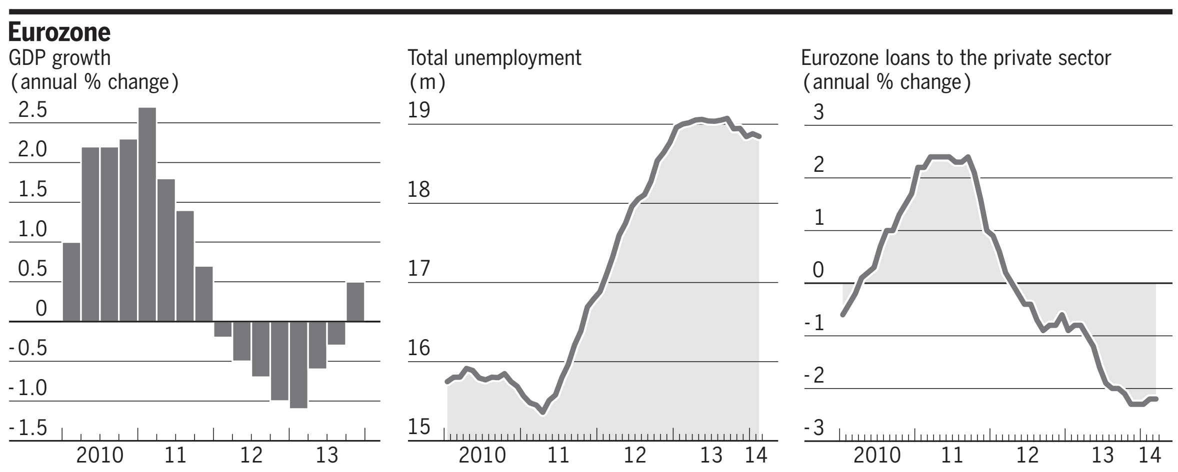
A European Commission proposal to that effect – partly inspired by the 2012 Liikanen report into bank structures – remains in the legislative pipeline in Brussels and is likely to remain a hotly debated reform as the institutions of the banking union bed down.

Thierry Philipponnat, secretary-general of the Brussels-based Finance Watch research group, says: "It is clear that important flaws remain in the design of banking union, not least the presence of banking structures that are incompatible with a credible bail-in and resolution mechanism."

Optimism as data show recovery is taking root

Economy PMI figures confirm there is a return to growth but jobs and disinflation remain concerns, writes *Claire Jones*

Driving ahead: eurozone manufacturers benefit from rising demand outside the bloc Armin Weigel/AFP/Getty



Source: Thomson Reuters Datastream

A cautious optimism has started to take hold in the eurozone.

After finding itself engulfed in economic and political crisis, figures out this month are expected to show that the currency bloc's fledgling recovery continued to take root in the first three months of this year.

Most data out in recent months have helped cement expectations that, after two years of contraction, the eurozone will finally return to growth in 2014.

The purchasing managers' indices, a gauge of momentum that is followed closely by policy makers, has signalled that a recovery in the bloc's core economies, such as Germany, is beginning to benefit weaker economies at its periphery. There are also signs that a recovery in manufacturing, which benefits from rising demand outside the bloc, is beginning to feed through to some parts of the region's dominant services sector.

Nick Matthews, economist at Nomura, says: "We do have a recovery. The business cycle data have been improving for quite some time now. There are increasing signs that it is broadening out."

Jörg Krämer, chief economist at Commerzbank, says: "I'm quite confident the recovery will continue."

He believes the eurozone economy is likely to grow by 0.3 per cent in the current quarter and about 1 per cent this year, broadly in line with other economists' expectations. But, while this is a marked improvement, growth would still remain at levels far lower than where they would have been if the bloc's economy had continued on the same trajectory as before the crisis.

Few expect the region to follow in the footsteps of the UK, which last year grew at a rate that far exceeded most economists' expectations, including those of chancellor George Osborne's fiscal watchdog, the Office for Budget Responsibility.

Growth in Britain is expected to exceed pre-crisis levels later in 2014, whereas in the eurozone that is unlikely to happen for years. If growth remains at about 1 per cent, there is little hope that the recovery will be powerful enough to make much of a dent in unemployment, now close to 12 per cent.

While the PMIs show that output is rising by more than the crucial 50 figure that separates expansion from contraction in many industries, a sub-index for employment shows very few companies confident enough in the recovery to begin adding jobs.

Businesses such as hotels and restaurants, which rely far more on domestic demand than manufacturers that can export their goods outside the region, are still shedding jobs, according to the polls of purchasing managers in the region.

More troubling still is that they are caught in a vicious circle, with job cuts likely to further weaken the domestic demand that such businesses so desperately crave.

Another problem that the recent spell of better growth has so far done little to alleviate is the shortage of loans to businesses. The latest data from the European Central Bank showed that loans to the private sector continued to decline by 2.2 per cent. Since the crisis intensified in 2011, net lending to businesses has fallen by 5 per cent.

There are, however, signs that demand for loans is beginning to pick up. Though lenders polled every quarter by the ECB reported in late April that terms for loans to businesses continued to tighten, they expected demand from companies for financing to rise in the months ahead. It was the first time since 2011 that banks had been so optimistic.

> 'We do have a recovery. There are increasing signs that it is broadening out'

Hopes are strong that the ECB's so-called Comprehensive Assessment, its health check of the bloc's biggest lenders, will boost investor confidence.

But the health check could do more harm than good if the test is not deemed sufficiently tough, or it uncovers capital holes too deep for investors to fill.

Another problem that continues to concern policy makers in the region is disinflation.

Though most view the chances of a Japanese-style bout of persistent falling prices as slim, continuously low inflation is a worry for the region's southern flank, where debt burdens are high.

At 0.7 per cent, inflation is now a little over a third of the ECB's target of below, but close to, 2 per cent and has consistently undershot both the central bank's and economists' expectations over the past six months.

Some believe this will force the ECB to take further measures at its next monetary policy meeting in June, though a bout of quantitative easing, where central banks buy assets outright, remains unlikely for now.

Frederik Ducrozet, economist at Crédit Agricole, says: "Inflation will likely undershoot ECB expectations further, and we still believe that fine-tuning easing remains more likely than not in June, possibly followed by targeted credit-easing in September if actual lending data improve too slowly."

While the mood in the bloc is changing, the job of ensuring a return to full health is far from over. Nomura's Mr Matthews says: "The ECB continues to acknowledge that the risks are to the downside."

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A political narrative that is framed by voter frustration

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demonstrators in Kiev fervently waved EU flags in the months before the downfall of Kremlin-backed President Viktor Yanukovich, might galvanise Europe's voters and their politicians, creating the kind of unified EU-wide foreign policy that many federalists had long hoped for.

But the continuing debate over sanctions has produced only fresh divisions, with ex-Communist members such as Poland and the Baltic states pushing for full-scale economic penalties, while western countries with strong economic ties to Russia, such as Italy, try to apply the brakes.

Despite the divisions on foreign policy and the widespread expectations of a strong populist showing, most EU officials believe the next group of Brussels leaders – which will be chosen in the weeks following the parliamentary elections – will face a landscape not overly dissimilar to the current one.

Though poised for big gains, populist parties will still be dwarfed by the two mainstream groupings: the centre-left Party of European Socialists and the centre-right European People's Party. Combined, they are expected to hold on to well over 400 seats in the 751-MEP chamber.

If the centrist Liberals can minimise their losses from the widely expected trouncing of their largest member parties, Germany's Free Democrats and Britain's Liberal Democrats, the traditional parties should be able to pass legislation with large majorities on their own.

Still, even if populist and anti-EU parties have little direct impact on EU legislation, their new Brussels platform could serve as a soapbox affecting the political calculus in their home countries.

Timo Soini, leader of the eurosceptic True Finns party (which now calls itself The Finns), achieved his best result in the party's history during 2011 national elections. Using his MEP perch, he railed against eurozone bailouts.

Similarly, Nigel Farage, the head of the UK Independence party, has caught national attention in Britain for his combative speeches in Brussels and Strasbourg.

Analysts argue that it was Mr Farage's rise in public opinion polling that forced David Cameron, the UK prime minister, to take a tougher line on the EU, including the promise of an in-out referendum by 2017.

And in the Netherlands, where the Freedom Party of

Geert Wilders has widened his political rhetoric to attack Brussels

anti-Muslim populist Geert Wilders has seen a surge in popularity as he has broadened his political rhetoric to attack Brussels alongside North African immigrants, Mark Rutte, the sitting Liberal prime minister, last year issued a list of 54 policy areas the EU should stay out of.

If such developments spread, it could cause problems for those advocating the EU's further integration, which has stalled as financial market pressure has subsided.

EU leaders were able to pass two landmark pieces of legislation creating a European banking union before the current parliament dissolved. The first set up a Frankfurt-based EU bank supervisor. The second created and funded a bank rescue system.

However, efforts to move further on fiscal integration within the eurozone have been met with a chilly reception.

A plan to require eurozone countries to sign "contractual arrangements" that would legally bind them into economic reform programmes similar to those currently agreed with bailout countries was set aside this year, in spite of the strong support of Angela Merkel, the German chancellor, in what officials said was a clear sign of reform fatigue.

If enthusiasm for eurozone integration continues to wane, the EU treaty change debate may instead be dominated by Mr Cameron, who has vowed to renegotiate Britain's relationship with the EU ahead of his 2017 referendum.

So far, other countries – including Germany – have been cool to his push to reopen the treaties for such a renegotiation. But a successful election for anti-EU parties could change the dynamics of that debate as well.

Response to Ukraine crisis highlights limits to power

Foreign policy Expectations often exceed what is possible, writes *Andrew Byrne*

Radoslaw Sikorski, Poland's foreign minister, could not mask his frustration after a meeting with his European counterparts in March.

"America is from Mars, Europe is from Venus – get used to it," he sighed, leaning back in his chair and folding his arms.

EU foreign ministers had finally agreed to impose sanctions on prominent Russians following the Kremlin's annexation of Crimea – but the list was too short for Mr Sikorski's taste. Seven weeks later and with deepening unrest in eastern Ukraine, the list has grown longer.

But there is little sign of Moscow pulling back and the EU is struggling to build consensus for broader economic sanctions.

For the EU, the battle for Ukraine is the greatest test of its 20-year old Common Foreign and Security Policy, an area that has resisted integration more than any other. In spheres such as trade, regulation and monetary policy, the EU has forged increasing cohesion, but foreign policy remains a showcase for disunity.

"The most powerful member states still have very different priorities," says Luis Simon, an expert in geostrategy at the Vrije Universiteit Brussel. "Those differences are deeply grounded in geostrategic contexts, histories, political cultures and economic structures."

Among her final duties as the EU's foreign policy chief this year, Catherine Ashton will write a new foreign policy strategy that will seek to overcome these divisions.

Her problems are as much internal as external. After two decades and four treaties, EU foreign policy remains stubbornly intergovernmental. Although Lady Ashton has scored some successes – notably her role in brokering a deal between Serbia and Kosovo, and in negotiations over Iran's nuclear programme – she remains institutionally weak and unable to act without the approval of all 28 member states.

The EU has the trappings of foreign policy but often lacks the ability to wield genuine power. Lady Ashton has built a diplomatic service of 139 missions but at a political level, decision-making is constrained. EU diplomats argue that expectations for EU foreign policy often exceed what is possible.

Current trends are not encouraging. Europe's population is falling and its economies are stagnating. Defence spending is declining. Even when countries decide to pool military resources, they do so bilaterally, as the UK and France have done.

Backing up diplomatic initiatives with better co-ordinated EU military resources seems a remote prospect. Even when leaders approve military operations, such as a deployment to the Central African Republic this year, mustering soldiers from the member nations still proves difficult.

But the crisis in Ukraine has also reawakened EU policy makers to the bloc's allure as a soft power.

Looking westwards: Ukrainians in Kiev show their enthusiasm for the EU during an anti-government protest late last year Sergei Supinsky/AFP/Getty

The Ukrainians who ousted President Viktor Yanukovich were furious that he had buckled to Russian influence and walked away from a wide-ranging trade and association agreement with Brussels. Many of those who gathered in central Kiev waved the EU flag. Many EU officials said this rekindled a sense of mission among leaders who had become used to EU flags being burnt during the eurozone crisis.

José Manuel Barroso, president of the commission, said late last year: "When we see in the cold streets of Kiev, men and women with the European flag, fighting for that European flag, it is because they are also fighting for Ukraine and for their future."

But those aspirations among the crowds of the Maidan have also piled pressure on the EU to help rebuild Ukraine's shattered economy. Shoring up Ukraine's finances in partnership with the IMF is the next step.

But the geopolitical struggle with Russia for influence reaches beyond Ukraine – both Georgia and Moldova will sign agreements binding them closer to the EU in June.

Lady Ashton's strategy will also have to respond to security challenges along Europe's southern rim, particularly in Syria, Lebanon, Egypt and Libya.

The foreign policy chief faced criticism for her muted response to the Arab uprisings, but she responded that the true test for the EU in the region would be how it contributes to building stable, prosperous societies in the long term.

The EU's actions in other parts of Africa, such as the Sahel, have earned it more praise. "We've seen successful EU anti-piracy missions off the coast of Somalia, training missions for the Somalian military, and missions in Mali and the Central African Republic," says Prof Simon. "This is an area where the EU is very active."

In 2008, a US report predicted that Europe would remain "a hobbled giant" with poor demographic trends, a divided foreign policy and an energy dependence on Russia that would foster "constant attentiveness to Moscow's interests".

The Ukraine crisis is now forcing the EU to discuss radical moves to co-ordinate energy policy more closely between nations. But there is little sign that this more collective spirit will spread to foreign policy.

Elites face uphill battle regaining voters' trust

Opinion
TONY BARBER

In Cold War times, Berlin's Glienicke bridge was a convenient place for the US and Soviet authorities to exchange captured secret agents and other prisoners, earning it the sobriquet "the Bridge of Spies".

Today, in a Europe healed of that era's ideological scars but struggling to place its desired unity on solid foundations, the Glienicke bridge stands for something different.

Last summer it served as the meeting place of 11 German economic experts, lawyers and political scientists, who drew up a manifesto for closer European union that deliberately challenged certain taboos set down by Germany's political leaders, and its constitutional court, in the course of the eurozone crisis.

The proposals of the self-styled Glienicker Group were soon matched by an initiative from the Eiffel Group, which consists of 11 French intellectuals equally preoccupied with the need to inject fresh impetus into the cause of European unity.

Both groups envision decisive steps forward in European integration – in particular, a new economic government, limited to the eurozone's 18 countries, which would be chosen by a new eurozone parliament.

No less striking is the similarity of the two groups' warnings against the complacent assumption that, almost six years after the onset of the financial crisis, Europe is on the mend.

"None of the fundamental problems underlying the euro crisis have been resolved – not the banking crisis, nor the sovereign debt crisis, nor the competitiveness crisis," says the Glienicker Group.

For its part, the Eiffel Group speaks of "a dangerous resentment" between Germany and the eurozone's southern states. It declares: "To turn our backs on Europe would today be anachronistic, and tomorrow suicidal . . . The euro has become the source of divisions. A section of public opinion has been lost."

It remains to be seen what influence, if any, the two groups' ideas will have in Berlin and Paris. Still, both groups deserve credit for drawing attention to what an awful lot of non-European observers would consider inescapable truths about official German and French attitudes to European unity.

> 'To turn our backs on Europe would today be anachronistic, and tomorrow suicidal'
> France's Eiffel Group

If, however, France and Germany ignore the Eiffel and Glienicker Groups, it will not be sufficient to blame the timidity or self-interest of their ruling elites. For this is public opinion to consider, too.

Bruised by the eurozone crisis, less trusting in the competence and integrity of their political and financial masters at national and EU level, millions of Europeans will either vote in the May 22-25 European parliament elections for far right, far left, populist and anti-EU parties or not bother to go to the polls at all.

In some respects, the most important result will be the turnout. Perhaps the unbroken trend of declining turnout in seven elections since 1979 will be reversed, and voting will surpass the record low of 43 per cent touched in 2009. If so, part of the explanation will probably lie in greater support for anti-establishment parties.

It would therefore be unwise for the mainstream pan-European centre-right, liberal and centre-left parties, even if they end up with a majority of seats in the next EU legislature, to pretend that the voters have somehow handed them a mandate to press on with bold schemes of eurozone integration.

The reality is rather that citizens have learnt from the mismanagement of Europe's monetary union not to trust politicians and technocrats who blithely promise that "more Europe" will automatically deliver economic prosperity and stability.

In fact, signs of voters' "integration fatigue" date back at least as far as 2005, when French and Dutch voters shot down by referendum a proposed EU constitutional treaty.

The paradox of European unity remains today what it was then. The ultimate purpose of this idealistic cause is to enrich, in the widest sense, the lives of Europe's people. Yet the people, in ever larger numbers, are resisting what is deemed to be best for them.

In his poem "The Solution", Bertolt Brecht offered a satirical comment on this problem: a ruling elite unhappy with the people should dissolve them and elect another.

In the real world, Europe's leaders face a long haul winning back the trust of their citizens.

The Future of the European Union

Demographics at odds with policies, as opposition rises

Voyage of hope: migrants rescued by the Italian navy off the coast of Sicily Reuters

Migration The issues raised by a shrinking workforce will not go away, says *Norma Cohen*

As Europe struggles to grow its way out of the recession, perhaps no issue attracts more debate than immigration.

The issue is fraught for several reasons, but first and foremost is the region's evolving demography. Almost all the EU's 28 nations are fortunate enough to share in one of the greatest human achievements of the 21st century: greater longevity.

Equally, most of the EU is home to a second trend. Falling fertility rates over the past 50 years have meant that with the exception of a handful of member states – France, Ireland and Sweden – women are having too few babies to keep the working age population stable.

That means that there are fewer workers likely to be available to provide the goods and services that make up the output side of the GDP equation and the growing population of retirees, with only pensions and savings to live on, will slow their consumption. All in all, that translates into slower, if not contracting, national output.

The effects on the fiscal side are equally alarming; a shrinking working age population that will have to support an ever-larger pool of retirees may face unsustainable taxation.

Were it not for popular opposition, an influx of working age people from other countries could prove beneficial, as various studies have repeatedly shown. In fact, in about two-thirds of the world's biggest economies, the working-age share of the total population declined in 2011, according to data from the Organisation for Economic Co-operation and Development.

Moreover, an OECD study from 2013 found that the fiscal effects of immigration, across all 34 member states, is broadly neutral, having a modest negative impact in some countries and a modestly beneficial one in others.

Countries with the largest number of young, recent immigrants have seen the greatest fiscal benefits. That is because younger arrivals tend to use fewer public services and are most likely to come to work.

"In terms of EU migration policy, there is clearly a disconnect between the demographics of Europe and the policies of the individual countries," says Anna Triandafyllidou, director of the European University Institute's cultural pluralism research area. "It is not a rational approach."

Populist opposition to immigration policy is rising in nearly every European state. The anti-immigrant mood has helped fringe rightwing political parties across Europe gain supporters who might have previously shunned them as extremist.

Opposition to immigrants is based on two, seemingly contradictory, premises, Ms Triandafyllidou notes. One charge is that migrants are taking jobs away from native workers, or that the competition they provide is driving wages down.

The other premise is that migrants – particularly those from other EU member states who are allowed to move freely within the region – are moving to countries seeking social benefits more generous than those in their home country.

And into the toxic mix of debate has arrived a growing tide of asylum seekers from wars raging in Syria, Afghanistan and Somalia, among others. EU data show that 435,000 of these registered in 2013, up nearly a third from just a year earlier. Of the 2013 applicants, 90 per cent were first-time applicants while the remainder were appealing against earlier judgments.

But overall, the EU's record on accepting asylum-seekers – whose numbers are a small fraction of overall migrants – is poor. On average, two out of every three applicants is rejected for asylum.

This is increasingly problematic for policy makers, Ms Triandafyllidou says. "When they are from Syria, Iraq or Somalia, even if they are not personally persecuted, you know that you cannot send them back."

When it comes to migrants from other EU member states, European governments have some, but not much, leeway since freedom of movement is guaranteed.

The UK government, in particular, is moving to counter the charge that migrants are seeking better jobless benefits. From July this year, unemployed people will have to live in the UK for three months before they are allowed to claim child benefit or child tax credit. This three-month qualification period already applies to jobseeker's allowance.

Britain is not alone. In Germany, Chancellor Angela Merkel's government is considering limiting the right of unemployed migrants from other EU states to remain in Germany and tightening access to welfare benefits.

But when it comes to migrants from outside the region – including asylum seekers – the issue may be more complex. According to data from Eurostat, roughly three-fifths of the region's 35m migrants in 2012 were from outside the EU. And a look at who applies for citizenship in EU member states suggests that a significant portion of those migrants represents effective "legacies" of previous colonial estates. Some EU member states extend preferential treatment to citizens of those nations.

For example, Morocco, Algeria and Tunisia represent three of the four countries whose citizens are most likely to seek French citizenship. Spain, which offers citizenship to those from former Latin American colonies after two years of residence, lists Ecuador, Colombia and Peru as three of its four biggest sources of new citizens.

Given the commitment to access for former colonial subjects and policies that have family reunion at their heart, even the strongest rhetoric may not be enough to stem the tide of what are, on economic grounds at least, badly needed people.

New targets put wind up green sector

Energy and climate

One-size-fits-all approach will not encourage necessary investment, writes *Christian Oliver*

Roof insulation may not be deadly, but it is Europe's unused secret weapon against Russia.

An experiment with two identical houses in Hungary laid bare the threat to Gazprom, which supplies 30 per cent of Europe's gas.

One house was left uninsulated and consumed 1,848 cubic metres of gas from September to February. The German company Knauf Insulation fitted the other with its highest grade materials and almost halved consumption to 982 cu m.

With buildings accounting for 40 per cent of Europe's energy consumption, Tony Robson, Knauf's chief executive, argues that the crisis in Ukraine adds a geostrategic motive for putting energy efficiency targets at the heart of the EU's environmental policy.

But he and many other green technology executives are disappointed by the path that Brussels is taking with its energy and environmental targets, which they say are misguided and, perversely, are pushing eco-friendly businesses out of the EU.

While the EU styles itself as a global leader in the campaign against climate change, energy has leapt to the top of the geopolitical agenda. Increasing tensions with Russia have revealed the dangers of depending on energy imports. Europe's industrial competitiveness is also seen as trailing far behind that of the US, which has been boosted by a shale gas boom.

EU policies in response to these challenges have triggered intense debate. In January, Brussels proposed landmark targets that will shape energy policy until 2030 and the 28 member states have until October to finalise the package.

The most important target proposed by the commission was that, by 2030, countries should reduce their greenhouse gas emissions by 40 per cent from 1990 levels. The commission hailed this as an ambitious objective; heavy industry lobbies and some members, including Poland, are seeking to dilute it by October.

Many companies say the target is badly structured. Focusing on one overarching, binding target for reducing emissions represents a very different approach from the targets set for 2020, when Brussels put stronger emphasis on specific goals for renewables usage, energy efficiency and emissions from transport. Those second-tier targets have all been sidelined in the 2030 proposals.

The commission's logic is that member states will have to determine how they make their 40 per cent emissions cut. The UK is likely to use more nuclear power. Germany is expanding renewables after deciding to decommission its nuclear power stations. Poland is looking to shale gas to reduce dependence on coal.

But companies that build renewable infrastructure, or produce low-emissions motor fuel or manufacture insulation are uniting in a chorus of dissent.

One big emissions target will not induce people to use more green technologies, they argue, saying that growth in their sectors to date has required specific targets. The industries complain that the lack of sector-specific targets is damaging investment, with banks seeing little evidence that the EU is creating an environment for their industries to grow beyond 2020.

"Unfortunately, we live in a world where, without legislation, energy efficiency does not just happen," Mr Robson says.

He says Europe's energy consumption in buildings could be greatly reduced by introducing quantifiable EU targets for emissions levels from set floor areas of buildings. There would be different criteria depending on the types of buildings and their ages.

But while the EU set a non-binding target of increasing energy efficiency by 20 per cent by 2020, there is no such target for 2030. Mr Robson says this means he is looking outside the EU for investment opportunities in areas such as Turkey, the US and Malaysia.

Groups such as Vestas and Alstom, which build renewables infrastructure such as wind turbines, have insisted the best way to ensure the growth of renewables is to set binding national targets for the percentage of energy that should be generated from renewable sources, which has not been done for 2030.

> 'We live in a world where, without legislation, energy efficiency does not just happen'

European companies pioneering the production of low-emissions biofuel from waste, such as Finland's UPM and Italy's Biochemtex, say the lack of a specific target for reducing transport emissions by 2030 is restricting their growth, pushing them to consider business in Brazil or China.

Brook Riley, climate campaigner at Friends of the Earth, says senior figures in the commission have a vested interest in arguing that the market can be left to reduce emissions because they devised the Emission Trading Scheme, the EU's carbon market. Although this has fallen into disarray, officials want to ensure it remains Brussels' main tool, rather than targets for renewables and energy efficiency, he argues.

"They've built their careers around the ETS. They need it to succeed, or rather they need to be able to claim it is succeeding," he says.

Reforms stretch holes in official safety nets

Social welfare

Governments are taking action to cut costs but sensitivities run deep, writes *Tony Barber*

On the principle that every crisis contains an opportunity, EU governments are using the continent's financial and economic troubles as a springboard for restructuring the welfare state, that expensive but seemingly irreplaceable element of modern Europe's way of life.

The challenge is not only to control costs in the traditionally high-spending areas of pensions and healthcare, but to get to grips with new types of deprivation such as family poverty and long-term exclusion from the labour market.

The stakes are high. Derided by US conservatives and Chinese communists as an inducement to debt and sloth, the welfare state is, for millions of Europeans, a pillar of social stability, a trade-off for capitalism and an element of democracy as essential as free elections and the rule of law.

In March 2012 the raw sensitivities were on full display in Greece. By undertaking the world's biggest restructuring of sovereign debt, the government dropped a bomb on the welfare state that almost halved the value of assets controlled by pension funds in the form of government bonds to about €10bn. Few actions in Greece's debt crisis shook society or inflamed the political climate so much.

According to Eurostat, the statistical agency, the EU's 28 nations spent an average of 29.1 per cent of gross domestic product on social protection in 2011, compared with 26.8 per cent in 2008, the last pre-crisis year.

This increase is little comfort to trade union leaders and other critics who rail that Europe's welfare reforms are a mishmash of higher retirement ages, reduced state pensions and lower jobless benefits imposed when wages are under pressure and unemployment affects 26m people, or 10.5 per cent of the EU workforce.

"The safety net is still there, but the holes are a bit bigger and some people are falling out," says Rudy de Leeuw, leader of Belgium's socialist FGTB union, which claims 1.5m members.

Governments of left, centre and right, in northern Europe as well as the south, observe that such measures are not just an emergency response to the debt crisis, recession and collapse of tax revenues. They are steps necessitated by deep-seated fiscal, social and demographic pressures that threaten, in the absence of reforms, to render a comprehensive, generous welfare state unsustainable in the long run.

> The rise in spending on social protection is no comfort to trade union leaders and other critics

The opposing arguments are finely balanced.

Official statistics in Estonia show that 7.3 per cent of the Baltic state's 1.3m population lived in absolute poverty in 2012, defined as a monthly disposable income of less than €196, and 18.7 per cent in relative poverty, or an income below €329.

Yet government officials say cuts in health insurance costs, lower pension increases and reforms of sick day compensation introduced after 2009 were essential to put Estonia's public finances, and hence social security itself, on a secure footing.

Italy's 2011-13 technocratic government, led by Mario Monti, passed a pension reform in 2011 that increased the age and minimum years of contributions needed to receive earnings-related pensions.

The changes, which ensure that from 2015 no workers will qualify until they reach the age of 66, were dictated partly by the need to defend Italy's eurozone membership.

But they also attempted to address the burden on state finances of an ageing population. On present trends, the proportion of pensioners in Italian public pension schemes, relative to contributors, may rise to 95 per cent by 2060 from 67 per cent in 2007.

Such challenges are visible, too, in Germany. Without large-scale immigration, some commentators predict that longer life expectancy and low birth rates in Europe's strongest economy will reduce the number of working-age people – who pay the taxes that oil the welfare state – to 36m-39m by 2050 from 50m today.

However, immigrants are indeed starting to arrive in large numbers: net immigration into Germany in 2012 rose to 369,000, the highest level since 1995.

As in the Netherlands and the UK, this has stirred controversy over whether eastern European immigrants enjoy unwarranted access to social benefits – a charge that governments in their native countries indignantly reject.

By raising the numbers of younger taxpayers in work, immigration may ease some pressures on the welfare state. However, in a policy paper published last year, Patrick Diamond and Guy Lodge of Nuffield College, Oxford, said European governments dedicated to welfare reform were still getting their spending priorities wrong.

"This has led to a politics of retrenchment based on cutting and trimming at the edges, rather than determining priorities on the basis of first principles and reshaping the welfare state accordingly," they wrote.

The electoral clout of the middle classes and elderly means that young, poor and unemployed Europeans are bearing the brunt of welfare cuts, when they ought to be the targets of social expenditure to alleviate poverty and put them into work, the academics argued.

Politics fuels anxieties over slow progress in transatlantic talks

Trade

Business groups fret that the two sides are digging in on transatlantic pact, says *Shawn Donnan*

The vision is compelling. If all goes to plan, Americans and Europeans alike will become part of a vast and virtually frictionless transatlantic market.

Gone will be the rogue and so often maddeningly divergent regulations. Thrown out will be the protectionist tariffs and quotas. Replacing it all will be a new transatlantic economic dynamism that acts as the glue of an ever stronger relationship.

A year after its launch, the case remains strong for the Transatlantic Trade and Investment Partnership, or TTIP, the trade pact meant to bind the US and European Union's economies.

As boosters on both sides of the Atlantic point out, five years after the global financial crisis, both Europe and the US still need whatever economic growth engines they can muster.

Moreover, the struggles of the EU and the US to respond to Russia's belligerence over Ukraine have added a strategic impetus to the talks.

In a recent speech, John Kerry, the US secretary of state, touted the TTIP, together with energy independence, as a key element of any joint response to Russia over Ukraine, or any other crises that may arise for that matter.

"That agreement will do more to change the way we do business and some of our strategic considerations than any other single economic step we can take," Mr Kerry told an audience at the Atlantic Council in Washington.

Negotiators on both sides of the Atlantic say they are making steady – albeit slow – progress. The original goal of concluding an agreement by the end of this year disappeared long ago.

But by the end of 2015, negotiators predict quietly, a deal could be done.

And yet you do not have to look very far to discover emerging sticking points, or the anxieties of a transatlantic business community fretting about losing momentum.

In a recent interview with the FT, Emma Marcegaglia, president of BusinessEurope, Europe's biggest business lobby group, said she was worried that both sides were being pigheaded.

"What we see is everyone sticking to their positions," she said, and the risk was that the TTIP may not "get done or gets done in a minimal way".

Ahead of a visit last week to Washington by Angela Merkel, the German chancellor, two other leading business groups – the US-based Business Roundtable and the European Round Table of Industrialists – warned that the negotiations were "entering a critical phase".

"US and EU political leaders and negotiators need to intensify and accelerate their efforts to move the negotiations forward," they said in a joint statement.

The anxieties are driven primarily by two factors.

The first is that, even as Russia has provided a greater strategic rationale, the politics on both sides of the Atlantic have become more complicated over the past year.

The campaigns around November's US midterm elections and the May European Parliament vote have yielded a domestic political context less conducive to trade.

In both Europe and the US the negotiations are also being conducted against the backdrop of increasingly vocal opposition and there is good evidence it is having an impact.

Public opposition in Germany and elsewhere to a proposed "investor-state dispute mechanism" that would allow individual companies to challenge government decisions before independent arbitration panels caused the EU to suspend negotiations in that area this year.

A joint survey taken in February and March in the US and Germany by the Pew Research Center and the Bertelsmann Foundation also found that while both Americans and Germans supported the idea of free trade in general, they were less supportive of individual elements of the mooted pact. Just 41 per cent of Americans and 38 per cent of Germans polled wanted to see all duties removed from imports. And just 39 per cent of Americans and 41 per cent of Germans wanted to remove all investment restrictions across the Atlantic.

'What we see is everyone sticking to positions,' says Emma Marcegaglia

The second reason for the anxieties among business is the tenor of the negotiations themselves. After spending most of the past year in the trade negotiators' equivalent of a honeymoon, the sniping has started in recent months. And that could augur badly.

European negotiators complain that the US's initial offer on tariffs was far from ambitious.

The US, in turn, is upset at what it sees as a cynical EU move to exclude certain agricultural sectors from the tariff discussions.

There are also more sticking points coming to the fore over just how regulations are made in Europe and the EU's long-defended limits on the use of "geographic indicators" for cheeses and hams and other regional agricultural products.

The risk for business is that the negotiations will bog down over the details in contentious areas that have caused the foundering of EU-US trade agreements in the past.

All of which reinforces a simple point. The vision of the future of free trade across the Atlantic remains strong and, arguably, more compelling than it has ever been.

The prospect shines brightly, but it may be difficult to attain.