REVISITING SCENARIOS FOR EUROPE: Central and Eastern European Perspectives

Future of Europe

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INTRODUCTION

After a rollercoaster 2016, this year has seen a plethora of suggestions for reforming the European Union. The entire continent is talking about the future of Europe. Between October 27 and 28, GLOBSEC’s Tatra Summit 2017 added to these discussions with expert analysis of existing proposals and our own ideas to find a way forward. To date, the overwhelming majority of visions that have received most attention have stemmed from EU institutions or older member states like France or Germany. And while we considered these visions from our lofty vantage point in the Tatra mountains, our enquiry nevertheless had a Central and Eastern European perspective. We aim to help shape a future that is good for Central and Eastern Europe (CEE) and the entire EU.

In his recent State of the European Union address, President of the European Commission (EC) Jean-Claude Juncker urged member states (MSs) not to inflame East-West divisions: “Europe must breathe with both lungs. Otherwise our continent will struggle for air.” There was plenty of unifying fresh air and fresh ideas in the Tatra mountains to propel the EU forward.

This past Spring, the European Commission outlined five scenarios for the future of Europe:

1. **Carrying On:**
   The EU continues doing what it is doing, the status quo is preserved.

2. **Nothing but the Single Market:**
   The EU focuses on the Single Market and gradually devolves other competencies and discussions to the national level.

3. **Those Who Want More Do More:**
   Willing member states are allowed to do more together and further integrate in specific areas.

4. **Do Less More Efficiently:**
   The EU chooses priority areas where the effort is concentrated with the goal to deliver more and faster, while other areas are devolved to the national level.

5. **Do Much More Together:**
   All 27 member states go forward together, integration continues across all policy areas.

Juncker’s State of the Union speech effectively added a sixth scenario to this vision. Elsewhere, EU member states, leaders and politicians have similarly put forward their visions and priorities for the future of Europe. The ideas of French President Emmanuel Macron have gained particular resonance and been widely discussed. Many EU observers are also looking to Germany – which is currently more focused on forming a national government – to lead and drive forward the next stage of European integration. The European Commission also admits that many EU regions feel neglected, giving rise to nationalist and populist sentiment.

We embarked on a project to examine what the future shape and trajectory of the EU means for Central and Eastern Europe, and what type of EU would most benefit the region. We aim to develop a constructive agenda that not only reflects the interests of “neglected” regions, but the whole of Europe.

We started our reflection by reviewing the EC’s scenarios. We also referred to proposals advanced by member states and politicians. Our recommendations incorporate insights from discussions held at GLOBSEC Tatra Summit 2017 and are a concoction of ideas derived from different scenarios and visions. All these ideas have two things in common: they are 1) good for CEE and 2) good for the EU.

The purpose of this report is simple. We strive to help CEE policymakers develop a package of goals and proposals to present at the next EU Summit in December – a package that benefits the CEE states and the rest of Europe. For this exercise, we identify “Central and Eastern European” countries as EU member states that acceded to the Union in 2004 or later and are former members of the Eastern Bloc: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia.
This report will specifically examine the following areas:

- European Monetary Union (EMU)
- Single Market
- Social Policy and Freedom of Movement
- European Defence Policy
- Foreign Policy and the European Neighbourhood
- European Climate and Energy Policy

During a heated debate at GLOBSEC Tatra Summit 2017, one of the speakers compared overly ambitious visions for the EU’s future to climbing Mount Everest without oxygen. It is not impossible, but to do so requires lots of preparatory camps and half-way stations. This report has a mountain in sight. To climb it, we have a set of recommendations to follow. Some of them are at the lower stages of the ascent, others are harder to reach. But step by step, they lead to the Summit.
CENTRAL AND EASTERN EUROPEAN PERSPECTIVES ON FUTURE OF EUROPE SCENARIOS

EUROPEAN MONETARY UNION

Membership of the Economic and Monetary Union (EMU) should be a priority for all CEE countries, alongside a careful assessment of the challenges the membership poses. The GDP of the eurozone is currently 72.5% of the total GDP of the EU and it will increase in proportion after Brexit.1 Currently only Slovakia, Estonia, Latvia, Lithuania and Slovenia from the eleven CEE countries are eurozone members.

SCENARIOS

Commission President Juncker’s scenarios provide some plausible directions to where the EU and CEE might be headed. For the CEE countries proposals for “Carrying On” and “Doing Much More Together” might be the best options to pursue over the long term. On one side an incremental completion of the EMU, based on the “Carrying On” scenario, can give time for CEE countries not in the eurozone to get ready to join. At the same time, however, an EMU with continued structural weaknesses would be less attractive and less stable.

In the “Doing Much More Together” scenario the CEE region will be able to be part of a fully completed EMU. Keeping in mind the limiting characteristics of the CEE - such as under-development, low productivity, higher levels of corruption, smaller administrative capacity - a harmonized EMU will ensure stable economic and fiscal environment—a great opportunity. One condition stands—only those CEE countries that are members of the eurozone will be at the negotiating table and part of decision making processes.

The “Nothing but the Single Market” option would be the least beneficial for CEE. Leaving the EMU in its current state will seriously destabilise the Euro and eventually the European market. With their smaller economies and internal structural faults, CEE countries would not be able to withstand the pressure. Similarly, “Doing Less but More Efficiently” will only selectively advance structural currency measures. At the same time macroeconomic and social safeguards— much-needed by CEE countries - might not be introduced in the “pick and choose” scenario.

For the CEE region, the most controversial option is “Those Who Want More Do More”. It immediately creates a rift between CEE members and non-members of the eurozone. Those that are inside will be moving at a faster integration pace towards converging to a more complete EMU. For those on the outside, joining such a fast-moving train will become less and less possible.

RISKS AND CHALLENGES

A rapid integration and consolidation of the eurozone poses numerous risks for the CEE countries. Out of the Visegrad Group (V4) only Slovakia is currently a member of the eurozone. Despite this fundamental difference of status, the V4 nevertheless remain reliable partners, sharing many characteristics including history, geography and economic make-up. Inevitably, once the eurozone becomes more integrated – and if no other V4 country joins the eurozone - there will be a growth in disparities within this small group, with Slovakia reaping the fruits of a more completed EMU and extra re-distributional channels. Further, if the eurozone moves forward in certain integration areas and starts to vote as one block in EU institutions, non-euro members might quickly feel marginalised. This scenario might also lay the foundations for the further destabilisation of the EU.

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The growth of disparities has to be carefully considered. With proposals for its own budget, a minister and parliament, the eurozone will be a self-sufficient and independent club within the EU. This will provide serious challenges for CEE countries outside the eurozone. Re-distributive mechanisms will change in terms of amounts and direction. A possible separate budget for the eurozone will result in a new ‘members only’ re-distributive channel. This, in turn, might lead to a further concentration of capital in the eurozone and the growth of significant social and economic disparities between CEE euro and non-euro members.

Moreover, the future set-up of the eurozone will more strongly reflect the positions of continental Western Europe than those of CEE countries, with less developed and structurally different economies. When it comes to social policy, taxation, energy market liberalisation and similar issues, Germany and France have much more in common than the more ‘liberal’ UK and CEE countries.

The eurozone undoubtedly remains a work in progress in which structural economic, financial and political reforms are still incomplete. This presents risks for CEE countries inside and outside the eurozone. In the case of the former, Slovakia, Estonia, Latvia, Lithuania and Slovenia cannot yet guarantee the stability of their economies and finances when the next economic crisis comes. In the meantime, some non-eurozone members like Poland and Hungary are hesitant to commit to joining the eurozone, afraid that another euro crisis will damage them if they release their national economic and financial autonomy to the supranational level.

During the last financial crisis, some CEE countries were able to use their independence from the eurozone to preserve their economies and financial markets. This was done through utilizing exchange rate fluctuations, controlling their own interest rates and, in the case of Poland, taking advantage of a larger internal market. However, a careful comparison of GDP trends among CEE countries before, during and after the 2008 economic crisis reveals a notable lack of differences between members and non-members of the eurozone (Figure 1). Active participation in the single market has, put simply, bound non-eurozone countries to fluctuations of the Euro. The difference between being part of the eurozone or not lies in the stabilisation and protection mechanisms available to members and the question stands if such mechanisms can be also created and sustained at a national level.

**Figure 1  CEE countries GDP trends pre- and post- 2008 economic crisis**

*Gross domestic product at market prices*

Source: Eurostat 2017
RECOMMENDATIONS

- It should be a strategic goal for CEE non-euro countries to prepare for the membership in the eurozone, and for others to improve their economies’ competitiveness, given the current direction towards the speeding up of integration. A main part of the process will be to introduce important systemic national reforms. These include macro-economic mechanisms to protect investments and insure against unemployment, bank deposit guarantees and fiscal discipline enforcement tools.

- To ensure taking full advantage of the benefits that the eurozone offers, all CEE countries should begin the push for membership. Indeed, while the EMU is still incomplete, the CEE can have a voice at the negotiating table when it matters, defending its own interests and ensuring protection for their economies in the process.

- As members of the eurozone, Slovakia, Estonia, Latvia, Lithuania and Slovenia should share their experiences and help Hungary, the Czech Republic, Poland, Romania, Bulgaria and Croatia when they are ready and willing to join. The eurozone in a higher gear will become less reachable as time passes.

- Substantial progress towards a genuine financial, economic and fiscal, and political union is necessary. The eurozone reforms to be introduced should include macro-economic mechanisms, stronger banking union, capital market union and a well-conceptualised and realised stability fund.

- An accountable and objective oversight system should be created if the EMU is to be a successful project, with all the necessary safety nets for the Euro and strong development mechanisms.
SINGLE MARKET

The single market is, without doubt, the EU’s greatest accomplishment. Nearly half a billion people enjoy broader consumption choices, cheaper goods and services, consumer protections and product safety. In the case of CEE, post-accession Gross Domestic Product (GDP) growth is mostly due to participation in the market. For most CEE countries the GDP doubled (Figure 2). In principal, a successful convergence to the single market should be a priority for CEE, with guarantees of all four freedoms of movement: people, goods, services and capital. But CEE countries should also be aware of both the risks and opportunities that convergence to the single market presents.

Figure 2  Comparing GDP growth in CEE

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP at market prices 2005</th>
<th>GDP at market prices 2016</th>
</tr>
</thead>
<tbody>
<tr>
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<td>3100</td>
<td>6800</td>
</tr>
<tr>
<td>Romania</td>
<td>3800</td>
<td>8600</td>
</tr>
<tr>
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<td>11100</td>
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<tr>
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<td>9000</td>
<td>12700</td>
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<tr>
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<td>14900</td>
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<td>10700</td>
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<tr>
<td>EU 28</td>
<td>23400</td>
<td>29100</td>
</tr>
</tbody>
</table>

Source: Eurostat 2017

SCENARIOS

None of the scenarios advanced by Jean-Claude Juncker will occur in their purest form. The suggestion of “Carrying On” gives clear benefits for the CEE region. It promises further economic liberalization and the guaranteeing of the four freedoms. However, the current proposal by President Juncker to increase the scope of qualified majority voting (QMV) to more areas is contentious for CEE. In the long run, QMV voting on single market policies could lead to less competitiveness for the CEE region. For example, cohesion support allows the CEE economies to catch up and be competitive in the European market. Change in the voting mechanism on the Multiannual Financial Framework from unanimity to QMV could lead to disregard of the essential needs of the CEE countries.

The “Doing Less More Efficiently” variation ensures minimal common standards for the region. There will be less EU regulation on some issues but stronger enforcement on others. This option allows the CEE region more freedom for tailored economic policies like taxation and social protection, without the pressure for harmonisation. Some of the four freedoms, however, are at risk. Given that so many CEE citizens travel, study and work in different countries, it’s important that freedom of movement is not constrained by national protectionist policies.

If the EU turns into areas with variable integration levels and multiple speeds (“Those Who Want More Do More”) the basic function of the single market will not change. However, the scenario of membership of the eurozone vs. no membership will diverge levels of economic development among the countries of the CEE.

The “Nothing but the Single Market” and “Doing Much More Together” scenarios are the least favourable possibilities for CEE. In the former, CEE countries may lose comparative advantage as movement of people will not be guaranteed. In addition, while standards in areas will vary, if not guaranteed by minimum rules important to CEE, protections can be lost. For example, CEE countries, led by Slovakia and the Czech Republic, are championing equal and enforceable standards in food quality. In October 2017, Bratislava held a consumer
summit on the subject of “dual quality” of foods, where the division between “first- and second- class EU citizens” was deemed fully unacceptable.

“Doing much more together” assumes that EU competences will be further increased in the single market and standards universally harmonized across the Union. This integrationist scenario might turn out to be attractive, if the countries in question proceed with national-level reforms that enable them to withstand competition from more developed peers in Western Europe. For the CEE region, rapid and deep integration might, if systemic challenges are not addressed, lead to lower competitiveness, loss of jobs and macro-economic stress.

RISKS AND CHALLENGES

The CEE countries share common characteristics, including low productivity, under-development, elevated levels of corruption, skills mismatch, smaller administrative capacity and [in some cases] political instability. This extra burden, as compared to more developed economies, might have a negative impact on the participation of these countries in the single market. It should be the strategic choice of CEE countries to align themselves with the high-flying economies of the EU.

Increased competitiveness is essential for full participation in the single market, and this will only occur in the CEE region if its constituent states are capable of withstand the pressures from already developed economies. The initial experiences of CEE’s in the 1990’s highlighted the dangers of hastily opening up of developing economies to well-developed competitors. CEE countries should prevent initiatives by member states or international companies that are divisive, discriminatory or exclusive, and that limit the scope of four freedoms.

Moreover, with the possibility of the EU being restructured into various areas with multiple levels of integration, some CEE countries could be limited in their opportunities for single market convergence. The CEE should make sure that any enhanced cooperation is open to the willing at any moment in time. Meanwhile, it is in the best interest of the CEE region to make sure the liberalisation agenda for the single market is implemented and protectionist policies are penalised/prevented.

Indeed, while Brexit will have an influence on the single market, what’s more worrisome for CEE is the inevitable change in the decision-making configurations that will occur in the EU. Traditionally the UK has been an ally to CEE states. In the new environment, however, CEE countries might struggle to defend their positions against some of the more powerful member states.

Some EU policies such as regional and agricultural initiatives have also contributed to the convergence process between new and old member states. However, the pace of this convergence has been slow. If re-distributive policies are adjusted without the realisation that the current structure still has a strong concentration of capital in older/richer members, then CEE countries might find themselves at the edge of market convergence, with weak political voice and lesser social development within the EU.

Figure 3 Revealing economic discrepancies between CEE and Western Europe

Gross domestic product at market prices

Current prices, euro per capita

Source: Eurostat 2017
RECOMMENDATIONS

- Successful convergence of CEE countries into the single market will require a number of national level reforms touching upon several areas of public policy: education, vocational training, labour market policies, social protection, e-government, and more.

- In the new financial framework, the EU should assist the functioning of the single market with redistributive instruments that bridge the social and economic gaps in the single market, which is particularly important for the CEE region.

- To take full advantage of the single market, the CEE needs to build up its capacity to negotiate at the European level—which is especially crucial in the context of Brexit—so that its interests are reflected in decisions, laws and allocation of resources. Some examples include climate change and energy, social policies, the digital economy and transportation.

- CEE countries should insist and work on guaranteeing that the European Commission (with help from the European Court of Justice) remains the objective guardian of the treaties and law-enforcing entity so that the single market is a level-playing field.
SOCIAL POLICY AND FREEDOM OF MOVEMENT

Although the fostering of social cohesion has always been an objective of European integration, a strong and comprehensive EU-level policy on social rights has not been imaginable for decades. Conceived of as an economic project, the EU has long treated social rights primarily as a by-product of cumulative economic growth and as a constitutive element in the Single Market ensuring a level-playing field (the minimum standards are supposed to stave off social dumping and a race to the bottom by member states). With too many dividing lines and seemingly irreconcilable domestic social and welfare models, the competencies for the social dimension though have remained largely in the hands of national governments.

Several recent developments, nevertheless, have changed the momentum of political discussions, rendering social policy a priority at the EU level.

Firstly, the economic crisis and the subsequent slow recovery shattered the premise that economic growth enabled by trade and globalization would automatically translate into sustainable prosperity shared by everyone. Given the social and economic insecurity and the sense of public unease surrounding the era of technology and robotization, Europeans are increasingly seeking protection from the state. The CEE population was affected disproportionately on account of the fact that prosperity buffers are thinner and levels of welfare are lower. Social divergences that have widened across Europe combined with years of austerity increased popular support for social spending and protection both domestically and within the EU.

Secondly, in many Western countries free movement of people is increasingly seen as an unwelcome component of European policies that undercuts the prosperity of local populations. The feeling of dissatisfaction with the uneven distribution of economic benefits is exacerbated by the fear of losing one’s job to a foreigner, often to cheaper labour from CEE. Many Western countries are now more politically motivated in equalizing the playing field for their domestic populations by lobbying for the upward harmonization of social standards across the EU. Hence, there is vocal support for the further elevation of various elements related to the social agenda to the EU level.

Thirdly, Brexit has changed the balance of positions towards EU-level social policies. Traditionally, CEE had a strong ally in Britain as regards to scepticism towards social legislation (work environment, non-discrimination, social dialogue, working time, etc.) at the EU level and at the same time support for arrangements that render the movement of people in the Single Market relatively smooth and free of bureaucratic hassle. With Britain out of the picture and many CEE countries not acting constructively, it is now easier to achieve compromise strongly tilted towards the gradually converging Franco-German social and labour philosophy.

Fourthly, not only national governments but also the EU Commission perceives Social Europe as a way to both boost growth and regain support of populations. Representing a new social contract offered by the EU to its disenchanted citizens, a “Social triple-A” might serve as a vehicle for unleashing a new wave of momentum. The Commission is hence determined to “put social priorities where they belong: at the top of Europe’s agenda”.

From the CEE perspective, however, for the new social contract to be credible, it has to take into consideration economic realities: the convergence between the West and East, while indisputably a desirable goal, is not happening fast enough. Poorer economies can hardly afford the levels of social protection that Western Europeans are enjoying today.

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RISKS AND CHALLENGES

Central European countries must find a way out of several dilemmas. First, the freedom of movement and the introduction of high social standards are a mixed blessing for CEE in the immediate future. On the one hand, participation in these areas undoubtedly brings numerous benefits: modernisation of the work environment, higher levels of social protection (at least at the level of the European minimum floor), outflow of the excess labour force, and remittances. On the other hand, the drive to provide higher living standards and better social protection for its citizens has to be weighed against the fact that the region’s competitiveness now is still often derived from its cheap labour force. The increase in social standards might eliminate this competitive advantage. Furthermore, there are other pivotal risks that CEE can only ignore at their own peril: loss of human capital, brain drain, strain on the public finances imposed by higher social protection, and manifest frustration - driven by observations that Western Europe continues to do better and the perception that the pace of convergence is falling short of expectations - in certain segments of society.

As a result, even though the convergence of the standard of living is a highly desired outcome of European integration, many fear that rapidly accelerating the process and taking a quantum leap forward in European integration will lead to the collapse of the region instead.

Second, while searching for a sound balance between social standards and competitiveness, the countries will be forced to consider whether they want to address the issue at the national or EU level and how, if at all, they want to combine the two. Working closer with Brussels might require an uncomfortable political reversal of the current “taking back control” approach in some CEE capitals.
SCENARIOS

Sliding all the way down to Nothing But The Single Market and the associated dismantling of the current social and migration agenda would result in increasing social and economic discrepancies in the EU. Due to the fact that Central and Eastern European member states are still less competitive and have lower social protection than in other parts of the EU, the region risks becoming a social and economic laggard of the continent. This scenario is, however, unlikely.

The most probable scenarios for the near future lie in the intersection of the Commission’s “Carry On”, “Do (Less) More Efficiently”, and “Those Who Want More Do More” projections. As social agenda and migration are tightly linked to the underlying economic cooperation framework, the legislation in the area of social policy and free movement is likely to be incrementally upgraded to support convergence.

In the – currently rather unlikely - case that EU MSs decide to pull a brake on the speed of integration and do less more efficiently, CEE countries will need to focus on ensuring a set of policies vital for the region:

- In principle: freedom of movement for all EU citizens, including free movement of labour.
- More efficient processes with regard to the transferability of retirement funds and access to cross-border health care, at least in urgent cases or at the minimum level, as part of the labour mobility system.
- Improvement of the system of recognition of diplomas and qualifications.
- Availability of funds that address social cohesion and help invest in human capital.
- Healthy level of social legislation that contributes to a harmonious exercise of the four freedoms.
- Minimum standardization of business regulations concerning labour rights and working conditions that ensures that small Central European national markets do not have unnecessarily peculiar standards hampering investment.

As the reform of the Eurozone moves forward with invigorated political backing from France and Germany, so too will the social and labour legislation for the member countries. This “Those Who Want More Do More” scenario – or “strengthened cooperation” in EU terms – is divisive for the region and not without controversies.

Firstly, a giant leap forward within the Eurozone might be too ambitious for Eurozone members from the region.

CEE countries have traditionally been supportive of the free movement of persons and the associated legislation regulating it. However, they have generally been sceptical about the feasibility of quick harmonization of minimum national-level standards as regards, for example, work environment, working time, and wages, as it would imply an increase in labour costs.
To advance the Eurozone, its CEE members might be cajoled into adopting social legislation that does not match their public financing capacity. With few reform specifications already agreed upon, it is hardly possible to safely predict that the costs of excessive social legislation would be smaller than the potential benefits arising from membership in the stable environment of a single currency. EU-level social measures supported by specially designed funds (e.g., unemployment schemes) and complementary to the national-level transfers might serve as an anti-cyclical stabilizer. Given the robust design, CEE Eurozone countries might benefit from a stabilization system with a stopgap mechanism ensuring that a financial crisis is not detrimental to social stability.

Secondly, multispeed integration galvanized the resentment of those currently outside the Eurozone. Without the support from the EU mechanisms that are being upgraded to compensate for potential negative effects from harmonization, the non-participating countries risk falling out of the single market and becoming entangled in the race to the bottom in social terms.

To quench resentment, the EU Commission is rightly attempting to engage the entire EU-27 with respect to social reforms or at least not cutting the non-Eurozone countries off from social programmes supporting convergence.

Despite – currently – only having very limited competencies in the area of social rights, the EU Commission advocates for Doing More Together. The European Pillar of Social Rights proposal revealed in spring 2017 is addressed firstly to the euro area but is open to all EU member states with the inherent view that ideally the whole Union would be part of the new arrangements.

A quantum leap forward for the whole Union in the area of social policy is highly unlikely and would be potentially destabilizing. In the longer run, “Doing More Together” would be, however, the most optimal model. There would be one European demos whose social risks are pooled at the European level and in which social transfers across MSs are directed to the regions or communities with the greatest need.

To get to this ideal, albeit remote, future, it is important for all CEE countries to ensure the availability at the EU level of fair distribution schemes and funding for social cohesion and convergence measures. The attempts to rapidly introduce higher social and welfare standards across the CEE region might lead to the loss of its competitive advantage, increased unemployment, and an inability to stabilize the labour market and economy overall.

The negotiations of the post-2020 MFF are the right time to secure fair access to EU funds for the affected regions and populations. With the UK leaving the Union, the EU27 are yet to agree on whether to accept the

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*The Pillar of Social Rights is structured around three categories: equal opportunities and access to the labour market; fair working conditions; social protection and inclusion.*
lower budget caused by Britain’s withdrawal or fill the gap by increasing contributions\(^5\). Although European Structural and Investment Funds (ESIF)\(^6\) comprise 37% of the 2014-2020 budget, CEE will not have an easy time negotiating the share and priorities for the next period\(^7\). The amount of money available at the EU level is certainly not sufficient to address all the problems. But all these programmes and other incremental proposals mentioned above are a step in the right direction.

**ADDRESSING THE COMPETENCIES CONCERNS: NATIONAL MEASURES AS A CRUCIAL STEP**

Further development of Europe-wide social regulations would require giving the Commission more powers and competencies. Many member states are cautious and perceive the Commission’s Social Pillar proposals as an unwarranted encroachment on national competencies. But the success of Carry On and Doing More scenarios, be it in the coalition of the willing or as the EU27, is inconceivable without a) making the existing regulations work more efficiently and b) MSs doing their homework.

The “more efficiently” step is also applicable to the enforcement of rules. The “posted workers” case offers an example. Only 0.5% of total employment in the EEA is involved in posting, and posted workers from low- and middle-income EU countries account for less than 0.3% of total employment\(^8\). Although the number is low, the posted workers are at the centre of yet another East-West clash in the EU. What should really be addressed is not the small number of cases when cheaper posted workers undercut the locals, but the much larger number of cases of undeclared or wrongly declared – in terms of skills or hours worked – workers used by both domestic and foreign firms. It is not the rules on posting but the enforcement of them that should be addressed. Proper databases and electronic systems of registration of workers and stricter responsibilities for the sending firm in the case of non-compliance could be part of the solution.

**Figure 7**

If one of the goals of the EU is to develop a new social contract with its citizens, the practical daily experiences of citizens with the EU machinery matter. There is still room, for example, for streamlining the bureaucracy involving the accessing of the social and healthcare system for mobile citizens. Public administration is most often in the hands of member states.

Finally, regardless of the pace of integration, CEE must do the necessary homework: the current model of competitiveness with its reliance on lower labour cost is not sustainable. Domestic reforms encompassing investments in human capital and measures to increase productivity are the pressing need of CEE countries; they are policy actions that will benefit the countries under any scenario.

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\(^6\) ESIF consists of five funds: European regional development fund, European social fund, Cohesion fund, European agricultural fund for rural development, European maritime and fisheries fund.

\(^7\) CEE can also benefit from the funds specifically targeting unemployment, education, training and other social issues – European Globalization Adjustment Fund, Youth Employment Initiative, Erasmus+ and Erasmus Pro, Employment and Social Innovation Programme and Fund for European Aid to the Most Deprived.

RECOMMENDATIONS

➢ To CEE Eurozone countries:
  • insist on the need to create a convergence fund for countries that need to catch up;
  • try to act as a brake on some initiatives such as a European unemployment insurance scheme if the need arises following the impact assessment of proposed legislation;
  • trust the core eurozone partners that tying their fortunes together in closer union will ensure that the wellbeing of any member is a priority for everyone.

➢ To CEE countries currently outside of the Eurozone:
  • keep the Eurozone door open and prepare for the accession that will eventually come;
  • coordinate with other CEEs and establish relations where CEE eurozone countries act as a spokesperson for CEE non-euro countries.

➢ To all CEE countries:
  • reform national socio-economic models as the current reliance on a cheap labour force as a source of competitiveness is unsustainable:
    − prepare to abandon the cheap labour and low cost social model;
    − make social investments that build human and social capital and raise productivity;
    − avoid entrenchment of the current model where the East is a cheap subsidiary to the innovative, post-modern West;
  • seek new allies after Brexit;
  • conduct impact assessment of proposed laws and initiatives

➢ To the whole EU:
  • improve portability and transferability of rights and benefits in policies related to free movement;
  • carry out necessary reforms of the Eurozone, Schengen, and labour acquis so that – whatever the level of ambition – the balance between West and East, competitiveness vs social protection, central coordination vs subsidiarity and respect for national welfare state models is preserved.
EUROPEAN DEFENCE POLICY

The rise in pre-eminence of future defence integration in Europe is driven by set of unique and historical factors. Following the highly (politically) turbulent years of 2015 and 2016 – represented by an apparent increase in acts of terrorism, enduring conflict in Ukraine, intensification of cyber-attacks, uncontrolled migration-related challenges and lasting civil war in Syria – the EU is experiencing a somewhat surprisingly positive (almost enthusiastic) political momentum. Much of that optimism has so far been driven by the avoidance of the feared potential takeover of Europe’s political helm by anti-systemic and populist (for the EU’s institutional angle, potentially destructive) forces in the Netherlands, France and Germany. More than that, the election of Emanuel Macron and continuity in the Bundeskanzleramt potentially constitutes a once in a generation boost for the most ambitious areas of European integration – including defence policy.

TOWARDS GREATER EUROPEAN DEFENCE AUTONOMY

For the European political mainstream to survive, it must demonstrate a clear ability to provide security for the society. Europe’s ongoing struggles with its porous southern borders, the threat of radicalisation and terrorism, its inability to shape the security dynamics of the conflict in Ukraine and meaningfully contribute to the stabilization of the Middle East all represent another boost factor for an enhanced (and more ambitious) defence policy. Essentially, future considerations for enhanced defence policies are shaped by two equally important (yet somehow contradictory) factors: lack of perceived security and excess of expressed enthusiasm.

Judging from the vantage point of the level of development of European Defence Policy, it is admittedly not an understatement to conclude that the EU will not have the capacity to fully replace NATO as the principal anchor of European security for at least another decade. However, NATO’s members are increasingly expected to contribute to its mission with a more robust and capable (autonomous) defence posture. Building better European defences is not necessarily about creating new institutions, but enforcing what the EU already commits to: mutually assisting member states to deal with perceived (internal or external) sources of insecurity. The UK’s decision to leave the Union changes the overall context of EU-level defence policy. With Brexit, the Union is losing a regional (sub-global) military power, a strong pro-Atlantic strategic advocate, but also an established opponent of further integration.

THE PERSISTING RISKS AND CHALLENGES

Figure 8 Comparative global military spending (billion USD)

The optimistic idea of enhanced European defence policy rests on two conclusive pillars. The first is constituted by the eventually beneficial nature of Brexit (acting as an enabler) for future European institution-building and policy development. The second is constituted by Europe’s increased sense of responsibility shared by the EU’s remaining 27 states, a scenario that’s in part driven by evolving American perspectives on the Alliance and its efficacy. However, the structural challenges faced by European defence integration remain fairly constant. First,
there does not seem to be a social consensus to spend more than the circa €230 billion that EU nations currently devote to their defences. Second, European defence strategy runs into similar obstacles as NATO, particularly when it comes to the vast differences between ‘Southern’ threats (driven by France, Spain and Italy) and ‘Eastern’ challenges (driven by Poland, the Baltics and to some extent Germany). Overcoming or at least addressing this obstacle is key for any future defence policy because both regions are arguably equally important areas of concern. In addition, a clear prioritisation of one region over another would pose a lasting challenge to the cohesion of any European defence policy platform.

**THE (MORE OR LESS) PREFERRED SCENARIOS**

If Europe (powered by a reenergized Franco-German engine) eventually utilises the unique political momentum for defence integration, the shape of Common Security and Defence Policy (CSDP) will evolve to a qualitatively new and higher level. Under this reenergised (and geographically inclusive) CSDP, EU members would succeed in fulfilling a generation-old ambition – to pool substantial financial resources together, integrate operational military assets and profoundly “increase solidarity in (European) defence matters”\(^9\). This setting would broadly qualify for the “Do Much More Together” option, as outlined by President Juncker. This setting would not only solidify the EU’s ambition of “strategic autonomy” in defence matters, it would also enable it at least a limited power projection in its broader neighbourhood. For some regional actors (for example, the V4 countries) this could open a window of opportunity to utilise battlegroups for showcasing emboldened ambitions and shared responsibility for increasing the footprint of European defence.

Arguably, the areas enjoying pre-eminence in the consolidated European defence policy are cyber defence, (defensive) hybrid warfare and a relatively wide array of policy areas within the framework of the internal-external security nexus. These include – border protection, counterterrorism and limited intelligence cooperation (both military and civilian). Indeed, given that a number of countries region have already been affected by these security challenges most already enjoy preeminent status in Central and Eastern European strategic deliberations.

For this scenario to effectively materialize, the EU needs to pursue two objectives. First, it needs to address its existing capability deficit, as represented by a lack of critical defence enablers, such as intelligence and surveillance tools, as well as logistical and command and control capabilities. Second, the defence build-up should be matched by adequate political determination to exercise the means of “strategic autonomy” (i.e. the EU battle-groups, integrated operational military HQ and Permanent Structured Cooperation) in real-life crisis scenarios. With such a high-level need for progress on numerous fronts (take just the two most notable: fiscal and political), European strategic unity will be tested with part of the EU potentially moving forward with a higher cooperative pace – in line with the "Those Who Want More, Do More" scenario.

However, with regards to threats emanating along the Southern and Eastern vector, Central and Eastern European countries have so far demonstrated an interest in mitigating the sources of insecurity in a cooperative fashion. The newly gained robustness of European defence policy would bring the EU one step closer to the equalization of its common defence clause (based on Article 42 of the EU Treaty) - which allows EU countries to make greater commitments to each other’s security – with NATO’s collective defence clause (enshrined in Article 5 of the Washington Treaty). Under ideal circumstances, the EU would also succeed in its ambition to consolidate the European defence industry market into a competitive military-industrial complex based on joint defence programmes (through the European Defence Fund) and genuine European technological innovation-supporting institutional and financial backing. This area of the EU’s defence ambitions could potentially prove to be a positive opportunity for Central and Eastern Europe to catalyse its stalling defence sector. Accordingly,

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staying outside the prime wave of defence policy integration would prove counter-productive for Central and Eastern Europe not to mention the strategic unity of the EU as a whole.

Last, but not least, EU will need to work on an updated (and adapted) modus operandi with NATO – the current anchor of security on the “old continent” – that better reflects Europe’s strategic potential. Given their mostly shared threat perceptions on the Eastern vector, it will be crucial for CEE to assure that the enhanced EU defence posture neither undermines the deterrence nor the territorial defence capacities of the Alliance. If European defence ambitions would go for **“Doing Less More Efficiently”** – i.e. leaving the Eastern security challenges to the Alliance while concentrating predominantly on issues related to the European South – the damage on European strategic solidarity could easily leave Central and Eastern Europe uninterested in further CSDP-related ambitions (such as operational integration).

**THE BARE MINIMUM (OR EVEN LESS)**

Although an imminent and profoundly progressive drift in European capabilities, instruments and determination is far from guaranteed, it seems unlikely that Europe would significantly reverse the current level of its ambition. In a less ambitious (and equally feasible) scenario (**“Carrying On”**), the CSDP would continuously enjoy an incrementally (but modestly) evolving posture with limited capability and decision-making capacity. Contrary to the ambitious EU Global Strategy, Europe would not achieve the desired “strategic autonomy” (and would not fully exercise the instruments attached to it) and would continuously remain a passenger in a strategic cart driven by the US. This is not in the interest of NATO, the EU, or those Central and Eastern European members which have been vocally supportive of significantly more beyond the status quo. Finally, if the EU was to be reduced to **“Nothing but the Single Market”**, any European defence policy (let alone CSDP ambitions) would essentially cease to exist and the concept of Europe as a global actor would decline, – leaving defence cooperation solely in NATO’s (and the United States’) hands.

![Figure 10](image-url)  
**The most desirable scenario for EU Defence Policy (from CEE perspective)**

**RECOMMENDATIONS**

*If Europe seeks to become a credible global actor (fully enjoying the support of Central and Eastern European states), it must simultaneously be a more capable part of NATO, as well as a more autonomous security actor in areas where the wider Alliance is not best placed to act suited. To successfully pursue such ambition:*  

- Central and Eastern European countries should address capability deficits and advocate policies that better address the generation-old challenge of granting both efficient and sufficient defence spending throughout the continent. European militaries have been made strategically impotent by outdated capabilities, neglected interoperability, disharmonised procurement and freeriding on American strategic commitments vis-à-vis Europe. Reversing these trends is a logical prerequisite for increasing Europe’s defence potential – whether an autonomous one or an allied one – and for a more self-confident CEE role in building that ambition.

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Europe should make a bigger push for **enhanced strategic solidarity**. The differences in threat perception between the eastern and western flanks of the EU are clear, but not necessarily fatal for a single European defence policy. With the rise of public perception in regard to the threats posed by terrorism and migration, Central and Eastern European countries have developed a better understanding for the necessity of having a crisis management capacity oriented towards the security challenges emanating from Europe’s South. Simultaneously, a more sizeable and visible “Southern European” presence in NATO’s assurance measures (i.e. forward presence) on the East of Europe would contribute to the strategic solidarity-building considerably. Central and Eastern European states should pursue enhanced strategic solidarity in Europe, both militarily and politically.

Central and Eastern European states should advocate and contribute to the development of policies that will eventually lead to the establishment of a European defence-industrial complex. Europe’s strategic autonomy can only be sustained (or even conceived) by a truly competitive and innovative European defence-industrial base that makes full use of the know-how and expertise of CEE companies and organisations. EDA and EIB activities within the ambitious European Defence Fund constitute a credible starting point for pan-European research, innovation, procurement and modernisation ambitions. However, when it comes to Central and Eastern Europe’s defence industry, it will also be crucial to guarantee the inclusion of regional SMEs and dual-use oriented industry actors to preserve competitive niches.
FOREIGN POLICY AND THE EUROPEAN NEIGHBOURHOOD

While the EU has never had a proper foreign policy, it would nevertheless be wrong to write off European-level activities in the area of international relations. Over time, the Union has become an increasingly vocal and active foreign policy player, with the High Representative for Foreign Affairs and Security and External Action Service becoming a quasi-foreign ministry. The EU’s role in achieving the breakthrough in the talks between Kosovo and Serbia (2013), successfully fighting piracy around the Horn of Africa (2014), brokering a diplomatic resolution to the Iran nuclear challenge (2015) and contributing to the new opening towards Cuba (2016) are some of the success stories of European foreign policy.

The EU has, however, failed to deliver in its near neighbourhood. Since 2003 and the advent of the European Neighbourhood Policy, the Union has failed to create stability beyond its borders. In other words, it has not created a ‘ring of friends’ in the East and South as it was planned. With some notable exceptions (such as Georgia, Ukraine and Tunisia) it is fair to say that many neighbours have turned away from the EU rather than become its friends.

EU foreign policy also remains one of the least advanced ‘common’ policies. Most important decisions, such as imposing sanctions on Russia or suspending accession negotiations with third countries, require unanimity among member states. Scenarios for future development range from maintaining the status quo ("Carrying on" or, as some say, "muddle through"), strengthening cooperation between likeminded states ("Those who want more do more" and "Doing less more efficiently") to the Europeanisation of national-level external policies ("Doing much more together"). Europeanisation implies a further pooling of national resources, possible majority rule decision making processes, and a larger allocation from the EU budget to external policies. Conversely, "Nothing but the single market" would de facto imply a step back in the Europeanisation of foreign policy as most issues would still be discussed on a bilateral basis.

Central and Eastern Europe’s participation in EU foreign policy initiatives has gathered momentum since the Lisbon Treaty came into force. The region has benefitted from EU activity in areas such as relations with Russia, cooperation with the Balkan countries, and the Eastern Partnership. At the same time, CEE countries have offered little in the way of support for the EU’s efforts to improve ties with Latin America, East Asia and its southern flank, most notably the Mediterranean Union, mobility partnerships or CSDP missions in Africa. None of the countries, even Poland – country with a biggest demographic and economic potential, would be shaping actively the European Global Strategy. Instead, CEE countries would rather limit themselves to being vocal about their own priorities without taking a more holistic approach. There have been some positive examples, such as Slovakia’s special focus on the Western Balkans, or Poland’s assistance to Ukraine or Moldova.

Figure 11
Areas where CEE should be active

- Shape the policy towards the southern flank of the EU – the Mediterranean Union, mobility partnerships or CSDP missions in Africa
- Participate constructively in reshaping the EU Neighbourhood Policy that would be more efficient in creating a ‘ring of friends’, ex. to offer more incentives in terms of trade, aid or stronger political ties to the third countries.
- Pay attention to initiatives oriented globally (relations with Latin America, ex. contribute more to the EU Trust Fund for Colombia or East Asia)
- Contribute actively to the European Global Strategy in its totality

However, the region remains underrepresented in those European Institutions (from top posts to administrators) where foreign policy initiatives take shape. As things currently stand only 17 EU Ambassadors (out of 140) are from CEE states, 49 out of 410 CEE officials work in EEAS headquarters and 27 out of 320 in the EU delegations. At the lower level, 235 out of 948 Administrators (AD) and 96 out of 300 AD posts are filled by Temporary Agents from CEE.

References:
11 Relaunching the EU, Report, Centre for European Reform, November 2017, pp. 17-20.
Furthermore, Central and Eastern Europe has hardly been a consistent and unified group in debates over the scope, ambition and priorities of the EU’s foreign policy. For example, while Hungary and Poland have grown skeptical regarding the delegating of some competences to European level (e.g. migration), they expect the EU to do more on other issues (such as external policy aspect of the Nordstream II project). With regards to dealing with refugee crisis, instead of compulsory relocation under any scheme, it is in favour of increased assistance for the refugees’ country of origin and periphery supporting the European Global Strategy’ priority to build the EU resilience of states and societies to the EU’ East and foremost to the South. Yet, CEE still significantly lags behind Western Europe in terms of providing development aid to third countries. The Combined total of CEE financing for development that comprises of net disbursements of official development assistance (ODA), other official flows (OOF) and private flows (mainly FDI), account for 1 365 million Euros (as of 2015), which is 3 times less than Belgium (3 336 million Euro).14


Source: EU financing for developing countries, Eurostat 2015; EU comparison 2017: Germany and the other member states, DeStatis 2017

If the EU (or group of likeminded member states) gets really ambitious about its foreign policy (not too likely), CEE risks being divided over whether to join such an agenda and how to effectively secure the attention of EU institutions for those policies and initiatives that are close to the region’s hearts.

Moreover, if EU foreign policy is to be shaped by coalitions of the willing in particular areas then CEE countries would also need to define which initiatives they should be taking up at the European level and how to ensure the tacit or vocal approval of other member states. Were the EU to revert to the Single Market as the only meaningful area of integration (“Nothing but the single market”), CEE countries would be deprived of a very important aspect of their membership: a geopolitical anchor in the Western European framework other than NATO. It would be a huge blow to policies that go beyond the traditional military-security framework while still being crucial for foreign policy, such as counter-intelligence, anti-terrorism, economic sanctions etc.

As for CEE’s general public, it favours strengthening cooperation in the field of foreign policy (as box below shows). Whatever the future holds, certain contradictions and ambivalence in the region regarding the EU’s external actions will not disappear. This, in turn, might lead to the further marginalization of CEE voices.

**Figure 14** Would you like the EU to intervene less than at present or more than at present in the area of foreign policy?

<table>
<thead>
<tr>
<th>Country</th>
<th>Less than at present</th>
<th>No change necessary</th>
<th>More than present</th>
<th>Do not know</th>
</tr>
</thead>
<tbody>
<tr>
<td>Romania</td>
<td>16%</td>
<td>6%</td>
<td>67%</td>
<td>9%</td>
</tr>
<tr>
<td>Slovenia</td>
<td>16%</td>
<td>8%</td>
<td>60%</td>
<td>6%</td>
</tr>
<tr>
<td>Croatia</td>
<td>23%</td>
<td>12%</td>
<td>60%</td>
<td>6%</td>
</tr>
<tr>
<td>Poland</td>
<td>16%</td>
<td>15%</td>
<td>57%</td>
<td>12%</td>
</tr>
<tr>
<td>Lithuania</td>
<td>26%</td>
<td>14%</td>
<td>57%</td>
<td>12%</td>
</tr>
<tr>
<td>Hungary</td>
<td>24%</td>
<td>12%</td>
<td>57%</td>
<td>7%</td>
</tr>
<tr>
<td>Slovakia</td>
<td>24%</td>
<td>11%</td>
<td>52%</td>
<td>7%</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>27%</td>
<td>14%</td>
<td>52%</td>
<td>7%</td>
</tr>
<tr>
<td>Czechia</td>
<td>29%</td>
<td>9%</td>
<td>48%</td>
<td>7%</td>
</tr>
<tr>
<td>Latvia</td>
<td>29%</td>
<td>11%</td>
<td>43%</td>
<td>11%</td>
</tr>
<tr>
<td>Estonia</td>
<td>16%</td>
<td>28%</td>
<td>42%</td>
<td>14%</td>
</tr>
</tbody>
</table>


**RECOMMENDATIONS**

» Realisation that the EU’s ambitious foreign policy outlook is strategically in CEE’s interest. As the region lacks the resources of big diplomacies like France or Germany, it needs the EU to help it face the challenges posed by the likes of Russia. Given that the United Kingdom was traditionally more receptive to CEE priorities in the east, the region should also invest in building up the capacity to participate in shaping and making of the EU’s post-Brexit foreign policy (personnel, budget, expertise, and readiness to lead in some initiatives, coalition building with other players such as Scandinavia or the Big Four, esp. Germany)

» CEE should also show a more ambitious, constructive and supportive approach to shaping EU foreign policy. If it wants the EU to speak with one voice on the implementation or renewal of sanctions against Russia, it would need to show more solidarity in “non-traditional” foreign policy areas such as commitment or financial support for the Southern Neighbourhood.

» In a world of global challenges, CEE should support the EU in strengthening its presence and status in international fora and organisations. Central and Eastern Europe can be heard on the global issues only if it stands together with the Union.

» By contrast, the “Nothing but the single market” scenario needs to be prevented at any cost (such an affordable cost is compromise on the EU immigration policy).
EUROPEAN CLIMATE AND ENERGY POLICY

The EU's landmark energy legislation, the Third Energy Package (TEP), was introduced ten years ago and adopted into law in 2009. Along with market-oriented measures, it elaborated the first EU-level climate policy provisions, as manifested in the carbon cap and trade system (Emissions Trading Scheme or ETS) and 2020 targets for greenhouse gas (GHG), renewable energy sources (RES) and energy efficiency (EE). Although the overall process of TEP implementation has moved slowly, it has provided Central Europe and its periphery (including non-EU Energy Community contracting parties) with the tools to successfully unbundle, liberalise, diversify, and integrate disparate energy markets.

More challenging for Central Europe has been grappling with the European Commission’s ambitious climate vision, but Visegrad Group countries have managed to set some of the lowest renewable benchmarks in the EU for 2020 which will be repeated for 2030 targets. As depicted in the chart, Czechia and Hungary have already met their 2020 target and only Poland will have difficulty.

Figure 15  Share of renewable energy in gross final energy consumption (%)

![Graph showing share of renewable energy](chart)

Source: Eurostat

Although Central Europe will largely meet its conservative climate targets, it is losing ground to Western European innovation and technology in the energy sector. The region has been successful in reducing emissions from 1990 levels, but policies do not incentivize RES penetration and financing for EE has been challenging. Rather than the RES driven clean energy transition sweeping across Western Europe, Central Europe is pursuing a decarbonization strategy that extends the status quo, replacing and expanding the baseload system to meet energy security (nuclear, coal) and decarbonization of electricity (nuclear) goals.

Central European 2030 energy strategies under development will continue to favour baseload power with limited RES expansion, instead focusing on dispatchable biofuels and geothermal. At the same time, Western Europe is pursuing a RES driven energy transition with storage technology and demand side instruments competing against coal and gas fired power reserves to provide system flexibility and balancing. One question is how micro-scale generation and the prosumer class will take shape in Central Europe, since consumer investment decisions (like with electric vehicles) are heavily dependent on financing and cost of capital which are much higher than in Western Europe.

Proposed nuclear expansion in the region faces challenging economic models, under pressure from delays and cost overruns, while coal costs of maintaining and modernizing coal thermal power plants will grow with rising carbon prices under the 4th phase of the EU ETS from 2021-2030. The fundamental question over the next 20-30 years is how a coal and nuclear-led baseload system of energy production in Central Europe will compete with the model of decentralized production emerging in most other parts of Europe.
CENTRAL EUROPE BENEFITED FROM COLLECTIVE GAS DIVERSIFICATION BUT IS RELUCTANT ON COLLECTIVE CLIMATE AGENDA

At the end of 2016, the European Commission proposed a new set of legislative measures known as the ‘Winter Package,’ the fourth such package of legislation following the TEP, to tighten the screws on the European single energy market and recalibrate the climate targets from 2020 to 2030 as part of the 2050 roadmap. It also builds on the recommendations for the Energy Union outlined by the Commission in 2015.

Underpinning the Energy Union strategy are principles that provide a comprehensive blueprint for delivering secure, affordable and clean energy for all EU citizens. Initially, the Commission used this platform to focus on traditional areas of gas security of supply, gas market integration and solidarity that matched well with Central Europe’s top energy priorities and concerns. It established the High-Level Group on Central and South Eastern Europe Gas Connectivity (CESEC) to accrue political support for joint gas and now electricity projects with positive regional spill over effects. CESEC complements the pan-European regulatory and transmission system bodies established under the TEP that have developed competencies and responsibilities and contributed greatly to transparency and cooperation in the region. In parallel, the gas stress test (2014) was followed by the European LNG and storage strategy (2016), which finally culminated in the adoption of the revision of the 2011 gas security of supply regulation that became law in the summer of 2017. As a result of these processes, the long ballyhooed physical gas infrastructure mission of the region, the North-South Corridor, will be completed by the end of the decade and Central European gas markets are more integrated and competitive than ever.

The ‘Winter Package’ now represents the European Commission’s departure from gas security and diversification to the low carbon EU single market, updating TEP energy market design and climate policy provisions in the context of the Energy Union principles. Market integration and competitive wholesale trade have been largely achieved across Europe, but the Commission now faces tough negotiations over capacity mechanisms (state energy subsidies), end-user price regulation, and new binding climate targets that are particularly sensitive in Central Europe.

ENERGY TRANSITION VS DECARBONISATION

The ‘Winter Package’ has asserted a more ambitious EU climate agenda as part of the 2050 low carbon economy roadmap and seeks to harmonise the patchwork of national policies and regulations that effectively block the single market and create major inefficiencies across borders. In Central Europe these proposals have largely been met with resistance, as governments are protective of national energy composition, consumer price regulation and foreign competition in future energy supply. While fighting to make these measures less intrusive, the region is also lobbying to keep 2030 targets low, particularly RES and EE.

Given the broadly conservative nature of ministries controlling national energy policies in the region, climate policy will continue to focus on sectoral decarbonization with financing for energy performance contracts (ENCOs) rather than adapting new technologies as part of an energy transition. It is in their interest to defend the status quo, a continuation of the baseload model relying on nuclear power to secure future energy supply. Unfortunately, serious questions emerge as to the economic viability of large-scale nuclear with falling RES costs and low wholesale energy prices. The chart below compares the levelized cost of energy in the US for new sources in 2022, and while solar PV and onshore wind are already cheaper than nuclear, costs for offshore wind are expected to fall dramatically over the next ten years.
The key distinction for Central Europe relative to west, north and south Europe is between an emission reduction strategy and a renewable-led energy transition. For the last decade Central Europe has staunchly pursued the former on the back of nuclear expansion while the rest of Europe moves in the other direction, pursuing innovation and technology. For most of Central Europe, the disastrous trial with feed-in tariffs at the turn of the decade has not been forgotten (or will not be forgotten) and, consequently, the window for large scale renewable energy sources seems to have closed for the moment.

The question is how all of this will affect the region’s competitiveness to 2030 and beyond. For the past ten years Central Europe has been lagging behind in pursuit of clean technology, not only in development but as an inflow or transfer. Less ambitious climate policies to 2030 can have longer term economic, social and energy security consequences. The EU Modernization Fund will not support upgrades to coal power plants from 2021 and without updated policies bottom-up micro generation and demand side response will not be exploited.

The 2030 outlook is not so much about sustainability, the environment and improved lifestyle for citizens as it is more immediate economic development, not only opportunities within the energy industry itself, but for energy as a competitively priced input to industry. With wholesale electricity prices projected to only rise slightly over this time period, poor policy choices resulting in underutilised or stranded assets paid by taxpayers and ratepayers will be amplified.

“The region’s soft national climate targets will be reached relatively easily but the lack of ambitious policy for incorporating new technologies and protection of domestic production can leave the energy sector at a competitive disadvantage for decades to come.”

RECOMMENDATIONS

Central European governments need to be more open minded about low carbon technologies and the prospect of disruption in the energy sector. While the energy transition presents short term challenges, the long term benefits far outweigh them. This is about politics and policies, which are still protective of incumbent interests and make it difficult for new market entrants to spur innovation. Central Europe cannot emulate or compare itself to the energy path of Western Europe, but governments should devote more resources to in-depth, holistic studies of the entire energy network, to determine where procurement is need and how new technologies might be integrated more cost-effectively. A more informed and balanced national energy strategy would lead the way for investment in clean technology and reduce risks of stranded or underutilized traditional assets.

- Broaden scope of regional energy security formats and dialogues to include regional interconnectivity and demand-side measures. So far regional energy security is limited to gas diversification, but it should focus more on the price of low carbon energy as an input and the cost of energy security. With heterogenous national policies favouring domestic forms of production and neglecting regional synergies, there are growing financial risks of over overcapacity and stranded assets that should be factored into energy security.
More **training and education** for state and local officials to coordinate and ensure better use of available financing for most cost-effective low carbon projects and initiatives. For now there are major coordination and information gaps and a dearth of experts with the ability to match available technologies and financing instruments with local conditions. Some clean technology and efficiency projects are awarded from EU grants and other loans but there is not a holistic, systematic approach. More collaborative efforts need to be made with the European Investment Bank and other lending institutions to identify and initiate bankable projects.

**Scenario analysis** to compare network procurement costs with investment in grid upgrades, comparing costs of maintaining the baseload (nuclear and coal) with some level of renewable energy penetration.
## SCENARIOS FOR CENTRAL AND EASTERN EUROPE

<table>
<thead>
<tr>
<th>Policy Area</th>
<th>NOTHING BUT THE SINGLE MARKET</th>
<th>CARRY ON</th>
<th>DO LESS MORE EFFICIENTLY</th>
<th>WHO WANTS MORE DOES MORE</th>
<th>DOING MUCH MORE TOGETHER</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Monetary Union</td>
<td>Danger of euro losing its value. CEE countries cannot withstand the pressure on their economies.</td>
<td>Gives time for CEE non-members to get ready and join. Necessary changes may take too long.</td>
<td>“Pick and choose” option for macro-economic and social safeguards is not favorable for CEE.</td>
<td>Divisions within CEE will deepen, unless all CEE commit to joining the eurozone.</td>
<td>CEE can gain from a stable economic and fiscal environment.</td>
</tr>
<tr>
<td>Single Market</td>
<td>No guarantees of all four freedoms and standards.</td>
<td>Good for CEE with further economic liberalisation and guarantees of the four freedoms.</td>
<td>Same minimal standards in CEE; tailored economic policies but no guarantees for the four freedoms of movement.</td>
<td>The basic function of the market will not change.</td>
<td>Overwhelming for CEE if no national level reforms introduced.</td>
</tr>
<tr>
<td>Social Policy</td>
<td>Dismantling of the current social and migration agenda would result in increasing social and economic discrepancies in the EU. CEE might become a social and economic dump of the continent.</td>
<td>Incremental update of social legislation. Unstable outcome if Eurozone goes forward without adjusting labour and social policies.</td>
<td>Depends on the areas selected as priorities. Convergence will decelerate if no cohesion funds for social dimension are available for the region.</td>
<td>Eurozone countries will go forward: too ambitious for CEE Eurozone members unless strong support provided. Non-Eurozone CEE countries risk falling behind.</td>
<td>Most ideal in the future. If giant leap forward now, CEE will lose their main source of competitiveness – affordable labour.</td>
</tr>
<tr>
<td>Defence Policy</td>
<td>Clearly the least favourable option, would actually mean the demise of EU’s quest for strategic autonomy.</td>
<td>Feasible, but given the current level of popular push for more robust defence posture, would likely prove insufficient for the public.</td>
<td>European defence policy has already been executed in a relatively limited manner – concentrating on occasional crisis-management, this would be counter-productive to European ambitions.</td>
<td>Already happening due to the tangible difference in defence capabilities and diverse threat perception among EU states. Not ideal, but still a likely sustainable path.</td>
<td>Would embolden European global policy and enhance its strategic autonomy. Although the level of ambition equals the level of financial burden – potentially problematic for a number of members.</td>
</tr>
<tr>
<td>Foreign Policy &amp; European Neighbourhood</td>
<td>CEE countries would be deprived of a very important aspect of their membership: a geopolitical anchor in the Western European framework other than NATO.</td>
<td>CEE countries keep limiting themselves to being vocal about their own priorities without taking a more holistic approach.</td>
<td>Risky as foreign policy would most probably not be chosen as priority area. For CEE the same as “Who wants more does more”.</td>
<td>CEE risks being divided over whether to join such an agenda and how to effectively secure the attention of EU institutions for those policies and initiatives that are close to the region’s hearts.</td>
<td>CEE shows a more ambitious, constructive and supportive approach to shaping EU foreign policy.</td>
</tr>
<tr>
<td>European Climate and Energy Policy</td>
<td>CEE has shown ability to integrate its energy markets and open trade, but still high market concentration.</td>
<td>CEE has been ‘carrying on’ with baseload model without uptake in variable renewable energy.</td>
<td>In the context of the EU, this would be ‘bare minimum’ status quo of solidarity measures for joint energy security.</td>
<td>No single country in CEE is taking lead in more progressive long-term climate policy.</td>
<td>CEE can shift energy security from gas to the power sector, take into consideration regional electricity and demand side measures.</td>
</tr>
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</table>
RECOMMENDATIONS

EUROPEAN MONETARY UNION

- It should be a strategic goal for CEE countries to prepare for the eurozone, given the current direction towards the speeding up of integration. A main part of the process will be to introduce important systemic national reforms. These include macro-economic mechanisms to protect investments and insure against unemployment, bank deposit guarantees and fiscal discipline enforcement tools.

- To ensure taking full advantage of the benefits that the eurozone offers, all CEE countries should begin the push for membership. Indeed, while the EMU is still incomplete, the CEE can have a voice at the negotiating table when it matters, defending its own interests and ensuring protection for their economies in the process.

- As members of the eurozone, Slovakia, Estonia, Latvia, Lithuania and Slovenia should share their experiences and help Hungary, the Czech Republic, Poland, Romania, Bulgaria and Croatia when they are ready and willing to join. The eurozone in a higher gear will become less reachable as time passes.

- Substantial progress towards a genuine financial, economic and fiscal, and political union is necessary. The eurozone reforms to be introduced should include macro-economic mechanisms, stronger bank union, capital market union and a well-conceptualised and realised stability fund.

- An accountable and objective oversight system should be created if the EMU is to be a successful project, with all the necessary safety nets for the Euro and strong development mechanisms.

SINGLE MARKET

- Successful convergence of CEE countries into the single market will require a number of national level reforms touching upon several areas of public policy: education, vocational training, labour market policies, social protection, e-government, and more.

- In the new financial framework, the EU should assist the functioning of the single market with redistributive instruments that bridge the social and economic gaps in the single market, which is particularly important for the CEE region.

- To take full advantage of the single market, the CEE needs to build up its capacity to negotiate at the European level—which is especially crucial in the context of Brexit—so that its interests are reflected in decisions, laws and allocation of resources. Some examples include climate change and energy, social policies, the digital economy and transportation.

- CEE countries should insist and work on guaranteeing that the European Commission (with help from the European Court of Justice) remains the objective guardian of the treaties and law-enforcing entity so that the single market is a level-playing field.

SOCIAL POLICY AND FREEDOM OF MOVEMENT

- To CEE Eurozone countries
  - insist on the need to create a convergence fund for countries that need to catch up;
  - try to act as a brake on some initiatives such as a European unemployment insurance scheme if the need arises following the impact assessment of proposed legislation;
  - trust the core eurozone partners that tying their fortunes together in closer union will ensure that the wellbeing of any member is a priority for everyone.
To CEE countries currently outside of the Eurozone
- keep the Eurozone door open and prepare for the accession that will eventually come;
- coordinate with other CEEs and establish relations where CEE eurozone countries act as a spokesperson for CEE non-euro countries.

To all CEE countries
- reform national socio-economic models as the current reliance on a cheap labour force as a source of competitiveness is unsustainable:
  - prepare to abandon the cheap labour and low cost social model;
  - make social investments that build human and social capital and raise productivity;
  - avoid entrenchment of the current model where the East is a cheap subsidiary to the innovative, post-modern West;
  - seek new allies after Brexit;
- conduct impact assessment of proposed laws and initiatives.

To the whole EU
- improve portability and transferability of rights and benefits in policies related to free movement;
- carry out necessary reforms of the Eurozone, Schengen, and labour acquis so that – whatever the level of ambition – the balance between West and East, competitiveness vs social protection, central coordination vs subsidiarity and respect for national welfare state models is preserved.

EUROPEAN DEFENCE POLICY

Central and Eastern Europeans should address capability deficits and advocate policies that better address the generation-old challenge of granting both efficient and sufficient defence spending throughout the continent. European militaries have been made strategically impotent by outdated capabilities, neglected interoperability, disharmonised procurement and freeriding on American strategic commitments vis-à-vis Europe.

Reversing these trends is a logical prerequisite for increasing Europe’s defence potential – whether an autonomous or an allied one – and for a more self-confident CEE role in building that ambition.

Europe should make a bigger push for enhanced strategic solidarity. The differences in threat perception between the eastern and western flanks of the EU are clear, but not necessarily fatal for a single European defence policy. With the rise of public perception in regard to the threats posed by terrorism and migration, Central and Eastern European countries have developed a better understanding for the necessity of having a crisis management capacity oriented towards the security challenges emanating from Europe’s South. Simultaneously, a more sizeable and visible “Southern European” presence in NATO’s assurance measures (i.e. forward presence) on the East of Europe would contribute to the strategic solidarity-building considerably. Central and Eastern European states should pursue enhanced strategic solidarity in Europe, both militarily and politically.

Central and Eastern European states should advocate and contribute to the development of policies that will eventually lead to the establishment of a European defence-industrial complex. Europe’s strategic autonomy can only be sustained (or even conceived) by a truly competitive and innovative European defence-industrial base that makes full use of the know-how and expertise of CEE companies and organisations. EDA and EIB activities within the ambitious European Defence Fund constitute a credible starting point for pan-European research, innovation, procurement and modernisation ambitions. However, when it comes to Central and Eastern Europe’s defence industry, it will also be crucial to guarantee the inclusion of regional SMEs and dual-use oriented industry actors to preserve competitive niches.
FOREIGN POLICY AND THE EUROPEAN NEIGHBOURHOOD

- Realisation that the EU’s ambitious foreign policy outlook is strategically in CEE’s interest. As the region lacks the resources of big diplomacies like France or Germany, it needs the EU to help it face the challenges posed by the likes of Russia. Given that the United Kingdom was traditionally more receptive to CEE priorities in the east, the region should also invest in building up the capacity to participate in shaping and making of the EU’s post-Brexit foreign policy (personnel, budget, expertise, and readiness to lead in some initiatives, coalition building with other players such as Scandinavia or the Big Four, esp. Germany).

- CEE should also show a more ambitious, constructive and supportive approach to shaping EU foreign policy. If it wants the EU to speak with one voice on the implementation or renewal of sanctions against Russia, it would need to show more solidarity in “non-traditional” foreign policy areas such as commitment or financial support for the Southern Neighbourhood.

- In a world of global challenges, CEE should support the EU in strengthening its presence and status in international fora and organisations. Central and Eastern Europe can be heard on the global issues only if it stands together with the Union.

- By contrast, the “Nothing but the single market” scenario needs to be prevented at any cost (such an affordable cost is migration).

EUROPEAN CLIMATE AND ENERGY POLICY

- Broaden scope of regional energy security formats and dialogues to include regional opportunities and demand-side measures. So far regional energy security is limited to gas diversification, but it should focus more on the price of low carbon energy as an input and the cost of energy security. With heterogenous national policies favouring domestic forms of production and neglecting regional developments, there are growing financial risks of over overcapacity and stranded assets that should be factored into energy security.

- More training and education for state and local officials to coordinate and ensure better use of available financing for most cost-effective low carbon projects and initiatives. For now there are major coordination and information gaps and a dearth of experts with the ability to match available technologies and financing instruments with local conditions. Some clean technology and efficiency projects are awarded from EU grants and other loans but there is not a holistic, systematic approach. More collaborative efforts need to be made with the European Investment Bank and other lending institutions to identify and initiate bankable projects.

- Scenario analysis to compare network procurement costs with investment in grid upgrades, comparing costs of maintaining the baseload (nuclear and coal) with some level of renewable energy penetration.