

## Historic turning point or just another chapter? The results of a foreign-policy summit

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### Summary

The March 2014 European Council could enter the history books as a turning point, not only in the EU's relations with Russia but also in its role as a foreign policy actor. Events in Ukraine inevitably dominated the Summit, with EU leaders adopting a balanced approach aimed at achieving three key objectives – de-escalation, containment/deterrence and cooperation – based on political and economic support for Ukraine, increased but limited pressure on Russia, and moves to strengthen ties with other EU neighbours. The Summit also discussed a range of economic and environmental policy issues, with the situation in Ukraine casting a long shadow over the discussion on energy policy, but failed to reach agreement on the EU's climate goals to 2030, or to put more flesh on the bones of calls for a European "industrial renaissance". However, two other developments were particularly significant: the creation of the second pillar of the future banking union, establishing a single regime for winding down failing banks; and changes to the savings tax directive, bringing years of negotiation to an end.

### Full report

Following a number of unspectacular EU Summits since the end of 2012 and the cooling off of the 'euro crisis', the European Council meeting on 20-21 March 2014 has a chance to make it into the history books.

The political agenda in the weeks and days before the Summit and at the meeting itself were dominated by the crisis in Ukraine and its wider implications for future relations between the EU/'West' and Russia. In reaction to the recent escalation of the crisis, EU leaders adopted a balanced approach based on three main pillars: (i) political and financial support for Ukraine, including the signing of the political provisions of the Association Agreement, financial support and the unilateral abolition of custom duties on products from Ukraine; (ii) increased but limited pressure on Russia by adding more names to the list of Russian and Ukrainian citizens subject to asset freezes and visa bans, and measures designed to isolate Moscow internationally; and (iii) accelerated association of other neighbouring countries with the EU, with a special emphasis on Moldova and Georgia, by bringing forward the target date for signing Association Agreements with both countries – a signal directed also towards Moscow.

All of this is designed to avoid a further escalation of the crisis while at the same time signalling to the Russian leadership that EU leaders are determined and ready to keep the door open to diplomatic solutions. It is too soon to judge whether this approach – based on de-escalation, containment/deterrence and cooperation – will work. But one thing seems clear: the EU and its members will have to deal with the wider implications and consequences of the crisis for some time to come, and it remains to be seen what impact the events of recent weeks will have on the Union's role as a foreign policy actor.

Besides Ukraine, EU leaders addressed a number of other issues: the European Semester, Europe 2020, industrial competitiveness, energy/climate, taxation and banking union (the Single Resolution Mechanism).

The European Council concluded the first phase of the 2014 **European Semester**, but without taking any concrete policy decisions: the heads of state and government simply had an exchange of views regarding the economic situation. They also had a first discussion on the implementation of the **Europe 2020** strategy ahead of the planned mid-term review at the Spring 2015 European Council.

With respect to **industrial competitiveness and policy**, EU leaders highlighted the need to strengthen Europe's industrial base and supported the European Commission's call for a "European Industrial Renaissance". However, they failed to present any concrete measures or a well-defined strategic plan for the long-term development of a new industrial policy, with the Summit Conclusions remaining vague and lacking specific policy substance on this point.

On Day Two of the Summit, deliberations between the heads of state and government focused on issues related to **energy dependency** and **climate change**. The spirit of, and concrete results emerging from, the March European Council indicate that EU governments are determined to promote energy security and to reduce dependence on individual suppliers such as Russia. Regarding climate policy, EU leaders could not reach a compromise on new targets because of divisions between Member States and simply set themselves a deadline of October 2014 for a final decision on the new policy framework.

After many years of negotiations, and following a decision by Luxembourg and Austria to give up their veto, the EU-28 were finally able to strike a compromise on changes to the Directive on the **taxation of savings income**. This opens the way for an automatic exchange of tax information between EU countries by 2017 and strengthens the Union's negotiating position on savings taxation *vis-à-vis* third countries (including Switzerland).

After months of intense discussions, the Council and European Parliament also reached a deal on the second pillar of the future banking union – the **Single Resolution Mechanism (SRM)** – which establishes a single regime for winding down failing banks. Following pressure from MEPs, the final deal is better than the original proposal, but the system remains highly complex and doubts persist about whether the SRM will be enough in practice and whether it will ultimately help to break the link between banks and sovereigns.

### **Ukrainian crisis – a turning point in EU foreign policy?**

Day One of the Summit, which started with the traditional meeting with European Parliament President Martin Schulz, was almost totally dominated by the crisis in Ukraine after Russia had occupied and annexed (or "re-unified" – as Moscow argues – with) Crimea in the week of the European Council meeting – a move condemned by the EU and its members as illegal and illegitimate.

In reaction to the escalating crisis, EU leaders adopted a balanced approach based on the three main pillars: political and financial support for Ukraine; increased but limited pressure on Russia; and accelerated association of other neighbouring countries with the EU.

#### ***Political and financial support for Ukraine***

Following recent events and the ratcheting up of tensions, the Union and its members were eager to move Ukraine closer to the EU. In a move designed to intensify relations and show solidarity and support for Kiev, EU leaders and Ukrainian Prime Minister Arseniy Yatsenyuk signed – in a ceremonial act before the start of Day Two of the Summit – the political provisions of the Association Agreement; the very issue that sparked the crisis last November and eventually led to the revolution in Ukraine.

EU leaders also reiterated their commitment to sign the remaining economic parts of the agreement, establishing a Deep and Comprehensive Free Trade Area between the EU and Ukraine, probably after Ukrainian elections scheduled for 25 May. The first meeting under the political dialogue established through the signing of the agreement's political provisions will take place in April.

In addition, the heads of state or government reaffirmed their readiness to provide immediate financial support (€1.6 billion) to Ukraine once the International Monetary Fund (IMF) and the Ukrainian government have agreed on the conditions for a support programme. To increase pressure on Kiev to embark on economic and political reforms, certain conditions have already been attached to this support. EU leaders stressed the need for Kiev to ensure the inclusiveness of governmental structures, reflect regional diversity and protect national minorities, undertake constitutional reforms, fight corruption, enhance the transparency of fiscal operations, and investigate all human rights' violations and acts of violence. The latter includes an investigation into the circumstances which led to the bloodshed on Maidan square in February 2014.

Finally, the EU decided to unilaterally abolish custom duties on products from Ukraine which, according to European Commission estimates, will save the country around €500 million a year.

### ***Increased but limited pressure on Russia***

After lengthy discussions, the heads of state and government decided to increase pressure on Moscow while at the same time leaving the door open for diplomatic initiatives aimed to de-escalate the crisis. In the words of European Council President Herman Van Rompuy: "In a situation like this we all must remain cool-headed. The goal is de-escalation and a political solution, while respecting international law."

Condemning the "illegal annexation" of Crimea and Sevastopol to the Russian Federation and in reaction to Russia's refusal to take steps to de-escalate the crisis, EU leaders decided to increase pressures on Moscow by: (i) imposing asset freezes and visa bans on 12 more Russian and Ukrainian citizens, added to the original list of 21 people agreed on 16-17 March (unlike Washington, which blacklisted senior Russian figures and even a Russian bank – Rossiya Bank – with close links to President Putin just as EU leaders were gathering in Brussels, the EU's list of additional names does not include people in Putin's inner circle); (ii) cancelling the next EU-Russia Summit and announcing that Member States will not hold bilateral summits/meetings with Moscow for the time being; (iii) further isolating Russia internationally by not involving Moscow in the next meeting of the G7 and suspending negotiations on Russia joining the Organisation for Economic Cooperation and Development (OECD) and the International Energy Agency (IEA).

While EU leaders increased their pressure on the Russian leadership, they refrained from more severe sanctions going beyond the so-called 'stage 2' level. However, the Summit Conclusions warn that any further steps by the Russian Federation to "destabilise the situation in Ukraine" would have "additional and far reaching consequences" for the relationship between the EU and Russia.

In more concrete terms, the European Council has asked the Commission and Member States to "prepare targeted measures", without giving any details of when this list of potential measures will be ready and what it might contain. In his press conference after the Summit, British Prime Minister David Cameron was more explicit when he mentioned "finance, military, energy" as areas being considered. Asked which Russian actions might trigger more severe reactions, German Chancellor Angela Merkel said that economic sanctions would 'only' be imposed if Russia sought to occupy parts of Ukraine beyond Crimea.

The fact that EU governments decided not to impose harsher sanctions signals a number of things. First, a vast majority of Member States want to avoid a negative spiral of escalation and mutual retaliation, which could easily spin out of control, with severe economic and political costs on both sides. Russia could even raise the stakes by halting cooperation with the 'West' on the civil war in Syria, Iran's nuclear programme or the fight against international terrorism. Second, Europeans do not want to enter 'stage 3' too quickly, thus giving themselves more room to intensify the pressure on the Russian leadership if the crisis escalates still further. Third, EU leaders fear the imposition of severe sanctions from which neither side would be able to backtrack even if the situation de-escalates. Fourth, EU governments are (compared, for example, to the US) much more subject to legal constraints which make it more difficult for them to target individuals not directly involved in the incident that triggered the sanctions – in this case, the annexation of Crimea. Last but not least, there was a heated debate between the EU-28 behind the scenes about whether to impose tougher sanctions in response to the

annexation of Crimea. Some countries – including Poland, the Baltic states, Belgium, Bulgaria, Denmark, Ireland, Luxembourg, Romania, and Sweden – wanted a more robust response to send an even stronger signal to the Russian leadership, while others – including Cyprus, Finland, France, Germany, Greece, Hungary and Spain – were (very) reluctant to go further because of strong economic, financial, historical or even religious ties. (See also Paul Ivan, [“EU’s sanctions against Russia – the need for clear goals”](#), *EPC Commentary*, 21 March 2014).

### ***Accelerated association of other neighbouring countries***

Another development at the EU Summit which attracted much less attention in European and international media was the decision by EU leaders to speed up the process of strengthening political and economic ties between the EU and Moldova and Georgia. The European Council agreed to bring forward the target date for signing Association Agreements with both countries, including a Deep and Comprehensive Free Trade Area, from August to June 2014.

This is a clear response to the increased pressures Moscow has been putting on Moldova and Georgia in an attempt to avoid a further strengthening of ties between these countries and the EU. The main concern here is Moldova, which has to cope with separatist tendencies in Transnistria and which is particularly vulnerable to Russian political and economic pressures (for more, see Paul Ivan, [“Transnistria – where to?”](#), *EPC Policy Brief*, March 2014).

### ***What comes next? Uncertainties and difficult choices***

As things stand now, EU governments and institutions are clearly intent on avoiding a further escalation of the crisis while at the same time signalling to the Russian leadership their determination and readiness to return to a cooperative environment despite the loss of trust.

The decisions taken at the Summit indicate that EU leaders want to contain the crisis, amid fears that it could pose the most severe security challenge in Europe since the end of the Cold War if events spiral out of control. First and foremost, they want to avoid a military conflict in their direct neighbourhood, which could, for example, be triggered by an (even accidental) incident between Russia and Ukraine.

EU leaders (and the US) also wanted to signal to Russian President Vladimir Putin and his associates that they will not simply tolerate the annexation of Crimea and infringement of the territorial integrity of Ukraine, although they are aware that there is little they can do but accept that Crimea is probably a lost case and now part of the Russian Federation. The EU and its members want to signal that they will not accept such breaches of international law in future and are determined to contain Russia and to increase pressures if Moscow decides to further escalate the situation in the eastern or southern part of Ukraine. EU governments seem confident that Moscow will not, in the end, prevail if it decides to embark on a path of continuous provocation/confrontation.

However, at the same time and for good reasons, EU governments do not want to return to the mind-set of Cold War confrontation in today’s fundamentally different world. The global and regional environment has become much more complex and interdependent, and it makes no sense to return to the past given that current and future challenges require cooperation among global actors and regional partners to find solutions rather than outdated rituals and actions. However, the events of recent months and weeks have undermined trust between Moscow and the EU, and it will be more than difficult to restore the minimum level of faith in each other that will be necessary to return to a logic of cooperation.

But will an EU approach based on de-escalation, containment/deterrence and cooperation work to serve this purpose? It is too early to give a definite answer to this question now because of a number of uncertainties:

- There still is a danger that the stand-off between Ukraine and Russia could escalate, although the fact that the Russian government finally agreed, on the day after the Summit, to a mission by the Organization for Security and Cooperation in Europe (OSCE) to monitor the security situation in Ukraine might be a first signal that Moscow is ready to de-escalate after annexing Crimea.

- Ukraine's future is by no means certain as long as the country's internal coherence remains under threat. In the immediate future, much will depend on the outcome of the upcoming elections and the readiness and ability of the future Ukrainian leadership to unite the country by accommodating regional diversities, including different political forces and protecting the rights of national minorities. Following the annexation of Crimea, the stand-off between Kiev and Moscow has already shifted to eastern Ukraine and it remains to be seen how the situation will develop in this part of the country and whether the Russian leadership might pursue actions aiming to (further) destabilise the situation.
- It is highly uncertain how Russia will react to a closer association between the EU and Ukraine if the new leadership in Kiev decides to sign and implement the remaining parts of the Association Agreement. Moscow might argue that the agreement 'violates' Ukraine's neutrality and impose sanctions on the new leadership in Kiev claiming that new economic ties between the EU and Ukraine breach Russia's accords with its western neighbour.
- Even if Russia decides to refrain from a further escalation, the conflicting parties, the EU and the US may all have to cope with Crimea becoming another frozen conflict like those in Nagorno-Karabakh, Transnistria and South Ossetia, and thus one more source of instability at the heart of Europe. This can only be avoided if Ukrainian and Russian authorities decide to get round the negotiating table to define the conditions of a new *modus vivendi*, which would be very difficult given recent events and the high level of distrust between the two sides.
- Even if one assumes that the current crisis will de-escalate (one way or another), it cannot be ruled out that the current leadership in Moscow might decide to continue playing the role of 'guardian of Russian ethnic minorities' in other parts of Europe, especially now that President Putin has seen his popularity ratings rise sharply in Russia in recent weeks.

All these potential challenges and uncertainties underline the volatility and complexity of the current situation. However, one thing is clear: whatever happens, the EU is now under much greater pressure than in the past to rise to the challenge, especially as it has become an active player in a multifaceted crisis right on its borders which is not likely to be solved/overcome any time soon.

As a consequence, the Union and its members will have to do many things in parallel while constantly considering the long-term consequences of their actions. The EU will have to: (i) keep up the pressure on Moscow while at the same time trying to avoid a further deterioration of the economically and politically significant bilateral relationship between the EU and Russia; (ii) support Ukraine without pushing the country to choose between the 'West' and the 'East', which could eventually tear it apart; (iii) explore ways to bridge the political gap between Moscow and the EU while learning from mistakes committed in the past; or (iv) if relations deteriorate still further, identify ways to manage the consequences of a severe and long-term stand-off with the Union's biggest neighbour to the East.

These are issues that the EU and its members may have to wrestle with for months and even years. From today's perspective, it is almost impossible to judge the potential long-term consequences of the 'Ukrainian crisis'. Future historians may well come to the conclusion that the developments in Ukraine and the wider implications of the crisis for the relationship with Russia were a turning point in the Union's role and self-understanding as a foreign policy actor. Jan Techau might be right in his assessment that "Ukraine is the first real strategic test of EU foreign policy" (see ["Ukraine, the Birthplace of Strategic Europe?"](#), *Carnegie Europe*, 18 March 2014).

Taking this one step further, future historians may well judge that shortly after the worst of the 'euro crisis' appeared to be behind the EU, the foreign policy crisis triggered by events in Ukraine made it even more necessary to further deepen cooperation between the countries of the Union – although this is a bold thesis at this point in time.

Besides the crisis in Ukraine and future relations with Moscow, the European Council addressed the following issues: the European Semester, Europe 2020, industrial competitiveness, energy/climate, taxation and the Single Resolution Mechanism.

## European Semester and Europe 2020 strategy – many words, but no concrete decisions!

The March European Council concluded the first phase of the 2014 **European Semester** by taking stock of the current economic situation and reiterating the policy priorities for this year. EU leaders had already decided, in December 2013, to put particular emphasis on policies enhancing competitiveness, supporting job creation and fighting unemployment (particularly among young people) and on the follow-up to reforms aimed at improving the functioning of labour markets.

EU leaders stressed that for the first time since the European Semester was launched a few years ago, the overall economic outlook seems more positive and promising. But they simply had an exchange of views with European Central Bank President Mario Draghi and did not take any concrete decisions. The Conclusions merely state that National Reform Programmes and Stability and Convergence Programmes should “respond in a concrete and ambitious manner” to last year’s Country Specific Recommendations and address the issues identified in the Commission’s recent analysis in the context of the Stability and Growth Pact and the macroeconomic imbalances procedures.

As expected, the heads of state and government did not discuss how to step up the economic coordination process in the framework of the European Semester. There was, for example, no debate on the idea of introducing “contractual arrangements” between individual Member States and the Commission to promote the implementation of structural reforms in the framework of the Semester by enhancing national ownership and providing specific financial incentives.

The European Council also had their first discussion about the implementation of the **Europe 2020 strategy** ahead of the planned mid-term review scheduled for the Spring 2015 Summit, which will be based on the results of a Commission communication. In the Conclusions, EU leaders acknowledge that progress towards meeting the strategy’s key goals has “slowed down” because of the crisis and that the long-term challenges affecting growth in Europe have “not gone away”. At a press conference during the Summit, President Van Rompuy and President Barroso acknowledged that the EU had fallen behind on some of its social targets, especially those relating to unemployment and poverty. However, EU leaders did not adopt any new measures and the Summit Conclusions merely state that efforts should be stepped up to reach the Europe 2020 targets and that the European Council “looks forward” to the planned review in 2015.

### Industrial competitiveness – renaissance without strategy

A lengthy section of the Summit Conclusions (three pages) is devoted to industrial competitiveness and policy, calling for a “European Industrial Renaissance”. The message from EU leaders is clear: industry is a key element of Europe’s economic competitiveness and the Union needs a “strong and competitive industrial base” as a key driver for economic growth and jobs. However, they did not present concrete measures to achieve this or agree a well-defined strategic plan for the long-term development of a new industrial policy (for more, see Claire Dhéret, [“Sharing the same vision – the cornerstone of a new industrial policy for Europe”](#), *EPC Discussion Paper*, March 2014).

On the contrary, the Conclusions are vague and lack substance when it comes to enhancing Europe’s industrial competitiveness. Here some illustrative examples: “industrial competitiveness should be systematically mainstreamed across all EU policy areas”; “efforts must continue to complete and fully exploit the potential of the internal market in goods and services”; “infrastructure networks...need to be developed and updated with intelligent and innovative technologies”; “smart specialisation should be promoted at all levels”, and “efforts should continue to improve market access around the world by facilitating the integration of European companies in global value chains”.

The most concrete proposal relates to promoting key enabling technologies, where the Conclusions call for the swift identification of projects aimed at strengthening key technologies, such as batteries for electro-mobility, intelligent materials, high-performance production and industrial bio-processes.

Regarding next steps, EU leaders have invited the Council, Commission and Member States “to continue work” and the European Council will come back to all these issues in the context of the Europe 2020 review in March 2015.

## Energy and climate – determination to reduce energy dependence; no decision on new climate targets (yet)

After the Ukraine Association Agreement signing ceremony, Day Two of the Summit concentrated on two issues: energy and climate. Against the backdrop of the latest developments in Ukraine, the discussions focused on the need to enhance energy security and reduce energy dependence, especially from Russia.

EU leaders committed themselves to intensify efforts to reduce **energy dependency** by developing an internal market for energy, enhancing the diversification of energy resources and reducing energy demand through increased energy efficiency. For as President Van Rompuy warned: “If we don’t take action now, by 2035 we’ll be dependent on foreign exports for up to 80% of our oil and gas.”

The spirit of, and concrete results emerging from, the Summit clearly indicate that EU governments are now much more determined to reduce energy dependence, which comes as no surprise given the Ukrainian crisis and the challenges it poses to Europe’s energy security. Russia provides around 30% of the EU’s natural gas and is its main supplier of crude oil (around 35%). Within the Union, Germany is the largest importer of Russian gas and some EU countries – including the Baltic states, Bulgaria and Finland – import almost all of their gas from Russia.

In recent years, the EU and its members have taken a number of steps to promote energy security and reduce dependence on individual suppliers. The Union’s gas network has become more integrated, the installation of interconnectors has progressed and reverse-flow technology, which allows gas to be transported in the other direction, has been extended. However, progress has been slow and much more needs to be done, given that despite all these efforts, EU energy imports increased from 63.4% in 2009 to 65.8% in 2012 (Eurostat) and the EU’s dependence on energy imports is predicted to grow still further given the expected decline of European sources of gas.

To reduce its energy dependence, the EU will have to take a holistic approach which aims to create an integrated energy market with a cross-border energy infrastructure, increase the share of renewables, diversify energy routes and imported sources of energy (including imports from the US, which has become a net producer of energy due to shale gas), add more reverse-flow corridors, enlarge storage reserves, pool the EU’s purchasing power by jointly negotiating contracts with energy suppliers and, last but not least, increase energy efficiency (for more, see also Annika Ahtonen, [“Russian belligerence and Europe’s energy security”](#), *EPC Commentary*, 19 March 2014).

The Summit Conclusions reflect the need to do all of this. However, the heads of state and government did not take any new or concrete policy decisions, but rather called on the Commission to conduct an “in-depth study of EU energy security” and present a comprehensive plan for reducing energy dependency by June 2014. This plan is supposed to reflect the EU’s need to “accelerate further diversification of its energy supply, increase its bargaining power and energy efficiency, continue to develop renewable and other indigenous energy sources, and coordinate the development of the infrastructure to support this diversification in a sustainable manner, including through the development of interconnections”. EU leaders also signalled that Member States will show solidarity in case of “sudden disruptions of energy supply”.

Regarding **climate policy** and the goal of reaching a compromise among Member States on the reduction of greenhouse gas emissions in preparation for the December 2015 Global Climate Conference in Paris, the heads of state and government launched the debate among themselves on the 2030 climate goals but could not reach a compromise now given significant differences in their positions.

Earlier this year, the Commission proposed to set a target for 2030 of reducing emissions by 40% from 1990 levels (up a 20% reduction by 2020). The Brussels executive wanted a political decision from EU governments by June, so the Union could go to the next United Nations summit in September with a joint position and thus spur other global powers to put forward their commitments, increasing the chances of a successful outcome of climate negotiations in Paris.

But the issue has split the EU into two camps. A number of eastern European countries – including Bulgaria, Czech Republic, Hungary, Poland, Romania and Slovakia – are worried about both the timeline and the overall target. They are also asking for a fair ‘burden-sharing’ between the EU-28 based on national impact assessments. Only then will they agree on specific targets and dates.

Other Member States – including Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Slovenia, Spain, Sweden, Portugal and the UK – actively support the Commission’s proposal and want a quick agreement among EU governments. But the so-called “Green Growth Group”, which also supports an EU-wide commitment to a renewable energy target of 27% (up from an expected share in 2020 of 21%), could not convince their partners of this during the Summit. As a consequence, EU leaders have now agreed that they will come back to the issue in June to take stock of the progress made, with the aim of taking a final decision on the new policy framework no later than October 2014.

### **Taxation of savings income – finally, a compromise!**

After many years of negotiations and opposition from individual Member States, the EU-28 were finally able to reach a compromise on the revision of the Directive on the taxation of savings income. Following increased pressure from EU partners and at international level, especially from the US, Luxembourg and Austria became the last Member States to give up their veto on the revised Directive, which will increase transparency through automatic exchanges of tax information between EU countries by 2017. This will help tax authorities to identify and chase up cross-border tax evaders and close pension and investment fund loopholes, as the EU-28 do not currently exchange data on interest earned from financial products linked to investment funds, pensions, trust or foundations.

It is also hoped that the agreement on the revised Directive will strengthen the Union’s negotiating position on savings taxation *vis-à-vis* third countries such as Andorra, Liechtenstein, Monaco, San Marino and, most importantly, Switzerland. The EU aims to commit these countries to fully implement the new single global standard for an automatic exchange of information developed by the Organisation for Economic Cooperation and Development (OECD) and endorsed by the G20. The European Council calls on the Commission to move forward in negotiations with these countries swiftly, with a view to concluding them by the end of the year, and to report on the state of play at its December 2014 meeting. If there is no progress in these talks with third countries, the Commission should explore possible options to ensure compliance with the new global standard.

### **Single Resolution Mechanism and Single Resolution Fund – a deal with uncertainties**

After months of intense discussions and following a final marathon negotiation which lasted 16 hours and ended just hours before the start of the Summit, EU governments – represented by the Greek Council Presidency and the Eurogroup President, the European Parliament and the Commission (trialogue) – reached a deal on the Single Resolution Mechanism (SRM), the second pillar of the banking union to stand alongside the Single Supervisory Mechanism (SSM).

The agreement still requires final approval by the European Parliament and Council, before the Parliament closes down for the elections, so that it can enter into force on 1 January 2015. It establishes a single regime for winding down banks involving a complex decision-making process which will be triggered by the ECB as the supervisory authority, and a common fund (Single Resolution Fund) worth €55 billion provided by banks to cover some of the potential resolution costs, but only after bank shareholders, junior and senior bondholders as well as large banks’ savers and institutional investors will have been obliged to cover the losses of a failing bank (bail-in).

The final deal reached in the trialogue is better than the original proposal agreed between EU governments in December 2013, but the system remains highly complex and doubts persist about whether the SRM will be enough in practice and whether it will ultimately break the link between banks and sovereigns.



The SRM compromise involves a regulation covering the main aspects of the mechanism and an intergovernmental agreement on the creation of the Single Resolution Fund (SRF). Key decisions will be taken by a Single Resolution Board involving permanent members as well as the Commission, the Council, the ECB (as the supervisory authority) and national resolution authorities.

The compromise between the Parliament and Council has streamlined the decision-making process somewhat, with the role of EU governments and national resolution authorities reduced with respect to bank resolutions involving less than €5 billion from the Single Resolution Fund, which will be owned and administered by the Board. A resolution scheme prepared by the Commission, setting out how resolution tools and funds will be used in cases below €5 billion, will be adopted by a smaller group of Board members (meeting in “executive session”), including the Chair, the Executive Director and three other permanent members. This streamlined procedure is supposed to speed up the process and make it “less prone” to political interference. The whole Board will only come together in “plenary session” if it is deciding on a bank resolution involving more than €5 billion in a single decision. In such cases, the largest EU countries (such as Germany or France) will have almost enough votes to veto a decision.

Following pressure from MEPs, EU governments agreed that the €55 billion in the Single Resolution Fund, which amounts to 1% of covered deposits, will be fully capitalised within eight years instead of the ten originally envisaged. The money made available to the fund through contributions from banks will also be mutualised faster than originally planned: 40% of the funds, which banks will originally pay into “national compartments”, will have to be mutualised after the first year and another 20% after the second, with the rest spread equally over the remaining six years.

The compromise reached in the trilogue also foresees allowing the Single Resolution Fund to borrow on the markets if the Board decides to do this at a plenary session. This would allow the Fund’s firepower to be strengthened in the early years when it has not yet accumulated the full €55 billion. However, the details of the lending facility are still unclear.

The establishment of a Single Resolution Mechanism is a major step forward which would have been unthinkable some years ago, and the fact that the EU institutions kept their promise by striking a compromise before the European elections and before the ECB takes up its role as a single supervisory authority is likely to further strengthen market confidence. The new system is definitely an improvement on the past, as it limits the need for massive bailouts financed solely by taxpayers and goes beyond a simple network of national resolution authorities.

But despite the abovementioned improvements/benefits, there are some unresolved issues and doubts about whether the scheme goes far enough and whether it will work in practice, for a number of reasons:

- The €55 billion foreseen for the Single Resolution Fund is a rather small amount considering that potential losses in the European banking sector might be much bigger, maybe even amounting to hundreds of billion. This deficit is aggravated by the fact the Fund is not allowed to use the European Stability Mechanism (ESM) as a final backstop, which *de facto* means that primary responsibility for winding down banks may, at the end of the day, still remains and burdens their home countries. The fact that the SRM regime does not include the “appropriate and effective backstop arrangement” called for in previous European Council Conclusions could undermine the credibility of the new system and fail to break the negative feedback loop between banks and sovereigns.
- Although it has been streamlined, the SRM decision-making process still remains very cumbersome, complicated and subject to potential vetoes and political interference, which in practice could make it difficult to reach agreement on a resolution scheme within the 48 hours required if a decision to shut down a bank had to be taken over a weekend.
- The fact that the Single Resolution Fund will, following German pressure, be created on the basis of an intergovernmental agreement limits the power of scrutiny at European level, especially in relation to the European Parliament’s powers. Some MEPs have already suggested that the intergovernmental agreement should be challenged in the European Court of Justice.

- There is not yet an agreement on how the Single Resolution Fund will be filled by banks and a “real tug-of-war”, as German Finance Minister Wolfgang Schäuble put it, can be expected between EU governments and institutions over how the levy will be organised in concrete terms on the basis of a Commission proposal.

The above limitations and uncertainties as well as the fact that the established banking union does not include a single European deposit insurance scheme (the ‘third pillar’) means that the system now in place is still limited. However, the fact that the intergovernmental agreement on the Single Resolution Fund includes a ‘repatriation clause’ – which states that the substance of the agreement should be integrated into the legal framework of the EU within ten years, at most, of its entry into force – might provide an opportunity to reform the EU Treaties and move from a ‘limited’ to a ‘full banking union’ worthy of the name in the foreseeable future.

### **EU-Africa Summit and Sri Lanka**

Besides Ukraine, the European Council Conclusions refer to two other external relations issues: EU-Africa relations and Sri Lanka.

Ahead of the 4th **EU-Africa summit** on 2-3 April 2014 in Brussels, EU leaders stressed that the Union remains committed to building a partnership of equals with Africa. They want to emphasise cooperation in a number of key areas: trade and development, democracy and good governance, the rule of law and human rights, and migration and mobility, including irregular migration and the fight against the smuggling of migrants and trafficking of human beings. The European Council also stressed that the EU will continue to provide operational support through its civilian crisis management missions and military operations, and consider ways and means to strengthen the African peace and security architecture and help African partners prevent conflict and address crises.

Finally, following particular pressure from the UK, EU leaders support the UN High Commissioner for Human Rights’ recommendation and called for the adoption of a resolution on **Sri Lanka** at the Human Rights Council providing for an international investigation into alleged war crimes by both sides during the war.

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