



GR:REEN

Global Re-ordering:
Evolution through European Networks



Responding to Crises: Perspectives on the European Union

Global Re-ordering: Evolution through
European Networks (GR:EEN)
High Level Policy Workshop

House of Lords
London
28 October 2014

Introduction



May I take this opportunity to welcome you to this high-level policy workshop ‘*Responding to Crisis: Perspectives on the European Union*’. The GR:EEN project has come a long way in the past four years of academic research. Providing cutting edge research into the EU’s role in an emerging multi-polar world, with research partners around the globe, and spanning eight work packages, GR:EEN has made some substantive steps forward in addressing key questions of the EU’s response to crisis and change in today’s global order. In drawing together this substantive research, this event is geared towards both the dissemination of our findings, and crucially to garner your opinions in addressing fundamental questions of how the EU has responded to new competitors and new crises and how this can be improved. Our work to date has already benefitted from the input of a wide variety of stakeholders. It is not just a case of our research having utility for non-academic users, but of it being informed from the very outset by the insights, interests and interventions of those very same communities. So, rather than just welcome you to today’s event, and thank you for finding the time to participate, I want to use this opportunity to thank everybody who has given their time – and of course, their intellect and observations – to help GR:EEN become a world class research programme.

Pr. Shaun Breslin

Director of Studies, GR:EEN

Director, Centre for the Study of Globalisation and Regionalisation, University of Warwick



Questions of the EU’s relevance, role and influence in international affairs continue to attract both the interest and criticism of both scholars and policy-makers alike. Today, both internally and externally the EU faces ever new and complex challenges and crises that call into question not only its relevance as an institution for its Member States, but its influence as a global actor. From the rise of new powers in the international system, to increasing challenges over energy insecurity, austerity measures and global economic crisis, to the resurgence of secessionist calls within Europe’s own borders, now, more than at any other time do questions of the EU’s place in a changing world require critical attention. It is to these fundamental issues that GR:EEN has been aimed since its formation in 2011, and it is these issues which bring us together today. Over the course of this afternoon we will be turning our attentions to both the EU’s external impact in tackling global crises, as well as the internal challenges that the EU today faces. Included in this booklet therefore are four policy briefings, prepared by and for GR:EEN, for your consideration and discussion. Following the event these briefings shall in turn be fine-tuned and circulated for wider dissemination.

On behalf of the GR:EEN project may I also take this opportunity to thank The Lord Purvis of Tweed for kindly sponsoring this event, to Lord Hannay of Chiswick, Baroness Scott of Needham Market, Lord Wilson of Tillyorn, and Professor Avinash Persaud for agreeing to chair our roundtable discussions, and to our GR:EEN partners, as well as all roundtable panellists and members for their time and participation. My thanks finally to our partners Dods and Research Fortnight for their support in providing rapporteurs to monitor and report on discussions. I hope that you will all enjoy your afternoon.

Dr Megan Dee

GR:EEN Postdoctoral Research Fellow

12.00 – 12.45	Registration and Lunch
12.45 – 13.15	Welcome addresses by Professor Shaun Breslin (GR:EEN), and Mrs Jacqueline Minor, Head of the European Commission Representation to the UK
13.30 – 14.30	ROUNDTABLE 1: Responding to new powers: The EU and global trade policy
14.45 – 15.45	ROUNDTABLE 2: The EU and energy security
16.00 – 17.00	ROUNDTABLE 3: The EU and global tax policy
17.15 – 18.15	ROUNDTABLE 4: Integration, devolution and regional leadership
18.30 – 20.30	Drinks Reception at The Cinnamon Club

All guests are warmly invited to join us for an evening drinks reception to mark the last year of GR:EEN's research and impact activities at the Club Bar in the Cinnamon Club, The Old Westminster Library, 30-32 Great Smith Street.

About GR:EEN

GR:EEN ('Global Re-ordering: Evolution through European Networks') is a global collaborative research project seeking to define the role of the EU in the emerging global order. Our research is coordinated over 8 work packages, delivering high quality research findings and policy recommendations as a coherent whole. GR:EEN is funded through the European Commission FP7 Framework Programme, Collaborative Project, SSH – Europe facing a rising multi-polar world, and has received an EU contribution of 7 944 718 €. Our partners include:

Universiteit van Amsterdam	Nanyang Technological University
Boston University	Norwegian Institute of International Affairs
Université Libre de Bruxelles	Peking University
University of Cape Town	United Nations University- Comparative Regional Integration Studies
Copenhagen Business School	University of Warwick
Central European University	University of Western Australia
Facultad Latinoamericana de Ciencias Sociales	Waseda University
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For more information about GR:EEN please visit our website at www.greenfp7.eu or contact our Project Management Office at:

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By Megan Dee (University of Warwick) and Jens L. Mortensen (Copenhagen Business School)

Introduction

The rapid rise of the emerging economies in the global trading system since the turn of the 21st century has generated significant uncertainty for the European Union (EU). The EU is the world's largest economy and trading bloc, the world's foremost bloc for both inbound and outbound international investments, and is a top trading partner for up to 80 countries. Whilst questions remain over the EU's capabilities and influence in other areas of foreign policy, on trade policy and within the global trading system, the EU is undoubtedly a great power. The geopolitical shift which has seen a growing assertiveness, and influence, of the emerging economies within both global markets and global governance, has however, had significant implications for the EU as a global actor and trader, and for its approach to global trade policy. Since 1999 the EU has subsequently, and pragmatically, altered its trade strategy, moving away from its previous managed globalisation strategy (1999-2006), to Global Europe (2006-2010), to the Trade, Growth and World Affairs (TGWA) strategy, launched in 2010 as part of the Europe 2020 Strategy for Smart, Sustainable, and Inclusive Growth. 2015 marks the half-way juncture for the Europe 2020 Strategy to which the TGWA strategy forms a core component. It further marks the commencement of the new Juncker Commission, and with a new European Trade Commissioner, Cecilia Malmström, at the helm of DG Trade. 2015 thus represents a crucial opportunity to re-evaluate the EU's global trade policy, and reconsider how the EU might pursue its trading interests, and develop its strategic outlook, to best adapt to a changing world.

In this paper focus is therefore given to the evolution of the EU's trade strategy, its implications for the EU's global trade policy – with particular reference to the ongoing TTIP negotiations with the United States and the WTO Doha Round – and recommendations for how the EU might adjust its strategic outlook for the period 2015-2020.

The emergence of a multipolar global trading system

A multipolar world exists where there are several centres or 'poles' of great power within the international system. In contrast to the multipolarity of the 19th and 20th centuries however, the 'polarity' of the 21st century is being assessed less on military hard power, and more on global shares of Gross Domestic Product (GDP), competitiveness in global markets, shares of world trade, and potential demographic and economic growth. More than this, whilst power continues to be seen in part as a calculable asset, assessed in terms of economic strength, population (and thus market) size, and technological capabilities of the major economies, it is also associated far more with political influence in systems of global governance. Within the global trading system this has become most apparent within the World Trade Organisation (WTO) where the emerging economies, namely including India, Brazil and China, have asserted an ever-increasing influence over the course of the Doha Round of multilateral trade negotiations. The fact that, by 2025, China and India are expected to have the world's second, and fourth, largest economies respectively, and that the developing economies are likely to outpace both the export and GDP growth of the developed economies by a factor of two or three in the decades ahead, are trends expected to therefore impact not just the wealth, and power, of the world's current global leaders – the United States and EU – but also the global balance of power in political decision-making.

The evolution of the EU's global trade strategy

Since the birth of the WTO in 1995 the EU's global trade strategy has fundamentally altered in response to the changing dynamics of world trade and the global trading system. In 1999 the EU's 'managed globalisation' strategy positioned the EU as the leading power within the WTO, and its main advocate for the launch of new multilateral trade negotiations which would broaden the multilateral trade agenda to establish new rules on trade and investment, competition, procurement, and trade facilitation, whilst reducing bound tariffs and removing non-tariff barriers (NTBs) in traditional trade policy areas such as agriculture, textiles, services, and industrial goods. Further calling a moratorium on all new bilateral and plurilateral trade negotiations, the 'managed globalisation' strategy established the EU as the WTO's champion, and the Doha's Round principle *demandeur*; being largely responsible for corralling the United States and developing world into supporting its launch. By 2003 the Doha Round was however, to experience the first signs of a new found assertiveness by the emerging economies, and a resultant stagnation in the WTO's multilateral trade negotiations. With ongoing disagreements over the very modalities that the Doha Round negotiation agenda should adopt – along with increasing entrenchment of the diverging stances of developed versus developing nations – the Doha Round was, by July 2006, suspended.

In what must be recognised as a pragmatic response to the impasse within the Doha Round, in 2006 the EU re-evaluated its global trade strategy. With the EU's efforts within the Doha Round proving ever more costly, and in further reaction to the United States' own aggressive pursuit of numerous regional and bilateral preferential FTAs with key partners, the Global Europe strategy brought a close to the EU's moratorium on bilateral and regional preferential trade agreements, and reopened the EU's pursuit of its trade interests beyond the forum of the WTO. Still prioritising the WTO as a principle forum for its external trade negotiations, the EU also began to pursue a variety of new bilateral trade agreements with countries such as South Korea, Ukraine, Canada, India, and several ASEAN countries. Global Europe further signalled a shift in the EU's policy towards the emerging economies. No longer accepting their development status as reason for non-reciprocation of trade concessions within

the Doha negotiations, and further recognising that the rising powers were combining their high growth with high barriers to EU exports, the EU raised its demands in expecting the emerging economies to take on greater responsibility in favouring market openness and to give Europe ‘something in return’.

However, with only one preferential trade agreement successfully negotiated by the EU between 2007 and 2009 (with South Korea), continued stalemate preventing progress within the Doha Round, and, following the 2008 global economic crisis, the added concerns of recession, rising protectionism, and market instability, the EU was again required to re-evaluate its global trade strategy. Launched in November 2010, the TGWA strategy was a specific response to several factors. First, the economic crisis resulted in weakened demand for European products and enhanced the EU’s reliance on growth through trade, and exports particularly. Second, projections showed that developing and emerging countries would account for nearly 60 per cent of world GDP by 2030, and with 90 per cent of world growth being generated from outside of Europe. The TGWA strategy thus placed priority onto securing the EU’s growth and competitiveness in a changing world, with particular emphasis on securing better access for EU products in traditional markets, whilst broadening its reach to access new markets as well. In sharp contrast to the managed globalisation strategy of the early 2000s which prioritised a ‘Multilateralism-First’ approach to global trade policy, and with a notable upgrading of the Global Europe strategy in favour of bilateral and regional negotiations with strategic economic partners, the EU’s global trade agenda since 2010 has thus been driven principally by a ‘Competitiveness-First’ strategic orientation in the face of the rising powers and their growing competitiveness in world trade.

TGWA policy implications

The TGWA strategy signified a major step forward in the EU’s approach to world trade and global trade rule-making which has had several important policy implications, including:

1. TGWA deliberately refocused the EU’s global trade agenda onto ‘new’ privileged policy issues including investment, procurement, and services as well as emphasising the broader need to enhance the EU’s foreign market access and to overcome regulatory barriers elsewhere. Important to note is that many of these issues are not dealt with under the current remit of the WTO’s Doha Round, but have been pursued through bilateral negotiations with key partners (i.e. the United States, China, Japan, Canada, Singapore, India), and in issue-specific plurilateral negotiations within the forum of the WTO (i.e. the Trade in Services Agreement).
2. Whilst the EU continues to stress that the Doha Round remains its ‘top priority’ and that the WTO has a ‘central role’ in the world trade system, the EU has exerted little energy within the Doha Round negotiations since 2010. Whilst it sought to play a mediatory role in 2011 in seeking to facilitate a compromise between American and Chinese interests on sectoral tariffs in the non-agricultural market access (NAMA-sectorals) negotiations, it has since been a fly on the wall as others negotiate around it. The EU’s support and consent remains critical to the progress and eventual outcome of any Doha deal, including any Doha-Lite deal stemming from the Post-Bali Work Package, but the EU’s performance within the WTO has been that of a cruiser.
3. The Transatlantic Trade and Investment Partnership (TTIP) negotiations are at the forefront of EU global trade policy at this time. TTIP is however a ‘game-changer’ for the global trading system. Portrayed by some as a ‘necessary’ and ‘strategic’ response to the changing trading order, and one that will in turn kick-start multilateral negotiations, it is, fundamentally, a post-crisis response by the EU and US to defend against future competitors, shape the future parameters of competitiveness in the global economy, and safeguard against the erosion of shared Atlantic values.

The EU’s trade strategy furthermore presents a number of challenges which require due attention in the next period of the Europe 2020 strategy. These include the likely efficacy of the EU’s ambitious, and far-reaching, negotiation agenda; the sufficiency of its trade strategy in addressing current trade dynamics; and the legitimacy of its approach in terms of global trade rule-making.

Efficacy

Whilst the EU’s prioritisation of bilateral over multilateral trade negotiations since 2010 is considered a pragmatic response to the ongoing stalemate and multilateral governance dilemma impacting the WTO, there are still no guarantees to the EU’s Competitiveness-First trade agenda. As the EU’s hard-fought FTA negotiation with Canada and the ongoing TTIP negotiations have increasingly proven, the EU’s bilateral trade negotiations today are neither simple nor easy. To make the types of gains necessary for enhancing EU growth and competitiveness, the EU must deal at the bilateral level with other virtually equal partners. Its bargaining strengths and capacity to make demands whilst resisting pressure for its own reforms, is therefore much reduced compared to negotiations with weaker or smaller states where the asymmetry of power stands in the EU’s favour.

The proliferation of the EU’s bilateral and plurilateral trade negotiations has moreover meant that, today, the EU is conducting trade and investment negotiations spanning a vast global network, including with the USA, ASEAN, Singapore, Canada (just concluded), Malaysia, Vietnam, Thailand, Japan, India, the Andean Community, MERCOSUR, Ukraine (awaiting implementation), Georgia (started implementation), Moldova (started implementation), Egypt (dialogue only), Morocco, Iraq (over access to the WTO), Azerbaijan, Kazakhstan, and China. With so many negotiations under way, questions must start to be raised as to the true efficacy of the EU’s approach. It further flags potential issues of how coherent each of these negotiating agendas are and the extent to which the EU will be able to then consolidate agreements made, particularly if, in the process, it alienates the WTO. Whilst these negotiations do present a substantial potential gain for the EU if concluded (TTIP alone is anticipated to inject €120billion into the EU economy), the EU will nevertheless be required to exert considerable energies if it is to achieve outcomes that it can count a success, and which in fact bolster EU growth and competitiveness.

In the case of the TTIP negotiations the question of efficacy is especially pertinent. Negotiations have already hit a wall of political resistance and normative contestations, with growing concerns over its highly ambitious scope and, until recently, limited transparency. Momentum within negotiations has moreover started to wane, and the window of opportunity for concluding negotiations before the American mid-term elections is rapidly closing. Within the negotiations a number of critical factors have further emerged that threaten progress, particularly including over regulatory convergence and the Investor-State Dispute Settlement Mechanism.

A core objective of the TTIP negotiations has been the need for regulatory convergence between the EU and United States. On this issue however, critics in Europe have particularly targeted the notion of TTIP as a ‘living’ agreement, fearing that it signals a future, pro-business regulatory approach. It is likely that an ambitious TTIP will be equipped with a horizontal chapter defining crosscutting disciplines across numerous regulatory barriers, with extended transparency requirements, and an institutional chapter establishing an independent body that will be mandated to tackle regulatory trade barriers in the future. However, the uncertain scope of the Horizontal Chapter on Regulatory Coherence has generated widespread misunderstandings. While TTIP is likely to host an institutional platform for future trade-related regulatory governance, in the form of the Regulatory Cooperation Council, this has so far been seen as a decision-making regulatory body beyond democratic control, potentially covering both prospective and existing regulatory measures of general application. This uncertainty has particularly fuelled anti-TTIP sentiments in Europe.

Another core TTIP objective concerns investment rules. The aim is to facilitate more private investment across the Atlantic and to develop a transatlantic model for future investment-related trade agreements, especially with the emerging economies. However, the Investor-State Dispute Settlement Mechanism is criticised for granting firms the right to sue governments and demand compensation if proven that investor rights diminished, by unfair, illegitimate and disproportionate public policies. It is seen as the irreversible shift from public to corporate power, forcing governments to compensate firms for legitimate public regulations to protect environmental or health interests. The legal process of secret, unaccountable tribunals, whose composition is hampered by conflicts of interests, has further politicised the issue.

In addition, critical efficacy issues are also present over the EU’s efforts to conduct free trade and investment agreements with the emerging economies. With China, challenges most notably exist in tackling the missed business opportunities owing to market access and regulatory barriers reported by 45 per cent of EU companies based there. Challenges also exist over the prominence of state-owned enterprises, unequal access to subsidies, and with serious questions over the adequacy of China’s intellectual property enforcement. In the EU’s ongoing negotiations with India and Brazil/MERCOSUR moreover there remain no clear signs of progress despite their longevity, particularly in addressing non-tariff barriers. In the case of India this includes quantitative restrictions, import licensing, mandatory testing, certification for large quantities of products, and lengthy customs procedures. Moreover, with a high average applied tariff of 13.5 per cent, Brazil’s market remains an expensive one for the EU.

Sufficiency

Whilst it is important to recognise that any strategy document is essentially a ‘living’ document, the TGWA strategy, and other aspects of the EU’s global trade policy, is already showing signs of being insufficient to the current trade climate. Launched in 2010 when achieving EU recovery from global recession was a critical driving factor, TGWA was crucially about surviving crisis. In nearly five years however, the EU has emerged from economic recession, has begun to show the first signs of being in trade surplus, has launched and is commencing with a far broader network of new trade and investment negotiations with key partners, and events in world trade have moved on apace, not least with regards a growing awareness of global value chains, value-added, and ‘trade in tasks.’ More than this, the politics of global trade governance has shifted dramatically in the past five years. TTIP has itself produced a knock-on effect for global trade governance, spurring on other mega-regional negotiations, diverting energy, momentum, and political will, away from the WTO, and raising criticisms of the EU and United States seeking to re-establish their former co-hegemony of the global trading system.

Within the WTO, progress has moreover been ponderous and the EU's endeavour to push for the Doha Round's urgent conclusion by the end of 2011 failed to materialise. Since then negotiators have increasingly distanced themselves from the Doha Round's single undertaking, with some progress being made towards achieving an 'early harvest' deal on trade facilitation, some agricultural components and addressing LDC issues, and which includes a new 'post-Bali work programme'. These new dynamics are not however, encapsulated within the current TGWA or broader Europe 2020 strategy and there is no clear EU policy or agenda for addressing the future of the WTO, or how TTIP and the EU's other negotiated agreements will explicitly complement multilateral trade liberalisation.

Legitimacy

The EU has consistently emphasised that its pursuit of trade liberalisation in bilateral and plurilateral trade and investment agreements is complementary to multilateralism and can help kick-start negotiations within the WTO – indeed signalled by the framing of TTIP regulatory issues as 'WTO+'. This has not however, been translated into any explicit effort to reinforce the role of the WTO as the legitimate trade legislator within the global trading system. More pressingly, there has been no clear signal by the EU that it has considered, or will look to address, the external legitimacy of TTIP, in terms of clarifying its global economic effects, in the need to ensure greater transparency, or the need to safeguard the ongoing and legitimate role of the WTO.

RECOMMENDATIONS

In order for the EU to respond to the current challenges of the global trading system, and its ongoing negotiation workload, it is recommended that the **TGWA Strategy should be refreshed for the final 2015-2020 phase of EU 2020**. Such a refresh should particularly consider the need for **a balanced, coherent, multi-level, and time-aware approach to the EU's negotiating agenda**. As the Doha Round has demonstrated, negotiation agendas can soon be outdated. A balanced prioritisation of the TTIP negotiations alongside the WTO's Post-Bali Work Programme should be addressed first and foremost before the Commission becomes immersed in negotiations with China, Japan or, in any contemplation of negotiations with Russia.

In contributing to that goal, in the case of TTIP **urgent clarification of the mandate of the proposed Regulatory Cooperation Council is required**. It should be stressed that the Regulatory Cooperative Council holds the potential of raising the transparency level of business-regulators interaction, and improving the political oversight capacity of the TTIP implementation process. Its decision making capacity must therefore be carefully crafted and specified. It is also imperative to **clarify the procedural rules of the envisioned chapter on investor rights in the TTIP**. A hybrid model of investigatory panel process open to private claims and a state-to-state Appellate Body can perhaps bridge this polarised debate. A roster of pre-selected panellists serving in an independent capacity should be established along with the creation of a permanent Appellate Body.

TGWA has done much to encourage a more competitiveness-driven approach to the EU's global trade policy. The EU should however, **take the opportunity of a new Commission to consolidate its negotiation agenda in order to maximise its likely benefit to cost ratio**, consider its preferences within each negotiation context to ensure coherence across multiple negotiation forums, and readdress its negotiation output to ensure that effort and energy is equally exerted in order to achieve the EU's core objective of achieving growth, jobs and competitiveness.

As part of a refreshed, balanced, and multi-level negotiation agenda, **the EU must critically revisit its policy and approach towards the WTO**. This should include:

- A willingness to **actively reengage in the Doha Round's Post Bali Work Programme**. The EU must move away from a cruiser role to again push for change, momentum, and progress within the WTO. The EU's Doha negotiation mandate moreover, remains principally embedded in Council Conclusions agreed in October 1999 and would therefore benefit from a refreshed approach by the Foreign Affairs Council. Such a refresh should include: **(1)** the recognition that the EU must respond practically to the new geopolitical realities of the WTO and be ready to accept further concessions; **(2)** a readiness to consider new flexibilities in exchange for concessions from the emerging economies. This may particularly include a new offer in agriculture in light of the CAP 2014-2020 reform;
- Whilst broad-based single undertakings represent the best case scenario for multilateral trade negotiations, enabling all players to achieve a positive sum outcome, they are unrealistic in an emerging multipolar global trading system. The EU must therefore **consider means of achieving its trade interests through smaller, more definitive, multilateral trade deals** or, as a second best solution, in the pursuit of plurilateral 'coalitions of the willing';

- The WTO is not 'unfit' to govern globalised trade but it needs updated rules to ensure that it remains a vital forum for countering the formation of rival trade blocks. The EU must consider ways and means by which to live up to its own multilateralist principles to **reinforce, support, and strengthen the WTO moving forward**. This will particularly require attention be paid to how the emerging economies are represented, and treated within the WTO, particularly with regards principles such as Special and Differential Treatment and Less Than Full Reciprocity. The EU should also join the United States in pushing for the upgrading of China's WTO status to full member rather than Recently Acceded Member;
- As an institution, the legitimising role of the WTO is impaired by the limited oversight capacities to monitor, discuss and analyse the actual economic effects of Free Trade agreements. The permissibility test of GATT Article XXVI, requiring net-liberalising economic effects for ex-ante approval of new trade agreements, is not functional. The EU must therefore **consider mechanisms for ex-post analysis of the economic effects of FTAs within the WTO**.

By **Andreas Goldthau** (Harvard/Central European University) and **Nick Sitter** (BI/Central European University)

“Soft power is the velvet glove, but behind it there is always the iron fist”

Robert Cooper (2004),
Director-General for external relations and political-military affairs, EU Council Secretariat

The biggest energy policy challenge that the European Union faces is security of supply. Policy recommendations commonly either invoke the need for more EU hard power – such as stronger external energy policy, a tougher stance towards Russia, stronger “pipeline diplomacy” with alternative suppliers of oil and gas – or more attractive soft power – primarily a matter of improving the working of the single energy market and persuading non-EU states in the near abroad to adopt similar market-oriented regimes. This brief assesses the EU’s policy tools in the energy sector, and explores whether what might be labelled ‘soft power with a hard edge’ can amount to a consistent and realistic policy strategy.

EU hard and soft power in energy

Hard power rarely works in the EU energy sector, primarily because the EU lacks the will and cohesion to exercise military and economic hard power to secure energy supplies. To be sure, the EU has exercised hard power in the form of counter-terrorist and –piracy operations; but not in order to secure energy supplies. Historical European examples of hard power in this sector include the establishment of the Anglo-Persian Oil Company, later BP. Contemporary US examples include the Fifth Fleet’s contribution to keeping the Strait of Hormuz open to international oil trade. Of course the EU has used energy as means and ways of exercising hard power, such as the oil embargo on Iran and sanctions against Russia. However, to the extent that the EU has hard economic power in the energy sector, this is primarily located at the member state level. What is more, it has not used hard (economic) power for energy-related ends. In short, the EU’s lack of hard power in the energy sector is not due to an ‘expectations – capability gap’, but to what might be called an ‘expectations – willingness gap’.

Soft power, on the other hand, is problematic for the EU energy sector because it cannot work if the targets (notably Russia) do not find the EU attractive as a model, or what it has to offer. To be sure, if non-member states do find it important to participate in the European integration project, this can give the EU leverage in terms of energy policy. A good example is Norway joining the European Economic Area, and the European Energy Community (which commits most of the West Balkans states, the Ukraine and Moldova to implementing EU gas rules on a voluntary basis). However, the EU’s effort to extend its rule-based regulatory regime for investment, trade and transit to the former Soviet states with the European Charter Treaty failed. Russia did not find it attractive, and the incentives coming with it did not convince other CIS countries either. However, there is some middle ground, and it stems from the EU being the world’s most attractive energy import market. This market might give EU soft power a hard edge.

Assessing the EU toolbox: why markets give soft power a hard edge

The most powerful instrument in the European Union’s energy policy toolbox is the regulatory rules that govern the Single European Market. This is of utmost importance in gas, the bloc’s most vulnerable energy sector. Three sets of directives, issued in 1998, 2003 and 2009, established the internal gas markets. Combined with competition law, they provide the EU’s soft power (the attraction of the Single Market) with a hard edge (conditions for third-country firms accessing this market). Important examples include:

- EU competition rules, such as prohibition on companies’ abuse of their dominant position, have forced energy firms to change their business practices. In the 1990s and early 2000s, the Commission broke up the Norwegian monopoly exporter GFU and other joint marketing ventures, including plans by Enterprise Energy, Marathon and Statoil to jointly market gas for the Corrib gas field, and the Danish gas supplier DONG’s agreement with the country’s main gas producers (Shell, A.P Møller and ChevronTexaco) to market their production jointly. The Commission and its network of national competition authorities has vetted and cleared a number of mergers, but their overall approach has been to use this power to impose conditions (usually divestment) for approving mergers and acquisitions, in order to promote competition.

¹ This brief is based on: **Andreas Goldthau and Nick Sitter, *A Liberal Actor in a Realist World: The EU Regulatory State and the Global Political Economy of Energy* (Oxford University Press, forthcoming).**

Since 2000, the Commission’s tactic vis-à-vis external suppliers has been guided by pragmatic problem solving. Its investigations of “destination clauses” in gas contracts, whereby exporters restrict the buyer’s freedom to re-sell gas anywhere in the EU or demanded a share of the profits in the case of resale, resulted in the removal of the practice from bilateral supply contracts between Gazprom on the one side and Italy’s ENI, Germany’s EON Ruhrgas and Austria’s OMV on the other, as well as between Algeria’s Sonatrach and its European business partners.

- The EU legal requirement that made firms “unbundle” transport and trade of gas permit third party access to pipelines and fostered competition among suppliers. External producers such as Gazprom need to comply with EU and national tariff regulations to the extent that they want to “come and play” on the EU market. Gazprom has sought, and partially secured exemptions from these rules on the pipelines linked to the Nord Stream project (which runs directly from Russia to Germany under the Baltic Sea, built by a consortium of Gazprom, E.ON, BASF, Gasunie and GDF Suez); but the Commission made clear that there would be no exemptions for South Stream (which runs under the Black Sea to Bulgaria and onwards to Central Europe, planned by a Gazprom-ENI joint venture). The six EU states involved agreed to let the Commission “assist” with their renegotiations with Gazprom.
- Article 11 of the 2009 directive – the so-called Gazprom clause – allows EU member states to take into account security of supply risks when they vet and certify third-country firms’ acquisitions, ownership and operation of gas transportation networks. It is noteworthy that this does not apply to EU-firms. Russia, which joined the WTO in 2012, complained in 2014 that this clause violates the GATS requirement for non-discriminatory treatment of foreign services and service providers. Still, the EU maintains that regulatory practices as applied in the EU need to reflect the goal of supply diversification, in addition to formal legal provisions.
- The EU supports infrastructure projects, which represent a classic ‘public goods’ problem, as part of its efforts of ‘market making’. This is done with a view to enhance diversity of pipeline routes from Russia (until the Nord Stream pipeline was opened in 2012, some 80 % of Russian gas exports to Europe crossed the Ukraine) and to link the EU market to additional suppliers, particularly in Azerbaijan and Turkmenistan. The Commission uses three tools to support pipelines: its regulatory tool kit to permit exemptions from single market rules for specific pipelines; its authority and expertise to lend support to any given project; and financial support for pipelines. The Commission’s most high-profile initiative was its support for the Nabucco project, which would bring Central Asian gas from Turkey to Austria via Bulgaria, Romania and Hungary. In one case, it even proposed what effectively amounted to a gas buyers’ consortium in the shape of the Caspian Development Corporation, a proposal that has seen renewed momentum in the shape of the recently proposed ‘Energy Union’. Although the Nabucco and CDC projects both failed, they nevertheless illustrated that the EU’s policy toolbox is somewhat wider than merely Single Market regulation.

The EU as a global actor in energy: using market power in a geopolitical game

In international politics, the EU regulatory state is emerging as an actor in its own right. This gives rise to a new and different take on the EU as a soft power: one that relies on attraction, but gives its attractiveness a hard edge. This hard edge is directed at both firms and governments:

- The EU’s soft power with a hard edge is directed at firms inasmuch as the Commission can and does oblige third-country firms to play by the rules of the Single European Market if they operate in the EU market. It has forced a number of firms to change their business models.
- The EU’s soft power with a hard edge is directed at governments inasmuch as the EU seeks to export its rules and support infrastructure projects. However, this power is conditional on the target states’ finding the EU regulatory model attractive, and/or assessing its benefits as outweighing the costs.
- The EU’s soft power coming with a hard edge is all about making energy markets and making them work. Almost everything the European Commission does in the field of energy policy is designed to complete the Single European Market, to extend it to the field of energy, and to render it more attractive for suppliers and consumers. In other words, the EU’s hard power derives from its attempts to mitigate public goods problems. Energy security is one of them – albeit one with a strong strategic dimension. Though often underappreciated, the EU regulatory apparatus, backed up with European market might, does have impact in fostering energy security, even short of hard power tools.

Nevertheless, the reach of EU tools – and hence its soft power with a hard edge – is clearly limited. It is more pertinent to gas than oil, because it is traded on regional rather than global markets. It is more relevant to the near abroad than more distant countries. And it is more applicable to transit countries than suppliers. The longer the attempted reach (in terms of distance), the more specific the tools need to be – as the Caspian Development Corporation initiative indicates. Finally, the EU's power is often more effective with respect to companies than governments, because its reach depends on how receptive the targets are. The EU's real hard edge comes into play when its policies target firms, operators and regulators; not the governments of producer states.

Implications for EU policy

This suggests that EU strategies need to start here. Given the characteristics of its policy toolbox, the EU will need to further sharpen and strengthen its instruments in the areas of competition policy, infrastructure support and market regulation. The EU, the world's largest and most attractive gas import market for decades to come, should invite companies to come, but to come and play according to EU rules. Further empowering the energy market watchdog – the EU Commission – will ensure both smooth market operations whilst competition rules as applied will make sure that external suppliers, as dominant as they may be, are held in check.

Within the GR:EEN project, Work Package One provides a stocktaking and theory-building function, focusing on how European actor-networks are involved in the European Union, transnational businesses, international organisations and non-governmental organisations. Our research focuses, in particular, on European networks of policy actors, entrepreneurs, and activists. Some of this research has explicitly adopted the 'experimentalist governance' framework led by Professors Charles Sabel and Jonathan Zeitlin, pioneers of this important literature who are part of the work package. Other work from GR:EEN WP1 engages with concepts such as 'multipolar learning' and 'transnational learning architectures', among others. Our cases have examined European networks across a range of issues, including learning within transnational businesses, training networks for eastern European economists, knowledge exchange between western and eastern European central bankers, transnational knowledge networks in areas such as anti-money laundering regulation, and policy and activist networks on European and global tax policy. While some of this research is in the writing process, much of it can be found on the GR:EEN website, in books with top presses, and in international peer-reviewed academic journals.

For this House of Lords event we decided that rather than have a roundtable on learning within European networks it would be more exciting to bring together elements of European policy networks to discuss an important and fast-changing topic: the EU and the global tax policy agenda. We invited Mr. Richard Murphy, who is well known in the UK and Europe for his strong views on tax issues, to provide a document on the 'EU and Tax Policy' to stimulate discussion among policymakers, practitioners, activists, and scholars. Professor Avinash Persaud, who was the Chair of the Warwick Commission on International Financial Reform, has kindly agreed to chair the roundtable. Our aim for the roundtable is to discuss the EU and global tax policy with opinions from a range of policy and professional networks represented, with the overall ambition of learning from these experiences.

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The EU and global tax policy

By Richard Murphy, FCA, Director, Tax Research UK

1. Introduction

This paper has been prepared as the basis for a roundtable discussion on the EU's role in what is now an accelerating area of policy reform worldwide: international taxation. Tax reform has been high on the agenda for the EU, the G20 and international organisations as many states seek to plug 'fiscal leaks' in a period of economic crisis and austerity. In the wake of the crisis the national and European welfare implications of ignoring 'fiscal leaks' has become obvious to all and made global tax reform a politically salient issue. While the EU is traditionally understood to suffer from severe collective action problems on tax issues, the European Savings Tax Directive has demonstrated some capacity to lead. Other organisations, such as the OECD, also seek to reform international taxation on issues such as transfer pricing and base erosion. The roundtable is intended to look at the EU's role in this debate.

2. Structure of this note

This note considers the EU and tax issues over time and within the international and national context. The aim is, quite deliberately, to place the discussion that will take place within the context of what the EU has achieved, what it needs to achieve given the enormity of the economic and fiscal issues it faces, and the constraints that exist on EU action.

The note deliberately addresses background issues that are unlikely to be discussed at the roundtable but of which awareness is needed if discussion is to be useful, before moving on to consider what are, in the author's opinion, the current major areas of taxation concern, where they are located and how the EU can through research, standard setting and by changing the political environment both within tax and broader issues of accounting regulation, competition policy and the approach it takes to creating the environment in which fair competition can occur effect change in this area without the need to change its own administrative or tax mandate. The opinions offered are based on a decade or more of research and thinking. For the sake of clarity sources are not quoted here, but the opportunity for expansion of the note exists in many areas.

3. Summary

The EU is not a tax authority and does not have a single universal currency. Tax law is devolved to state members and is fiercely protected by them. Progress on tax issues is frequently difficult because of the requirement that EU decision-making on the issue be unanimous. Despite that the EU has had some notable tax successes including the European Union Savings Tax Directive and the EU Code of Conduct on Business Taxation as well as measures on tax cooperation and information exchange and mutual assistance. VAT is an EU wide tax whilst broader opportunities for action in accounting, corporate and competition law if the will for action exists. There is up to €1 trillion to won by action on tax abuse, but 85% of the gains are domestic evasion, not international avoidance. The focus on international tax abuse has been important in putting this issue on the agenda, and the EU has dimensions of that agenda it needs to address, particularly relating to transfer pricing within the EU, tax competition issues, EU based tax havens and abusive tax arrangements, but to ignore more fundamental issues would now be a mistake when these other areas of concern are already the subject of OECD attention.

The key issue for the EU is revenue raising to close deficits. If that is the case the EU has to lead the way in finding that money: this is the boldest statement of aims that it can have for its tax policy. This requires:

- A proper estimation of tax gaps
- Investment in tax authorities
- Vastly improved regulation of companies, trusts and other structures that facilitate abuse
- Effective domestic information exchange from banks to tax authorities
- The creation of greater transparency in the economy from multinational corporations downwards to expose those cheating tax systems
- The creation of new tax reporting standards for the declaration of business income to remove the opportunities for tax and accounting arbitrage that undermine effective competition now and which provide a platform on which fair competition is built
- Enhancing tax system design to reduce the boundaries within and between systems that encourage abuse.

To put it another way, there is an enormous exercise in new thinking and design needed which the EU is ideally placed to lead to be run in parallel with a pragmatic exercise in enforcement to create the level playing field that has always been the basis of the European dream.

4. EU is in a strange place with regard to tax

- a. It's not a tax authority
- b. It has no tax that it charges
 - i. Although having a VAT to EU standards is a condition of EU membership
- c. It has only a partially applicable currency when much modern economic thinking suggests that tax and monetary issues are closely, and even intimately, related
- d. Any decision it does take on tax has to be unanimous
 - i. And on issues such as the update of the EU Savings Tax Directive that delayed progress for many years
- e. And yet I consider it one of the most effective agencies in the war on tax abuse that we have seen
- f. And that it could do more than almost any other agency to change the nature of debate on tax in Europe and, maybe, well beyond

5. The weapons the EU has available to it

- a. Treaty principles
 - i. Broadly applied to personal taxation
 - ii. Non-discrimination principles apply
- b. Directives
 - i. VAT (Relatively advanced harmonisation)
 - ii. Corporate taxation (Parent - subsidiary directive)
 - iii. The EU Savings Tax Directive (First and second incarnations)
 - iv. Mutual assistance
 - v. Excise duties
- c. Administrative cooperation
 - i. Exchange of data between members
 - ii. The Fiscalis programme of tax administration cooperation
- d. Soft law
 - i. The EU Code of Conduct on Business Taxation
- e. Competition law
 - i. The latest attacks on Apple, Amazon, Starbucks, etc
- f. Policy initiatives
 - i. The Common Consolidated Corporate Tax Base
 - ii. Home state taxation
 - iii. Tax fraud and evasion initiatives
- g. Research
 - i. A considerable output
 - ii. Impact?
- h. Accounting Directives
 - i. The Directives could be really powerful
 - ii. Harmonisation
 - iii. Disclosure (E.g. Country-by-country reporting)
- i. ECJ
 - i. A changing role
 - ii. With the Halifax case being the highpoint
- j. Company Law Directives
 - i. At present a missed opportunity that currently provides a licensed opportunity for tax abuse
- k. Trust and Foundation regulation
 - i. A massive gaping hole
- l. International Financial Reporting Standards
 - i. Potentially advantageous but a project captured by corporate interests that has refused to accept the need of governments, regulators, tax authorities, investors and stakeholders for information on which tax can be assessed or liabilities appraised.

6. The issue

- a. EU tax loss to abuse may be €1 trillion (my 2013 estimate, widely quoted, including by the Commission)
- b. 85% is likely to be evasion
- c. Maybe 15% avoidance
- d. Most will be domestic
 - i. A point very often overlooked of late
- e. There is, though, a major EU wide issue
 - i. Transfer pricing is an issue on internal EU trade
 - ii. Accounting and tax laws can be arbitrated within and between member states
 - iii. There remain significant tax havens within the EU itself including Luxembourg, Ireland, The Netherlands, Cyprus, Malta, London (and its spider's web of satellites – the UK Crown Dependencies and the British Overseas Territories)
- f. Harmful tax competition
 - i. On rates (Ireland, The UK, now)
 - ii. On tax base (The worldwide v territorial conflict and arbitrating it)
 - iii. Allowances and reliefs
 - iv. Special provisions
- Participation exemptions
- Patent boxes
- Film subsidies
- v. State aid (Advance pricing agreements)

7. The EU's effectiveness

- a. The EU Savings Tax Directive was the first tax haven automatic information exchange scheme
- b. The latest version deals with beneficial ownership and trusts incredibly well
- c. This all happened long before anyone dreamed of FATCA
- d. The Business Code of Conduct worked: incredibly powerful in impact on some abuses and tax havens like Jersey
- e. Tax cooperation agreements are ahead of OECD - but no one seems to notice
- f. The new use of competition law could be very effective
- g. There have then been considerable EU successes
- h. But despite these successes the EU has punched below its weight of late
 - i. Because the issue has not been seen as important
 - ii. Because of the need for unanimity
 - iii. Because the drive of the late 1990s appears to have been lost
 - iv. Because some states just kept saying No
 - v. Because there has been a lack of political will to think collecting tax is the right thing to do

8. The imperative for change

- a. Eurozone States in particular and EU member states in general are suffering:
 - i. Low or no growth
 - ii. Deficits (Not always within ECB constraints)
 - iii. High levels of government debt
 - iv. Austerity programmes
 - v. High levels of unemployment
 - vi. Low levels of investment
 - vii. Limited export prospects

- viii. Dependence on government spending to stimulate growth that cannot be achieved within existing economic straitjackets
- b. The common need is for additional tax
 - i. From 2009 to 2011 the focus was on tax havens
 - ii. From 2011 until now the focus has been on the multinational corporation
 - iii. The appeal of both has been the problem has been firmly located 'elsewhere' i.e. outside the domestic agenda, even when viewed from Brussels
- Small island rogue states
- US corporations, in no small part
 - iv. But my work and that of those few tax authorities who are brave enough to do tax gap analyses always show evasion is a bigger issue and the challenges are domestic as well as international
- c. Tax can fulfill the EU dream
 - i. The EU is predicated on the belief that fair and open markets can meet needs
 - ii. But fair and open markets require a level playing field
 - iii. The failure to tackle tax abuse internationally is market failure
 - iv. But that's also the case domestically
- Tax abuse distorts the allocation of resources
- Undermines fair competition
- Creates a race to the bottom
- Discourages investment
- Ultimately reduces the return on capital
- Reduces productivity because of failure to invest in people due to short term view it induces
- Reduces actual and measured GDP
- Creates a spiral of decline
- Brings competition into disrepute
- v. The need is to make that dream possible

9. Fulfilling the dream

- a. The EU could transform the environment surrounding tax (This is much more important than most would think):
 - i. Campaigners have changed tax without a single power to do so
 - ii. The OECD changes tax without the power to enforce change
 - iii. The UN's tax work in developing countries is in the same place
 - iv. Even the IMF is only able to advise in many cases
 - v. The whole G8 / G7 / G20 initiatives are persuasive alone
 - vi. In all cases it is the power of ideas that effects change
- b. What are the big ideas then?
 - i. Two of them
 - ii. Building the level playing field
 - iii. Finding the money

10. Building the level playing field

- a. A fair tax system is the foundation of a strong economy
- b. But tax systems cannot compete: the theory of competition is predicated on the idea that failure is acceptable and failed states are unacceptable
- c. Tax cooperation, openness, accountability, trust and equality of treatment are therefore the predicates of fair taxation

- d. How are these goals achieved in an EU context?
 - i. The EU needs to build a conceptual framework for tax - and especially for tax on profits which is at the core of much of the evasion problem
 - This is not as hard as you might think - key elements of this are hidden within the CCCTB
 - Some of the CCCTB is transformational when it comes to thinking on taxation
 - ii. Building a tax reporting framework
 - The EU has disparate accounting standards
 - The IFRS Foundation has consciously refused to engage with the needs of tax authorities as an issue
 - The need now is to establish a common set of tax reporting standards to ensure tax authorities (and others, including corporate management, investors, regulators and stakeholders) get the data they need to properly appraise tax, and assess it
 - This needs to provide a common framework for reporting across EU. A level playing field is not possible without it but it does not require common tax rates
- a. CCCTB demands this
- b. So does home state taxation
- c. The result would be common EU reporting standards, especially for bypass eases without third party suppliers of capital - whose needs are not in any event being met by many existing reporting standards
 - iii. Ensuring accountability
 - There is an assumption that accountability is a burden on incorporated business throughout Europe and this has resulted in significant exemptions from regulation and disclosure of data on public records
 - This culture has to change. The ability to trade with limited liability has to be matched by an obligation to disclose the risk being imposed on society and the price being settled to compensate for that risk exposure - which is tax
 - This demands that all accounts - meeting EU tax reporting standards - must be published in full on readily accessible public registers. Disclosure of beneficial ownership is a key part of this
 - Similar arrangements must extend to trusts and foundations
 - Full country-by-country reporting is essential for all multinational corporations
 - iv. Overcoming abuse
 - General anti-abuse rules to be the norm
 - Purposive tax legislation to assist legal interpretation is essential
 - Regulation of advisers to impose liability on tax scheme creators, endorers and vendors is vital
 - Legal protection against claim for failing to mitigate tax liability essential to protect professional advisers who refuse to sell tax abuse schemes is needed
 - Regulatory bodies for tax professionals must be required to take involvement in tax abuse by their members considerably more seriously
 - v. Designing integration of tax systems
 - Horizontal equity
- a. So that income from differing causes gives rise to similar total tax liabilities
- b. Big risk areas:
 - i. Labour income v investment income
 - ii. Payroll and social security contributions
 - iii. Corporate tax rates v personal tax rates
 - Vertical equity
- a. Failure to deliver progressive taxation
- b. Big risk areas:
 - i. Income tax v capital gains
 - ii. The absence of effective wealth taxation
 - iii. Interactions between benefits and taxation
 - iv. Relief for indirect taxes on those with low earnings

11. Finding the money
 - a. Limited progress is being made with multinational companies
 - i. E.g. Country-by-country reporting
 - ii. But it's not on public record and so delivers little pressure for change or any measure of effectiveness - or pressure at a corporate level to evidence compliance, which is fundamental.
 - b. Some progress is being made on automatic information exchange
 - i. But this dependent on knowing beneficial ownership
 - ii. There is a massive kick back on identifying beneficial ownership let alone having it on public record - which is needed to ensure effective monitoring
 - iii. The success of current progress is not yet known
 - c. But the biggest issues are domestic
 - i. We allow companies completely unregulated access to limited liability - which provides the easiest cover for tax abuse
 - ii. Company regulation is weak
 - 400,000 UK companies disappear without trace each year
 - Of the 3 million companies in the UK less than 2 million are asked for tax returns
 - a. Several hundred thousand so not submit them even then
 - b. Only about 1.1 million admit to taxable income
 - c. Less than a million pay tax
 - d. What do the rest do?
 - e. Can we now tolerate up governed tax systems with so many unanswered questions?
 - iii. Very few EU companies have made attempts to estimate their tax gaps
 - Those that do - like the UK's HM Revenue & Customs - use a bottom up methodology based on tax returns received that is bound to underestimate tax gaps because tax evaders try to operate outside the system
 - How can anyone manage a tax system without knowing how much it might be trying to collect?
 - The EU could and should develop better methodologies on this issue and require that they be used
 - iv. Domestic automatic information exchange systems are far too weak in many EU countries
 - By 2016 it will be easier for UK tax authorities to get information on a UK controlled company in Cayman than it will be on one in Manchester
 - The EU must create automatic exchange from banks to tax authorities within all member states on bank ownership and trading and on all suspected self employed persons. Nothing might do more to beat tax evasion than this
 - v. More investment in data is needed by tax authorities
 - Credit
 - Assets
 - a. Cars
 - b. Property
 - c. Investments
 - d. Travel

Libertarian thinking has prevented this but trade offs have to be made

- vi. But most of all, we need investment in people, training and systems to do this invaluable job - and this requires a change of attitude from politicians who consider that tax collection is a cost, not a revenue generating activity

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By Prof. Dr. Luk Van Langenhove, Ewout Ramon, Josh Gartland, Paula Retzl and Anna Selzer (United Nations University Institute on Comparative Regional Integration Studies (UNU-CRIS))

Executive Summary

It is often said that we are evolving towards a borderless world. But ever since the end of World War II, the number of borders has been increasing. Not only are there now more states, there are also more internal borders as well as more groupings of states (with their own external borders) than ever before. Multiple layers of governance are becoming the norm in democratic societies. This situation, however, poses a number of challenges, both for sovereign states and for regions below and above the state-level. These challenges include questions concerning solidarity, efficiency and legitimacy. There are ample opportunities in dealing with these challenges, but the bottom-line remains: they demand a dramatic re-thinking of how to organise governance.

Introduction

We are living in a paradoxical era. It is, at the same time, one of globalisation and one of regionalisation. Everything around the globe is becoming more and more connected, and co-operation at the world level is required to tackle many complex problems. Capital flows globally and communication technologies are dissolving borders. Yet we are witnessing a rise in the number of sovereign borders as the number of states increases. Borders are emerging within and above states too, as they embark on decentralisation on the one hand and regional integration projects on the other. Reallocation of authority is indeed occurring not only downwards to the subnational level, but also upwards to supranational levels. One might say that the era of centralisation has been followed by an era of decentralisation. The result is that today's "borderless" world has more borders than ever.

Sovereign authority has become divisible and shared among various loci of governance. In practice, the state's sovereign rights, entitlements and obligations have also been conferred to and endorsed by entities other than states. It is herein argued that the state voluntarily hands over part of its sovereign powers to local, sub-national, regional and supranational units, but also to private entities, as part of a strategy designed to govern efficiently in an era of intensified globalisation. Sovereignty is not fully retained by the state, nor is it entirely transferred to new loci of power in response to the changing patterns of governance. Instead, it has to be conceived of as divisible, divided among various sites at the local, regional, national and international levels and in the public and private spheres. While before, state sovereignty entitled states to recognise new states, negotiate treaties, sign agreements, declare war and conclude peace, protect national citizens abroad and cast votes in international organisations, we now see some of these entitlements and obligations conferred to entities other than states. As a result, governance is now a matter for states and quasi-states.

Globalisation has encouraged a spectrum of adjustment techniques and strategies and, in certain respects, a more activist state. States have not only delegated sovereign powers to supranational regional and global organisations, they have also devolved authority to sub-national entities at the (micro-)regional and local levels. Decentralisation and devolution of powers are driven mainly by a concern for efficient allocation and delivery of public goods, and have resulted in a system of multi-level governance.

Within this framework of multi-level governance, a parallel can be drawn between the 'Brexit' (UK-EU) and 'Scoxit' (Scotland-UK) debate. They both concern national identity and self-determination, and both reflect a certain disillusionment with established political elites and institutions. Multi-level governance can be explained by three logics: efficiency, distribution, and identity. These three logics are related to distinct conceptions of the purpose of government. First, government is there to provide public goods such as security, clean air, etc., which would not be provided by the market or by rational individuals. The structure of this government should then reflect the efficient provision of public goods given their economies of scale and externalities. Pressure to reform arises in the tension between actual government structures and the most efficient ones. Second, government is there to enforce distributional outcomes. The government structures will then reflect the power in society. Pressure for regional reform will respond to changes in power structures or changes in how rulers are selected. Third, government is an expression of community and the demand for self-determination on the part of normatively distinct, territorially based groups. The structure of government should then reflect the pattern of community. Sometimes these logics reinforce each other, but sometimes they clash.

It comes down to finding ways of staying together for the mutual benefits, while also allowing all units of governance to be apart. The main caveat of the shared sovereignty model is however the risk of demands for greater autonomy and self-determination by these partly autonomous entities. It is a phenomenon that can be described as the 'Frankenstein scenario', when creations turn against their creator. Research indicates that the more autonomy a region receives, the louder the calls for more self-determination become. In 86 per cent of the cases where a new state has arisen through secession, the region already possessed statehood characteristics in the period immediately before its independence. These secessions, together with a period of decolonisation, have caused the number of states in the world to rise sharply over the last decades. In 1948, only 74 states were members of the UN, today there are 193.

Despite voters' "no" to separation, the issue of Scottish independence is not off the table. In a way, Scotland has established for itself a position of regional leadership. The Scottish nationalists have demonstrated a persistent willingness to acquire additional political and economic independence. The partial acceptance of their demands has been demonstrated by the Prime Minister's promise to devolve additional powers, including taxes and welfare, in an equal manner to all four constituent parts of the UK. In addition, the capacity of Scotland to lead has been assured by its role as chief demandeur for autonomy. It remains to be seen how far Scotland will want to push its regional leadership role. Either devo-max will generate a more federal state; or the Union's separation will be sealed by a new referendum.

Challenges

Governance of societies occurs at different levels. Next to the classical sovereign states, there is a growing number of quasi-states: units of governance that are not states but that have some statehood properties. States will have to search for a modus vivendi with these quasi-states, but they will face a number of challenges in the process.

1. Solidarity

With the proliferation of borders there has been a shrinking of the scale of solidarity. The last European elections, with the significant gains enjoyed by nationalist parties, represent one example, as do the numerous secessionist movements around the world, such as the Scottish independence campaign. Between the Scottish and the rest of the British people, but especially with regards to English nationals, solidarity has been weakened. This lack of solidarity can be observed in the "yes" campaign's discourse that public services and especially resources should be shared among Scottish people rather than with the rest of the UK. The distinction drawn between the Scots and other British citizens is based on the argument that the two groups have different historical, political, and cultural characteristics and therefore do not share enough similarities for feelings and practices of solidarity to flourish among them. According to this argument, there is a lack of "mechanic solidarity", in Durkheim's terms, between Scottish people and the rest of the UK.

Although Scottish citizens do share more among themselves than with the rest of the UK, there are indeed British-wide identity elements, such as common values, history and culture. Most importantly, these shared elements are conceived of by most Scots as not opposed but rather complementary to their Scottish identity. Nevertheless, this was not the message promoted by the "yes" campaign. With the referendum campaign, the feeling of British and Scottish identities as opposed has been much reinforced. This situation represents a challenge of reconstructing a multi-faceted feeling of identity, in a way that being Scottish, English, Northern Irish or Welsh can again coexist peacefully with Britishness. The question is therefore how to engender a multi-layer system of mechanic solidarity.

However, similarities are not the only basis for solidarity. Divisions of labour, by engendering interdependence, can create another form of solidarity. This is what Durkheim termed "organic solidarity", based on difference. This kind of solidarity admits much more diversity than the latter and therefore is perhaps more suited to contemporary societies given societal trends towards differentiation, individualisation, and specialisation.

These two kinds of solidarity are always intertwined, but perhaps even more so in the case of the UK. The challenge is to identify which kind of policies and competency divisions between different levels serves best to balance these two kinds of solidarity in order to maintain on the one hand local identities and on the other hand enough solidarity among different peoples.

2. Efficiency

Organic solidarity, by promoting social cohesion through division of labour, can also contribute to efficiency thanks to specialisation.

Assuring the efficiency of policy making remains another challenge for a devolved UK. The motives for devolutionary initiatives, which in the past relied almost solely on mechanic solidarity for justification, have broadened to encompass a desire for greater efficiency in a globalised world. However, further devolution does not necessarily increase the economic efficiency of government

From an economic efficiency point of view, the separation of already small states is not desirable. Unified states prove to be more efficient, since duplication costs in law enforcement and defence are avoided, free trade is assured, and the provision of local public goods is granted. The benefits of decentralisation (such as increased participation in decision-making and greater local accountability) may be attained through implementing the appropriate degree of decentralisation of authority among regions. That being said, the benefits of a unified state cannot be equally distributed among all citizens. There are three factors that can influence a region's decision to secede: political factors arising from the differences in regional preferences over fiscal policy; the

efficiency losses from separation; and tax-related factors, emerging when per capita incomes vary across regions. Scottish voters decided that the efficiency benefits associated with remaining part of the UK were worth a lesser degree of control over political decisions when compared to independence. Nevertheless, the possibility exists that poorer regions may prefer independence despite both efficiency losses and losses of income in the form of fiscal transfers from richer regions. One way of avoiding a full separation is to allow regions to determine their own redistribution policy independently within a federal state. Inequality between regions resulting in redistribution is a major source of conflict between sub-national entities. The challenges Scotland is facing in terms of efficiency and legitimacy are closely interrelated. In the long term, a government's survival can only be guaranteed through the acceptance of its authority and the assurance of its political institutions' efficiency.

3. Legitimacy

This brings us onto the challenge of legitimacy. Political legitimacy is inherently subjective. For Locke, it is the acceptance by a community of a governmental body's claim to authority. The changing nature of identity and solidarity has caused many Scots to question Westminster's representativeness, a key source of democratic legitimacy, leading one and a half million of them to reject its claim to authority by voting for independence. Westminster's legitimacy may also suffer among English voters. Although the government plan to resolve the West Lothian question by barring Scottish MPs from voting on acts affecting England alone, 'devo-max' may well increase pressure for a separate, English parliament. Indeed, the question mark over Westminster's legitimacy to govern has not been resolved with the Scottish referendum. In time, Wales and Northern Ireland may demand independence for themselves.

Compounding the changing nature of identity however, the legitimacy of Westminster has been undermined by some of the adverse effects of globalisation (and liberalisation), from which the Scots have perhaps suffered disproportionately in relation to the rest of the UK. Efficient policy making is a crucial source of legitimacy. Yet here Westminster's powers are being sapped by globalisation trends, which are eroding the number of policy areas under its control. The paradox is that as more powers are drained by globalisation and devolved by governments, the capacity of Westminster to lead in the UK, and hence its legitimacy to govern at all, is called into question.

Policy Recommendations

1. From Mechanic to Organic Solidarity

Recognising that solidarity does not necessarily depend on similarities represents an opportunity for diverse societies such as the United Kingdom. In order to cement solidarity among the different parts that compose the Union, it is necessary to make policies aiming to specialise each country in different economic and scientific functions, functions that would be complementary to each other and necessary for the economy and science of each of them individually. Furthermore, the same reasoning might be used in terms of policy and decision making by splitting different functions of the same policies areas among different government levels. Additionally, higher specialisation can contribute to increase efficiency and productivity.

Certainly, material issues play an important role. As we have seen during the campaign for the Scottish referendum, one of the arguments defended by those wanting independence concerns welfare policies, which are decided upon in the Scottish parliament but depend on taxes collected by Westminster. In this case it is clear that not all policy areas can be used to create organic solidarity or at least that some kinds of policies are more sensitive and require a careful division of functions. Ultimately, however, it is often possible to create organic solidarity by dividing functions of the same policy between different levels of governance. Indeed, sometimes such multilateral organisation of policy making and implementation can boost efficiency and effectiveness too.

2. From Subsidiarity to Mutuality

The independence referendum has been a chance for the United Kingdom and Scotland to reflect on and reform their union. In a world moving from unipolarity towards a networked form of multipolarity, non-state actors that compete and cooperate become more important. The radically changing multilateral system could increase both efficiency and legitimacy. In a federal UK, each region could prove its usefulness to the others. Agreements could be reached on the basis of the principle of mutuality instead of subsidiarity. The principle of subsidiarity argues that all levels of governance in a stratified space of layers of governance from local to global, should be done at the lowest level possible. This classical notion of subsidiarity is no longer the best normative principle applied to multilevel governance. Given the increasing complexity of multilateralism, the principle of mutuality could be used to organize the "web" of governance. Mutuality is where each level of governance, participating in joint-decision-making, fosters the legitimacy and capacity of the others. Instead of quarrelling over the best distribution of competences between levels

of governance, the focus should shift to how both regions and states can mutually contribute to manage governance issues. Regions and state should stop competing and reinforce each other. Regions will endure challenging their place in the global governance system, whereas states will lose their capacity and sovereignty in dealing with global challenges as well as managing internal affairs.

The Scottish case illustrates that the region building process is not only about acquiring statehood properties but also driven by a nationalist component aiming at the transformation of a region into a full-fledged state. Nonetheless, regionalism is possible without a nationalist component and could contribute to moving away from nationalism. On a sub-national level, regions which are partly driven by efficiency motives could remain within an existing state, where they can contribute to optimal governance. In a multipolar world, states are increasingly confronted with the sharing of policy competences within networks comprised of formal governmental institutions and other actors, such as regions, private sector actors and lobbyists. The interaction between these interdependent actors, structured around negotiation and the defence of interests in policy making and implementation, exemplifies an opportunity to boost organic solidarity and legitimacy within the UK. Both the central government and regional governments should better engage with these policy networks in order to increase the solidarity, efficiency and legitimacy of the system.

3. Increasing Legitimacy

The even devolution of powers to the constituent parts of the United Kingdom might actually strengthen the legitimacy of Westminster. The majority of Scots have always been more in favour of devolution than independence. Relieving the UK government of those policy areas where its authority is in question might strengthen its claim to govern those areas left under its control, areas where devolution is not possible, such as defence and monetary policy. In addition, regional governments endowed with more powers may be better placed to find solutions to pressing policy problems affecting their communities. Here, the legitimacy of the system as a whole might be strengthened by more efficient policy-making at the regional level. Moreover, by bringing policy making to the lower levels, popular participation in, and therefore the representativeness of, policy making is enhanced, increasing the legitimacy of the system. Finally, equalising the powers of the parliaments and assemblies of the constituent parts of the UK, by increasing the representation of regional communities in Westminster, might enhance the legitimacy of the British system as a whole.

Of course, should regional governments be seen as more legitimate than Westminster, independence claims may again rise to the surface. It is therefore up to the central government in Westminster to put forward a coherent, convincing and, vitally, positive narrative as to why the four parts of the UK are indeed "better together", one that emphasises the UK's common history and pluralistic national identity, and the common institutions such as the pound, the BBC and the Foreign and Commonwealth Office which benefit from British economies of scale. Such a story has to draw on the UK's mechanic solidarity which, while damaged, still resonates with 55 per cent of Scots. But it has to build on organic solidarity too, highlighting the differences between the constituent parts of the UK that have enabled the Union to function as a single whole for so long.

Conclusion

The sovereign state is confronted with multiple challenges in the contemporary era. Increasingly, policy making is occurring at levels both above and below the state. Even though states are losing power in relation to regions at the national and supranational level, the number of sovereign states in the world is increasing. Furthermore, there is strong evidence that the more statehood powers a region has, the more likely it is to demand independence and the more likely it is to get it.

How Westminster deals with the challenge of Scotland's regional leadership will be instructive for other European states, such as Spain and Belgium. From the defence of the Union by all three major parties during the referendum, the willingness of Westminster to remain a leader in the UK seems assured. However, Westminster must work to retain the acceptance of its leadership among the constituent parts of the UK, while retaining its capacity to lead. Acceptance of Westminster's leadership will be determined by the extent to which it is able to promote organic solidarity and balance it with mechanic solidarity among the peoples of the UK. The acceptance of Westminster's leadership in the UK, i.e. its legitimacy, will depend on the extent to which 'even' devolution can increase participation, representation and efficiency, as well as the justification its politicians are able to furnish as to why the UK should stay together. Finally, Westminster's capacity to lead will depend on its effective use of policy networks and the progress it is able to make towards a system of mutuality.

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