



Global Counsel

# The next European Political Cycle

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# About Global Counsel

Global Counsel is a strategic advisory business.

The start of a new European political cycle in 2024, coupled with a series of key national elections, will shift the balance of power in the EU institutions. The GC team works with clients in monitoring, anticipating and adapting to these changes, as well as helping them understand the commercial implications of political risks and opportunities. We also support European businesses and civil society to ensure their arguments and evidence are relevant to a new political agenda.

Our offices in Brussels, London, Singapore, Washington DC and Doha are supported by a global network of policymakers, businesses and analysts.



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# The next European Political Cycle

2024 will see many of the current set of Commissioners change, potentially a new Commission President, a new European Parliament and certainly a new President of the European Council. This change of personnel will also mean a change of policy. Even if the Commission President stays the same, new policy demands from the Council and Parliament and new personalities in the Commission will mean a changed agenda.

This will pose a series of challenges for European governments, businesses and civil society to anticipate the refreshed political landscape and to ensure their ideas, arguments and evidence are relevant to a new political agenda.

**Ursula von der Leyen is set for reappointment as Commission president, but the college of Commissioners and its policy agenda will be reshaped by changes in national governments since 2019.** Her centre-right EPP European political party will be in an historically weak position in the European Council, but von der Leyen remains the easiest choice for EU heads of state and government. If she is not chosen, the field is wide open. The Spitzenkandidaten process is not set to dominate the appointment but still matters as a vehicle for von der Leyen's reappointment. The Greens' influence in the next European Parliament may weaken.

**There will be a shift in priorities in the next political cycle but the detail on issues like enlargement and competitiveness will be hotly contested.** There has been a political response to European industry's growing concerns about the continent's competitiveness. A shift to the right in the European elections may amplify it, translating in some cases into higher subsidies, in others to a focus on deregulation and deepening the single market. Enlargement is now again a practical concern, which poses hard challenges for the future of the EU budget, the EU's institutional arrangements and governance issues around the rule of law.

**The legacy of a college focussed on a series of crises, from the pandemic to soaring energy costs, will be difficult choices on the Eurozone's fiscal framework.** The next Commission must work through whether the green and digital transition must need some rebalancing against new and returning priorities. Co-ordination of spending on health and defence, and in securing supplies of energy and raw materials, all have their advocates in EU capitals, while the departures of traditional 'hawks' in Mark Rutte and the German CDU may remove some of the political obstacles to making permanent the recovery and resilience facility.

**The balance between openness and autonomy will continue to be contested in the debate on open strategic autonomy/sovereignty.** The transformed relationships with China and Russia since 2019, and anxieties about the US election in 2024, have all cemented concern at heads of government level about the importance of projecting EU economic power. The use of newly developed tools such as the anti-subsidy or anti-coercion instrument on non-EU companies, as well as the progress or otherwise in developing common standards on artificial intelligence and data, will reveal the extent of 'collateral damage' that concerns economy ministries and business stakeholders. The response to Russian aggression will remain a first order priority.

## KEY DATES ON THE PATH TO TRANSITION

**Nov 2023 - Mar 2024:** European political groups decide on Spitzenkandidaten and on policy platforms. For example, the centre-left PES Congress on 10 November will agree a Resolution on priorities, before a further Congress in Q1/2024 approves a manifesto.

**6-9 June 2024:** 27 member states hold elections, sometimes combined with regional or local elections. There are differences in approach, with some countries organised into regional constituencies and others with national lists. 16 members use the "d'Hont" method of allocating seats proportionally. The number of MEPs increases from 705 to 720.

**End-June European Council (and possible further meetings):** Heads of state and governments decide Commission President and other senior appointments such as the High Representative.

**July:** Member states not securing a 'top job' then nominate their candidates for Commissioner, in consultation with the Commission President, who then allocates a provisional portfolio, subject to confirmation from the European Parliament.

**September/October 2024:** Newly-formed committees in the European Parliament vet Commissioner candidates nominated by Member States. Successful candidates (normally all but one or two) then receive "mission letters" from the President derived from overarching political guidelines. These documents will clarify any structural changes around the roles of Commissioners, Vice Presidents, Executive Vice Presidents and possibly other tiers.

**1 November 2024:** New Commission takes office and prepares work programme for 2025.

# A changing political landscape in member states

The leadership and policy direction of the next European political cycle will arise from two debates: a pan-European debate among political élites and the sum of national debates in member states. Elections to the European Parliament are a set of national events, not a pan-European one. But the debate on the EU's future agenda between governments and those who lead European political parties is a Europe-wide one.

1

**A shaken political landscape:** Snap elections will take place in the Netherlands on 22 November. The alliance of centre-left PvdA and Greens (GroenLinks) are currently leading the polls after announcing they will run together in the elections alongside the centre-right VVD. The question remains how well the populist Farmers Citizen Movement is expected to perform and who the next potential Dutch PM could be.

2

**Far-right in the coalition:** Belgium will hold elections in June 2024 while Austria will go to the polls in autumn 2024. Both countries are expected to see the rise of right-wing parties, with Austria's Freedom Party and Belgian Vlaams Belang party leading the polls. In addition, while in Croatia the ruling centre-right Croatian Democratic Union (HDZ), is expected to gain the most votes, the party could turn to the right-wing Homeland Movement as its potential coalition partner after the elections in July 2024.

3

**New elections or continuation of the left-wing coalition government:** Spain's centre-right PP was the most voted party in the July election but fell short of a majority. If the party does not manage to gather enough support to govern, Spain will go to new elections unless caretaker PM Pedro Sanchez can get the backing of pro-independence regional parties.

4

**Two entrenched camps:** the ruling nationalist Law and Justice party in Poland (PiS) faces a tough election in October. On current polls, PiS will narrowly hold onto power in coalition with the right-wing Confederation party. A change of government to former President of the European Council Donald Tusk's Civic Coalition would be a significant victory for the EPP and would see a resolution of Poland's disputes with the Commission on the rule of law.

5

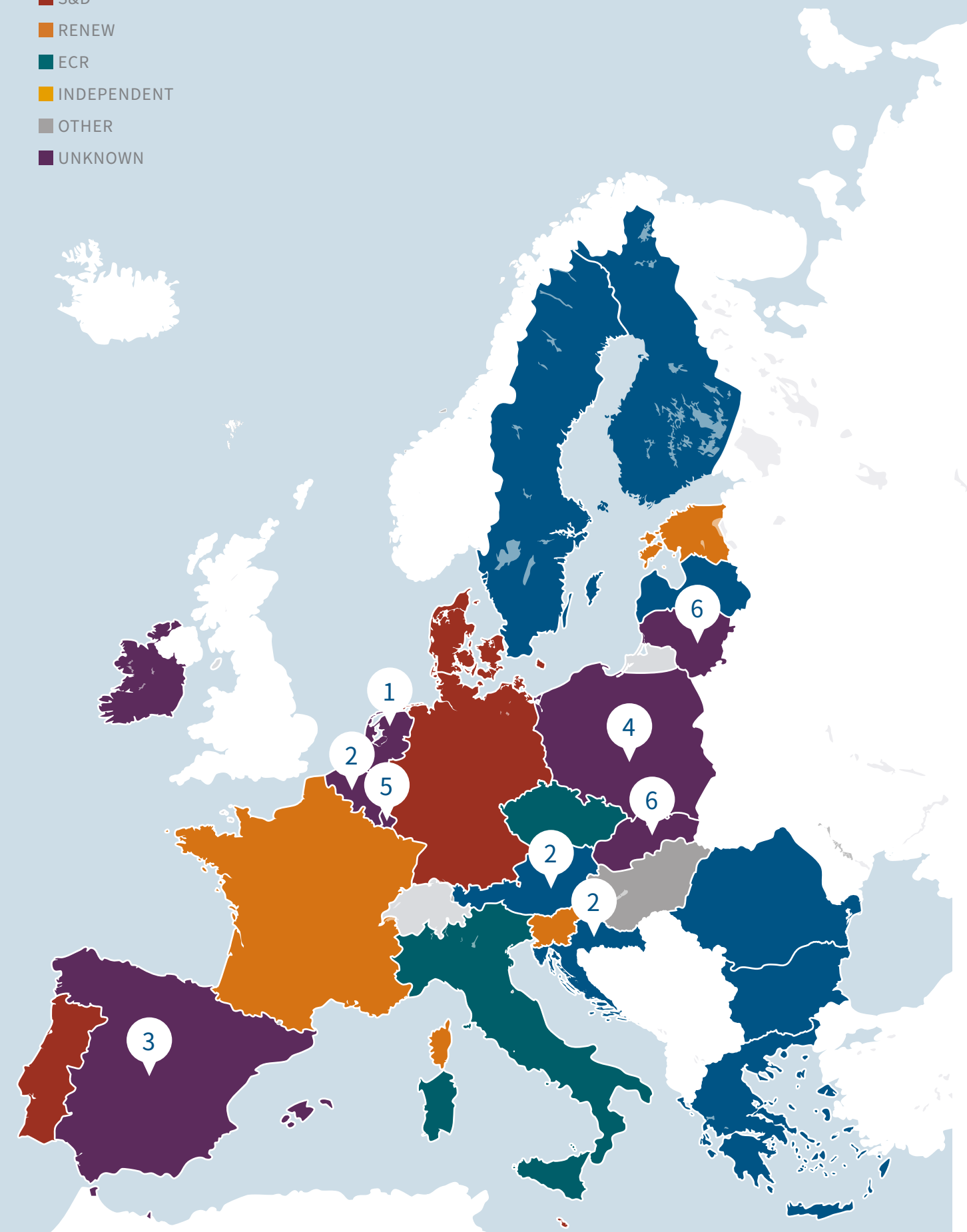
**Greens in a major loss:** Luxembourg voters will elect the Chamber of Deputies on 8 October. The latest polls predict that the current government is likely to hold on to its slim majority in parliament. The Greens, holding the opposition, are expected to continue to make significant losses as already experienced during the local elections in June.

6

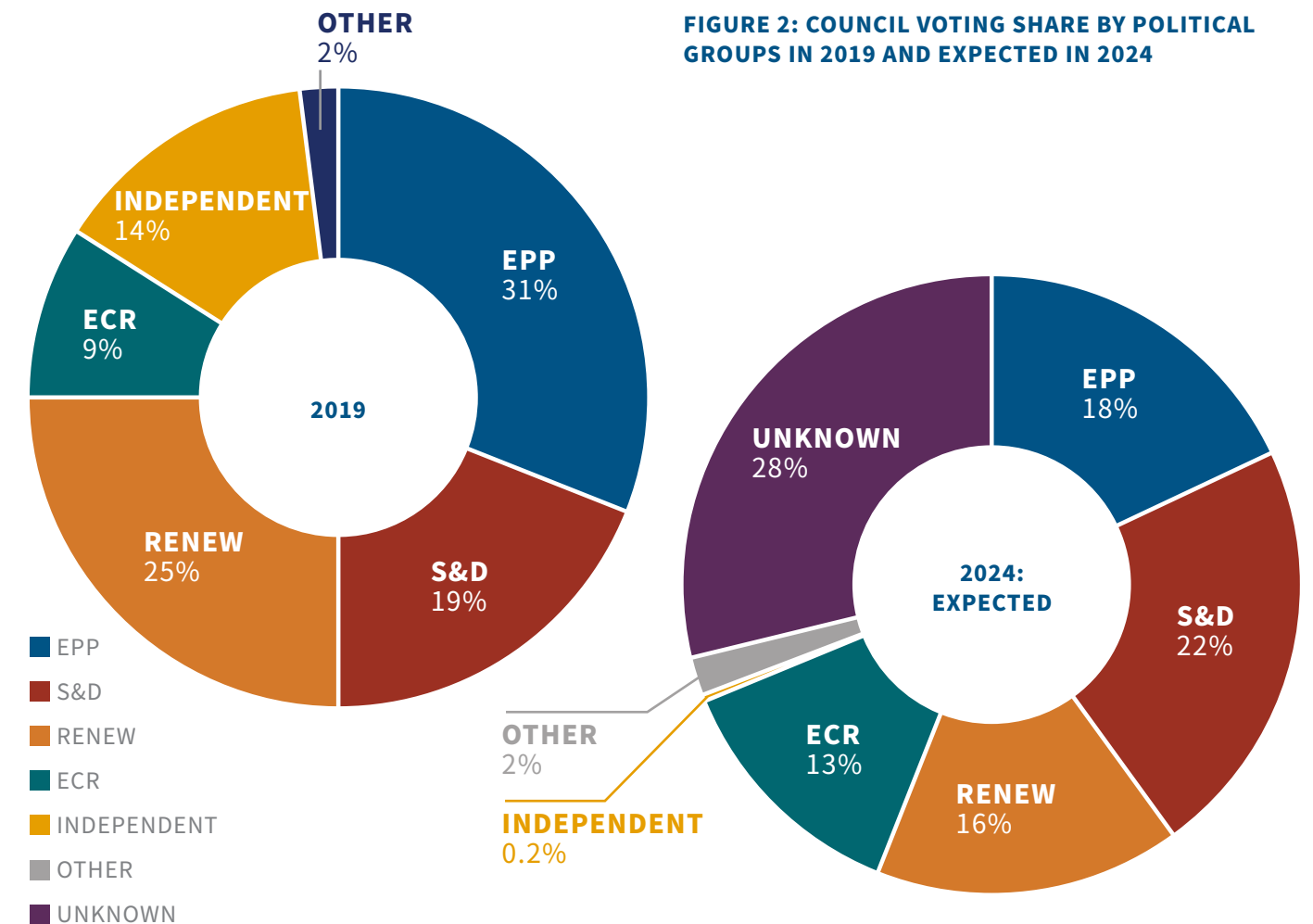
**Shifts in the policy directions:** Slovakia is heading to early general elections on 30 September. The polls project that the current opposition, comprising the populist Direction-Social Democracy (Smer-SD) and Voice-Social Democracy (Hlas-SD) parties, is likely to do well in the autumn elections. Whilst an ideological u-turn is unlikely, less Western-oriented policymaking might be expected after the election. In the meantime, the current polls predict a shift from the centre-right to the centre-left led government in Lithuania after the October 2024 elections, impacting the policy direction in the country.

FIGURE 1: ELECTIONS IN MEMBER STATES IN 2023 AND 2024

EPP  
S&D  
RENEW  
ECR  
INDEPENDENT  
OTHER  
UNKNOWN



# A new balance of power in the European Council



**The European Council is the most important institution in setting the agenda for the next political cycle.** The Council chooses the next president of the Commission and other top jobs, and inevitably the personality shapes the programme. Policy bargains are also made as part of the Commission president appointment process. Although the European Parliament has great influence and contests the Council's role, it is influence on an agenda already shaped by the Council.

**The European Council in 2024 will be more fragmented than in 2019.** Unless there are changes of government in Spain or Poland, none of the big five EU member states will be led by the EPP, a real weakening of its hand. Heads of state and government will be broadly distributed among the EPP, the harder right ECR, the centrist Renew, the centre-left S&D and, of course, Hungary's unaffiliated nationalist Orban. National elections since 2019 have meant a change in political affiliation at the European Council level in five EU countries. Most importantly, Germany now has a centre-left Chancellor and Italy has a prime minister from the hard-right, albeit one who has proven to be a co-operative European.

If PiS can keep power in Poland, the ECR will have real force at the Council. In Finland, a left-wing government has been replaced by a centre-right coalition, Sweden and Czechia have moved to the right and in Cyprus the presidency is now held by an independent, albeit still from a centre-right background.

**With elections in nearly a third of member states over the next year, the political balance of the European Council by the time it takes its decisions on top jobs is unclear.** There are upcoming elections in Poland, the Netherlands, Luxembourg and Slovakia this autumn and elections due in Belgium and Ireland, where the EPP-aligned centre-right may lose office, in 2024. Spain's tight election outcome may mean a further election later this year. If the centre-left can stay in power there, S&D's hand will be considerably strengthened in the Council. Lithuania's next presidential election may also fall before the EU's top jobs are settled.



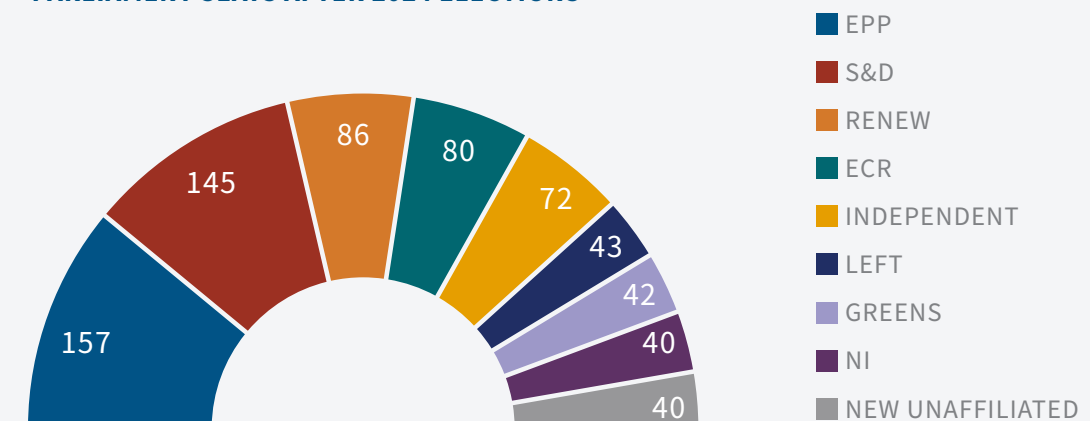
# Ad-hoc alliances for appointments and for policy in the European Parliament



IMAGE: EUROPEAN PARLIAMENT

The next European Parliament will likely shift to the right but that may not be the basis for a coherent majority. On current opinion polls, the centre-right EPP-aligned parties are expected to roughly preserve their current position, with improvements on their 2019 European Parliament election performance in Spain and some smaller member states making up for potential losses elsewhere. Parties further to the right are set for a better showing in a number of EU countries, including the big member state Italy. The hard right did poorly in Spain's election in July, but there is a national political explanation for that and by itself is not proof of a Europe-wide trend. On top of that, 2024 does not look like a good year for the centre-left, who are not flourishing electorally in either France or Germany, while the centrist Renew group are likely to fall back in their biggest national delegation (France - Macron's Renaissance) and the Greens face a similar situation in Germany. But this rightward shift will not mean a centre-right to right governing majority on its own and the Renew group is currently vocally insistent that they will not form a coalition with the centre-right and hard right: they want the current coalition that spans the centre-left and centre-right to persist. But even with a coalition spanning the centre-right and -left, the rightward shift would still have an effect.

FIGURE 3: PROJECTED DISTRIBUTION OF EUROPEAN PARLIAMENT SEATS AFTER 2024 ELECTIONS\*



The new European Parliament will have 720 MEPs but current polls are based on 705.  
SOURCE: EUROPEAN PARLIAMENT

The process of each political group nominating a lead candidate ("Spitzenkandidat") to become Commission President is not set to determine the next Commission presidency but the EP election will have impact. 2014 was the breakthrough for the Spitzenkandidaten process but in 2019 the Council pushed back and no Spitzenkandidat was chosen as Commission President. The General Affairs Council, reflecting the heads of state and governments' wishes, continues to reject the Spitzenkandidaten process.

This time the difference between Council and Parliament may turn out to be both academic and potentially precedent-setting: if von der Leyen is the EPP's Spitzenkandidat and is in any case the Council's choice then both sides will be able to claim victory without sacrificing their ideological principles. If she is not, and the winning Spitzenkandidat is someone else, there is no sign that the EP has the determination and the unity among group leaders to risk a crisis and force their candidate through: they did not in 2019, and in 2014 Jean-Claude Juncker had the advantage of being broadly acceptable to most of the European Council.

In 2019, too, the Council made clear its strong preference for a President with senior ministerial experience, which potential EPP Spitzenkandidaten in the European Parliament like Roberta Metsola or Manfred Weber lack. But whichever EP group wins the plurality of seats will have some moral force behind a claim to the Commission presidency for a candidate from their group. The European Council's national leaders would risk some embarrassment and the complication of a row with the EP in defying that mandate: that would be a difficulty but not an impossibility. But as the polls and institutional positions stand, it is good news for von der Leyen's hopes of a second term.

Confirmation hearings and regulatory scrutiny over the next four years will be based on ad-hoc coalitions. Competitiveness will count for more and Green issues for less. And it will have an impact on the choice of Commission president.



# Competitiveness at the core of the Commission's agenda?



IMAGE: EUROPEAN PARLIAMENT

**Ursula von der Leyen is in a strong position to stay as Commission President but she still has hurdles to overcome.** She has Chancellor Scholz's support for now (he would rather have her as the German Commissioner than a Green, whom otherwise the German coalition agreement would oblige him to nominate). But if von der Leyen is not a Spitzenkandidat support for her is harder to maintain. Her candidate status is likely but not guaranteed: she has a poor relationship with the EPP's secretary-general and group leader in the Parliament, Manfred Weber, who has sought to promote alternative Spitzenkandidaten in the past, such as the current EP president Roberta Metsola, and many EPP members are unhappy with her programme, believing she has leant too far to the left, particularly on the Green Transition. Von der Leyen will need President Macron's support, which has not been guaranteed to encourage von der Leyen to heed French views over the next year. It is not obvious, however, that there is a realistic alternative candidate for the presidency who would be more favourable to France. So as long as von der Leyen can become the EPP's Spitzenkandidat and as long as the EPP wins a plurality in the European elections she is set fair for reappointment. If either or both of these conditions are not met she could be in trouble.

**If von der Leyen is not reappointed the field will be wide open.** Commissioner Thierry Breton would like the job but in his current role has been a notable proponent of his home country's perspective and his European party, Renew, will not do better than third place. A French Commission President would be hard for some member states to support. The former Italian prime minister and President of the ECB Mario Draghi could gather support, should he want the job. The outgoing Dutch prime minister Mark Rutte has been talked about, but he says that he does not want the job. Other prominent figures are the Portuguese prime minister António Costa, the former Irish prime minister Micheál Martin, IMF Managing Director Kristalina Georgieva and the former Finnish prime minister Alexander Stubb. They also have the credentials to succeed Charles Michel as President of the European Council: he cannot be reappointed to further term.

**The next European Commission will be under pressure to place the EU's competitiveness at the heart of its priorities.** European industry faces considerable challenges to its competitiveness: third countries' subsidies and protectionism, high energy prices, regulatory burdens, inadequate infrastructure, skills shortages, falling behind in investment in R&D and a lack of access to capital. The centre-right, in particular, in the Parliament and national capitals will press for the next Commission work programme to address these challenges. A report by Mario Draghi in Spring 2024 will provide arguments and ideas, though the current mood of national freedoms in areas like state aid means Draghi faces a battle to match the impact of Wim Kok's 2004 report on the Lisbon Agenda, which created the European Semester process.

Priorities will also be shaped by the shift of the political balance in the European Parliament and Council, with an impact on files such as the current proposal for a Corporate Sustainability Due Diligence Directive and the future climate policy more generally. Who is in what job will continue to matter: for instance, Breton has championed moving forward with the "fair share", also known as sender-pays principle. The next Commission's agenda will also be shaped by what it inherits from the current one: the Belgian presidency in H1 2024 is expected to face a large workload on Capital Markets Union, legislative proposals under the Economic Security Strategy and European Health Data Space. It is unlikely to complete all of it.

## STRATEGIC ISSUES

**The next Commission's agenda will be dominated by three big questions: geopolitics, the EU's global competitiveness and the EU's size and shape.** Von der Leyen promised a "geopolitical Commission" and events since her appointment in 2019 have indeed necessitated one. The geopolitics of the triangular relationship between the EU, the US and China, as well as the Russian security threat, will continue to demand a European strategic response. European businesses are increasingly concerned about their global competitiveness and the challenge to it from America's and China's industrial strategies. Their concerns are being listened to by some member states and by the centre-right. Both the pace of the green transition and the response in economic strategy will be contested. Geopolitics has revived the EU's enlargement agenda, and that has revived the debate about whether the EU will need to change its budget and internal institutional rules to accommodate a bigger membership. The question of how the EU arrives at its future size and shape will absorb a great deal of political energy from the next Commission.



# A refreshed economic and policy agenda

**The next European Commission will have new tools to act on its ‘strategic autonomy’ ambitions but deploying them would mark a shift in its current approach.** In the current legislative term, the evolving concept of ‘open strategic autonomy’ has shaped new policies at the nexus of trade, industrial and competition policy. The European Commission linked existing powers to new triggers: perceived or actual economic coercion, lack of reciprocity or the demise of the multilateral trade dispute settlement system in the World Trade Organisation. But because these are often wide in scope, and vague in definitions, the upcoming Commission will play a crucial role in putting to use the untested ‘strategic autonomy’ toolkit. Whether it will be applied for deterrence, as initially conceived, or to promote a more ‘geopolitical’ EU, will depend on the Commission’s composition and member states’ judgements on how assertive the EU should be. This will likely entail a continuation of the balancing exercise that we have seen in the past five years between the weakened advocates of trade openness and ‘Europe first’ proponents of greater technological and economic sovereignty.

**Economic security will be the underlying theme behind the industrial, competitiveness and trade agenda.** The strategy unveiled in June 2023 was a scene-setter and a platform for the von der Leyen Commission to seek a political mandate from member states to act on the EU’s strategic autonomy ambitions. Economic security will be present in all economic policy debates - from security considerations in the energy transition away from fossil fuels, to digital and tech infrastructures, as well as overreliance on certain trade partners. Von der Leyen’s pitch for a common EU economic security agenda is aimed at making the link between tech-industrial policy and national security more apparent, framing greater EU coordination as an imperative in the geopolitical context of de-risking from China, even though China was not named in this context to avoid diplomatic offence. This would entail greater scrutiny of EU firms’ global value chain architectures and potentially policy-driven interventions favouring security over efficiency, and would require the Commission to act at the edge of its legal competence. Member states are wary of giving away powers within their national security prerogatives, even for EU unity’s sake: the strategy’s reception at the June European Council was cool and it was not endorsed by name. The EU’s economic security policy will be in play as member states and the next European Parliament use their leverage over appointments to shape the next Commission’s approach.

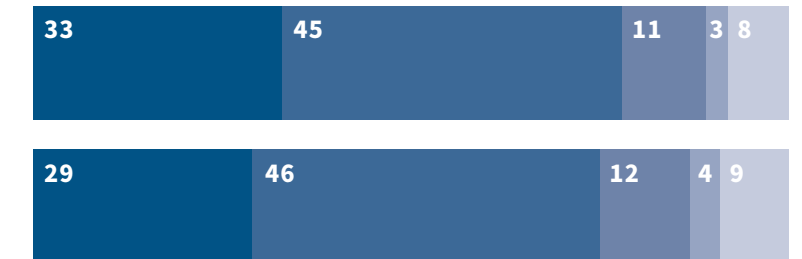
## GREEN TRANSITION

**The next Commission’s energy and climate policy priorities and political narrative will be affected by European competitiveness concerns.** The war in Ukraine and the EU’s commitment to phase out its Russian energy imports have triggered a shift in focus in energy policy, from decarbonisation to security and, in turn, to competitiveness. So far, the Commission’s approach to securing alternative energy supplies has been focused on the very short-term, by buying expensive natural gas stocks ahead of each winter. Meanwhile, measures taken in 2022 and 2023 to cushion the impacts of the crisis for consumers have left member states with significant levels of public spending to recover from. Energy prices have been identified as one of the EU’s key competitiveness challenges by both industry and policymakers. The next Commission and Parliament will be therefore left with finding a long-term way out of the energy crisis for Europe, while carrying on the energy transition at pace and preserving a favourable environment for businesses. This includes delivering on power market reform and on the Green Deal Industrial Plan, with political agreements awaited for 2024. EU legislators will also be expected to address the energy transition’s funding challenge. This could well entail, as alluded to by current Commissioners, the expansion of the upcoming EU Hydrogen bank to other clean energy technologies deemed strategic. The EU Energy platform, launched in April 2022 to structure the way member states purchase natural gas on the global market, could also be extended, both in time and scope, to cover other clean gases including hydrogen.

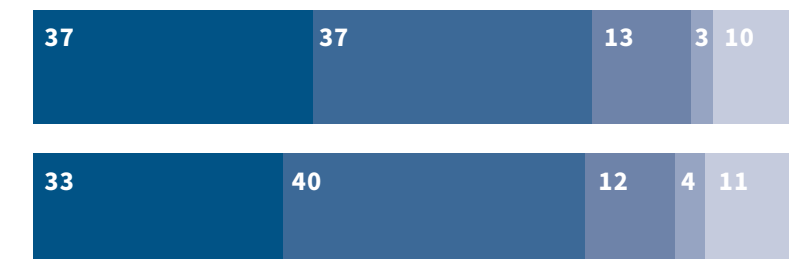
**The outcome of the 2024 EU elections will matter for the future of the Union’s green transition.** Calls for a regulatory “brake” on further climate policies have been issued from the right of the European Parliament, along with several EU capitals before the summer. A stronger centre-right and right and a weaker Green Party would have an impact on the direction of EU energy and climate policy: the European People’s Party (EPP) has been leading the argument for a reduction of the green transition’s “burdens” for businesses. Such a shift would mean that both Parliament and Council could align in support for a new phase of energy and climate policy focused on implementation and mitigation for consumers, including businesses. But ecologist parties across the EU have been calling for more ambition on carbon neutrality, so greater Green representation in the Parliament would push it towards opposition to member states’ centre ground on the issue. The immediate impact will be on the negotiations on the new 2040 climate targets and the revision of member states’ National Energy and Climate Plans, which the Commission must assess by the end of 2024. This Commission may issue a Communication on the 2040 targets before the end of its term, but the policy package will be worked on by the next one.

## EUROBAROMETER RESULTS TO THE STATEMENTS:

“Taking action on climate change will lead to innovation that will make EU companies more competitive” (% - EU27)



“The costs of the damages due to climate change are much higher than the costs of the investments needed for a green transition” (% - EU27)



SOURCE: SPECIAL EUROBAROMETER 538 CLIMATE CHANGE - REPORT, EUROPEAN COMMISSION, JULY 2023

■ TOTALLY AGREE
 ■ TEND TO AGREE
 ■ TEND TO DISAGREE
 ■ TOTALLY DISAGREE
 ■ DON'T KNOW



## DIGITAL TRANSITION

Having spent much of this mandate addressing the problems deemed to be caused by large tech platforms, the European Commission will likely shift its focus to European consumers' experience of the internet. Work on assessing the 'fairness' of rules for digital consumers is already underway, with the results to feed into new initiatives in the domain of consumer protection online. The EU-level debate over child safety online is starting to gain the same prominence seen in member state-level discussions, with progress on age verification being identified as a key issue for solving numerous child safety problems. Online advertising is also likely to be a priority - particularly looking at the use of personal data to target advertising, which could in turn impact work on the highly likely review and revision of the GDPR. Finally, the Commission will be pouring resources into implementing and enforcing the two flagship laws from the current mandate, the Digital Services Act and Digital Markets Act, with new initiatives in these areas only likely to emerge if these rules are shown to be ineffective.

**Beyond content, boosting Europe's industrial competitiveness via the tech and telecoms sectors will continue to be an important theme.** Current Commissioner Thierry Breton has called for a European Telecoms Act to address issues facing the sector, likely to include the vexed question of 'network fees', by which tech companies would be asked to contribute to telecoms network costs, among others. But the ambition and nature of any new proposals will depend greatly on the personality and political weight of the next Commissioner in charge of the portfolio - which may or may not be Breton himself. Cybersecurity is likely to remain an ongoing focus, not least because of the continuing threat from Russia. Implementation of the NIS2 Directive, Cyber Resilience Act and other existing legislation will be important; supply chains could be an area for new action. Artificial Intelligence is the final standout issue: while the AI Act is likely to be finalised and is intended to comprehensively regulate the market in Europe, new issues will likely emerge that could require legislative solutions. Use of copyright-protected content in AI training data is one such candidate, despite negotiations between industry counterparts; generative AI in general, as well as its specific use in areas like cybersecurity, could be another.

## FISCAL INTEGRATION

**The EU's fiscal policy must address the legacy of the pandemic and the current challenge of aggressive industrial policies.**

During the pandemic and the energy crises, the EU relaxed its fiscal and state aid rules to allow member states to support firms and households. Recent crises have also revealed vulnerabilities in European supply chains because of a lack of investment in infrastructure and production capacity over the past decades. The EU now faces a changed global environment marked by intensifying industrial competition with the US and China. In response, the EU is using pandemic-era support measures as a template for a more active industrial policy to compete with the US and China. The temporary pandemic recovery fund has been revamped to channel public investment into the green and digital transitions, and the Commission has further expanded the scope and the timeframe of looser state aid rules to subsidise green tech projects. However, this spending must still be properly accounted for in government budgets, and the Recovery Fund has limited capacity and only runs until 2026. Talks about a potential European Sovereign Fund are still at an early stage. Beyond this, member states must rely on their own budgets to support industry.

**Relaxation of state aid rules has disproportionately benefited the member states with the deepest pockets.** Through the pandemic, 77% of state aid payments came from Germany and France. In 2021, Germany spent €121.21 billion on state aid, 36% of total EU state aid expenditure, followed by France with €63.3 billion, 19% of total EU state aid expenditure. Within the state aid provided by both countries, the level of pure aid is much higher than in other member states. Even though Italy and Spain have also provided higher levels of state aid, they mainly offered repayable instruments, with lower amounts of aid during the pandemic. Although this more active industrial policy is not widely disputed, the growing dominance of member states with larger balance sheets could put others at a competitive disadvantage even more, increasing the fragmentation of the single market and exacerbating economic differences across the bloc.

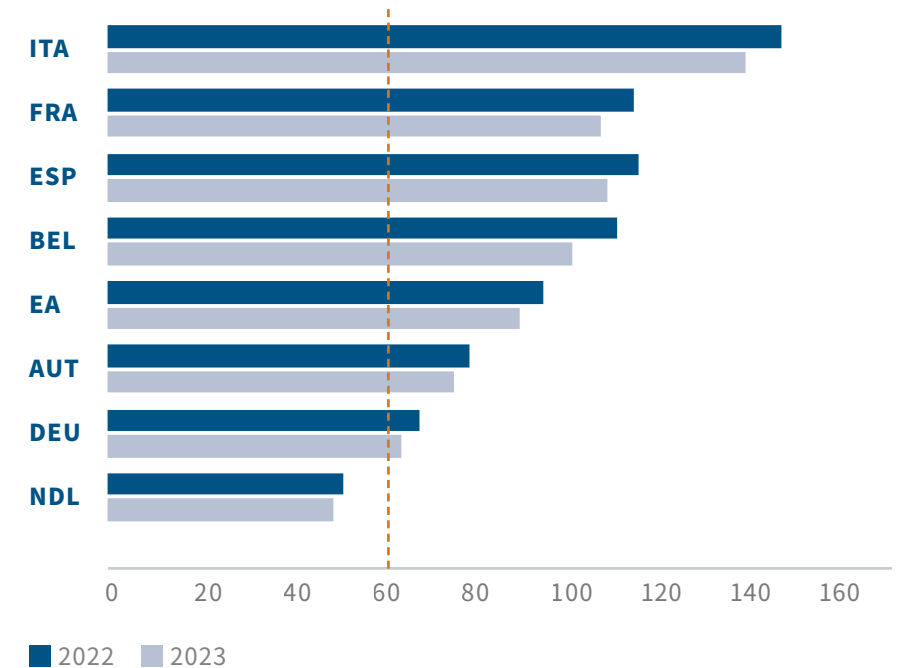
**There is a strategic case for reforming the current fiscal rules to facilitate public investment, but tensions between the more frugal and fiscally looser member states persist.** Public debt has risen sharply since the Commission suspended the fiscal framework in 2020. The rules are scheduled to return in January 2024; what they return as will determine whether the next Commission inherits this as a controversial area of policy. The Commission proposed a reform in April, with a country-specific approach and greater flexibility in reducing debt. Countries with deficit levels exceeding 3% of GDP would have a four- to seven-year multiannual spending plan to gradually adjust their spending without constraining economic growth. The bargain at the core of this proposal is that the Commission would offer more fiscal space for member states to support investment, in return for greater

control over their spending. EU members are divided about this flexibility and persisting disagreements between member states are likely to prolong negotiations, reaching into next year. Germany's liberal finance minister is insisting on binding rules, and that the growth in government spending must remain slower than economic growth. Germany fears that giving too much discretion to the Commission over debt-reduction targets would allow enforcement to be politicised. Conversely, France, with no clear fiscal plan to reduce its debt, wants more flexibility, as does highly indebted Italy, with the latter also advocating for a 'golden rule' for spending on the twin transition.

**Although negotiations will likely lead to greater flexibility, even with laxer rules rising borrowing costs will constrain highly indebted member states.** Fiscal space differs between member states. Across the EU, government debt levels are ten percentage points of GDP higher than before the pandemic and debt servicing costs have been climbing further because of the sharp rise in interest rates. Even though looser state aid rules allow EU countries to spend more on the twin transition, governments will be under pressure to provide credible short- and medium-term fiscal plans to avoid sharp market reactions. Historically frugal countries like the Netherlands introduced budget cuts this spring, as has Germany (albeit with some spending streams moved off budget into special instruments), which is aiming to return to its constitutional debt-brake rule. This puts further pressure on fiscally weaker member states such as Italy, Belgium and Spain. A reimposition of strict fiscal rules and tight monetary conditions, without the ECB effectively serving as a backstop, will constrain some member states more than others in using the expanded state aid rules. The debate about a greater level EU fiscal capacity will be unavoidable for the next Commission.

## GOVERNMENT DEBT LEVELS HAVE RISEN

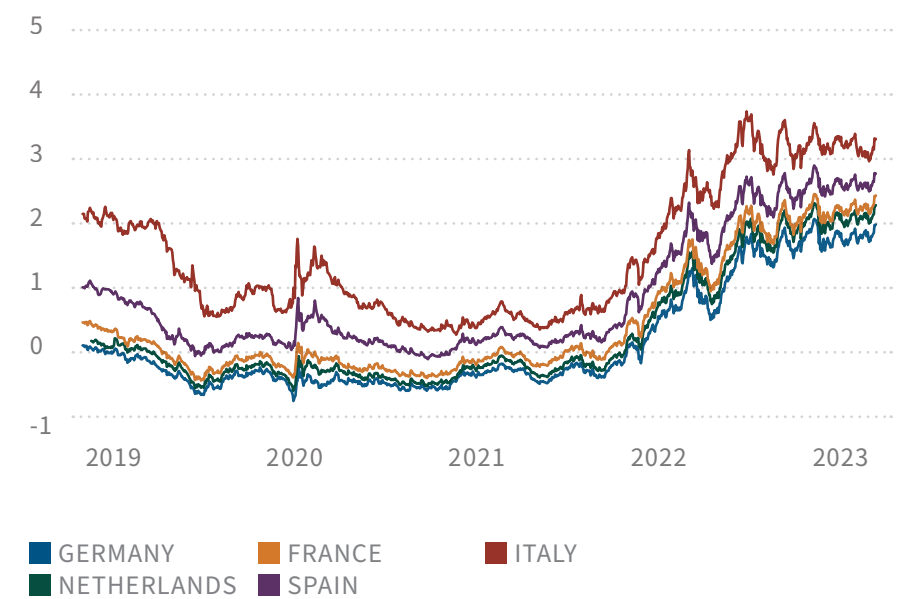
Gross public debt, % of GDP, above line exceeds Maastricht criteria for public debt/GDP ratio



SOURCE: EUROSTAT, GLOBAL COUNSEL

## BORROWING COSTS HAVE INCREASED

Government Benchmarks, ten-year yield, %



SOURCE: MACROBOND, GLOBAL COUNSEL

# An outward looking EU under pressure to reform within

## ENLARGEMENT IN EUROPE'S NEIGHBOURHOOD

The next European Commission will face significant strategic challenges in foreign policy. The enlargement agenda, comatose for a decade, has been revived and is set to become one of the biggest policy issues for the next Commission. The EU is having to respond to the challenges of Russian aggression and strategic rivalry, Chinese strategic competition and an American ally pursuing a new protectionism and with an uncertain political direction after the presidential election in 2024. Von der Leyen said she would lead a more "geopolitical" European Commission and indeed she has had to. Russia's invasion of Ukraine has forced the Commission and the Council to adopt unprecedented foreign policy decisions. In response to the invasion the EU has deployed sanctions and aid, for the first time including weapons deliveries, and has begun to think more strategically about its trade relations (inter alia, through its Economic Security Strategy).

The EU's traditional foreign policy instruments - aid, trade, and sanctions - have evolved, but so have the challenges that the next Commission will be facing. A second Trump presidency would present the most profound challenge to the EU: on European security and on a rules-based world order in trade. On China, the EU and its member states must navigate the balance between their own economic resilience, the economic value of trade, the utility of a working relationship with the Chinese government and American pressure. More broadly, the EU must determine its interests in the balance of that economic resilience and economic openness. Russia's war against Ukraine will remain a first order concern: the level and length of both the EU's material aid to Ukraine and of its sanctions on Russia will be hard policy questions. The EU will also develop its role in defence industrial policy. Externally, its relationship with its southern neighbourhood and the management of migration flows will at the least stay as a significant issue. But enlargement, made pressing by Ukraine's and Moldova's achievement of candidate status and the EU's geopolitical rivalry with Russia in those countries and the Western Balkans, is likely to be the most difficult.

## SUPPORTING UKRAINE AGAINST RUSSIA AND THINKING ABOUT ENLARGEMENT

Although the war's outcome is unknown, the EU will play a leading role in Ukraine's reconstruction. The post-war reconstruction of Ukraine - already estimated to cost \$525 billion and rising - will require funds from a mixture of public and private sources. The EU has helped lay some groundwork by proposing a new financial instrument, the Ukraine Facility, to support Ukraine's recovery with at least €50 billion - consisting of a mix of grants and loans, some earmarked for the private sector - over 2024-2027. The German finance minister is insistent that further financing of support for Ukraine should be kept separate from the EU's long-term budget and this will feed into a larger argument about the budget's future. The Commission is likely to continue to be one of the main drivers behind coordinating and pooling international donors' funds for reconstruction as it co-hosts the permanent staff of the newly established Ukraine multi-agency donor coordination platform, an international format to determine the extent of private sector involvement in reconstruction.

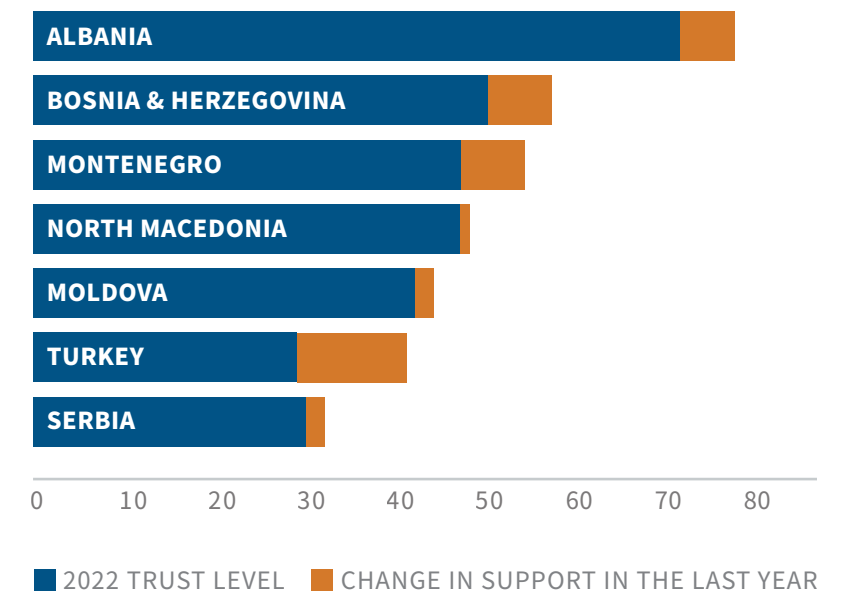
The next EU legislative cycle may break the status quo over EU enlargement in the Western Balkans. In June, French President Macron declared that Paris no longer saw obstacles to EU expansion, a reversal of France's previous enlargement scepticism. The revamped accession mechanism has provided more options to pause the process and politically this has allowed accession negotiations to be opened with Albania and North Macedonia, EU candidate status granted to Bosnia and Herzegovina, and Kosovo to apply for EU membership in 2022. However, continued tensions between Serbia and Kosovo will complicate the EU accession path for both nations. Meanwhile, the Serbian public have become disillusioned with the EU membership, with for the first time in years those in favour of it now fewer than those against it. Belgrade - especially if President Vučić remains in power - will call for more concessions and special treatment from Brussels in return for their continued EU accession commitment.

This round of enlargement will be more challenging than the previous generation's. In October, the European Commission is expected to publish its annual enlargement package with reports on how much progress aspirant countries have made towards joining the bloc in the future. Although legally there is no 'queue', the Commission must ensure that there is a balance of effort going into the longer standing aspirants in the Western Balkans and Ukraine and Moldova. The experience of some more recent EU members and concerns about governance in today's aspirant countries mean that there will be strong pressure for stricter rule of law conditionality. The process will be made more complicated by the uncertain commitment to liberal democratic values of some governing entities in the Western Balkans and Georgia, extant disputes between candidate countries themselves and between candidate countries and their EU member state neighbours.

Further enlargement is creating a debate about what internal changes the EU should make to make a bigger EU work. There are three main questions: first, whether unanimity should be reduced in foreign policy and taxation. The advocates for more qualified majority voting here, who tend to have advocated the same long before the enlargement issue arose again, point to unanimity blocks by the likes of Hungary and Poland and worry that more members with uncertain governance values might make decision making impossible. But those two countries and some other smaller member states still see unanimity on foreign policy and taxation as vital to protect core national interests. Second, there is the size of the College of Commissioners, which at 27 is already very large and at potentially the mid-thirties would be highly impractical. But a condition of Ireland's agreement to the Lisbon Treaty was that there would be one Commissioner for each member state, a condition now embodied in a Council Decision, changing which would be not only politically challenging but potentially legally difficult in Ireland. Third, and perhaps hardest, there is the future of the EU budget: poorer new members, and particularly Ukraine with its large population and huge agricultural sector, would turn many net beneficiaries of the budget into net contributors and consume much of the CAP. Addressing these challenges will be a high political priority for the next Commission and may mean treaty change, albeit limited.

FIGURE 4: LEVEL OF TRUST IN THE EU IN CANDIDATE COUNTRIES

June 2023 compared to mid-2022 levels, %

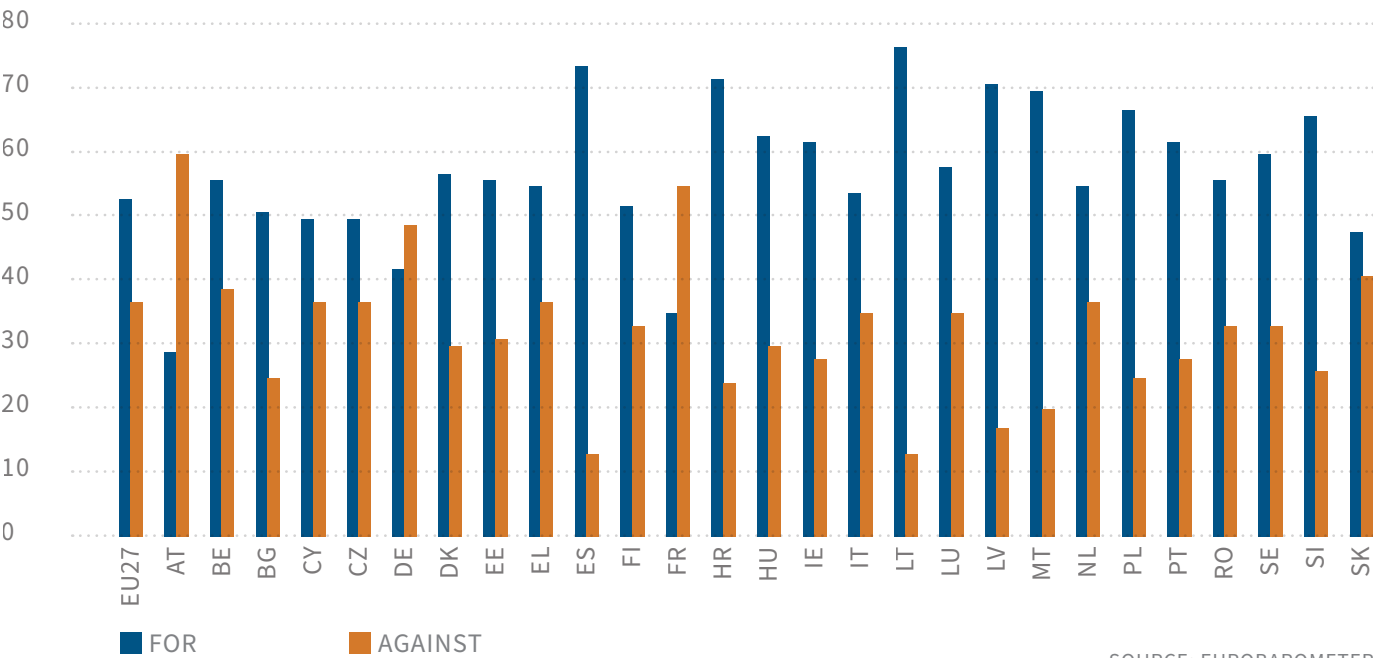


SOURCE: EUROBAROMETER #99



**FURTHER ENLARGEMENT OF THE EU TO INCLUDE OTHER COUNTRIES IN FUTURE YEARS (%)**

May/June 2023



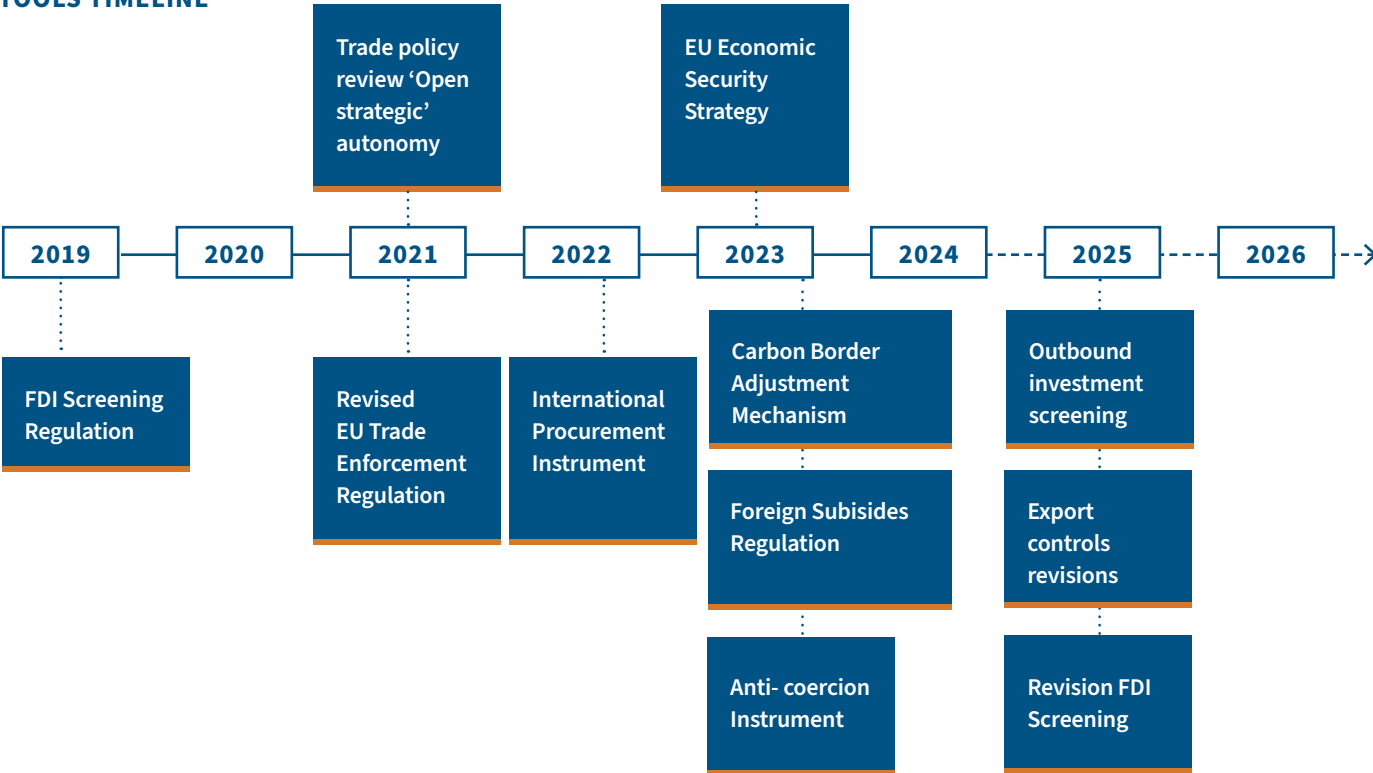
SOURCE: EUROBAROMETER

**TRADE: “DE-RISKING” EU-CHINA RELATIONS**

The ‘China challenge’ will be a constant item on the next Commission’s trade and foreign policy agenda. The challenge China poses combines three main factors. First, China is the EU’s largest trading partner, the two together comprising one third of the world’s GDP. But the EU’s trade balance with China is increasingly negative and EU firms and investors do not enjoy a level playing field in China. Second, unlike with Russia, the EU imports and exports a broad variety of products from and to China, including rare earth minerals and clean technologies on which the EU’s energy transition hinges.

The EU’s chief diplomat Josep Borrell already warned in 2022 that the bloc is far more dependent on China than on Russia. Third, and most importantly, the space for ever-accelerating and ever-expanding economic cooperation is shrinking. This is due to China’s technological progression, which allows it to rival European industries in new areas such as clean tech and electric vehicles, similar to how these industries face competition from US, Japan and South Korea but with far fewer controls on its trade and economic practices, as well as normative confrontations and the growing global geopolitical fragmentation.

**FIGURE 5: THE TRADE TOOLS TIMELINE**

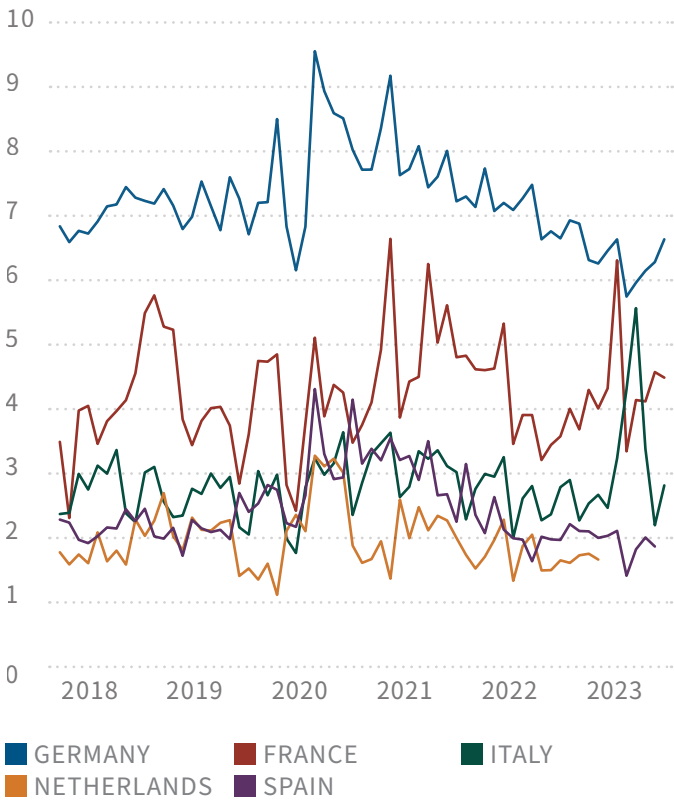


The most pertinent trade question for the next European legislative cycle will be what “de-risking” means. Former Latvian Prime Minister Krišjānis Kariņš has called it the “million-euro question”, although measured by the volume of EU-China trade it is a €230 billion question. For some, like German Chancellor Olaf Scholz, de-risking is primarily a task for private businesses. Others, mainly in Central and Eastern Europe, where NordStream’s labelling as a “private business” project is not forgotten, want a clearer strategic steer from the EU authorities. The next Commission, then, will also want to prevent an East-West split in the EU on China, as used to be the case on Russia. For now, de-risking is the agreed approach to the EU’s categorisation of China as a partner, competitor, and systemic rival. But de-risking is a successful policy headline because the de-risking concept is vague enough for all 27 members to rally behind it. Many European industry representatives also want a coherent approach.

The next Commission and Council will have to determine what de-risking means in practice. De-risking is not decoupling: China is wanted as partner to meet global challenges, such as climate change (e.g., as a supplier of solar panels) and public health (e.g., epidemic control), and help on migration (taking on a greater role in humanitarian assistance or debt relief) could be material. This ‘realist’ interpretation of de-risking could soften the EU’s stance on China and lead to more, albeit less strategically critical, trade with China, as incumbent Commission president Ursula von der Leyen said in Beijing in 2022. On the other hand, Borrell’s comparison of the EU’s dependence on China with Russia is a reminder that a complete decoupling in certain sectors is imaginable in a crisis. The EU’s ability to diversify its supply chains and reduce critical material and technological dependencies on China will be tested.

**GERMAN EXPORTS TO CHINA REMAIN HIGH**

Exports to China, share of total exports, monthly %



SOURCE: MACROBOND, GLOBAL COUNSEL

**EU RELIES HEAVILY ON CHINESE RAW MATERIALS**

Share of imported raw materials from China needed for the production of strategic technologies in the EU

**ELECTRIC TRACTION MOTORS**

**WIND TURBINES**

**SOLAR PV**

**ROBOTICS**

**DIGITAL TECHNOLOGIES**

**DRONES**

**3D PRINTING**

**LI-ION BATTERIES**

**PCS & HYDROGEN TECH**

**TRANSATLANTIC RELATIONS BEYOND 2024**

The future of transatlantic relations depends not on the next European political cycle but on the American presidential election. Another America First president would, at least, risk deep disagreement on climate action, carbon neutrality, sanctions, trade and a greater push towards industrial competition. Most critically, such a president might mean an end to Europe’s American security guarantee. A deterioration in the transatlantic partnership would also increase the EU’s appetite to pursue greater strategic autonomy and could make the EU’s hard security an urgent, even existential, policy priority. A Democrat victory would see greater continuity: a blend of co-operation and disagreement on trade and technology, with continued effort into making the TTC (Transatlantic Trade and Technology Council) head off emerging problems. Both the EU and US have successfully coordinated their economic and individual sanctions policies against common threats posed by hostile regimes such as those in Iraq, Syria and Iran. The war in Ukraine has led to a decision to increase technical co-ordination on sanctions between the EU and the US to a point where the transatlantic partners are contemplating the need for a permanent system, in case they need to deploy similar coercive measures to another state in future. Potential future points of disagreement are CBAM, a potential return of punitive tariffs linked with bilateral disputes on steel and aluminium or civil aircraft, as well as approaches to regulating the products and services of US tech companies - especially AI. Finally, whether Ursula von der Leyen stays as Commission President matters for transatlantic relations: as a strong Transatlanticist, she has sought to ensure that transatlantic disputes, such as over the Inflation Reduction Act, have been contained, that the TTC is a success and that a greater role for the EU in defence does not cause difficulties with NATO. A different Commission President could mean greater tension in all these areas.

**Global Counsel Ltd**  
Avenue d'Auderghem 22-28  
1040 Bruxelles, Belgium

T: +32 (0)2 808 52 50  
E: [info@global-counsel.com](mailto:info@global-counsel.com)  
[www.global-counsel.com](http://www.global-counsel.com)  
[@global\\_counsel](https://twitter.com/global_counsel)

## LEAD AUTHORS

**Denzil Davidson**  
Director, EU Institutions  
✉ [d.davidson@global-counsel.com](mailto:d.davidson@global-counsel.com)

**Tom White**  
Group Director and Head of EU  
✉ [t.white@global-counsel.com](mailto:t.white@global-counsel.com)

**Ana Martinez**  
Practice Director, Europe and Eurasia  
✉ [a.martinez@global-counsel.com](mailto:a.martinez@global-counsel.com)



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