THE STATE OF THE EUROPEAN UNION IN 2022

Key takeaways for CEE from the State of the Union address of EU Commission President Ursula von der Leyen

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Issues & Sectors	**Russia's War in Ukraine, Energy Crisis, EU Green Deal, Free Trade, EU Enlargement, EU Investments, Global Supply Chains, Rule of Law**
Stakeholders	**EU Institutions, EU Member States, Ukraine, Russia, USA, China**

Responding to Russia's war against Ukraine and tackling Europe's energy crisis were the main themes of the 2022 State of the European Union annual address from European Commission President Ursula von der Leyen. The President's speech outlined the EU's strategic, political and economic priorities and directions for the next working year and beyond across multiple sectors, including the green and digital transition, foreign relations, regional security and the global economy.

As well as pledging continued and unwavering support to Ukraine, the EU's top executive has proposed an EU-wide solution to the deepening energy crisis, while the Commission also aims to revitalize the European Green Deal – a major policy package aimed at making Europe carbon neutral by 2050 – by focusing on the potential of hydrogen power. In another strategic move, the Commission announced draft legislation to secure supply chains and critical raw materials, while von der Leyen also endorsed stalled trade agreements between the European bloc and Latin American countries.

Below, Aretera provides a summary of this year's State of the Union address and its implications for Central and Eastern European, as well as Southeast European countries.

This memo will cover:

- current and future EU support to Ukraine, as well as EU-Russia relations,
- potential EU-wide solutions to the energy crisis and new additions to the EU's Green Deal,
- new strategic initiatives from the European Commission,
- the EU's continued disputes with Hungary and Poland.

On 14th September, Ursula von der Leyen, the President of the European Commission – the European Union's top executive body – delivered her annual State of the European Union (SOTEU) address before the European Parliament in Strasbourg. Unveiling the main political priorities of the European bloc for the next 12 months and beyond, the EU Commission President defined the strategic political and economic directions for the European project and outlined a number of initiatives the EU executive body is planning to introduce across several industries. Below, we summarize and evaluate the main takeaways from von der Leyen's speech and how it could impact the EU, as well as the wider Central and Eastern European region.

SUPPORTING UKRAINE TAKES CENTER STAGE

The EU Commission President began her speech by reaffirming the European Union's support towards Kyiv as Russia's war against Ukraine continues. Shortly before the SOTEU address, the Commission proposed a further €5 billion in macro-financial assistance (MFA) to Ukraine, to follow the €5.4 billion already provided.

Going beyond financial aid, von der Leyen unveiled proposals to align Ukraine and its economy with the European Single Market, most notably by increasing bilateral trade, extending the bloc's free-of-charge roaming area and supporting Ukraine's reconstruction as the war continues, beginning with €100 million to rebuild damaged or destroyed Ukrainian schools. The EU is widely expected to play a major role in Ukraine's post-war reconstruction in addition to its current, short-term support, with the Commission likely to lead the EU in designing these efforts.

Since the Russian invasion began on 24th February, the European bloc has introduced several rounds of political, economic, financial and sectoral sanctions against the Kremlin. While von der Leyen also reaffirmed that the EU's sanctions regime against Russia is here to stay, it remains unclear what further sanctions the EU will introduce against Moscow in the short term. While some have raised the possibility of further sanctioning Russian energy, other EU member states are either silently or openly against sanctioning Russian fossil fuel imports, particularly Russian gas, with the Hungarian government being their most vocal opponent, given its heavy dependence.

COMMISSION PROPOSES EU-WIDE SOLUTION TO ENERGY CRISIS

With the severe economic impact of Europe's deepening energy crisis high on the agenda of EU member states and governments, the European Commission President outlined an EU-wide proposal to tackle the fallout from increasingly high energy prices.

Under von der Leyen's proposal, the EU would introduce mandatory electricity savings (most notably at peak consumption hours), a windfall tax to capture part of the excess profits made by fossil fuel companies and a European price cap on excess profits made by companies operating infra-marginal power plants (those not using gas to produce energy). By introducing the latter two measures, the Commission expects to collect an estimated €140 billion, which EU governments could use to support energy consumers.

The proposals come after EU energy ministers failed to agree on a Europe-wide solution package to the crisis, which, based on an earlier Commission proposal, included capping the price of Russian gas. The cap was opposed by certain Central and Eastern European EU member states heavily reliant on Russian gas and fearing a potential shortage. These initiatives will be the main issues on the agenda during the next EU energy summit on 30th September.

The energy crisis began well before Russia's invasion of Ukraine, with the Kremlin accused of deliberately pumping prices up and reducing gas supplies in the lead up to 24th February. According to the Commission President, Russia has weaponized energy to improve its political and military positions, while the Kremlin has been floating the idea of halting gas supplies to Europe for months.

As a result, the EU has been working to drastically reduce its fossil fuels dependence on Russia. The effort has seen some considerable initial success: the share of EU gas imports from Russia has fallen from 40% of all EU gas imports in 2021 to just 9% today. The European Commission is taking the lead in the diversification effort, focusing on securing natural gas imports from alternative sources (such as Azerbaijan) and LNG imports from other countries (such as the US).

Heading into 2023, the Commission is expected to initiate and/or endorse proposals to decouple prices in European electricity markets and "break the dominant influence of gas on the price of electricity." According to von der Leyen, Europe needs "a deep and comprehensive reform of its electricity market", which is likely to be reflected by Commission proposals in upcoming EU energy summits.

ENERGY CRISIS GIVES IMPETUS TO EUROPEAN GREEN DEAL

In 2020, the von der Leyen-led Commission was instrumental in the EU's adoption of the European Green Deal, a major policy package aimed at making the European bloc carbon neutral by 2050, supporting sustainable industries, the use of alternative energy sources and smart transport.

Describing it as a "game changer" and a key component of the European Green Deal, the EU Commission President singled out the use of hydrogen and announced a proposal to create a European Hydrogen Bank, with the aim of creating a future hydrogen market and securing €3 billion in investment for the sector.

Vowing to accelerate the green transition, the EU Commission President also announced the European Raw Materials Act, an upcoming piece of draft EU legislation that aims to secure critical raw materials against the uncertain international environment.

As pointed out by von der Leyen, "China controls the global processing industry" as almost 90% of rare earths and 60% of lithium are processed in China. The EU needs to update its links with "reliable countries" and key growth areas, and secure supplies of lithium and rare earths that could power the green economic transition.

HUNGARY & POLAND AT THE CENTER OF RULE-OF-LAW DEBATES

In addition to the multiple international and economic challenges, the European Commission President also stressed efforts needed to counter democratic backsliding and eradicate corruption, adding that payments under the EU's common budget (Multiannual Financial Framework – MFF) for 2021-2027 will continue to be linked to upholding judicial independence and the rule of law.

While the Commission President did not single out any EU member states, the message was a clear statement aimed implicitly at the Hungarian and Polish governments. Budapest and Warsaw have been locked in long-running disputes with EU institutions over allegations of democratic backsliding (and of systemic corruption in the case of Hungary), with the debates at a crossroads for both countries.

Most recently, on 15th September, the European Parliament overwhelmingly supported a non-binding but symbolically important EU parliamentary report, which found that Hungary is “no longer a democracy” and should be considered a “hybrid regime with an electoral autocracy”. Of the 705 EU lawmakers, 433 MEPs supported the resolution, which is an historic first in European politics.

In April, Hungary became the first target of the EU’s newly introduced rule-of-law conditionality mechanism which allows the EU to sanction member state governments by freezing EU funding under the MFF, the bloc’s seven-year common budget. In an effort to secure funds under the MFF, the Government of Prime Minister Viktor Orbán recently unveiled a series of anti-corruption reforms, including the establishment of an independent anti-corruption agency and tighter rules in the country’s public procurement system. Under the procedure, the Commission has until 22th September to decide whether it will recommend freezing some of Hungary’s EU funding to member state representatives in the Council of the EU, which holds the right to introduce the sanctions through a qualified majority vote.

By pledging to implement anti-corruption reforms, the Orbán Government also hopes to unlock billions of Euros in post-pandemic recovery funding under the Next Generation EU program. In June, Hungary became the only EU member state still awaiting the Commission’s approval of its recovery funding plan after the EU executive body endorsed the Polish national plan to utilize recovery funds – in exchange for Poland implementing reforms to ensure judicial independence. However, tension has since then reignited between Warsaw and Brussels, with the fate of EU recovery funding for Poland again hanging in the balance.

NEW INTERNATIONAL PARTNERSHIPS & TRADE AGREEMENTS

During her speech, the EU Commission President also endorsed French President Emmanuel Macron’s proposal to create the European Political Community, a newly proposed intergovernmental cooperation format between the EU’s member states and 17 other European and wider European countries. The format would bring together EU candidate countries (such as Ukraine, Moldova and several Southeast European nations), the South Caucasian states (Armenia, Azerbaijan and Georgia) and close EU partners (such as the UK, Norway and Switzerland).

While it is yet to be seen how and with which countries this cooperation format would launch for a number of reasons, including the renewed fighting between Azerbaijan and Armenia in the South Caucasus, von der Leyen’s endorsement of this wider European cooperation format and Macron’s call to establish the European Political Community is likely an effort to counter Russia more strategically in political and economic terms as the war in Ukraine continues. Von der Leyen also endorsed the EU membership aspirations of Ukraine, Georgia and Moldova, however in practice the future of EU enlargement remains uncertain.

The EU Commission President also highlighted the EU’s partnership with Latin America and other parts of the world. Building on the EU’s Global Gateway investment, which was instrumental in the construction of COVID-19 vaccine factors in Rwanda and Senegal, the EU Commission will endorse further European investments in Latin America as part of a larger investment strategy. In addition, von der Leyen announced already stalled free trade agreements with Chile, Mexico and New Zealand for ratification, however, whether these submissions will be successful depends on the EU’s decision-making bodies and the stance of member state governments.

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If you would like to schedule a discussion of this paper, please contact:
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