

Analysis

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State of the Union: where does Europe go?

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Celebrating its day this year, European Union faces more challenging future than ever before. To cope with new challenges and unstable world, it needs a clear strategy and political commitment to implement it. We must invest more in reducing our strategic dependencies and strengthening political center, fundamental for Europe's global agency and unity.



Who are we?

European Union is a democratic normative political construct that for seven decades has been integrating European states voluntarily joining the community. There are 27 full member states of the Union, with the population of 450 million people. As there is no federal state on the top of this structure, Europe needs European level of regulations - in reality performing the federal state function - that brings the main mechanism allowing to replace national rules with European rule book, creates cross border links and manages common European public goods.

While democracies in Europe and across the world have their constitutions, the EU has its treaties and the rule of law imperative. It is the law, rooted in shared values which holds member states together and makes Europe a community of law. It is also a sui generis zone of influence.

There are many European states functioning within a variety of institutional frameworks binding them with the EU: members of European Economic Area (EFTA - Norway, Iceland and Liechtenstein), Switzerland with its specific agreements, and the UK - former EU member, closely integrated with the EU through Trade and Cooperation Agreement. Finally, there are 9 candidate countries (and Kosovo) who aim at accession to the EU in the nearest future.

In October 2022, on the initiative of the EU, European Political Community has been established - an intergovernmental forum embracing 44 European countries as well as European institutions, home to nearly 700 million people. The EU has also developed



association agreements with 8 mediterranean countries of Middle East and Africa, as well as Chile and Mexico.

In this context, the European Union can be described as a meaningful global power with its zone of influence, covering most of the European continent and based on the rule of law. One could also add that the European Union has developed over decades FTAs with more than 80 countries across the world. Europe has developed a rare capability to integrate what is diversified, as well as incredible adjustment capacities. This is the essence of Europe's existence and its comparative advantage. In Europe's DNA there is also capability to build compromises, and preference for democracy and rule of law. These features are conducive to Europe's survival in difficult times and facilitate building international relations.

Reinventing Europe

In recent years the EU has made a lot of efforts, reflected in reports, debates and consultations, leading to identifying its weaknesses and strategic objectives, as well as linkages between external and internal challenges. As everything in the turbulent world is related to everything else, and changes explode in thousands of places, it proves necessary to connect all the dots and dependencies. Europe is now in the process of reinventing itself. Crisis management mode is replaced by strategy. The 2026 Commission work program, focused among others on single market, security, competitiveness and resilience, comes under the title "Europe's independence moment".

Europe's strategy to strengthen its economy and global position combines security and building defense potential with its competitiveness strategy. Security and competitiveness



are mutually reinforcing, stimulating and incentivising. Europe has also moved toward prioritising simplification, effective implementation and enforcement of regulation and action. It also decided to look deeply into the future competitiveness of our economy through the perspective of digital market. This is a space that can be weaponised easily in case of dependency. In this context it seems responsible and legitimate to build an independent stack of digital technologies and make steps toward digital sovereignty.

Technological autonomy

Enforcement of the digital strategy fostering innovative solutions and infrastructures, strengthening Europe's resilience, while protecting its strategic assets and reducing its technological dependencies would require fast track action in the context of the new executive order on regulating access to American technologies and president's power to limit or shut down American digital services to foreign users, similar to the previous idea of the AI diffusion rules.

This type of risk inspires to extend reliance on Europe's cloud computing infrastructure and makes it legitimate to build Europe's own integrated internet platform - it is not a rocket science any more - with a full range of services. In line with democratic values, and based on EU regulation, with active elimination of disinformation, fake news, Russian propaganda, hate speech. Open to everybody in the world, it could also become a tool for a positive narrative about the European integration.



Getting back competitiveness

International competitiveness of the European economy would benefit from the European style creative destruction combining new firms, products, talents, technology and financial models which can generate new drivers of change if rooted in a coherent ecosystem. Competitiveness can be further boosted with changes in the way Europe legislates, rebalancing it toward less prescriptive and more principle based, less restrictive and more conducive to incentivising, marginalising national egoism and interests, making it more risk friendly and better exploiting benefits of different levels of legislation.

The way we legislate has been for years debated in small circles, aiming as well at agreeing on moving away from certain element of political culture, national egoisms and interests, toward trust and pragmatic approach to European common goods. In 2026, a new legal approach to harmonization of national laws and discretions is expected with a regulation on the 28th regime, a proxy for harmonization, with a big chance to boost innovative companies and sectors.

This could be a sort of coalition of the willing at the business side level. There is a chance that these processes will gradually eliminate not only bad laws but also bad policies. I see the attitude of member states to the 28th regime as a test of political will to move towards political reforms for the sake of economic competitiveness. Also, taking into account the demographic situation in the EU, in particular in fastest aging economies of Central and Eastern Europe, competitiveness challenge would require rational approach to immigration policy.



Capital

Limiting the competitiveness financing to the availability of private investment funding might lead to underestimating a necessary revolution in public funding. Indeed, the experience demonstrates that access to private investment financing has become over decades a fundamental hurdle in competitiveness building. But financing comes in reality as a double challenge requiring major progress supported by ‘whatever it takes’ approach to public finance. For decades European instinct has been to reach out to public pocket first and distribute available funds through national envelopes.

Now there is the constitutional moment when Europe should boost the European capital market, decide which sectors can deliver higher efficiency of spending coming from private or public pocket, implement changes to MFF, hopefully moving away as much as possible from national envelopes and toward project based competitive funding. As MFF negotiations go on there is still the risk that reforms will be lost in negotiations killing the ground for efficiency and effectiveness, new sources of funding and new financial models, both at national and European levels.

Indeed, there is a need of giving a hard look to public-private financial partnership, use of public funds’ leverage power, new financial ecosystem conducive to innovation, overcoming hurdles to start up and scale up funding, from venture to institutional investment, also well functioning equivalent of DARPA (Defence Advanced Research Projects Agency), as European Research Council dedicated to long term research does not have enough power and funds. Research funding is the area where changing the



proportions between funds at national and European level could bring improvement in efficiency of spending.

The need of change goes beyond new approach to financing, new sources of funding and financing models, new funds market based and privately managed, already reflected during the MFF process. Lack of appetite for treaty change, of policy reforms facilitating enlargement, lack of political will to boost European capital market make the change less efficient and effective or even less likely to happen.

If underperformance of European economy is indeed partly due to insufficient availability of investment financing, the enforcement of the Savings and Investment Union (SIU) should bring more diversified financial opportunities and enhance channeling savings where investment is needed. The truth is also that financing will not solve structural problems. Here come the second enabler of existential relevance - productivity. The SIU allows groups of member states to act where there is no EU wide consensus. Part of it can be handled within the 28th regime, but wherever it will be relevant reaching out to coalition of the willing approach not only for political reason but also competitiveness wise should be encouraged.

Increasing productivity

To upgrade its productivity, Europe needs to overcome the trap of mid technologies. There is no reason, except for political will, not to treat this technological challenge as seriously as the Union treated the Russian energy dependency after their criminal aggression on Ukraine. Combining the competitiveness with defense strategy and action



is already taking place. What still lacks is the need to strengthen European competences, avoiding the famous trap of 27 bonsai armies, and build a truly European market without excluding non EU participants to avoid technological isolation.

For competitiveness purpose, also in security area the Union needs to act bottom up and top down in terms of policies, ecosystems and funding, while exploiting the potential of cooperation across Europe and beyond. More than a decade of efforts to build a European capital market demonstrates lack of political will to move beyond national structures and supervision. Neither the SIU nor the December 2025 market package presented by the European Commission have changed the attitudes.

While SIU ideas on incentivising both capital demand and supply and funding instruments have started to materialize at national level, enhancing institutional framework and market structures for a fully fledged European capital market is slow. Eliminating fragmentation is a precondition for scaling and opens high potential for expanding growth and competitiveness. This can become a reality through regulatory framework establishing ecosystems which enhance linking competitiveness with single market expansion, incentivising cross border links and boosting level playing field. Replacing national options and discretions with single rule book can be powerful and prevent costly race to the bottom and arbitrage. There is some potential in the simplification methodology which opens choices to de-regulation, business friendly environment, burden reduction, in particular for smaller companies.



Facing China and USA

It is worth to bear in mind that Europe has not yet exploited the competitiveness driven by and rooted in sustainability. They have been seen mostly as cost, or at best, cost in the short term. This is where Europe should decide on how to position itself toward China which is rapidly moving forward on sustainability related technologies leaving quickly declining market space for other competitors, including in particular Europe.

On sustainability linked technologies China is advancing rapidly as global competitor. With negative attitude toward sustainability in the US, and with China becoming world champion, Europe should fill this gap on the Western side. Its clean tech industry is under pressure between the new American industrial policy and Chinese expansion. Current American administration made a sharp turn on Biden's approach, and practically everything even remotely related to climate change is banned, stopped, phased out legally. Tariffs will squeeze out clean tech exports from US market.

For Europe, in the context of competitiveness, it is time to decide how much of the sustainability driven market will be there to grab in the future, beyond the Chinese share, based on overcapacity, low cost and subsidies. However, Europe needs to expand the clean tech-industry to avoid a trap of new dependency. Targeted tariffs, use of trade defensive tools, including public procurement instrument in the context of unfair Chinese rivalry, good regulatory framework should be considered in this context.

Europe has been also working on reforming its competition policy and state aid rules. The IRA has reminded us that while in US there are state subsidies at federal level, in Europe the fiscal space belongs to national level. Unfortunately, a proposal by Letta Report to



create a state aid framework at EU level was not picked up so far. History also demonstrates that the fiscal space at national level is highly diversified leading to fragmentation of single market.

Conclusion

The good news is that Europe is not anymore following crisis management mode, and increasingly thinking and acting strategically. Also, it has to address the challenges I would call political. Unity requires leaving national interests and egoisms at the gate to Berlaymont or any other headquarter of European institutions.

Europe aims at advancing its long term competitiveness by reducing its strategic dependencies, accelerating its defense capabilities with industrial development, pushing toward internal shift of competences and toward replacing national interest with European public goods approach. While strengthening its domestic potential Europe aims at upgrading its global role. It reaches out to both regulatory mechanism and policy spaces not existing before.

Geopolitical perception of the new enlargement goes beyond traditional costs and benefits math, toward seeing Ukraine as a crucial element of security architecture of Europe and a source of innovation, technology and competitiveness. Europe needs to find unity for ensuring finalization of enlargement which is of fundamental importance for the European geostrategy, peace guarantees and economic might of the European continent.



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