Chapter Six
Europe’s Watershed Moment

Daniel S. Hamilton

The European Union has a closing window of a decade’s time to position itself as a world-class player in an increasingly competitive and connected world. If it does not, the resulting strains and stresses could challenge Europe’s very construction. In this regard, Europe’s economic crisis could be a watershed moment: either the spur to a more competitive continent, or the time when Europe lost out decisively to more vigorous and rising powers.¹

The economic crisis has demonstrated forcefully to Europeans that the very connections that generate economic opportunity in good times can be transmission belts for economic turmoil in bad times. The same interlinked monetary system that exerts downward pressure on inflation and interest rates can transmit financial insecurity at the click of a mouse. The same global demand that fuels European exports can also boost prices for many daily needs.

The Great Recession hit the EU hard, plunging the continent into its deepest recession in the postwar period.² Most of the EU’s old member states, already plagued by low growth, have struggled to reestablish their footing. Many of the EU’s new member states, which until the crisis had been doing better than many non-European emerging economies, fell further. Rapidly unraveling debt and banking crises offer stark evidence that the 2008 financial meltdown con-


continues to reverberate and will take years to play out. Financial reforms are lagging and sovereign risks linger. Europe must steel itself for an inevitable string of bank restructurings. EU member states need to fix the conditions that gave rise to big budget deficits. New mechanisms are needed at EU level and within the eurozone to deal with future defaults. Recovery will take time and require painful adjustments, as households and creditors work through the overhang of excessive borrowing and lending, and the associated decline in asset prices and job opportunities; and as financial institutions work to strengthen their balance sheets to meet higher standards for capital and liquidity. And as all scramble to recover, divergent policies could undermine European solidarity.

In many ways it is appropriate to focus on the EU as an economic entity, given the common trade policy, the Single Market, and delegation of many aspects of economic life to the European Commission. But the EU consists first and foremost of its member states, and each offers strengths and faces challenges unique to its particular situation. In fact, Europe’s economic crisis has underscored the diverse reality of the European Union.

Some EU member states host companies that are highly-connected world-beating exporters and investors. They have proven to be successful in building highly-skilled, adaptable workforces and in ensuring that economic gains extend widely throughout their societies. Others struggle to boost the potential of their people. Some European countries are driving global innovation; others are catching up; and still others are competing fiercely with rapidly rising economies elsewhere. The economic and financial crisis has affected each EU member state in different ways.

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According to the World Economic Forum’s Global Competitiveness Index, overall the EU continues to feature prominently among the most competitive regions in the world, with 5 EU member states ranking among the 10 most competitive economies in the world and 10 among the top 20. But the rankings also reveal great disparities within the EU, particularly with new member states, all of which ranked behind China.5

The rankings reveal different sources of strength and weakness. The Benelux and the Nordic countries, for instance, compensate for their small size with excellent skills, sound institutions, and, particularly in the case of the Nordic countries, a strong capacity for innovation. Some countries in the core, like France, need to focus on increasing labor participation while others, like Germany, need to tackle obstacles to service sector expansion to support domestic demand. The OECD estimates that northern European countries are well positioned to cope with the G20 world, thanks particularly to their education levels, their focus on high-tech products, their strong innovation frameworks, and their commitment to help workers adjust as jobs come and go. Most are competing less head-on with rapidly developing countries. Moreover, the export sectors of most northern European economies are geared towards fast-growing products and most have trade surpluses in services.6

Member states in the middle ground have substantially less innovation and as a whole suffer from poorer institutions than the leaders, even though their macroeconomic performance and the basic skills of their population are similar.7 Almost half of the EU’s member states ranks lower in competitiveness than China; some also rank behind Russia, India and other rapidly developing countries. In general, EU


members from southern and eastern European are having a harder time coping with the new world rising because they score below average on most indicators, with their relatively poor human capital levels a major weakness. Not only do these countries tend to be competing head on with rapidly developing nations, they also have less inherent strength to deal with the challenges.

The EU’s great diversity argues against a one-size-fits-all economic strategy. Yet the EU as a whole faces many common challenges, and the EU boasts considerable strengths when EU member states band together to boost trade, attract talent, or spark innovation. To the extent that individual member states are able to pool their strengths and advance common or compatible approaches, all stand to gain relatively more than if each stood alone.

European Economies: A “SWOT” Analysis

Table 1 offers an EU “SWOT” analysis that summarizes the EU’s strengths, weaknesses, opportunities and challenges. Let’s look first at the EU’s weaknesses and challenges, and then its strengths and opportunities.

Weaknesses and Challenges

The European Union is challenged on a number of fronts. Large government deficits persist despite a reviving global economy. This danger is exacerbated by the legacy of the Great Recession: in most EU member states, public debt has soared way above 60% of GDP. Restoring government debt to 60% of GDP by 2030 will require painful fiscal adjustment in many countries.

The EU is in danger of fracturing along northern, southern and eastern lines. In general most northern EU member states exhibit high education levels, strong innovation capabilities, and strengths in upmarket goods and knowledge-intensive services. Southern member states overall face challenges ranging from fiscal deficits, major debt and in some cases severe challenges of competitiveness. Eastern member states were hit hard by the crisis and are still struggling to catch up with old member states while competing head-on with rising markets
Table 1. Europe: A SWOT Analysis

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<tr>
<th>Strengths and Opportunities</th>
<th>Weaknesses and Threats</th>
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<tr>
<td><strong>Goods</strong></td>
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<tr>
<td>*World's largest trader in goods.</td>
<td>*Weak in a large number of high technology export markets</td>
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<td>*Market leader in medium technology and capital intensive exports.</td>
<td>*Some member states still mostly rely on exports of low-tech goods</td>
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<td>*Top supplier of goods to developing countries.</td>
<td>*Export gains overwhelmingly in traditional products and markets, rather than in new products or new markets.</td>
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<tr>
<td>*#1 in export market share in 9 of 20 different product categories.</td>
<td>*Still &quot;overweight&quot; in trade ties to developed countries, and &quot;underweight&quot; in ties to developing markets.</td>
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<tr>
<td>*Maintained global export share over past 15 years.</td>
<td>*Lost market share in some fast-growing emerging markets</td>
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<tr>
<td>*Withstood emerging competition better than U.S. or Japan.</td>
<td>*Trade deficits with all BRIC's except India</td>
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<td>*Strong in environmental goods</td>
<td>*China small comparative advantage over the EU as a whole in research-intensive goods and technology-driven industries</td>
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<td>*High-growth demand in European specialties</td>
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<td><strong>Services</strong></td>
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<tr>
<td>*World's largest regional trader in services.</td>
<td>*Failed to capitalize on Single Market in services.</td>
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<tr>
<td>*#1 in 8 of 11 categories of services exports.</td>
<td>*Uneven capabilities: southern and central EU member states could be at competitive disadvantage</td>
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<td>*Services: all of net job growth in the EU.</td>
<td>*Lagging services productivity is the source of the GDP and productivity growth gap between the EU15 and the U.S.</td>
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<tr>
<td>*Share in global services trade much higher than that of the BRICs.</td>
<td>*Must harness high tech and adequately educate/train workforce.</td>
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<td>*EU home base is significant market for services.</td>
<td>*Failed to spark services innovation.</td>
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<tr>
<td>*In past decade EU15 almost quadrupled their services trade balance.</td>
<td>*BRICs increasing services exports faster than the EU, U.S. or Japan.</td>
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<td>*Services trade surplus with every world region except the Caribbean.</td>
<td>*India's services firms competing hard with EU companies in third markets.</td>
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<tr>
<td>*Well positioned to take advantage of the globalization of services.</td>
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<tr>
<td>*Services account for over 70% of EU GDP but only 23% of global exports: room to grow.</td>
<td>*Financial crises propagate to all markets easily.</td>
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<tr>
<td>*Services FDI providing key access to emerging markets.</td>
<td>*Financial crisis halted 3 decades of capital markets expansion.</td>
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<td>*Non-EU foreign affiliates account for large share of EU services exports</td>
<td>*Widespread concern about the volatility of capital flows.</td>
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<tr>
<td>*Boosting services sector productivity to the EU15 average or to EU best-practice levels per sector could add 3-20% to EU productivity.</td>
<td>*UK and euro zone: largest declines in cross-border capital flows.</td>
</tr>
<tr>
<td><strong>Money</strong></td>
<td></td>
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<tr>
<td><strong>Capital</strong></td>
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<tr>
<td>*Critical source of capital for other world regions.</td>
<td>*Major deficits and debts among EU member states.</td>
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<tr>
<td>*Largest portfolio investor in North America, Wider Europe, Russia, India and Oceania: 2nd largest in Africa, Caribbean, Rising Asia, Japan and Middle East.</td>
<td>*EU has only 4 of the top 20 financial centers worldwide; 15 of top 40.</td>
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<tr>
<td>*Despite woes, euro is legitimate and favorable alternative to dollar.</td>
<td>*EU financial centers account for 8 of the 20 worst global performers.</td>
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<td>*Euro has allowed EU to attract more of world’s excess savings.</td>
<td>*EU secondary financial centers losing ground to other centers.</td>
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<tr>
<td>*Deeper capital markets have become more globally competitive.</td>
<td>*Eurozone: no common economic policy to go with common currency</td>
</tr>
<tr>
<td>*Capital flows within euro zone without exchange rate risk.</td>
<td>*Eurozone: euro crisis unnerving investors, could subvert integration.</td>
</tr>
<tr>
<td>*EU financial centers account for 10 of the 20 best performers.</td>
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## Strengths and Opportunities

**Foreign**
- Largest provider and recipient of FDI among all world regions.
- Home base dynamic and significant.

**Direct Investment**
- 55 of the 100 largest non-financial multinational corporations.
- U.S. FDI in EU more than next 20 investors combined.
- EU FDI inflows more than twice the amount flowing to U.S.
- EU outward FDI increased five-fold in past 15 years.
- Outward FDI boosted EU GDP by more than €20 billion between 2001-2006; EU workers increased income by almost €13 billion.
- Stronger position in BRICs as investor than as exporter.
- EU FDI stocks in BRICs heavily oriented to services.
- FDI is main means for EU services firms to access BRIC markets.
- EU companies well placed to invest in high-growth sectors of rapidly rising economies.

**Energy**
- EU leads U.S. and Japan in energy efficiency and sustainability.
- EU companies lead in high-growth global clean energy sector.
- 13 of world’s top 15 clean energy R&D companies.
- Substantial lead in patents in air and water pollution control, renewable energy and solid waste management.
- Opportunities for energy efficiency and renewables worldwide.
- EU can lead effort to break link between production of wealth and consumption of resources.

## Weaknesses and Threats

**Foreign**
- Restrictions on FDI persist in many emerging markets.
- EU reliant on inward investment; must remain attractive as high-talent place to invest, work and innovate.

**Direct Investment**
- The EU’s overall dependence on energy imports will rise from 55% in 2008 to 70% in 2030.
- All member states except Denmark are net importers of energy.
- By 2030, EU will have to import up to 80% of its natural gas. Germany, France and Italy already exhibit this rate.
- 12 member states are 100% dependent on foreign gas imports.
- The concentration of energy production in a handful of countries will grow.
- EU probably not able to reduce its energy dependence on Russia.
- The resource and energy needs of rapidly developing countries are unsustainable.
- Clean energy not big enough to make a significant difference to growth.
- Clean energy not likely to be consistently cheaper than dirty sources of energy anytime soon.
- Widespread commercialization of clean energy technologies faces substantial hurdles.
- EU companies challenged by the clean energy investments by U.S., Japan, China, and South Korea.
- EU maintains biofuels barriers on Brazil and other exporters.
- Failure to secure sufficient energy supplies would be devastating.
Strengths and Opportunities

People
* Rich human resources compared to other regions.
* EU commitment to free flow of labor within its borders has been a boon to sending and receiving countries alike.
* Most countries have sought to target highly skilled migrants.
* EU Blue Card offers promise to attract high-skilled talent.
* EU accounted for 16% of worldwide refugees at the end of 2009.
* EU Blue Card offers promise to attract high-skilled talent.
* EU Blue Card offers promise to attract high-skilled talent.

Ideas
* Overall a competitive and highly connected innovation economy.
* EU innovation leaders: Denmark, Finland, Germany, Sweden and UK
* Next tier: Austria, Belgium, Cyprus, Estonia, France, Ireland, Luxembourg, Netherlands and Slovenia.
* EU performs better than U.S. in 6 of 17 innovation indicators and growth performance better in 13 of 17 indicators.
* Strong innovation performance lead over the BRICs.
* 9 of top 20 countries in terms of Network Readiness.
* EU companies: 31% of the top R&D companies. U.S.: 34%
  Japan 22%.
* More than 25% of scientific publications, highest share of any region.
* Non-EU companies based in EU key to EU R&D investment.
* R&D investment to 3% of GDP could create 3.7 million jobs and increase annual EU GDP by up to €795 billion by 2025.

Weaknesses and Threats

* The EU is aging, shrinking, and has become a net importer of labor.
* Europe is the world’s oldest region.
* EU labor markets still fragmented.
* These trends exacerbate mismatches in labor supply and demand.
* Today’s migration inflow of 1 million/year not enough to offset the trends.
* To compensate for declining labor participation rates, EU needs to double immigration levels.
* EU has become a magnet for the unskilled.
* Highly skilled foreign workers only 1.7% of all workers in the EU.
  Australia: 9.9%; Canada: 7.3%; U.S.: 3.5%.
* 85% of unskilled labor goes to the EU and 5% to the U.S.
* 55% of skilled labor goes to the U.S and only 5% to the EU.
* EU must be more effective in making itself a more attractive destination for qualified and highly motivated potential immigrants and their families; but anti-migrant forces rising.
* EU loses skilled hundreds of thousands of skilled emigrants each year to Oceania, North America and Wider Europe.
* EU innovation performance very uneven.
* Moderate Innovators: Czech Republic, Greece, Hungary, Italy, Lithuanai, Malta, Poland, Portugal, Slovakia, Spain.
* Catching-up Countries: Bulgaria, Latvia, Romania.
* Consistently fails to meet goal of 3% share of GDP for R&D; failed to catch up to the U.S.; fallen further behind South Korea, Singapore and Japan; could be eclipsed by China.
* Clear innovation performance gap in favor of the U.S. and Japan.
* U.S. companies invested nearly 5 times more than EU companies in semiconductors, 4 times more in software and 8 times more in biotechnology.
* Inadequate attention paid to demand-driven innovation; social and services innovation.
* Stronger focus needed bringing ideas to market.
* Significant barriers to circulation of highly-skilled individuals.
* EU patent system still fragmented.
elsewhere. There are some exceptions, but such varied challenges are straining European solidarity and the Union’s effectiveness.

Unemployment, inactivity and poverty still blight too many European lives. Almost half of the EU’s member states ranks lower in competitiveness than China; some also rank behind Russia, India and other rapidly developing countries. Some EU member states still mostly rely on exports of low-tech goods that tend to encounter less dynamic world demand, hampering gains in market share, and also more intense competition from low-cost countries. The EU is still “overweight” in its trade ties to developed countries, where demand is relatively static or growing slowly, and “underweight” in its trade ties with rapidly growing developing markets.

Except for a small subset of countries, the EU’s innovation performance and its productivity lags other advanced economies. The services sector remains a sleeping giant. Secondary European financial market places are losing ground to other advanced and emerging financial centers.

Aging and shrinking populations challenge European competitiveness at a time when competition has gotten tougher. They make social safety nets harder to finance just when the need for them becomes greater. Immigrant workers are crucial as the EU confronts a rapidly aging work force and an acute labor shortage of skilled and semi-skilled workers. Yet the EU has become a magnet for the unskilled, struggling to assimilate and integrate migrants into society while falling short in the global competition for talent.

The EU will continue to rely on traditional sources of energy and depend on foreign sources for over half of its energy supply, with some EU member states critically dependent on a handful of foreign sources. And the combined and ultimately unsustainable resource and energy needs of rapidly developing countries and advanced economies are adding significant pressure to Europe’s energy picture.

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In addition, rapidly developing countries are recording high growth rates while Western economies, including many in Europe, struggle to recover from the financial crisis. Over the next five years the EU and other advanced economies are unlikely to grow more than 3% a year while the developing world is likely to grow more than 5% a year. Mature industrial economies are losing about a percentage point a year in share of world GDP to emerging markets.\(^9\) In a world of overall growth, simply having a smaller share of an expanding pie is not necessarily all that bad, and the developing economies are emerging quickly from a low base. But such a world is not a given. Growth rates are uneven for particular EU countries and companies, and there are still significant risks to future growth.

Despite its accomplishments, the EU remains a patchwork of jurisdictions and regulations. The Single Market has come a good way, but still has a good way to go. Integration within the EU is far less than that within the U.S.; trade between U.S. states is two to three times higher than trade between EU member states. Decision-making is often fragmented and ineffective. The lack of a European patent means that patenting an idea in the EU is 10 times more expensive than in the United States.\(^10\) EU member states operate under a common trade policy, but their trade orientation and performance vary considerably. In areas such as agriculture the EU remains highly protectionist. Eurozone members share a common currency without a common economic policy, and the euro crisis has hobbled European recovery.

Of course, the EU’s diversity can be one of its great strengths. An EU that could move only in lock-step would be an EU unlikely to progress at all. Yet in many ways, the European Union is still less than the sum of its parts. There is considerable discrepancy between the EU’s challenges and the ability and propensity of its member states to address them together.\(^11\)

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**Strengths and Opportunities**

Fortunately, the EU’s challenges are balanced by some notable strengths. The EU accounts for 5 of the top 10 and 10 of the top 20 most competitive nations in the world, and for 8 of the top 10 and 22 of the 30 most “economically globalized” nations in the world.\(^{12}\) With only 7% of the world’s population, EU GDP of about €12 trillion accounts for nearly 30% of the world’s economic output. The U.S accounts for 27%, Japan for 9% and China for less than 6%.

Northern European EU member states in particular are well positioned to cope with the G20 world, thanks particularly to their education levels, their focus on high-tech and upmarket products, their strong innovation capacities, and their commitment to help workers adjust as jobs come and go. Moreover, the export sectors of most northern European economies are geared towards fast-growing products and most have trade surpluses in services.\(^{13}\)

Over the past twenty years the EU has grown from 12 to 27 members and has made considerable progress toward a single internal market. Together, the creation of the Single Market and the enlargement of the EU created 2.75 million additional jobs and contributed an additional 1.85% growth between 1992 and 2009.\(^{14}\) The euro shields a significant portion of intra-EU commerce from currency fluctuations. The EU is culturally rich; boasts an extraordinarily well-educated population, sophisticated product and financial markets and significant technological prowess; and is experimenting with the boldest type of supranational governance on the planet. It has at least as many wealthy consumers as the United States. Life satisfaction and happiness are higher in Europe than any other part of the world. European workers still enjoy a larger share of their countries’ wealth than do U.S. workers, and most European countries have safety nets for work-

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ers that would be the envy of anxious U.S. employees. While Europe traditionally has experienced higher rates of unemployment than the United States, for many this has been more than offset by the stagnant incomes and growing income inequality that have plagued the U.S. in recent decades, and in the wake of the financial crisis the situation has reversed, with U.S. unemployment higher than in most of Europe. Life expectancy has increased and Europe could be a leader in healthy aging. Educational opportunity is expanding. Diversity has the potential to be a great source of creative strength. Successfully managed migration could help meet Europe’s economic and social needs.

Europe’s internal transformation has had profound external consequences. The EU is the world’s largest exporting entity, largest source and destination of foreign direct investment, largest donor of foreign aid, and a critical source of capital for many other world regions. The EU is home to some of the world’s most competitive companies, who are not just holding their own against global competition but have emerged or maintained their status as global leaders within their respective industries. The EU has maintained its share of world exports despite the rise of other trading powers, and is a more significant trading partner for the BRICs than either the U.S. or Japan. Rapidly emerging economies are registering high demand in the types of products in which many European exporters specialize.

In a world of continental-sized players, the EU has become an important vehicle for relatively small European countries to amplify their presence on the world stage, and to manage globalization without resorting to protectionism. EU member states together have greater ability than any of them alone would have to develop standards for globalized commerce, food and product safety, and financial transactions. Common minimum regulations in the EU have moderated potentially destructive competition among member states while allowing for national differences. EU enlargement has enabled European companies to make use of a bigger Single Market to extend their production networks and thus to compete more effectively. Billions of euros in EU structural funds boost prospects for poorer

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regions and transition economies and make Europe as a whole more fit for global economic competition. In all these areas the EU is, and seen in Europe to be, a vehicle for European states to negotiate the terms of their deepening integration with each other and their widening interactions with the rest of the world.16

The EU is also a leader in clean energy and energy efficiency. It is better positioned than others to break the link between the generation of wealth and the consumption of resources. The BRICs and many other rising markets are all growing rapidly in a world economy premised on extensive use of oil and gas and intensive use of resources. That is untenable for a global economy of 7 billion people. Breaking this link could open the way for an entirely different patterns of consumption and competitiveness. Europe could lead the way.

None of these strengths are easily tapped, however. Instead of embracing its periphery, the EU is fearful of it. Rather than advancing low-carbon competitiveness, too many companies and politicians use it as an excuse for further protection. Rather than embracing flexicurity and related initiatives, too many hold onto false securities of the past. And rather than taking advantage of the real possibilities offered by services, European politics still portray them as low-wage and low-skill, pose false choices between services and manufacturing, and are fearful of opening up home markets to their own EU partners, much less competitors from abroad.

The 2020 Strategy: Good, But...

Given these challenges, EU leaders in 2010 set forth a strategy to turn the EU into a “smart, sustainable and inclusive economy delivering high levels of high levels of employment, productivity and social cohesion” by the year 2020. They placed three related priorities of smart, sustainable and inclusive growth at the heart of their “Europe 2020” strategy, and under each priority enumerated various “flagship” initiatives and headline goals.17 Relatedly, the Commission seeks to


implement the Single Market Act, a blueprint it has offered to revitalize the Single Market by the end of 2012, the 20th anniversary of its birth. Its proposals, inspired by a 2010 report by Italian Prime Minister and former Competition Commissioner Mario Monti, include simplified accounting rules; improving small business access to public procurement contracts; boosting electronic commerce; building down barriers to intra-EU transportation; facilitating cross-border venture capital; more open and competitive pan-European procurement processes; promoting social entrepreneurship; online commerce; full implementation of the Services Directive; and streamlining recognition of professional qualifications across the Union.18

The overall thrust of these efforts is promising and deserves broad support. But the fatal weakness of the previous effort, the so-called Lisbon Strategy, was its inability to provide incentives or to ensure implementation by EU member states. In the end not one of the Lisbon Strategy goals was achieved over a ten-year period. The Europe 2020 Strategy seeks to remedy this weakness with a number of monitoring measures, but in and of themselves they are unlikely to ensure that member states take the tough decisions needed.19,20 Commission President Jose Manuel Barroso himself identified what many deem to be central to the strategy’s success or failure: political will among member states. “We have to be quite honest,” he has said, “there are 27 member states and if they don’t want to play ball nothing will happen.”21

The Strategy needs to be accompanied by incentives to member states to improve performance, for instance by using the EU budget as an incentive mechanism and using conditionality as a disciplining principle. Those who meet headline targets could receive additional EU funds. EU transfer rules need to be revised to better reward reformers

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and punish laggards; and compliance must be enforced more decisively than in the past. National reform agendas could be assessed by an independent expert group, as a way to reward good behavior and punish bad policies. EU transfers could be withheld if countries do not comply with the reform agenda. Peer review should be avoided, as pressures to weaken discipline would arise, as experienced in the past with the Stability and Growth Pact (SGP). The need to build better incentives to reform into the European governance framework is hardly new. But the crisis has made changes more pressing.

**Key Recommendations**

The European Union and its member states have a window of opportunity to reposition themselves for the challenges of a vastly different world. Given current trendlines in such key areas as trade in goods and services, financial markets, energy dependencies, demographic changes and innovation performance, they have about decade’s time to address their weaknesses and capitalize on their strengths. If they do so, Europeans are likely to prosper in the new world rising. If they do not, the resulting strains and stresses could challenge Europe’s very construction.

Will the financial crisis be remembered as the moment when the EU finally cracked? Or as the spur to a more competitive Union? During the first few years of the new decade most EU member state governments will be preoccupied with recovering from the financial crisis and restoring confidence in EU and euro zone economic policy coordination. Yet even if successful, such efforts will prove inadequate to the larger challenges facing the European Union. Even as they tackle the lingering crisis, policymakers must simultaneously lay the foundation for continued European competitiveness in an increasingly interconnected world.

How can this be achieved?

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There is no one-size-fits-all model. To a large extent, each member state must devise its own strategy. Different pathways can lead to success. Different circumstances call for different relative priorities. Countries in southern Europe need to focus more on regaining competitiveness, while others should promote higher labor force participation or more open service sector markets. Some common priorities do emerge, however, that underscore the importance of working better at European level. To the extent that individual member states are able to advance together along the lines below, each is likely to be strengthened as well.

Here are 8 basic priorities.

1. First things first—get the recovery right. EU leaders urgently need to fix the financial system and tackle burgeoning deficits and debt without undermining Europe’s fragile return to growth. Addressing weaknesses in the financial system is essential to a strong and sustained recovery. Unfortunately, EU leaders have adopted hesitant and piecemeal approaches to the debt problems of the eurozone’s weakest members, which have not helped those countries return to growth, have not reassured nervous investors, and have not protected other eurozone countries from further contagion.23

2. EU leaders urgently need to fix the financial system and tackle burgeoning deficits and debt without undermining Europe’s fragile return to growth. Case-by-case crisis management isn’t working. More fundamental reforms are needed, including a eurozone fiscal union to underpin monetary union; the substantial European Stability Mechanism as a permanent crisis resolution mechanism; fiscal and financial reforms that actually support—and enforce—the growth and stability pact targets that have been ignored for many years; and related efforts to improve economic performance. Permanent bail-outs are not the solution to Europe’s economic challenges. As Jean Pisani-Ferry notes, weaker EU member states need to regain their footing and resume economic growth, “not to be put inside an economic oxygen tent.”24 This will require EU leaders to convince weary voters to accept some short-term

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economic pain in order to build down deficits and debt and reposition their economies to compete successfully in the changing global economy.

**2. Raise productivity to drive overall growth.** The EU must boost its productivity if it is to deal with its demographic challenges and sustain its social welfare model.\(^25\) Better utilization and productivity of labor would lift EU GDP substantially. McKinsey estimates that boosting services sector productivity to the EU15 average or to European best-practice levels per sector could add 3-20% to the region’s productivity.\(^26\) And simulations by the IMF and the European Commission suggest that if all EU member states were to adopt best practices by the EU’s 3 best performers in labor markets and the services sector, overall EU GDP growth would rise by as much as 1/2 percentage point of additional annual growth annually over the next 5 years.\(^27\) Stagnant or flagging productivity, on the other hand, will mean a period of low or no growth, which is likely to generate greater domestic and intra-EU conflicts while leaving the EU behind in a world or high-growth competitors.

Specific challenges vary across EU member states. Germany, France, and some smaller countries need to improve their utilization of labor, while many southern and eastern member states need to focus on more basic requirements, such as their institutional setting, infrastructure levels, market efficiency, technological readiness, and skill levels.\(^28\) Yet even though each member state faces its own unique challenges, all are likely to benefit from strengthened coordination. The Europe 2020 strategy offers some useful ways forward, yet in many areas does not go far enough. Reforms could include a shift from labor to VAT taxes; reducing entry barriers in key services sectors; offering better tertiary and vocational education opportunities; promoting more effective links between business-related research and universities, allowing universities to patent output even when research has been financed through public programs (as permitted by the


\(^{26}\) [Beyond Austerity](http://ec.europa.eu/trade/creating-opportunities/trade-topics/european-competitiveness/global-europe/); See Chapters 4, 7, and 8 of Sapir et al., *An Agenda for Growth*, op. cit.

\(^{27}\) Allard and Everaert, et al., op. cit.; Mourre, op. cit.

\(^{28}\) Almunia, op. cit.
Bayh-Dole Act in the United States); and attracting high-skilled foreign talent. In the past, reforms have succeeded when the agenda was driven by European institutions and a common sense of purpose, but largely failed when agendas relied on peer pressure among member states alone.

3. Complete the Single Market. The Single Market is both the bedrock of European integration and the EU’s most potent instrument to address the challenges and opportunities of the G20 world. The European Commission estimates that completing, deepening and making full use of the Single Market would potentially produce growth of about 4% of GDP over the next ten years. A more complete and vibrant Single Market would provide countries and companies with a stronger geo-economic base in a world of continental-sized players. It would give EU countries greater opportunities to exploit their full comparative advantage, and would give EU companies new possibilities to restructure their activities on a pan-European scale. It would much improve the EU’s attractiveness as place to invest, work and study.29

Completing the Single Market would create jobs and boost trade, investment, productivity and growth. The EU itself is still the key market for all EU member states. Two-thirds of all EU goods and services, FDI and private portfolio investment is transferred among EU member states. Yet major opportunities go missing. Cross-border procurement, for example, accounted for only around 1.5% of all public contracts awarded in the EU in 2009. Cross-border services account for only 5% of the EU’s GDP, compared with 17% for manufactured goods traded within the Single Market. Only 7% of EU consumers used the Internet to make cross-border purchases in 2008. In energy, national champions control 80-100% of domestic electricity production. A single EU energy market could lower prices for consumers and make energy supplies more secure. The ratio of intra-EU15 exports to GDP is 70% less than the ratio of intra-U.S. exports to GDP.30


30 http://www.oecd.org/document/30/0,3343,en_2649_34569_38979998_1_1_1_1,00.html; Monti, op. cit., p. 9.
A Digital Single Market is a related opportunity left untapped. The cost of non-digital Europe is significant: according to a recent study the EU could gain 4% of GDP by stimulating the fast development of a Digital Single Market by 2020. This corresponds to a gain of almost €500 billion and means that the Digital Single Market alone could have an impact similar to the 1992 Single Market program itself.

4. Awaken Europe's sleeping giant: services. The EU could make things easier for itself by playing to its strength in services — its biggest untapped source of jobs and economic growth. Services account for all net job growth in the EU. Intra-EU services trade is 35% higher today than it would be without the Single Market. Nonetheless, services account for just 20% of Europe's trade, even though they account for 70% of Europe's output. Although the EU-wide Services Directive has helped forge a more coherent approach to services within the EU, it is not fully implemented, and excludes such critical areas of potential innovation and productivity growth as financial services, health, employment and social services. One recent study found that if the Services Directive were fully implemented, it could deliver more than 600,000 new jobs and economic gains ranging between €60-140 billion, representing a growth potential of at least 0.6-1.5% of GDP. And if services competition in the eurozone was raised to U.S. levels, the European Central Bank estimates that service sector output could be increased by 12%. Innovation, efficiency, investment and jobs could all be sparked through stronger competition, particularly in business-to-business services; easier entry requirements into professional services sectors and easier cross-border transfer of degrees and training certificates; lifting entry barriers in such network industries as energy and transportation; providing crucial

32 Beyond Austerity, op. cit; Allard and Everaert, et al., op. cit.
34 Soete, op. cit.
enablers such as standards, education, and infrastructure in business services, tourism, and telecommunications; and facilitating European scale across member state borders. Member states such as Germany and those from northern Europe are particularly losing out on these opportunities.

The European Competitiveness Report 2010 highlights the particular importance of the “creative industries” to the EU’s future prosperity. Such industries are essentially services industries. They range from information services, such as publishing or software, to such professional services as engineering, architecture, advertising and design. They account for 3.3% of total EU GDP and 3% of employment, and are among the fastest growing sectors in the EU. Overall employment in the creative industries increased by an average of 3.5% a year in 2000-2007, compared to 1.0% a year for the EU economy as a whole.\(^{36}\)

A true Single Market in services would also position the EU well internationally. The EU is a world-class leader in services trade, including in exports of creative industries products and services. EU services companies are also major investors in services; in fact FDI has become the main means for EU companies to get access to high-growth emerging markets. More effective efforts to facilitate services investments, not just trade, would pay dividends to EU services companies, which still lag U.S. firms when it comes to such key markets as Japan, India, China and Rising Asia.\(^{37}\)

5. **Break the link between the production of wealth and the consumption of resources.** The EU should lead in the transition to a low-carbon economy and promote itself as a showcase of energy efficiency and innovation. This will be neither quick nor easy. Fossil fuels are convenient, versatile, and in many cases cheaper than many

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\(^{36}\) More than 97% of respondents to a 2010 survey in EU member states thought the creative industries were “important” or “very important” in supporting innovative activities, encouraging economic growth and creating new jobs. *European Competitiveness Report 2010*, op. cit., pp. 13-14. See also the European Commission’s “Green paper—Unlocking the potential of cultural and creative industries,” available at http://ec.europa.eu/culture/our-policy-development/doc2577_en.htm.

renewables. But as David Buchan has noted, the EU has the capacity and the propensity to lead the great escape from fossil fuels. Reducing EU energy consumption by 20% by 2020 would reduce the cost of energy imports by €100-150 billion annually, and could create a million new jobs. Under current policies, however, the EU will only reduce consumption by 10%, so the EU will miss out on at least €50 billion a year in cost savings and half a million new jobs unless stronger energy-saving approaches are put into place, including incentives to address up-front costs and efforts to heighten end-user awareness. The EU’s green stimulus spending has been only half that of the U.S. and one-quarter of that provided by China. Prioritizing public funding of clean energy would send a strong signal to business and act as a catalyst for private investment.

6. Innovate. Innovation drives economic growth and offers new solutions to existing challenges. It has become even more important as Europe’s native population ages and shrinks, since population growth cannot fuel economic growth in Europe. The EU can—and must—offer greater opportunities to young start-ups and entrepreneurs; facilitate the mobility of workers within and across companies; invest more in R&D and higher education; boost possibilities for continuous development of skills; welcome highly-skilled migrants; introduce a unified EU patent and related litigation system; continue to build innovation clusters in sub-regions of the EU; improve access by small- and medium-sized enterprises to financial resources, simplified administrative procedures and better protection of intellectual property rights; facilitate the exchange of people, skills, technologies and ideas between large and small businesses to boost overall innovation capability; and build a more vibrant EU base of small and medium-sized companies, which are essential for growth and jobs.

The EU must also turn from its traditional focus on benchmarks of innovation input such as R&D measures to a concerted focus on innovation output, and focus on user needs, demand opportunities, organi-
zational, process and social innovation. It needs to focus more explicitly on getting ideas to market. It must recognize the collaborative and cross-border nature of innovation in today’s world and actively forge and strengthen its innovation networks around the globe. The December 2010 initiative by 10 EU member states to move ahead with a unified European patent is a step in the right direction.

An effective innovation strategy must encompass both manufacturing and services. The EU needs to build on such areas of competitive advantage in high-tech manufacturing as intelligent manufacturing systems, aerospace, digital electronics and biopharmaceuticals. As emerging markets move into higher-value-added activity, ensuring that the EU maintains its advantage in those sectors will be key to keeping the EU a location of choice for innovation activity and investment. And a coherent services innovation strategy promises to extend the scope of innovation activity more widely across the Union.

The EU also needs to remain at the forefront of protecting and promoting intellectual capital. Robust protection of intellectual property drives European innovation and attracts capital to innovative and creative enterprises. It protects inventions and content and is a critical element in the fight against counterfeiting and piracy.

7. Power to the people. The EU and its member states must tap the potential of their people if they are to manage demographic challenges, sustain their social model, develop the skills needed in a knowledge-based economy, and prosper in the G20 world. In particular, the EU needs to develop a pan-European talent strategy that attracts skilled foreign labor; ensures the free movement of people among member states; facilitates better links between business and education; improves access to and harmonizes key features of the labor market; promotes higher education and training in key enabling technologies; and boosts overall skills training and re-skilling across the Union. Europe’s aging population also represents a market opportunity for certain sectors, in particular healthcare, pharmaceuticals, medical and nutrition products, tourism and leisure, which should be encouraged to innovate to meet changing demand patterns.41

The EU also has the opportunity to demonstrate that economic strength can go hand in hand with high standards of welfare, despite intense competitive pressures. EU leaders can show that it is possible to reap globalization’s benefits while making its costs bearable to those who are directly affected by rapid economic change. “Flexicurity” arrangements piloted by Denmark and other member states is one example of how Europe is doing just that.42

8. **Become a critical hub in the G20 world.** The EU is well placed to be a key hub of a multi-polar world in which new centers of economic and political power have emerged. The EU should use its network capital to make itself a focal point for the exchange of ideas, people, capital, goods, services and energy innovation in the interconnected G20 world. The more connected the EU is, the more competitive it is likely to be. The EU needs to advance on four fronts.

   **First, don’t forget your base.** That’s the first rule of politics, and it should be the first rule of EU international economic policy. The Single Market is the platform for a more competitive EU in a G20 world. Better use should be made of it, as suggested earlier. “Europeanization” can be as economically profound for many EU companies and countries as “globalization,” and this study has shown that Europeanization of goods, services, capital, energy, people and ideas and the competitive networks than accompany them extend beyond EU borders to encompass the EU’s neighbors in Wider Europe. Before the recession the EU benefitted enormously from the dynamism of its closest neighbors. Europe’s backyard can generate tremendous opportunities again—if the EU is prepared to deepen existing ties and widen its networks. If one considers the potential of Wider Europe, the EU essentially has a China right in its own backyard. Yet the popular image is of the Polish plumber and the Turkish construction worker.

   **Second, create an open Transatlantic Marketplace.** This study underscores that potential for the EU to build an even more vibrant base through its almost organic ties to North America. No two continents are as economically fused as Europe and North America, and

those bonds have tightened, not loosened, since the end of the Cold War. Together North America and the EU still comprise more than half of global GDP, are the world’s and each other’s most significant partners in terms of trade, investment, innovation and the norms and standards that guide global commerce. Rather than take the transatlantic partnership for granted or treat it as a “legacy” relationship rooted in the past, policymakers are called to use its considerable potential to tap new sources of innovation and growth.

The transatlantic economy is the freest in the world — but it is not free. Significant results could be achieved for smarter and more sustainable growth as well as more and well-paying jobs, from related initiatives to conclude a transatlantic zero tariff agreement; build down non-tariff measures on each shore of the North Atlantic; align legislation on “upstream” issues such as nanobiotechnology, e-health or e-mobility; and work together to establish and ensure international adherence to high level global standards in such areas as intellectual property protection, food and consumer safety and public procurement. The payoffs could be substantial: the impact of a mutual opening of the EU’s Single Market and North America’s vast continental market would be the equivalent of giving every European and American an entire year’s extra salary over their working lifetimes.43 Even as the U.S. and the EU push multilateral liberalization through the Doha Development Round, they should advance transatlantic market-opening initiatives in services, financial markets, telecommunications, energy, innovation policies and other areas not yet covered by multilateral agreements.

Third, leverage high-growth markets. Completing the Single Market and bolstering the EU’s extended base in Wider Europe and

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43 The benefits would be widespread. An open transatlantic market for air transport services, for instance, could boost transatlantic travel by up to 24%, increase consumer welfare by over $6 billion annually and boost economic output in related industries by at least $9 billion a year. Full transatlantic integration of securities markets could lead to a 9% reduction of the cost of capital for listed companies, 60% reduction in transaction costs, and an almost 50% increase in trading volume. Aligning U.S. and EU automotive regulations could reduce the cost of every car and truck by up to 7%, with important knock-on effects for the extensive networks of suppliers and distributors across each continent. See Daniel S. Hamilton and Joseph P. Quinlan, Deep Integration: How Transatlantic Markets are Leading Globalization (Washington, D.C.: Center for Transatlantic Relations, 2005). See also Koen Berden, et al., Non-Tariff Measures in EU-US Trade and Investment—An Economic Analysis (Rotterdam: Ecorys, 2009)
North America would position the EU much better to face the challenges and leverage the opportunities offered by the fast-growing markets of the emerging world. EU companies must overcome the relative inertia evident in their export orientation to compete with emerging market companies in high-growth economies.

Despite the use of such terms as BRICs, this study has shown that the nature of the EU’s ties to other world regions varies significantly, and each must be approached on its own terms. The EU needs to open the Chinese market to EU goods, services and investments; improve standards for trade in goods and services; address counterfeiting and other intellectual property challenges, currency distortions and discriminatory Chinese policies. With Rising Asia it has the opportunity to build on its free trade agreement with South Korea to conclude additional pacts with others, and to press ahead with its renewables trade. The consumer markets of China and Rising Asia together will rise from 12% of world consumption prior to the economic crisis to about 32% in 2020, becoming the main driver of world growth and a key opportunity for the EU—if European companies reposition themselves and are able to export value-added goods and services to these growing consumer markets and establish affiliates to provide goods and services locally.44

The EU could be a major partner for Russia if Moscow would be prepared to tackle seriously its profound domestic challenges and further develop its energy infrastructure while shifting to a more balanced economy. The EU needs to strengthen its surprisingly weak links to India while bracing for tough competition in third markets from Indian services providers. And it can do more to engage Brazil through services, investment and collaboration on new energy sources.

There are some common threads in EU ties to emerging markets. Major challenges arise from weak regulatory frameworks, uneven enforcement of laws, continuing non-tariff barriers to trade and relatively low environmental and labor standards, which often discriminate against foreign companies. Prominent examples are intellectual property rights protection and its enforcement in China, labor legislation in India and Russia, and environmental regulations in both Russia

and China. In addition, the strong role of the state in many emerging markets, which can be expressed in terms of preferential subsidies, tax preferences, or privileged access to bank loans or raw materials, especially for state-owned enterprises, can hamper efforts by EU companies to be competitive both home and abroad. State interference in China poses particular challenges for EU companies, in view of the export-driven character of the Chinese economy and the potential scale and scope of the Chinese domestic economy.

**Fourth, don’t neglect key economies.** As the EU engages vigorously on these fronts, it needs to address areas in which it has allowed its economic ties to erode. Africa is perhaps the most prominent example. But Latin America has also been neglected. And Turkey is shifting its trade away from Europe.\(^{45}\) EU companies have sacrificed considerable opportunities in these three markets, losing market share to rising competitors, particularly from Asia.

The rise of rapidly developing nations presents many opportunities for the EU, but also very real challenges. The EU still has time to reposition itself to prosper in this new world rising, if the political will is there. But time is not standing still. And in the end, history will remember not only how well leaders managed this or that crisis, but how well they positioned their countries for the future.

**Four Scenarios**

Europe’s future economic performance depends on its ability and its propensity to leverage global growth, human talent and innovation while exploiting European strengths and consolidating public finances. These external and internal drivers define four possible scenarios for Europe’s future: *Competitive Europe, Losing Steam, Europe Unhooked,* and *Europe Adrift.*\(^{46}\)

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\(^{45}\) Adjustments at home and in the EU need to be accompanied by a sustained commitment to a rules-based system of open global commerce, underpinned by concrete efforts to reduce trade and investment barriers with the rest of the world. An immediate priority in this regard is agreement in the Doha round of multilateral trade negotiations.

\(^{46}\) Figure 1 was adapted with thanks from a chart on scenarios for the UK economy in Vanessa Rossi and Jim Rollo, “Aiming for New Vigour: The UK in the Global Economy,” Chatham House Briefing Paper, June 2010.
Figure 1. Four Possible Scenarios for Europe’s Future

**Losing Steam**
- World growth numbers due to sluggish developed economies and less buoyant emerging markets. This dampens EU exports, FDI inflows and economic growth in general, limiting the recovery.
- EU exports and FDI remain overweight in internal markets and US, and underweight with regard to opportunities in emerging markets.
- Tremendous pressure on economic and monetary integration as some EU member states capitalize on opportunities while others fall further behind.
- EU fails to attract or nurture high-skilled labor as populations age and chronically pressure on workforce, migrants, companies and governments.
- Social tensions rise as governments forced to make drastic cuts in social welfare systems and education.
- EU fails to develop coherent, competitive energy policies that reduce dependence on non-renewable energy and promote energy sustainability.
- Investment capital vanishes as investors turn to other markets for better opportunities.

**Europe Adrift**
- A weak global recovery, together with poor fiscal management and inward looking economic and monetary policies, leads to further debt crises in EU member states and crises of euro and of sterling.
- The EU economy suffers from a prolonged slump of little to no growth, productivity diminishes and debt levels remain high.
- Perpetual crises management undercuts the credibility of European integration and the European model, diminishing European influence in the world.
- Low global growth damps opportunities for European investors and exporters, limiting options for smart, sustainable growth, lowering investment in the innovation economy and in skilled labor, and dampening EU productivity.
- Stagnant Europe diminishes opportunities for inclusive growth, leading to greater social divisions.
- Welfare provisions of EU member states increasingly unsustainable as smaller workforce proves unable to supporting aging populations.
- Lack of energy innovation and internal EU dissonance stymie EU energy policies, deepening energy dependencies.
- Worker’s rights, wages decline, anti-immigrant forces gain ground, less chances at higher prices for consumers.

**Competitive Europe**
- The EU and its member states successfully leverage their regional linkages to seize new business opportunities.
- EU and member states maintain focus on investments in innovation, high skills and digital opportunities, boosting productivity.
- EU and member states build their hand in applying innovation to sustainable energy and sustainable growth.
- Healthy growth and declining public deficits give governments greater room to promote inclusive growth and pro-migration policies.
- Greater economic convergence, eurozone fiscal union, and better performance among EU members boost confidence in euro and sterling.
- High global growth puts additional pressure on resource costs and availability, but European sustainable growth models partially offset these pressures and also offer additional business opportunities.
- EU completes the Single Market.
- EU attracts high-skilled migrants at higher overall migration levels, and advances more effective integration policies.
- Policy initiatives open major emerging country markets and inject greater dynamism into deep linkages with wider Europe and North America.

**Europe Unhooked**
- EU fails to leverage high global growth due to poor fiscal management and inward looking economic and monetary policies. The recovery is weakened and confidence erodes in the euro and in sterling.
- Competitive advantages in goods and services are undermined; investment inflows shrivel as high-growth opportunities beckon elsewhere.
- Divergences widen in member state economic growth and innovation performance, adding further pressure to the euro.
- EU crises mean that many EU member states fail to boost productivity or leverage high growth opportunities, losing markets to global competitors.
- Social tensions rise as governments forced to make drastic cuts in social welfare systems and education.
- High global growth puts additional pressure on resource costs and availability, while continuing fiscal and financial challenges blunt the EU’s ability to promote sustainable growth models as a source of European competitiveness.
- EU loses critical market share in goods and services to faster-growing, more innovative competitors.

**High global growth (4-5%)**
- Successful fiscal consolidation
- International/EU Policy Successes

**Low global growth (2-3%)**
- EU fiscal crisis
- EU and Member State fiscal failures
Competitive Europe

If the EU is to maintain and even advance its competitive position, it must not only build on its strengths and address its weaknesses, it must bolster its capacity to leverage the dynamism of other key regions and to absorb innovation and talent from beyond its borders. In the scenario dubbed Competitive Europe, the EU and its member states are successful in doing these things in a high-growth global environment.

Under this scenario, the EU and its member states address their fiscal and financial problems and inject new vibrancy into their home base by improving the economic governance of the eurozone, including the historic step of eurozone fiscal union, and boosting the capacity of the EU Single Market and the free flow of goods, services, money, energy, people and ideas within it. They leverage higher growth to seek greater economic convergence among EU member states at levels of high competitiveness across the board. They supplement these initiatives with efforts to infuse additional dynamism into their broader geo-economic base in Wider Europe, and to invigorate the EU’s deep economic connections to North America, in particular by knocking down non-tariff barriers to transatlantic commerce, fueling greater innovation linkages, and opening up the transatlantic services economy.

These initiatives proceed in tandem with more effective efforts, both through trade and foreign direct investment, to capture greater market share in new markets, particularly in China and Rising Asia, and renewed attention to Africa. EU firms capitalize on their advantages in services and in high-tech, upmarket and environmental goods across all markets; as well as the opportunities rapidly rising economies offer to EU medium-tech capital goods industries and those engaged in infrastructure development. Activist policies address aging and shrinking populations, boost integration levels and advance skills and training across the board. They promote innovation and knowledge-based investments, particularly in energy sustainability.

Losing Steam

Under this scenario the EU and its member states agree on ways to improve their competitiveness, but the promise dissipates due to persistently low European and global growth as the recovery from the finan-
cial crisis stutters. EU exports and FDI remain overweight in developed country markets, as opportunities falter in emerging markets. Pressure builds on economic and monetary integration as some EU member states capitalize on opportunities while others fall further behind. Social tensions rise as governments are forced to make further cuts in social welfare systems and education. The EU fails to attract or nurture high-skilled labor as populations age and shrink, adding to pressures on workers, migrants, companies and governments. Investment capital weakens as investors turn to other markets for better opportunities. Flagging investment, in turn, makes it harder for the EU to reduce acute energy dependencies and promote energy sustainability.

**Europe Unhooked**

Under this scenario the global growth environment is good but the EU and its member states prove unable to generate the efforts needed to maintain and advance their competitiveness. The EU fails to leverage global growth, the recovery is weakened, and confidence erodes in the euro and in sterling. Faster-growing and more innovative competitors capture market share in a variety of goods and services, and investment shrivels as high-growth opportunities beckon elsewhere. Divergences widen even further between high-performing member states and thus unable to maintain their competitive position. Social tensions rise as governments forced to cut back on social welfare systems and education, and limited investment funds blunt the EU’s ability to promote sustainable growth models as a source of European competitiveness.

**Europe Adrift**

Under this scenario there is low global and European growth and the EU and its member states fail to advance efforts to advance their competitiveness. Debt levels remain stubbornly high and further debt crises erupt in some EU member states, triggering a crisis of confidence in the euro and sterling. Continual crisis management erodes the credibility of European integration and the European model, diminishing European influence in the world, prompting intense debate about the nature and relevance of the EU itself. Innovation and productivity flag. The EU loses critical market share both in goods
and services to faster-growing, more innovative competitors. Social divisions are exacerbated and the welfare state provisions of EU member states simply become unsustainable as a smaller workforce proves unable to support aging populations. The lack of energy innovation and internal EU disputes limit the possibilities for coherent EU energy policies, thus deepening energy dependencies among a greater number of EU member states. Workers suffer, wages decline, and anti-migrant forces gain ground. Consumers are confronted with less choice at higher prices.

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Europeans need the European Union now as much as they did a half-century ago, but for different reasons. For fifty years, the European project was about internal reconciliation and reconstruction following the collapse of an earlier era of globalization into war and depression. It was a grand experiment in harnessing closer economic integration to build prosperity and peace. Over the past twenty years it has extended those benefits to more of the European continent than ever thought possible. Today, in a new context and with new challenges, Europeans once again have the opportunity to harness integration—to use their network capital to position themselves for the new world rising and to generate a better life, not only for themselves but for billions around the world. Whether they will use the coming decade’s window to do so is likely to determine the relevance of the European project in an increasingly competitive and connected world.