The Future of Europe

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Europe today …

It's no big secret that Europe lies at the center of the global economic crisis, setting the pace of recovery-or the absence of it-for the whole world. What's even worse is that after three years of experimentation with different policies, including hard austerity measures and bailout programs, we still don't have a clear idea of what went wrong and how to get out of this mess.

What we do know is that it all started roughly four years ago. In an attempt to fight the credit crunch of 2008 and the recession of 2009, most European countries, following the decisions of the *G20 London Summit in April 2009*, used fiscal and monetary stimulus to reinitiate the economy. Although successful in the beginning, stimulus came at a cost, i.e. increased budget deficits and government debts. It soon became clear that just as companies and banks did during the outbreak of the 2008 Credit Crunch, now countries also needed bailout programs as they faced the possibility of defaulting on their debt. Starting with Greece, Ireland and Portugal soon followed asking for financial help from the EU and the IMF. And help was granted in return for heavy austerity measures. As it turns out, these programs didn't have the expected effect to shield Europe against further contagion. Recently, *Spain* also agreed to a banking bailout program and many think that the country will soon apply for a *bailout* for its public finances as well. *Italy* doesn't look very good either.

Today, the credibility of the Eurozone is now openly debated and the *impact* of austerity programs is challenged even by their "makers". Overall, Europe's economy is weaker than ever before and extremely unstable and its future potential is getting worse by the day.

What went wrong?

Obviously Europe's debt crisis is a complex issue that is going to be debated, probably for many years. However, there is enough evidence to support that the EU put too much effort to clean up public finances and completely neglected the key structural issues that Europe has been facing for a long time, namely: **reduced global influence, low growth, population ageing, reduced competitiveness against developing countries, increasing energy dependency, and loose coordination among participating countries.**

The last point has been more or less proved by the way EU dealt with the debt issue during the last two years. The other points though need some more explaining…

Reduced global influence

Europe is getting less influential on a global level. Fig. 1 illustrates its falling contribution to global GDP indicating an alarming reduction in relative economic power after 1960.

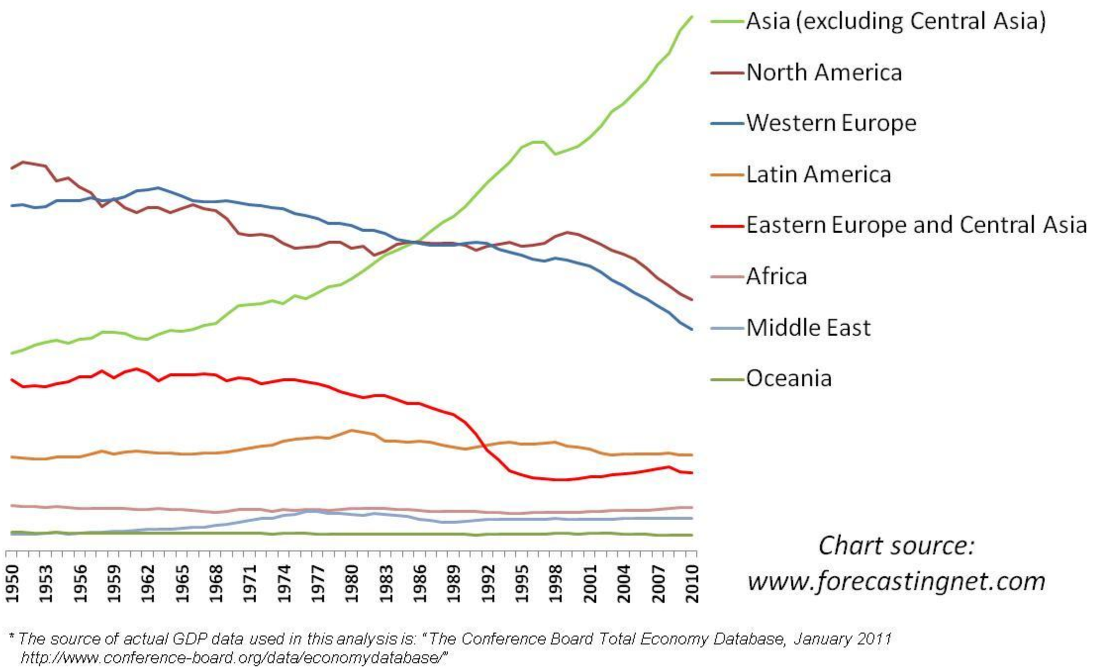

Fig. 1 Europe's declining global influence: Regions' % contribution to Global GDP

An even closer look to Germany, France, Italy, and the U.K. reveals that even the biggest economies in Europe have been declining after 1960, in terms of GDP contribution to global GDP.

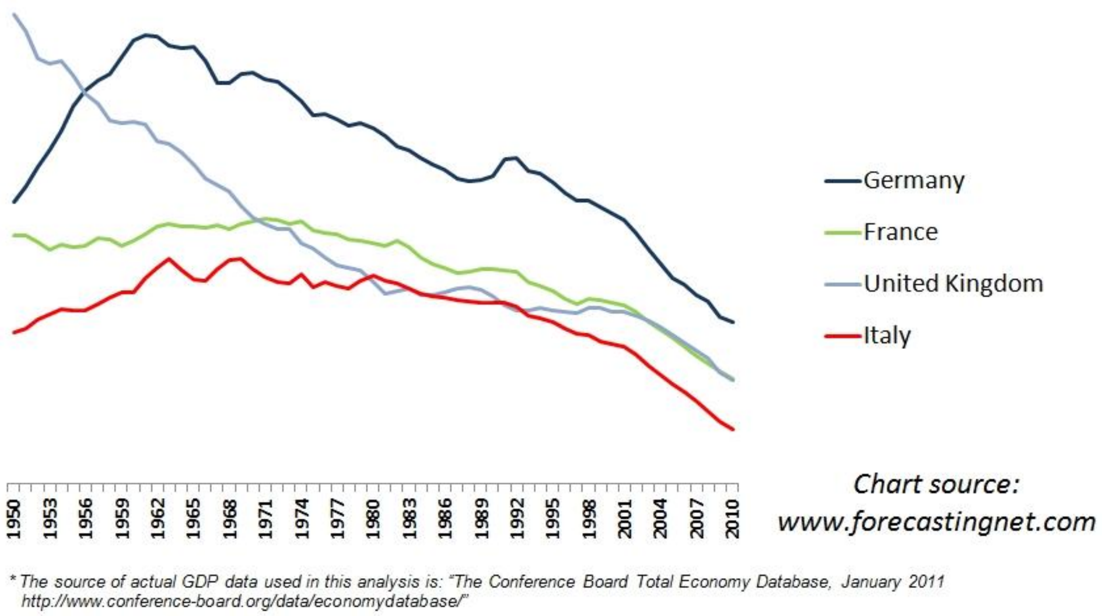

Fig. 2 Countries' % contribution to Global GDP

Low growth

Europe is one of the worst growth performers compared to the World's average, other developed and developing countries (see *Table 1.1* in IMF's WEO report). And this is getting worse as the latest estimates from the *World Bank*, the *IMF*, and the *Economist Intelligent Unit* anticipate the Eurozone to contract in 2012 while the rest of Europe will slowdown even more.

Population ageing

Europe is currently the "champion" of people over 50 years old contribution to the general population (36%) against all other continents. According to *recent research* people over 50 years old contribute negatively to GDP per capita growth, probably because productivity and creativity decline after a certain age.

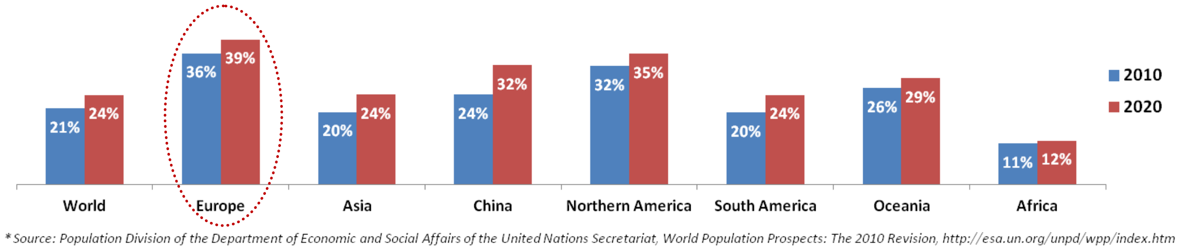

Fig. 3 % of ages over 50 for the years 2010 and 2020

By 2020 the ageing problem will get even worse as this part of the population will increase even more to 39% thus hindering Europe's future growth.

Reduced competitiveness against developing countries

The evolution of the *Global Competitive Index (CGI)* for the biggest European countries (Germany, France, U.K., Italy, Spain) as compared to the other two most important international powers (China, U.S.A.) is very revealing. European countries' GCI follows either a stabilizing or a slightly downward trend, nothing to worry about; however, China is catching up in this area. It has already surpassed Spain and Italy and in the following years it will probably reach the other European countries as well. So, now Europe doesn't compete with China in just numbers but also in terms of quality. By the way, the same goes for the United States as well.

Energy dependency

Europe's energy *dependency* (see p.6) has been increasing in the last twenty years, as *energy production decreased* (see p.17) during the same period. And that happened in a region that-especially its south part-has a strong, yet unexploited, potential for renewable energy.

The future of Europe: a world of conflicting options

So, contrary to popular belief that increased lending, first in the financial and corporate sector and then on a country level, is the key source of Europe's problems, it turns out that this may be just the tip of the iceberg in a series of many structural problems. Most countries in the continent, especially the more developed ones, are gradually ageing both literally-in terms of population average age-but also in terms of creative mentality and competitiveness. As a result, Europe is losing momentum in the global economy as it becomes more and more "yesterday's news". Combined with the increasing energy dependency this limits Europe's future potential and makes any rescue plan a puzzle even more difficult to solve.

Keeping this in mind, the future of Europe depends on if and how EU's political leaders will decide to effectively address all these still unresolved issues along with minimizing public debts and budget deficits. The most important question they will have to answer is if they want a "tidy" or a "large" Europe.

Slow death: the "tidy" Europe scenario

Europe will continue to use contractionary policies putting more control to member states' fiscal policies, especially those with bigger economic problems. **In an attempt to further tidy up public economics, the EU will once more neglect all the important structural problems of the European economy, further limiting its capacity for creativity and growth.** In turn, this will increase the possibility for more calamitous scenarios, including a new recession, country defaults, the disintegration of the financial sector, and finally the depreciation or even the collapse of the Euro.

As a counter measure, the EU will be forced to either issue Eurobonds or print money to raise the necessary funds for country or corporate bailouts. However, this is fighting debt with more debt and it will only have a limited effect on the real economy. We have already witnessed this in the United States where printing money was used intensively to stimulate the economy, before and after the crisis started, leading only to a short-term recovery. The problem here is that printing money creates "artificial" wealth by increasing the money supply and liquidity in the market; however, this is only short-term as it is not backed up by actual value creation in the real economy through innovation and creativity. The Eurobond has the same problem as well as it is more of an instrument to redistribute risk than to create value. Apparently, we need more real value to boost growth. Hence, the "large" Europe scenario.

Risky expansion: the “large” Europe scenario

Europe decides in favor of a major restructuring in an attempt to fight its structural problems. Austerity measures and bailout programs are being transformed to focus more on government efficiency and economic growth. No more across the board, horizontal, budget cuts and tax increases but selected cuts of unnecessary costs and bureaucracy.

New investments are channeled to high potential areas, especially-but not exclusively-to the energy sector. This effort includes both implementation of large renewable energy plants and search for energy resources such as oil or natural gas, mainly in the South, but also R & D to improve materials and equipment, construction methods, and energy storage techniques. **That will help decrease Europe’s energy dependency and give a competitive edge in the energy sector thus improving its competitiveness in the following years.** As a side benefit, Europe will also become a key player in fighting the repercussions of climate change, an issue that will top international agendas in the following decades. Of course, energy is not the only sector Europe could invest. **Education, agriculture, food products, and tourism are also important sectors where Europe can further its already important footprint.**

However, all these investments will require more funding. That’s where **printing money** or the issue of **Eurobonds** could be useful to facilitate these investments either by direct Government spending or the launch of funding programs that will help the private sector to take the appropriate initiatives. If successful, these initiatives will help create real value and profits in the economy and will generate new jobs thus boosting growth through more innovation.

For that we will also have to unlock our creative potential through a series of policies that will give more benefits for entrepreneurship-especially to the young ones-and research in the selected areas of investment. Through this process, we may also discover other areas where Europe can thrive. There are many candidates that mostly require specialized expertise and to a lesser degree enormous funding, like the information communication technology sector, business consulting, etc. We shouldn’t be surprised if significant development would occur in these areas as well. All these, will naturally lead to giving the young people more opportunities to work and innovate in both the business and the academic world.

These solutions depend on both the European South and North and on both weak and more developed economies. So, all EU countries will have to work together through targeted actions and investments. **The increased bonding in Europe will not come from “forced” unifications and strict legislation or policies but from a common cause and a common plan to achieve it.**

Conclusion

So, which scenario is the most likely to happen? Today, we are already following the first one, unsuccessfully. Sarkozy lost the recent elections in France, in part because of his focus on more austerity and control. Hollande, on the other hand, proposed more focus on new growth initiatives and won the elections. Merkel, seems to withdraw from her previous rigid statements about control under the pressure of other European leaders, especially Hollande and Italy's Monti. In the *June EU summit* a new funding program worth of 120 billion € was decided. In Greece, the newly elected Government is also arguing in favor of a renegotiation of the bailout terms, focusing on economic development to fight the raging recession. Something is happening, that's for sure. The first seeds for a new strategy towards a "large" Europe have been planted. But this is not enough. We need a new vision for Europe, with specific targets and a plan to achieve them. And the clock is ticking. If we enter an endless debate on policies we will lose our window of opportunity, as *Soros* recently said.

To conclude, Europe's future remains uncertain as the balance between a slow austerity death (the "tidy" Europe scenario) and a long term-but also risky-recovery through a series of reforms and targeted investments (the "large" Europe scenario) is not yet determined. From one side we have Merkel, the remainder of the two advocates-the first is Sarkozy-of the first scenario. On the other hand you have politicians like Hollande (at least during his pre-election "era") but also the common knowledge of the market. Although there is some evidence to support a shift towards the "large" Europe scenario, it's still hard to say which side will prevail. However, we do know one thing for sure:

Where Europe is heading in the long run depends on the choices of today...