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White Paper by the Global Agenda Council on Europe

Europe: What to watch out for in 2016-2017

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The European Union seems to be moving from one emergency to the next. Europe's leaders are in crisis-fighting mode: reactive, improvising, often uncoordinated – but ultimately modestly successful. The Eurozone has not splintered; Russia is smarting under Western sanctions; some burden-sharing on refugees has been agreed. Busy with short-term problems, however, Europeans have taken their eyes off more profound, long-term challenges. How the European Union copes with its immediate problems in the next couple of years will determine how the continent will fare in decades to come.

In this White Paper, we – the Global Agenda Council on Europe – are analysing some of the most pressing issues confronting the EU in 2016-2017. We present the choices that European leaders must make in the years ahead and explain how these could shape the Union's medium to long-term development. To illustrate how different policy choices interact, we have drawn up two fictitious scenarios of how the EU could evolve in the next 10 years.

The immediate economic concerns that dominated the European agenda in 2008-2014 are lessening. The cyclical upswing in the European economy, however, must not make governments complacent about the need for reforms. Faced with stagnating or shrinking working-age populations, European countries simply must fix their productivity problem to generate long-term growth. In innovation and digitization, Europeans often seem obsessed with data privacy and protection rather than grasping new opportunities. The European Commission's laudable attempts to integrate and improve EU markets – for example, for energy and capital – have so far been slow to get off the ground. The arrival of millions of migrants, asylum seekers and refugees is a great opportunity for an ageing Europe, but only if governments, together with the private sector, act swiftly to help the new arrivals find jobs.

External political challenges also abound: an unpredictable and revisionist Russia and the meltdown in the Middle East are confronting Europe with geopolitical threats of almost unprecedented complexity. Will European governments pull together to act resolutely? Or will they discard whatever is left of their common foreign and security policy? The answer will determine whether the EU can stabilize its neighbourhood in coming years or risk importing instability from abroad.

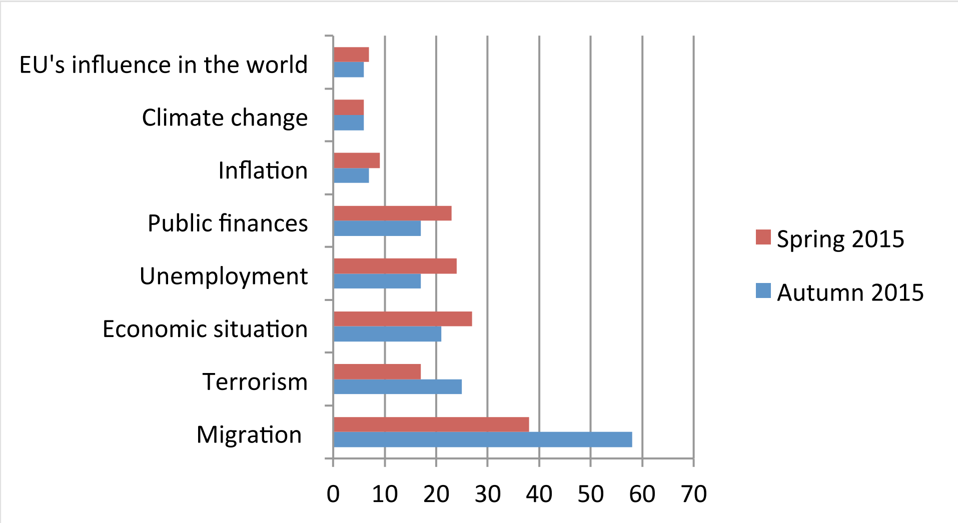
Another critical question concerns the United Kingdom's future in the EU. Will Prime Minister David Cameron, together with his European partners, manage to convince the British that they are better in than out? If Britons vote to leave the EU in 2016 or 2017, the UK will probably disintegrate and the entire European integration project will suffer a possibly irreversible setback.

EU leaders must tackle all these issues at a time when the idea of European integration is losing its popular appeal. Six in 10 Europeans did not bother to vote in the 2014 European elections. Only four in 10 had a positive opinion of the EU in 2015. Although Europeans gradually regained their confidence in the EU as the region emerged from the euro crisis, the refugee crisis is making them doubtful again. At the end of 2015, migration topped the list of European concerns in all but one EU countries (Graph 1). European leaders must deliver solutions, and fast, if they want to prevent support for the EU imploding in coming years.

Graph 1

What do you think are the most important issues facing the EU at the moment?

in % (selected issues)



Source: Eurobarometer

Growing anti-EU sentiment affects national politics, too. In 2015, a partly anti-European left-wing coalition took over in Portugal, the generally pro-European Poles voted for a populist and eurosceptic government, while in France, only the coordinated efforts of mainstream parties prevented the nationalist *Front National* from gaining regional power.

Public disaffection is, to some extent, a hangover from the euro crisis. More profoundly, Europeans are confused about the purpose of the EU. Traditional arguments about Europe as a peace project have lost their appeal. If eurosceptic attitudes spread further, the temptation for Europe's national governments to go it alone will rise – at a time when the need for common solutions to complex problems is stronger than ever.

Current crises, however, could also be an opportunity to imbue Europe with a new narrative. If European countries are working well together to tackle slow growth, refugee challenges and external threats, the EU would no longer be seen as a lofty and distant political ideal but as an effective, if sometimes irksome, crisis-fighting mechanism.

What leaders should be paying attention to in 2016-2017

1. The European economy

We expect the cyclical upswing in the EU economy to continue in 2016-2017. Europe's medium to long-term growth prospects, however, look decidedly mediocre. In a fast-changing global economy, Europeans have no time to waste to improve the functioning of their economies.

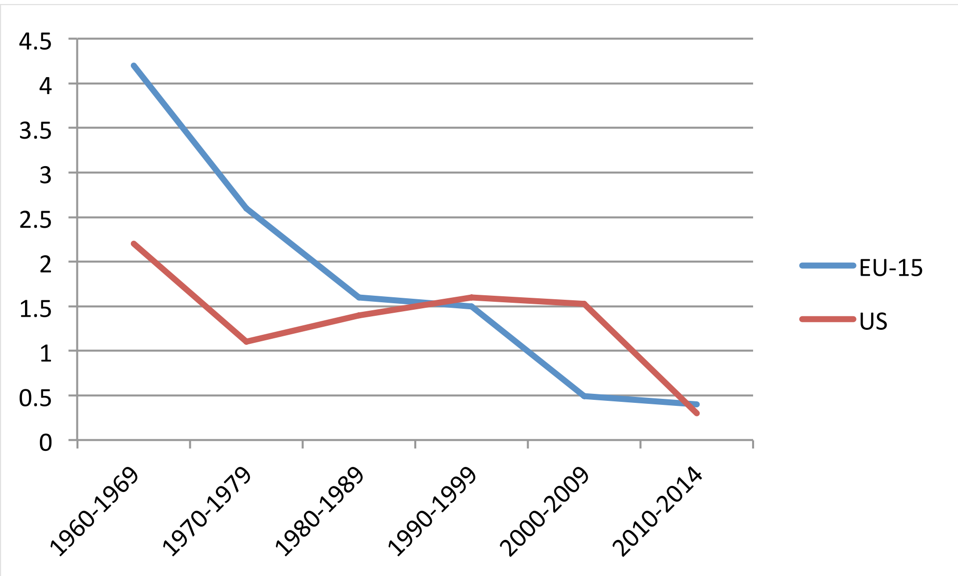
GDP growth in the EU reached an estimated 1.8% in 2015 and job markets keep improving. One reason why average unemployment in the EU is still well over 10% is that participation rates are rising across Europe – in stark contrast to the United States where the share of people available for work is falling. Europe's superior performance in this respect is due mostly to the growing numbers of older workers in jobs, a sign that changes to early retirement rules and other reforms are having some effect.

Despite this steadily improving picture, economic policies keep becoming more expansionary. The European Central Bank (ECB) has decided to extend its massive bond-buying programme beyond its original expiry date of September 2016, as inflation remains stubbornly under the ECB's target of "below but close to 2%". The impact of lower oil and commodity prices will wear off, but other global deflationary forces are likely to persist as emerging markets remain weak. A seemingly technical problem for the ECB is that inflation, as measured by consumer prices, will stay more or less flat, whereas nominal GDP keeps improving. Hence, ECB policy will become increasingly pro-cyclical, which increases the risk of asset bubbles and the misallocation of capital. quantitative easing (QE) will also prevent rebalancing within the Eurozone, as it is boosting spending mainly in the euro periphery rather than the core.

Fiscal policy, too, could become more expansive as "austerity fatigue" spreads. There will be little guidance from the European Commission, which is using exemptions and loopholes in EU fiscal rules to pursue a more "political" approach to monitoring and enforcement. Although individual countries will welcome a little more fiscal leeway in the short term, the lack of rigorous oversight may undermine fiscal sustainability further down the road.

We see a substantial risk that the cyclical upswing will breed complacency across Europe. The EU's workforce is ageing and shrinking (there will be 16 million fewer people of working age by 2030, even with steady net migration). Labour productivity growth in the EU has been trending downwards for decades (Graph 2) and has been stuck at about 0.5% since 2010. With a shrinking pool of workers and almost flat productivity, Europe's economy will not be able to grow in the long term.

Graph 2
Labour productivity is stagnating
Annual labour productivity growth per person employed in %



Source: European Commission (AMECO)

Low productivity is, to some extent, the flipside of an improving labour market, as liberalization has brought more low-wage, low-skilled workers into jobs. It is worrying, however, that Europe does not seem to be able to reap substantial productivity gains from years of single market integration, improving education levels and, more recently, large-scale investments in digitization and other new technologies.

A large export surplus, also in ICT and other value-added services, suggests that the EU does not have an underlying competitiveness problem. One thing that sets Europe apart from the US, however, is that its innovative companies rarely grow fast. A deeper and more integrated European market would allow businesses to reach scale more quickly. From this perspective, the European Commission's various initiatives in 2014-2015 to remove remaining obstacles to pan-European business and investment (see Box 1 and next section) could improve European growth prospects in the medium term. These flagship initiatives will not, however, make a noticeable difference to growth in 2016-2017.

Signposts

- ⚠ Are EU initiatives to deepen the single market for capital, energy and digital goods and services gaining momentum?
- ⚠ Does the cyclical upswing in EU economies lead to complacency on reforms?
- ⚠ Is the ECB further extending its bond-buying programme, despite continuous strengthening of the Eurozone economy?

Box 1: **European economic policy initiatives**

Juncker investment Plan: The Juncker plan (official name: European Fund for Strategic Investments, or EFSI) is supposed to mobilize €315 billion in new investment across the EU by 2017. The EU budget and the European Investment Bank together are providing €21 billion in capital and guarantees, in the hope of leveraging the remaining €294 billion from national budgets and the private sector. Governance issues and a dearth of shovel-ready projects have made for a slow start. The plan's most immediate impact will be in those countries that have plenty of money for co-financing as well as efficient structures to administer complex projects – which are not those that need new investment most urgently. Moreover, the EU's investment plan pays scant attention to education and training, which is surprising given the EU is suffering from high youth unemployment coupled with widening skills gaps.

Euro reform: In June 2015, the heads of the EU institutions and the ECB laid out their vision for a deepening of the Eurozone in the Five Presidents Report. According to this two-step roadmap, the euro members would, until 2017, focus on reforms that can be implemented without changing the EU treaties, such as making monitoring and coordination of economic and fiscal policies more effective and completing the Banking Union. Ideas for more far-reaching steps, such as a larger Eurozone budget for stabilizing troubled member economies, are left for later. In implementing the Five Presidents Report, the European Commission is initially focusing on two things: setting up new institutions (a Fiscal Advisory Council, National Competitiveness Authorities), the impact of which will most probably be limited; and trying to add a joint deposit insurance to the Banking Union, which remains too politically controversial, especially for the Germans.

TTIP: Negotiations for a Transatlantic Trade and Investment Partnership started in 2013 and dragged on slowly throughout 2014 and 2015. US presidential elections in 2016 and mounting political opposition in Germany and some other EU countries could well delay an agreement into 2017 or beyond. Since the focus of TTIP is on removing regulatory obstacles to transatlantic business, the economic impact is hard to predict. Most economists expect it to be modest but positive. More significant would be the political signal that would be set by the world's two biggest economic blocs, the EU and the US, together shaping the rules of global trade.

Energy Union: In February 2015, the EU bundled (partly existing) policies to integrate EU grids and pipelines, diversify supplies and reduce energy use and carbon emissions into an Energy Union. Progress will remain halting as long as EU member-states jealously defend their sovereignty in this area, especially with regard to energy-market opening. Meanwhile, the growing share of renewables could lead to problems in the power sector, as ageing national grids are unable to cope with the intermittency of solar and wind power, while conventional power stations will no longer be profitable if only used as back-up.

Capital Markets Union: In September 2015, the European Commission launched an Action Plan for deepening and integrating European capital markets. The aim is to wean Europe off its over-dependence on banks and unlock new funding, in particular for small and medium-sized businesses and infrastructure. The Action Plan consists of a plethora of small steps and stock-taking exercises, from simplifying issuer prospectuses to lowering capital requirements for long-term investments. This pragmatic approach is in line with the Juncker Commission's promise to keep new regulations to a minimum and it signals a turning of the regulatory cycle, with a new balance between ensuring financial stability and allowing financial institutions to play their proper role in financing investment and growth. The Commission's caution also corresponds with political reality: major regulatory initiatives or centralized supervision would have fallen foul of UK opposition.

2. Digital Europe

The years 2016-2017 will determine whether Europe creates a digital roadmap to support competitiveness and growth or slips into digital mediocrity. The centrepiece of this agenda will be the Digital Single Market, which is one of the priorities of the Juncker-led European Commission. But the broader question is whether Europe dares to embrace accelerating technological change or fights a rearguard action by focusing on data privacy and protecting national industries and ICT champions.

Creating a Digital Single Market could add €340 billion to the EU economy per year, according to estimates from the European Parliament. The opportunities are plentiful. Today only 15% of online shopping in Europe takes place across borders. The various EU member countries still differ greatly in terms of digital infrastructure, business environment and skill levels (Graph 3).

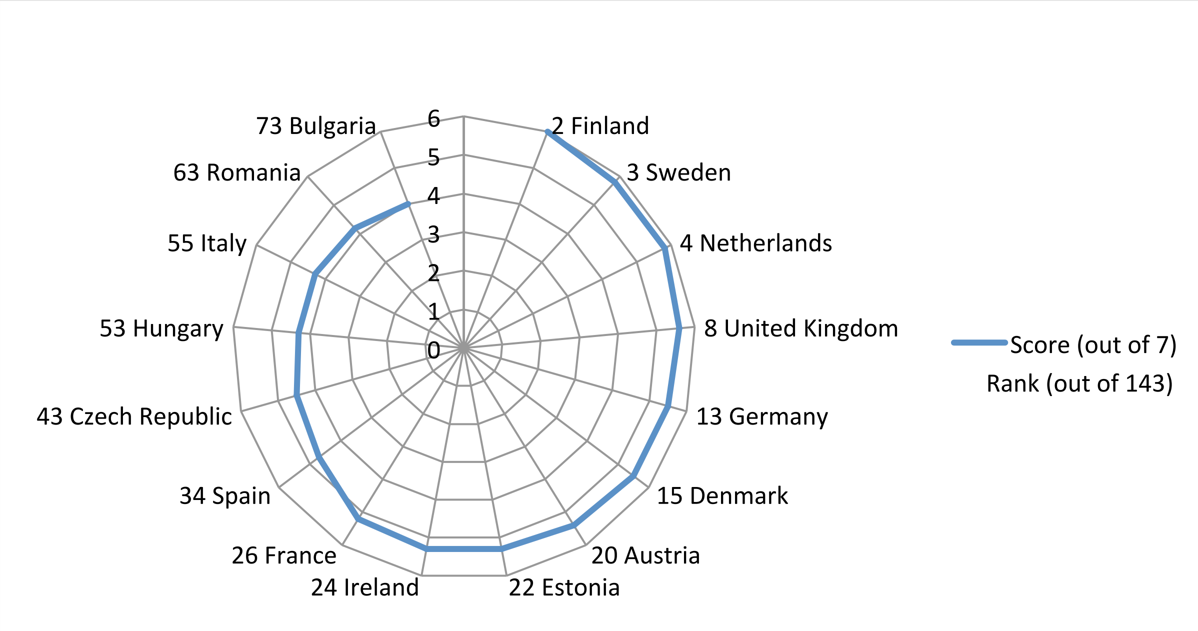
If barriers to cross-border business came down, consumers would benefit from greater choice and the quality of products and services should improve. Intensified competition would force European companies to speed up their digitization and transformation efforts, which, in turn, would help them grow. For example, SMEs with a solid online presence boast revenue growth up to 22% higher than those without, while those companies that have already achieved above-average digital revenues tend to grow 1.5% faster than the industry mean.

Europe's innovative start-ups, which now frequently decamp to the larger US market to reach scale, would enjoy more growth opportunities at home. New industries could develop and expand. Cloud computing, for example, has the potential to reach €174 billion per year in Europe by 2020.

Graph 3

A digital divide in Europe?

Networked Readiness Index (selected countries)



The Networked Readiness Index measures, on a scale from 1 (worst) to 7 (best), the performance of 143 economies in leveraging information and communications technologies to boost competitiveness and well-being.
Source: World Economic Forum

Removing barriers to cross-border digital business will not in itself be enough. Digital content and services will flow more freely across borders only if differences in consumer protection, copyright laws and VAT systems are evened out. Over €80 billion will have to be invested to build fast broadband networks across Europe. Much of this will have to come from the private sector, which will require stable and forward-looking regulation. Massive efforts will be needed to train the engineers, programmers and innovators needed for the digital economy. The ICT skills gap in Europe has already reached 900,000. A new balance will have to be found between those producing digital content and those distributing it. The EU will also have to push forward its Capital Markets Union project to provide more seed funding and venture capital to innovative start-ups.

Much of Europe's digital future will be determined by its approach to data – the currency of the new economy. The free flow of data is required for everything from pan-European value chains to the sharing economy. Europeans, however, rarely ask how data can help improve the competitiveness of their businesses or increase their consumer surplus. Rather, their concerns are often about privacy and security issues, especially since the Snowden revelations. A good example are current attempts by some European governments to contain data flows geographically, instead of making data safer through encryption and helping consumers own and manage their data.

In line with such attitudes, many Europeans cheered the 2015 decision of the European Court of Justice to declare invalid the Safe Harbour agreement on data-sharing with the US. The verdict has caused widespread uncertainty among companies that rely on data flows across the Atlantic. On the other hand, the EU's new Data Protection Regulation, although criticized as overly strict by some businesses, is a step towards replacing 28 national regimes with common rules and one-stop-shop regulators.

Another area that will be critical for Europe's digital future is how it deals with online platforms, which, in the definition of the European Commission, comprises everything from online auction houses and shops to search engines, sharing sites, social media and internet-based payments systems. The exponentially growing use of international (mostly US-based) platforms in European countries has fuelled calls that the EU should write specific regulations for them. The focus, however, should be on fostering an environment in which European entrepreneurs can create and grow their own platforms, instead of restricting what non-European ones can do.

Signposts

⚠ Will the EU's new data protection rules make it easier for European firms to innovate and exploit the potential gains from big data and consumer profiling?

⚠ Will EU initiatives – including the Digital Single Market, the Juncker investment plan and the Capital Markets Union – create a more conducive environment for European start-ups to grow in the EU market?

3. Migration

We predict that immigration and the integration will remain the hottest political issues in Europe in 2016-2017. Migration represents a valuable economic opportunity for an ageing Europe – but only if governments, together with the private sector, take steps now to help hundreds of thousands of new arrivals find jobs.

Almost 1 million applications for asylum were lodged in the 28 EU countries in 2015, compared with about 600,000 for 2014, according to official EU statistics. Although those numbers appear daunting, total first-time asylum applicants in the past five years amount to roughly 0.4% of the EU population. This modest average hides stark differences between EU countries. About 1 million refugees, asylum-seekers and migrants arrived in Germany alone in 2015 (the number who officially applied for asylum that year was lower, hence statistics can be tricky to reconcile). In relation to its existing populations, Sweden received the most refugees.

Forecasting how migration and refugee flows will develop is fiendishly difficult, but there are good reasons to assume that the current influx will not abate soon. First, as the war in Syria continues into its sixth year, the 4 million Syrians holding out in neighbouring countries will lose hope of returning home. Second, other unstable countries in the region, most notably Afghanistan and Iraq, have become a major source of migration. Stabilizing these quasi-failed states will take years. Third, a rapidly rising population in Africa, combined with dysfunctional political systems, unreformed economies and rock-bottom commodity prices, will drive further waves both of economic migrants and political refugees towards Europe.

The influx in 2014-2015 has forced European countries to address shortcomings in their asylums systems, which will make the inflows more manageable. Between 10% and 40% of asylum-seekers in various EU countries used to come from the western Balkan countries, which have now been declared "safe". Application procedures are being streamlined everywhere. In 2015, they ranged from eight days in the Netherlands to six months and more in Germany. Larger numbers of those who lack a valid claim are being returned home (in 2014 less than 40% were).

Countries will also have to speed up the process of verifying and approving the qualifications of immigrants (which can take years at present). But since only a limited number of the latest arrivals appear to have transferable qualifications, the biggest challenge will be language training, professional education and programmes for integrating newcomers into labour markets. Past data for Germany indicate that in the first year after arrival, only 8% of refugees of working age found a job.

After five years, this share went up to 50%. Governments, together with the private sector, will have to redouble their efforts to increase these numbers (see also Box 2).

In the meantime, the immediate economic impact of the refugee influx will be through fiscal spending on housing, food and integration and training measures. In Germany, the additional spending should lift GDP growth by 0.3% in 2016.

Many Europeans will continue to welcome and support the refugees. In some places, however, the influx will also play into the hands of populist parties and right-wing movements. Between 60% and 80% of people in France, Spain, the UK and Italy told pollsters in 2015 that they were unhappy about the immigration policies of their governments. While in Germany anti-immigration sentiment should remain largely confined to extra-parliamentary movements, in France it might propel Marine Le Pen into the run-off of the 2017 presidential election. In the UK, migration could be the decisive factor in the in-out referendum (see below). In some other EU countries, incumbent governments will adopt a tougher stance on migration to recapture voters that are drifting towards populist challengers.

Domestic political pressures could make it harder for governments to find workable compromises at the EU level. EU leaders issued plenty of statements in 2015. But the agreements they forged –, for example on centralized registration and Schengen-wide redistribution of refugees – have barely been implemented. By 2017 the EU should see some progress towards an EU asylum system. In the meantime, however, tensions over "fair burden-sharing" could make it harder for EU leaders to find solutions to other pressing issues, including the UK's renegotiation or Eurozone reform.

Signposts

- ⚠ How forceful are efforts by both the public and the private sectors to integrate new arrivals into labour market?
- ⚠ Do mainstream politicians manage to address public concerns about migration, while stressing the medium-term opportunities related to it?
- ⚠ Are EU countries fortifying their national borders instead of working together to manage the EU's external border more effectively?
- ⚠ Are political declarations and EU agreements on border controls and the registration and redistribution of refugees being implemented in practice?

Box 2: **Migration as an historic opportunity**

Europe's history has always been shaped by migration. Today, migration is a structural, long-term and global issue, not a short-term humanitarian emergency. Europeans should regard it as an historic opportunity.

Europe needs migrant workers to compensate for the decline of its own working-age population, which threatens to undermine social welfare systems and public finances. In addition to integrating newly arriving refugees, European countries will also have to facilitate legal economic migration; for example, through a workable regime of "blue cards" (EU-wide work permits for non-EU nationals). Increasing the labour market participation of migrants is key. It can be achieved only in partnership with the private sector, to match migrant skills with employers' needs and provide on-the-job training on a massive scale. For this to happen, national governments and the EU will have to provide fiscal incentives, guarantee schemes and more liberal legislation.

If integration policies improve, Europe could enter a virtuous circle. If more migrants find jobs, they will require less public support and start paying taxes and social security contributions. If migrants see opportunities for getting ahead, they will be keener to integrate. Such developments would deflate support for nationalist and xenophobic politicians. Europe will enter this virtuous circle only if it redirects its migration debate from burdens to opportunities. If it fails, the political consequences will be painful and profound.

4. Geopolitical risks

For decades after the end of the Cold War, Europe enjoyed an increasingly stable and benevolent geopolitical environment. No longer. Since at least 2014, the EU has been facing growing insecurity and multiple threats as a result of both a more volatile global scene and a dramatic deterioration in its immediate neighbourhood. This trend is likely to continue in 2016-2017.

How fundamentally Europe's external environment has changed is illustrated by the EU's own strategy statements. When the EU first released a European Security Strategy in 2003, it stated: "*Europe has never been so prosperous, so secure or so free. The violence of the first half of the 20th century has given way to a period of peace and stability unprecedented in European history."*

By 2015, when the EU High Representative for foreign policy started working on a new Global Strategy, she acknowledged that "[t]*he world – and our perception of it – has become more dangerous, divided and disorienting".* Hopes that the stability of the EU would radiate and promote stability in its surroundings have given way to fears that the EU is importing instability in the form of refugees and terrorism.

Many European business leaders have been slow to integrate heightened political risk into their planning processes, partly because the usual warning signs of political instability – commodity prices and bond spreads – are not flashing red (as a result of the shale oil boom in the US and QE easing in Western economies). Political leaders, meanwhile, have been so busy with multiple domestic and European crises that they have often lacked the attention and resources for a more far-sighted and forceful foreign policy.

Few, if any, predicted the military adventurism of Russia either towards Ukraine or in Syria; and practically all of the assumptions underlying Western policies in the Middle East since the Arab Spring have been proven wrong. Today, a revisionist Russia in the East and a multifaceted meltdown of large parts of the Middle East in the South presents Europe with foreign and security policy challenges of almost unprecedented complexity. Much of the EU's credibility and weight in the future will depend on how it handles its immediate external challenges.

The starting point is not particularly propitious. The EU has not managed to build a strong and coherent common foreign and security policy. On the contrary: EU countries have often gone it alone in recent years. NATO, meanwhile, faces its own challenges. A NATO summit scheduled for July 2016 will have to grapple with demands primarily from the alliance's Central and Eastern European members for a stronger deterrence posture. Although most NATO countries have stopped slashing their military budgets, most are still far off the agreed target of spending 2% of their GDP on defence.

The Kremlin, for one, will be watching developments in European foreign and security policy closely. A combination of military strength and internal fragility could make Russia even more unpredictable in the years ahead. President Putin, who looks set to stay in power beyond 2017, might bide his time as far as Ukraine is concerned, hoping that the West's half-hearted engagement will present new opportunities for expanding Russian influence beyond Eastern Ukraine. There remains a risk, however, that the Kremlin will be tempted into further political and military adventurism in an attempt to divert attention from its domestic economic and social woes.

Ukraine's fate will not be decided solely in Moscow; developments at home will be equally important. Western support for Ukraine's crumbling economy will remain hesitant as long as Kyiv fails to tackle political infighting and ubiquitous corruption. If, however, the Ukrainian government continues on its current cautious reform course, the Ukrainian economy might turn from deep recession to gradual growth by 2017.

An early resolution of the conflicts in the Levant looks extremely unlikely. Even a diplomatic deal between the US, Russia, Iran and other major powers would not necessarily bring peace between the fighting factions on the ground. Nor would it help to restore the economic and social fabric of the region, which has been largely destroyed. A recovery will take decades. Therefore, Europe must be prepared for the continued migration of people from these and also more far-flung regions, where people are losing hope for a better future. The ongoing conflicts in the Middle East may also translate into heightened terrorism risk in EU countries for years to come.

Against this background, the EU's relationship with Turkey – a key strategic actor in the region and already home to over 2 million refugees – will become more important. In late 2015, the EU revived Turkey's largely frozen accession talks, while Ankara promised to cooperate in managing refugee flows. A settlement of the long-running conflict in Cyprus – which looks possible in 2016 – would add further momentum to the EU-Turkey talks and might allow for a more constructive dialogue between Turkey, the EU and NATO on security and migration.

The US will be chiefly focused on its presidential election in 2016, which might limit its attention to international issues. For the EU, this would be troublesome since US leadership is regularly the precondition for any international initiative. In January 2017, a newly elected president will move into the White House. He or she will probably reach out to the Europeans, offering co-leadership and demanding that they share more international responsibilities, in particular in their own neighbourhood. The EU must not miss this opportunity.

Signposts

- ⚠ Is the trend towards a renationalization of foreign and security policies in the EU reversed in favour of a more decisive role for the Brussels institutions?
- ⚠ Is Western policy robust enough to deter President Putin from venturing into further military adventurism?
- ⚠ Are EU countries increasing their defence spending more resolutely? And is the EU using existing means, such as its rapid-reaction battlegroups, to stabilize its neighbourhood?

5. The risk of Brexit

The British government in 2015 started negotiating a “new deal” for its EU membership. The outcome will inform an “in-out” referendum that will be held probably in early summer or autumn 2016. Although many assume that Britons will vote to “stay”, experience of past referendums suggests that the risk of a vote to “leave” is substantial. At the end of 2015, for example, a majority of Danes rejected plans for further EU integration that had been backed by all mainstream parties in the preceding campaign.

A Brexit would be a turning point in EU integration, which has, so far, been seen as largely irreversible. Other European governments would come under pressure to offer their voters a vote on EU membership, too, and the resulting calls for national “special deals” might handicap EU policy-making for years to come.

In November 2015, the government of David Cameron laid out its priorities for the negotiations (see Box 3). The demands are rather narrow and were widely anticipated in other EU capitals, so a deal by February 2016 should be feasible. A deal-breaker could be Cameron’s demand to exclude workers from other EU countries from certain top-up benefits given to their British peers.

Box 3: **UK demands in the negotiation**

Euro “ins” and “outs”: The UK wants safeguards that the 19 Eurozone members cannot outvote the non-euro countries on EU policies, and that Eurozone policies will not harm the single market. The UK is particularly concerned about decisions affecting financial services. Since nine EU countries are still outside the euro, some adjustments to voting procedures should be feasible.

Competitiveness: The UK is pushing for stronger efforts to make the EU economy more competitive, in particular through cutting red tape for business, deepening the single market and concluding TTIP. No EU country will oppose such demands, but concrete steps will be hard to achieve by the time of the referendum.

Treaty: The UK insists on an opt-out from the EU treaty goal of “ever closer Union”. It also wants the EU to give national parliaments more powers to stall or reject new EU rules. The time before the referendum is too short to change the EU treaties. But the UK is likely to be given a written commitment that the rights national parliaments gained in the Lisbon Treaty will be fully adhered to and that these issues will be addressed the next time the treaties are changed.

Migration: David Cameron has called for stricter rules on migration, in particular curbs on in-work benefits for EU nationals coming to the UK. This is proving difficult both legally – it probably contravenes the principle of free movement of workers – and politically, since Central and Eastern European governments, in particular the Polish government, will vehemently oppose any form of discrimination against their people working in other EU countries.

Since Cameron’s list is regarded by most Britons as rather modest, the government would have to succeed with all its demands to declare the renegotiation a clear success. Most other European governments will be too busy with their own issues, from national elections to tackling the refugee influx, to devote much attention to the British negotiations. Nevertheless, a certain amount of drama, threats and acrimony looks inevitable before a final deal is sealed, which could unsettle investors and turn more Britons against the EU.

Polls have fluctuated over recent years, with majorities in favour of leaving in 2013-2014 being replaced by a preference to stay in through much of 2015. The refugee crisis in 2015 has intensified widespread frustration in the UK that EU membership prevents the government from fully controlling national borders. By the end of 2015, some polls were again showing a slim majority in favour of Brexit. Therefore, the refugee crisis may yet prompt Cameron to postpone the referendum until 2017, to allow more time for Europeans to regain control of the situation.

Most studies indicate that Brexit would be damaging to British growth, jobs and investment. Although many Britons dislike the EU, most are likely to be more concerned about the risks involved in leaving. On the other hand, those who question the benefits of EU membership will feel vindicated if the EU continues to fumble the refugee influx and other critical issues. Therefore, the outcome of the referendum remains too close to call.

If a majority votes for staying in the EU, a newly confident British government could re-engage in EU policy-making, having manoeuvred itself to the sidelines in recent years. As a euro "out", the UK would remain in an awkward position alongside an ever more integrated Eurozone. The challenge for future British governments will be to compensate for this detachment by concentrating on areas where British and EU interests coalesce, such as deepening the single market in various areas, strengthening common foreign and security policies and concluding external trade and investment deals.

Should the British vote to leave, the UK would enter a period of profound domestic turmoil, which would extend also to the rest of the EU. Cameron would resign. A new, possibly more eurosceptic prime minister would conduct the ensuing negotiations to first dissolve the UK's membership and then conclude a new bilateral economic agreement with the rest of the EU. This agreement would need to be distinct from both the Norwegian take-it-or-leave-it position on EU regulation and the cumbersome sector-by-sector Swiss approach. This negotiation process would sap much of the EU's political energy for at least two years – at a time when so many other pressing issues are vying for policy-makers' attention. A Brexit would also leave the EU without one of its main advocates of open markets and sensible regulation, which could tilt the balance of European economic policies more towards government intervention and protectionism.

The UK itself would most probably dissolve since Scotland would almost certainly vote to leave the UK to join the EU – a result other EU members are likely to accept, despite the precedent it would set for secessionist regions in other EU countries. Outside the UK, Brexit would inflame already growing populist movements. Calls for similar renegotiation processes and in-out referenda might arise in the Netherlands, France, the Czech Republic and elsewhere.

Signposts

- ⚠ Can David Cameron achieve his demands in negotiations with the other EU countries?

- ⚠ Who leads the campaign to remain in the EU? Since the arguments for leaving are often snappy and emotionally appealing, while those for staying are long-term and complicated, personalities will count for much in the pro-EU camp.

- ⚠ What else is happening in the EU? A large number of Britons remain undecided and could be swayed by events at the last minute; for example, a flare-up of the Greek crisis or a worsening of the refugee situation.

The state of the Union in 2026 – two scenarios

These two fictitious scenarios are meant to show that the decisions EU leaders will take in 2016-2017 will shape Europe's future for years to come. They also illustrate some of the links between different policy areas. They are not meant as forecasts.

1. If all goes wrong

As the post-crisis upswing petered out and unemployment started to rise again towards the end of 2016, European leaders focused on shoring up domestic support, while neglecting the deepening political crises in the European neighbourhood. After direct military clashes between US and Russian forces in Syria, diplomatic efforts for a solution ceased and the country fully disintegrated into chaos, taking much of the Levant region with it. Almost 4 million Syrians and Iraqis moved towards Europe, while an escalation of fighting in Ukraine brought another 2 million people to the EU's borders. The intensifying refugee crisis served to fully unravel EU solidarity.

Since the EU had failed to effectively manage its external borders, one EU country after another reinstated national border controls and erected fences, especially after a string of terrorist attacks was adroitly exploited by xenophobic politicians in various countries. By 2018, free movement in the EU was but a distant memory.

Bitter wrangling over refugees also frustrated attempts to reach a mutually acceptable deal between the UK and the other EU governments. Following a resounding vote to "leave" in autumn 2017, a more nationalist and uncompromising government took power in London. A year later, a majority of Scots voted to leave the UK and applied for EU membership. In 2019, a majority of Catalans voted likewise, triggering a severe constitutional crisis in Spain that resulted in a declaration of martial law.

With the EU already on the ropes and immigration dominating public debates across Europe, Marine Le Pen won the presidential run-off in France in 2017, having promised to renegotiate France's membership with the EU. Berlin was much less accommodating than it had been vis-à-vis the UK a few years earlier. Even traditionally pro-European Germans tired of the hostile rhetoric coming from France and Poland. In the 2019 elections for the European Parliament, the anti-EU *Alternative für Deutschland* came first. Having got nowhere with her demands, President Le Pen promised an in-out referendum in case she was re-elected. In 2023, the French narrowly voted to stay in but the political atmosphere in the EU remained poisonous.

Amid so much political turmoil, governments paid scant attention to economic policy. Franco-German tensions had stalled Eurozone reforms, with the result that the Italian debt crisis of 2025 once again threatened to destroy the single currency. Unemployment across the EU hit an all-time high of 14% that year. Following the European Parliament's rejection of a new Safe Harbour agreement, several EU governments set up approval procedures for any kind of cross-border transfer and storage of data. Protectionism spread also in the services sector, while the reinstatement of national border controls contributed to the unravelling of pan-European value chains in manufacturing. In 2019, the EU used a clampdown on dissidents in China to impose economic sanctions on its biggest trading partner. After a weak TTIP agreement failed to clear the German Bundestag, efforts to liberalize transatlantic trade were also abandoned. Frustrated by the EU's weakness and indecisiveness, it took President Hillary Clinton until 2020 before she made her first visit across the Atlantic.

2. If all goes right

The EU's new Global Strategy for foreign and security policy, agreed in 2016, turned out to be more than words. Faced with serious external threats, European governments pooled their efforts to give more robust support to Ukraine, while also helping to stabilize the situation in and around Syria through buffer zones and large-scale aid. Turkey, flattered by its prominent position in the Global Strategy, joined these efforts.

The prospect of peace and improved conditions in refugee camps in Lebanon and Jordan helped to slow the flow of people into Europe. This allowed EU countries to devote more resources to helping new arrivals find jobs and integrate into local communities. The "not in my name* campaign against extremism, that brought together Muslims in over 20 EU countries, also helped to take the wind out of the sail of anti-immigrant politicians. In 2025, the European Commission estimated that those migrants that had arrived in the previous decade were contributing 0.2% to EU growth a year.

The UK, having voted to stay in the EU in 2016, threw its full weight behind a stronger EU foreign policy, a swift conclusion of TTIP and the various EU initiatives to deepen the single market. With its 2017 election out of the way, and increasingly worried about slowing growth, Germany joined the UK's push for European competitiveness. In 2020, the new European Commission packaged a dozen half-finished economic policy initiatives into its "go Europe!" strategy, with the aim of matching US productivity growth within three years. Although this goal was narrowly missed, 2023 was nevertheless memorable as the year when the first European start-up surpassed the US internet giants in terms of market capitalization.

After much tinkering with Eurozone rules and institutions, the Finnish presidency of the EU in 2020 managed to forge a "grand bargain" in which euro countries finally accepted more central oversight over budget policies and reforms in return for a larger EU investment and stabilization budget. By the middle of the decade, the euro's fast growing role as a global reserve currency was one of the reasons why the US was increasingly looking to the EU as a real partner in global affairs.

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