

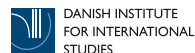


Think Global – Act European

The Contribution of 14 European Think Tanks to the Spanish, Belgian and Hungarian Trio Presidency of the European Union

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GLOBAL GOVERNANCE

Internal and External Challenges for the EU: the Economic Agenda of the Spanish-Belgian-Hungarian Trio Presidency

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The Spanish-Belgian-Hungarian (SBH) Trio Presidency covers not only 18 months in time, but a period of historical challenges for the future of the European integration. Some of them will be concentrated into this one-and-a-half-year period, while others will continue (or even become more acute) in the period beyond the SBH Presidency. But the first and most decisive steps concerning their nature, direction and intensity will be taken before mid-2011.

Pre-crisis role of the EU in global developments

Prior to the crisis, the EU could be described as a 'fragmented power' in international relations, that is, as a power whose effectiveness varied depending on the field, and as a potential power whose effectiveness was being hampered by internal fragmentation.

As a result of several decades of development, the EU has become a leading player in international trade, global capital flows (including mergers and acquisitions due to the developing internal market) and development aid. Also, it has created a much-envied social welfare system, high living standards, political and social stability and (somewhat balanced) prosperity. Despite shortcomings which are in some ways increasing (particularly as compared to the USA), the EU is also a global player in research and development, as well as in education and innovation potential.

Alongside the United States, the EU has also emerged an international standard-setter. The rules of the game of most international economic and financial institutions are based on laws

and norms inherited from, and transferred by, Western Europe and the United States. More broadly, the institutional representation of the EU is fragmented (between community level and nation-state competence), but its weight in international organisations and decision-making processes is undeniable.

There is however a substantial and in some cases growing gap between the EU's global economic role and its political and security roles. Member states, often cross-competing for more influence, can cope less and less effectively with the emerging influence originating in other large countries (or groups of countries) of the world. The lack of a common strategy towards China, Russia, Latin America – let alone the USA – represents a major barrier to the full exercise of Europe's economic (and potential political) weight in the global arena.

Additional gaps can be identified: the quality and speed of the community level decision-making process. There is a serious challenge to streamlining European institutions, legislation and procedures.

The SBH Trio Presidency will face three fundamental challenges:

- Crisis management, including exit strategies and the handling of the financial, social and probably also ideological consequences of the crisis and its management,
- Re-emerging global issues (e.g. migration, energy, international stability, monetary issues, etc.),
- The development of European integration, including a new balance between deepening and widening.

Although with different urgency, all of them will shape the SBH Trio Presidency.

From crisis management to exit strategies

The global crisis has not ended, even if the main part of the financial crisis seems to be over. The unfolding of the macroeconomic crisis has sent rather contradictory signals, both regarding recovery and also the possibility of new risks and a potential negative turn. Moreover, the social crisis, as a result of the macroeconomic downturn and the collapse of international trade, is likely to deepen during the SBH co-Presidency. Finally, an ideological and political crisis may be unfolding, as an unfortunate but inevitable accompanying factor of the deep economic recession. It could entail growing anti-global, anti-EU, anti-capital sentiments as well as nationalism and xenophobia. In order to avoid the real danger that the post-crisis environment of Europe will be quite different from the pre-crisis environment, immediate action is necessary across the EU, both at European and member states' levels.

Bruegel has contributed to the discussion on the European exit strategy. It envisages five main actions to be phased in over time. First, the identification and recapitalisation of stil

ailing banks must be completed, with a clear phasing-out schedule for state support. Second, member states should adopt medium-term sustainable budget plans to be implemented from 2011. Third, monetary policy should remain as supportive as possible (keeping interest rates low). Fourth, the planned European Systemic Risk Board should become operational in summer 2010. Finally, an *ad-hoc* reinforced consultation mechanism must be set up in order to ensure the necessary coordination of emergence between member states, and in consultation with central banks (for a period of 2.5 years but renewable once).

These measures aim at addressing the consequences of the crisis – one that has already resulted in huge budget deficits and rapidly growing public debt in most of the EU, not least in the eurozone. The proposed strategy emphasises the need for strengthened coordination in exceptional circumstances, over and above what is called for by the Stability and Growth Pact.

The SBH Trio Presidency will take place at a period of abnormally high budget deficit and increasing public indebtedness. Available instruments to reverse negative developments include:

- Substantial cuts in budget expenditures (with inevitable consequences for welfare spending – a rather difficult step in a period of deepening social crisis),
- Tax increases (potentially threatening even modest economic growth),
- Making use of inflation to liquidate large part of the outstanding debt (a possible scenario in the US but a less likely one in the EU),
- Spreading the costs of the crisis over a longer period (this, however would mean a partial redistribution of the costs to the younger generation)

None of the responses at hand is thus without adverse consequences and all are bound to result in severe economic and political difficulties. The role of the Presidency and the Commission will be to trigger adjustment, to help mitigate the adverse effects of it, and to avoid that divergences in the speed and nature of the responses give rise to intra-EU tensions. It is by no means an easy task.

The EU-27 is unlikely to be able to return to its pre-crisis growth path in the next few years. Although (sharply) negative growth rates may be overcome in 2010-2011, overall growth will be insufficient to offset the fall in output and may remain sluggish. In addition, pre-crisis growth and catching-up in new (and potential) members will be seriously affected, even according to the most optimistic scenario. While enlargement could be considered a major success story prior to the crisis, the continued development of the new member states can no longer be taken for granted, especially in countries that relied extensively on foreign savings under a fixed exchange rate regime.

One of the most difficult situations to be faced by the EU and the member states is that of the labour market. While labour shedding has been avoided in most EU countries (with the

exceptions of Spain and some of the new member states, especially the Baltic countries), adjustment has now started and subdued growth is unlikely to reverse it in the short-term.

What, in effect, will probably be done is some form of redistribution of jobs among more people (through, e.g., the promotion of part-time contracts). Since unemployment (and high inactivity) rates are unlikely to be reduced during the SBH Trio Presidency period, active labour market policies will need to be promoted without jeopardising Europe's global competitiveness. In this context, the SBH Trio Presidency could produce a feasibility study identifying the pros and cons of a future-oriented employment strategy, including its potential financial burden.

A last issue is the functioning of the single market. Government's interventions, starting from the bailing-out of banks through substantial financial injections into selected sectors (mainly the car industry with its cross-industry implications) and the saving of many jobs, did not generate fundamental restructuring or the creation of future-oriented job opportunities. On the contrary, it seems in some cases to have consolidated vested interests and unviable structures. The new engines of growth are yet to be seen and their emergence may be delayed by dysfunctional capital and labour markets. As a consequence, Europe's relative loss of weight and dynamism in comparison to China and other emerging economies will continue, and the shift of the global growth pole(s) away from Europe risks being accentuated.

The EU and global challenges

International trade has started recovering and is likely to recover further in 2010 and 2011, provided trade protectionism remains contained as it has been so far. However, China is expected to become the leading export nation even if it successfully rebalances its growth model. This rise of emerging countries should not be taken as a threat. It will not jeopardise the EU's ability to play a global role in international trade discussions, but will create more balanced power relations, with growing weight for the emerging economies. Limitations to the EU's power and influence are in fact more internal than external.

International capital flows may also recover but a different pattern is likely to emerge. FDI can be expected to become a genuine two-way street. The EU has to adapt to the fact that it is not only European companies that are allowed to invest in rapidly growing markets, such as China, India, Russia, Brazil, etc., but also Chinese, Indian, Russian, or Latin American capital that may look at the EU as a promising location for their direct investments.

Europe will face serious challenges in the task of restructuring international economic and financial organisations. A sustainable solution for the global crisis does not only need a prudent and internationally accepted regulatory framework but also institutional restructuring that takes into account the current (and partly future) changes in the global balance of power. The challenge for Europe is twofold:

- First, it should aim at preparing the ground for a common, EU-level representation and interest implementation (enforcement) in the leading international organisations. The aggregate weight of EU members will be reduced across the board, since more space and weight has to be given to emerging global players. But Europe will not necessarily be on the losing side if it can act as a community. For instance, even in the case that the voting share of EU member states in the International Monetary Fund (IMF) were to shrink substantially, if there were an EU-level representation the EU could easily acquire the largest voting share in this organisation, probably on par with the US. In this context, a lot depends on the integration capability and willingness of the member countries (mainly the large ones).
- Second, the G20, a necessary but only the first step to reckon with ‘new global realities,’ could be used by the EU to create a genuinely multipolar global system with strong EU positions. The first signs do not confirm this direction. Even if talks of a G2 are exaggerated in view of the difficulties of involving China in global governance, the US-China relationship has undoubtedly gained considerable strategic importance. And the question is absolutely justified: where is Europe in this game and what should Europe’s role be? In this context, the urgent task of defining the ‘mission of Europe’ in the 21st century emerges. It must not be missed in the Trio Presidency agenda.

A number of other global issues determining global development or substantially affecting Europe’s future must be dealt with in more detail. Environment and climate change will be a constant component of the SBH Trio Presidency. Additional issues waiting for a clear (or clarified) position at the community level include energy security, a common migration policy, instruments and implementation forms of the EU’s ‘soft power’ in current and potential future international conflicts, etc.

Internal development of European integration

Although practically all global issues mentioned in the previous chapter have an obvious impact on the future of the EU, some internal developments have to be addressed by the Trio Presidency as well. (*Ceteris paribus*, they would have an effect on the EU’s global position as well.)

Beyond any doubt, the entry into force of the Lisbon Treaty is a fundamental step in creating the institutional and legal framework for a more active EU, despite a number of barriers that remain and, more importantly, due to the still growing gap between the decision-making process of the EU and that in major competing countries / regions (it should not be forgotten that the ratified Lisbon Treaty mainly contains changes that are based on the global reality a decade ago and certainly well before the crisis; it has to be seen to which extent the Treaty will be able to cope with or adjust itself to the new and rapidly changing global realities). What is now urgently required is twofold. First, the rapid and unrestricted implementation

of the Treaty ('institutional deepening'); and second, the narrowing of the gap between widening and deepening, mainly in certain key economic policy areas of the EU (internal market, labour market, social issues). It must be emphasised that, with the exception of the big-bang enlargement, the decades-long enlargement process of European integration was always preceded by an ongoing process of deepening (common trade policy at the time of the British accession, Delors's single market programme during the Mediterranean enlargement, or the EMU at the time of the accession of three small and developed countries in 1995. The 'integration vacuum' created by the lack of the necessary deepening before the enlargement in 2004 (and 2007) must be filled, without stopping further enlargement – an issue on the SBH Trio Presidency agenda. However, this agenda must be more balanced and put more emphasis on the process of deepening. The new institutional framework and, hopefully, the management of the post-crisis situation will be able to generate the critical minimum of a breakthrough in this field.

Final remarks

Considering:

- The rapidly changing global environment, the impact of the crisis on different geographic areas and on different economic and social structures in the world,
- As well as the looming medium- and longer-term challenges,
- Plus recent intra-EU developments,

the SBH Trio Presidency should launch a major Europe-wide campaign, involving a large number of citizens, on the following issues:

- How to define 'European values' and 'identity' in the 21st century,
- Based on such values (and deficiencies or shortcomings), identify the strong and weak points of Europe in the changing global setting,
- Define the key issues of 'Europe's mission' (much more than the outdated formulation of *finalité politique*) in the emerging new global balance-of-power game,
- Finally, the clarification of instruments, institutional forms, international or regional cooperation schemes (including temporary or lasting alliances), timing and sequencing (and intra-EU leadership) of implementing the main objectives of such a 'mission'.