SCHUMAN REPORT ON EUROPE

STATE OF THE UNION 2012

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Thierry Chopin and Michel Foucher

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Translated by Rachel Ischoffen and Helen Levy

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Preface

Governance

This is the fashionable expression when talking of the European Union.

2011 was the year of the public debt crisis, notably blamed on the poor economic governance of the euro zone and of the Union.

This well polished expression in fact hides much more serious flaws than a simple lack of economic, budgetary and fiscal coordination. In reality the entire community is suffering because of the way it is governed. This means that it quite simply lacks … a government.

For the time being it seems incapable of taking that "federal leap forwards" which paradoxically the financial markets, judges of the short term, now deem vital.

However the European Union does not deserve the mistrust which it is subject to right now.

A unique geopolitical achievement, it has accomplished its initial goal, which was to bring stability back to a continent where disorder, conflict and contest have often led us to the edge of the abyss. Its successes are tremendous, but at the turn of the 21st century, which for some started with the fall of the Berlin Wall and the acceleration of globalisation, it is now brought into question. Instead of continuing integration the Europeans contended themselves to sit back, watching and commenting on the emergence of new players.

Europe, the continent of stability, whose economic and social model, likewise its international relations, impresses because of its modernity, is facing a challenge launched by traditional capitalism, which is embodied in the Anglo-Saxon model but taken to its limit and excess by the emerging countries.

Victim of the short term it continues however to be part of the long term and can only be judged from this point of view. Today it is better to live in Europe than in any other continent. This is what many, who either want to join it or move here, think.

It is therefore its governance, its decision making procedures, its internal and external representatives which it has to consider from a new angle. The methods of the past will no longer be enough.

The articles in this book written by eminent personalities all converge and plead for a new European vision of the world, which demands thought about exercising power, economic and trade policy, the common budget and also new trade, competitiveness, agricultural and industrial policies. The Union must make in depth reform in order to address the new world and to give value to its extremely positive assets. A debate has now been launched on how to achieve this. The method is unimportant if the vision is just, if decisions are taken and applied and if confidence is regained!

It is to help in this quest, towards their definition and in their implementation that the "*Schuman Report 2012 on Europe – State of the Union*" is bold enough to innovate and criticise but also, and above all, to make proposals.

Jean-Dominique GIULIANI

Chairman

Robert Schuman Foundation

The Emerging European Social Model, an Asset to Face the Crisis

Yves BAROU

Europe's social dimension is often forgotten or limited to the work done by the European Commission. However, although the Commission has an obvious and important role to play, Europe's social dimension should be defined from a wider view point.

The social history of each European country has been built on the base of conflict, innovation as well as, in both cases, on negotiations to achieve satisfactory solutions, and in this way to define social norms. Governments everywhere have played a regulatory role but these necessary legislative interventions have, more often than not, followed the action of "social partners": unions, companies, regions etc…

Indeed autonomy has emerged in the social arena, which does not have its origins in the political sphere. Social democracy has not identified with political, parliamentary democracy. The same applies and will apply to Europe.

Europe and the social dimension: unity in diversity?

Can we consider Europe as an asset though? Many authors have described the various models existing: continental, Mediterranean, Anglo-Saxon, Nordic[1]. It is true that there are major differences between countries, in the same way as they exist between companies, sectors or regions. Moreover, the way the unions and industries are structured and levels of decentralisation are the obvious heritage of these different histories. But this breakdown takes less and less account of progress and innovation, as these are primarily responses to new and widely shared issues.

In other words although ignoring history, culture and different traditions is not the point in question here, we also have to see, and this is the most important aspect – what is emerging before our very eyes: a European social model based on a specific history, an original approach, a common culture, a model which could be an asset against the crisis.

1. Cf. Gosta Esping-Andersen, *The Three Worlds of Welfare Capitalism*, Princeton University Press, 1990 ; we might also refer to André Sapir, "Globalisation and the reform of European social models", *Bruegel policybrief*, November 2005.

T. Chopin et al. (eds.), *Schuman Report on Europe*

In order to see it we have to have an overview of an ever globalised world. For example, we have to compare China, the USA and Europe. On doing this it appears quite clearly – particularly for HR departments/directors with global experience, practices and responsibilities - that we share a great deal in Europe and, on this basis, we can strengthen our competitive advantages. This can be done on the condition that we do not go straight from an arrogant stance, which characterized Europe just a few years ago, to an attitude of systematic self denigration and also on the condition that we take more notice of our common points rather than our differences.

Businesses are building Europe thanks to their transnational operability!

We are Europeans and claim this identity because we do not believe that the American or the Chinese social models are appropriate for the future.

On the contrary, Europe and its 27 countries could become the world's laboratory; learning to rise above national differences to set out new, common standards could prove to be vital know-how on a worldwide scale. In an extremely specific area Europe has succeeded in establishing railway-signalling standards and by doing so it has laid down the foundations for global standards. Why should we not aim to adopt a similar approach with regard to social issues: this supposes learning from experience, understanding good practices and organising cross-fertilization; it also supposes gauging specific European features and defining this famous "European social model".

In a time of globalisation Europe as a region indeed benefits from extremely specific circumstances: for example distances are comparable to those of the USA, and the quality of its infrastructures makes it possible to split the working week, for example, with two days in Paris and three in Hamburg (this is not the case however between London and Sydney); cultural differences exist in Europe but they are of a secondary nature in comparison with those on other continents; living standards are a lot closer than on the world scale; the political systems of the Member States are quite similar; the European Union is working towards the creation of a common framework for social dialogue; Europe now reflects a specific employment market.

Definition of an emerging European social model: pact for employment, social dialogue and distribution of the fruits of growth

Several common features, only the last two of which are usually taken into account, can define the emerging social model. However on each point divergent forces are simultaneously at work and new challenges are rising.

Common norms created by companies

European companies still enjoy strong business cultures with high levels of commitment and a sense of belonging; mercenary practice has not become the rule and companies enjoy a certain level of stability in their teams and therefore in terms of their competences. An implicit pact for employment, particularly evident in Germany, characterizes Europe. Overall European businesses have distinguished themselves by a high level of protection against economic risks, thereby strengthening loyalty to the company. Securing one's professional life is sought in the face of the crisis which forces people into greater professional mobility.

More than anywhere else the management of working time reflects the will to find a balance between professional and family life. Working time is one of the most significant social indicators involving lifestyle, the increasing share of working women and the level of childcare facilities for example. The Netherlands (due to part time work) and Germany (due to agreements that are mainly negotiated by each Land), have the lowest annual total of working hours (1,378 and 1,390 hours respectively). Contrary to preconceived ideas, France finds itself in an intermediary position with an annual total of 1,473 working hours, which has resulted mainly from company agreements signed at the start of the 2000's, that include original flexibility mechanisms (annualisation, counting in days for executives, etc.). For its part the UK still has the highest number of annual working hours in spite of a shortened Friday (1,643 hours on average), without achieving however the rates seen in the US or in China.

The distribution of earnings is tighter than elsewhere, - tighter than in the USA and in China in any event; this is still true in companies as in society and this comprises a kind of social glue. The European model is characterized by a virtuous circle of significant collective productivity gains and has produced, for many years, a more egalitarian distribution of the fruits of growth.

The union movement is an important element, even though on observation the differences in union membership levels can be surprising. Apart from the Scandinavian countries with membership of around 70% (because of union membership in the service industry), levels vary from one country to another: France (8%), Germany (19%), UK (26%). But everywhere unions are major actors with high turnout in professional elections. Moreover the emergence of European Union movements, with the European Trade Union Confederation (ETUC), the European Services Union (UNI Europa) and the Industrial Union that is now being created has been evident since the Athens Congress in 2011.

Consultation and negotiation methods are also inherent to the European model: European directives on information, consultation and even European committees have contributed and continue to contribute towards transposing them Europe wide, and by doing this, they bring national traditions closer together. Negotiation methods which were the result of value being given to consensus in certain countries and of the need to settle conflicts positively in others, converge in three ways: everywhere negotiations are increasingly undertaken at the company level and less at the branch or regional level. By doing this pragmatism and the quest for tailor-made solutions win over ideology; European agreements signed by international groups for their European entities are emerging (200 to date) and helping by addressing new themes to extend the range of collective negotiation, which in turn leads to European standards. Finally the idea of majority agreements, which are by definition stronger and easier to implement, and obvious in many countries, are becoming the rule, especially in France where the tradition of minority agreements was however, firmly established.

Choosing to regulate

Legislation governing labour has developed over time through laws and negotiation, and offers real guarantees to employees; but its complexity, which in part reflects complicated situations, has become a problem for companies. Although national legislation remains very different from one country to another, there is however a common vein in continental Europe, and that is of a collective framework which relativises the range of the individual work contract.

The Welfare State, in its role of re-distribution has embodied the maturity of the European countries. The approach, which has been more egalitarian than elsewhere, has not been limited just to companies but has found its place in terms of social goods, such as education and healthcare. In spite of its imperfections this approach has proven effective and has clearly helped towards growth. It now has to contribute to a different kind of generational balance.

Common stakes

Globalisation and the crisis have obviously forced European countries to question this social model. But these doubts, far from being a factor for further differentiation, could lead to the development of new solutions, which, in fact, will bring harmony to existing practices. For each of these present challenges, some countries are showing the way.

More human companies

The most obvious joint challenge is of course that of rising unemployment – at around 10% right now within the Member States – and its counterpart, dualism in a labour market split between secure and insecure jobs. The burden of unemployment weighs mainly on young people.

Germany is however an exception, with an unemployment rate that is half the above figure. This reflects the original way it has managed decreasing activity over the last few years; it has avoided the trap of employment becoming the leading adjustment variable and has used partial unemployment and has only made limited use of relocation. Combined with the traditional strength of apprenticeship and of course the stability of its industry, this approach has stabilised businesses, by enabling them to retain their competence and to maintain unemployment at a moderate level. This exception, although not everything can be transposed, lights the way for other countries.

In addition to this, demography is the most difficult issue, since the share of senior citizens is extremely high in Europe and several countries, such as France, have been indulging in the vice of early retirement since the 1970's. We still have to find a position for the 60 year olds and part time work might recover its dynamism in this area.

A further challenge, both managerial and global, is being launched at European companies – and that is the integration of the Y generation, the children of Erasmus, who are seeking greater autonomy with a more critical attitude towards the traditional organisation of work and wages. But potentially Europe has some specific advantages: the traditional balance between the collective and individual, opportunities for mobility offered by the unified labour market, experiments in time management particularly in the Netherlands, the place offered to women in the labour market especially in north European countries. If Europe rejected the dogma of single managerial thinking it could come up with answers adapted to business life: how can a profession be assessed without stigmatising people? How can each individual become the player in his own professional development? How should life be injected back into team work? How can we have more human companies?

A new social pact consistent with limited growth

The sovereign debt crisis is forcing us to review redistribution levels, which have decreased however over the last few years as well as to re-assess social policy priorities. Choices will have to be made; if possible these will be joint; we might also be able to share some aspects of social policy. The European social contract will have to be re-created in a context of slow growth and with challenges being made to the need for higher productivity.

Moreover the financial crisis is clearly a challenge to governance. Again Europe might have the answer. All of the ingredients are indeed there. There is the German tradition of social relations, typified by the presence of employees on the companies' boards and the quest for shared social solutions. However, this does not mean co-management, because shared solutions only apply to the social field. The example of restructuring is a revealing example since the economic decision is not the focus of just a simple consultation, as in France, whilst social measures have to be the focus of an agreement. Therefore everyone retains his role but "social plans" have to be focus of a consensus

Potentially, Europe could provide answers to these questions. It has the diversity, the quality of human capital, the size, the humanist culture in order to rise to this challenge. Convergence is occurring even if the man in the street does not really realise it.

Europe also possibly shares the same language – that of negotiation – which is clearly the most modern method to innovate and settle problems. This is possible in Europe since unions exist within companies and also thanks to their independence. This dual condition is not to be found either in the USA nor in China! Yet to negotiate there has to be two sides! European style social dialogue, apart from the fact that it has served in other countries around the world, from Latin America to Australia, is clearly an asset – it is a comparative advantage and in all events, an indicator of the European social model. It might prove decisive when a new social pact has to be re-designed without which changes are hardly possible.

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But does Europe have time to do this? Relations in the world's balance of power develop quickly. It is urgent for us to acknowledge a revamped, more coherent European social model which could then be an asset for Europe.

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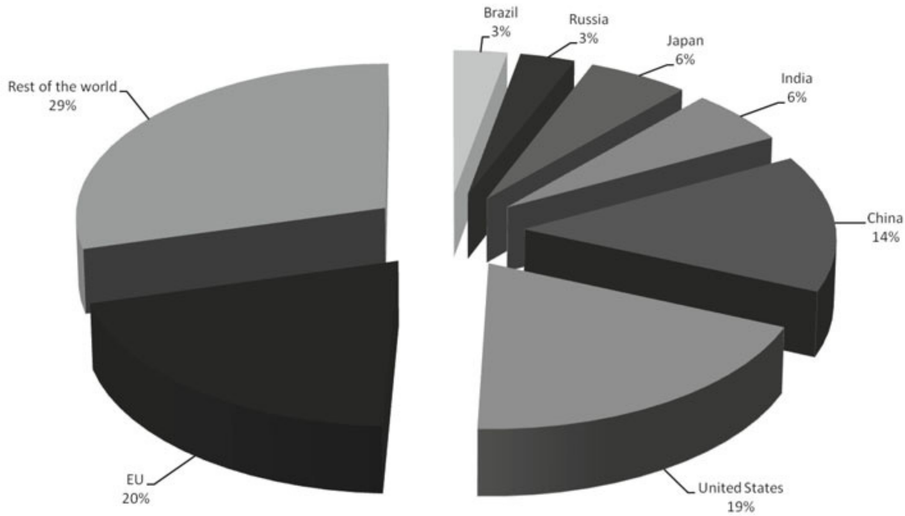
I.1.1. Distribution of global GDP, at PPP (2011)



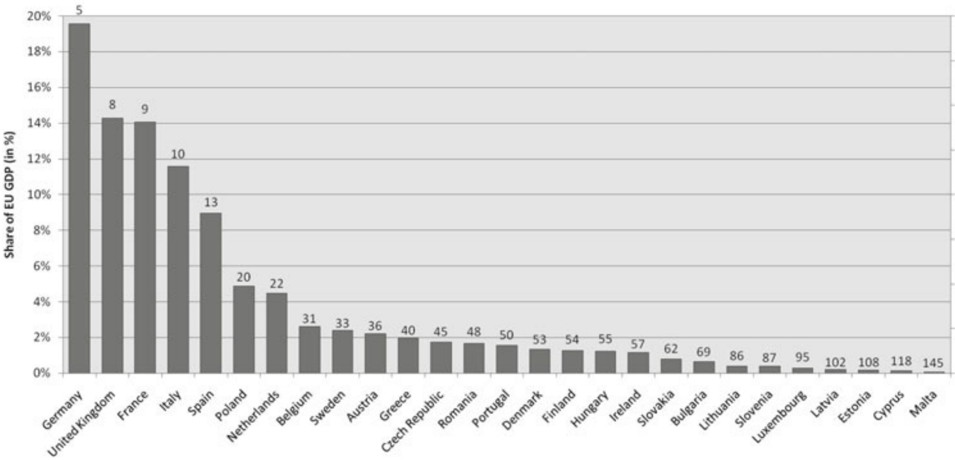
Source: IMF
Data collected and collated for the Robert Schuman Foundation, © FRS

In 2012, the European Union (EU) celebrates its 62nd anniversary. From its beginnings as the European Coal and Steel Community (ECSC) to the entry into force of the Treaty of Lisbon on 1st December 2009, it has become a global economic power of comparable size to the United States. Together, the two economies account for 39.1% of global GDP in terms of purchasing power parity (PPP). As partners and competitors, they have been the main shapers of globalisation for a long time.

The rise of emerging economies like Brazil, Russia, India, and, above all, China, redraws the map of the world economy. In 2011, the "BRICs" together accounted for 26% of global GDP. The economic crisis, which started in 2007 in the American subprime mortgage sector, contributes to the shift in economic power. While it has severely hit Western economies, emerging economies have fared much better and accelerated the process of catching-up with advanced economies. Emerging economies, however, still have a long way to go to reach the level of the Western economies. In particular, they need to put their growth models, which are mostly very dependent on exports, on a more sustainable growth path by strengthening their domestic markets.

Nevertheless, this overview should not obscure the fact that globalisation has been of significant benefit to the EU, contributing to more efficient product specialisation, a restructuring of industrial value chains and connection with new consumers.

I.1.2. GDP of EU Member States at PPP and world ranking (2011)



Source: IMF and author's calculations
Data collected and collated for the Robert Schuman Foundation, © FRS

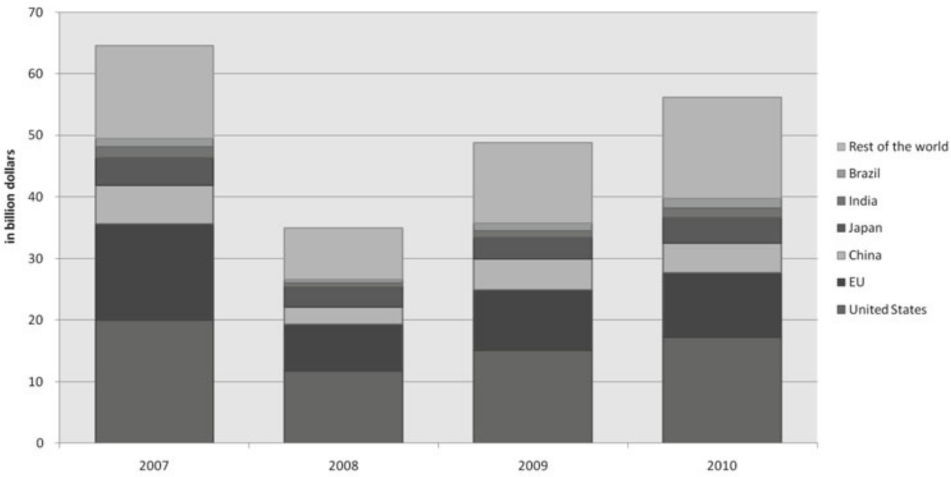
Germany, the United Kingdom, France and Italy together account for 60% of the EU's GDP and are individually among the ten largest economies in the world, though smaller than the economies of the United States, China, India and Japan. The EU as a bloc, however, is the largest economy in the world, underlining the importance for European countries to join forces if they are to preserve their influence on the world stage.

It has to be noted that this ranking is based on GDP in terms of purchasing power parity; when GDP is valued in nominal terms, European countries are better placed. This difference is due to the difference in living standards that would be experienced in different countries for someone with the same salary. Consumers in advanced economies can usually afford internationally traded goods more easily than consumers in developing countries, but pay more for their daily living expenses. In short, life is more expensive in Europe.

The EU is composed of economies of very different sizes. This makes governance in the EU complex: a country like Malta, with an economy that is only 1/283rd the size of Germany's, would have the same political weight when decisions are taken by unanimity. In contrast, when decisions are taken by qualified majority (which takes into account the demographic weight of each country) the relative power of each country is better considered. But this also implies that Member States might have to accept decisions on which they do not agree.

This structure of the EU also plays a major role in the solution of the current economic crisis. After all, it is the Member States which are the most powerful economically that can shoulder the huge financial assistance for the countries in trouble and, hence, are able to keep together the EU and the euro area.

I.1.3. Stock market capitalisation of the world's main financial centres (2007-2010)



Source: World Development Indicators database, World Bank
Data collected and collated for the Robert Schuman Foundation, © FRS

European and American financial centres account for about half of the world's stock market capitalisation. Capitalism developed early in Western countries and was facilitated by the spread of stock markets for the exchange of bonds. The name 'bourse' (stock exchange) stems from the Van der Buerse family from Bruges (in modern Belgium) where the first stock exchanges were established in the 13th century. Today, Western economies are the direct heirs of this long legacy. The largest stock exchanges in the world are NYSE Euronext (United States and continental Europe), NASDAQ OMX (United States and Europe) and, to a lesser extent, the London Stock Exchange.

Stock exchanges were established much later in other countries. The Tokyo Stock Exchange was created in 1878. The exchange in Shanghai was established in 1866, but was closed for much of the 20th century before re-opening in 1990.

The differential in the timing of the creation of stock exchanges provides a good illustration of the important position of the United States and the EU in developing the international financial system, though today a slight decrease in the share of European financial centres can be observed. New York, London and Frankfurt are first-rate financial centres enabling economies to attract capital and investment from other parts of the world.

I.1.4. Distribution of GDP between different sectors and change between 1990 and 2009

	Agriculture		Industry		Services	
	% of GDP in 2009	Change since 1990	% of GDP in 2009	Change since 1990	% of GDP in 2009	Change since 1990
Austria	1.5	-58.7%	29.2	-9.4%	69.3	8.1%
Belgium	0.7	-67.5%	21.7	-30.9%	77.6	16.7%
Bulgaria	5.6	-66.9%	30.3	-38.4%	64.1	89.7%
Cyprus*	2.1	-69.6%	19.6	-24.4%	78.3	16.5%
Czech Republic	2.3	-63.4%	37.2	-23.7%	60.5	34.4%
Denmark	0.9	-77.0%	22.5	-12.1%	76.6	8.8%
Estonia*	2.9	-82.8%	29.1	-41.3%	68.0	101.5%
Finland	2.7	-58.1%	28.2	-16.1%	69.2	15.1%
France	1.8	-58.1%	19.0	-29.8%	79.2	15.3%
Germany	0.8	-45.9%	26.5	-29.1%	72.7	18.9%
Greece	3.2	-66.3%	17.8	-31.9%	79.1	22.5%
Hungary*	4.3	-70.4%	29.4	-24.6%	66.2	42.8%
Ireland	1.0	-88.8%	32.0	-7.4%	67.0	18.3%
Italy	1.8	-47.4%	25.1	-21.8%	73.1	13.4%
Latvia	3.3	-85.0%	20.6	-55.3%	76.1	138.1%
Lithuania	3.4	-87.6%	26.9	-12.7%	69.7	65.7%
Luxembourg	0.3	-78.9%	13.1	-51.9%	86.6	21.4%
Malta	1.8	-47.1%	33.0	-40.5%	65.2	58.4%
Netherlands	1.7	-60.5%	23.9	-18.8%	74.4	80.7%
Poland	3.6	-56.0%	30.5	-39.2%	65.9	58.2%
Portugal	2.3	-74.0%	22.7	-20.6%	75.0	19.9%
Romania	7.2	-69.9%	26.0	-48.0%	66.9	154.1%
Slovakia	2.6	-64.8%	34.5	-41.6%	62.9	87.9%
Slovenia*	2.4	-58.2%	33.9	-20.2%	63.8	22.8%
Spain	2.6	-52.4%	26.1	-22.5%	71.3	17.2%
Sweden	1.8	-53.4%	25.3	-18.0%	72.9	11.6%
United Kingdom	0.7	-60.4%	21.1	-38.2%	78.2	22.0%
EU	**1.5**	**-58.9%**	**23.9**	**-28.2%**	**74.6**	**18.2%**
Euro area	**1.5**	**-56.7%**	**24.2**	**-25.8%**	**74.3**	**16.3%**
United States*	1.2	-39.9%	21.4	-23.2%	77.4	10.4%
Canada**	1.6	-42.9%	31.8	1.6%	66.5	1.1%
Japan*	1.5	-40.5%	28.0	-28.4%	70.5	20.8%
Russia*	4.7	-71.7%	32.8	-32.1%	62.5	78.3%
China	10.3	-61.9%	46.2	11.9%	43.4	37.7%
India	17.8	-39.3%	27.0	0.3%	55.3	26.1%
Brazil	6.1	-24.9%	25.4	-34.3%	68.5	28.7%

* Data of 2008; ** Data of 2006

Source: World Development Indicators database, World Bank

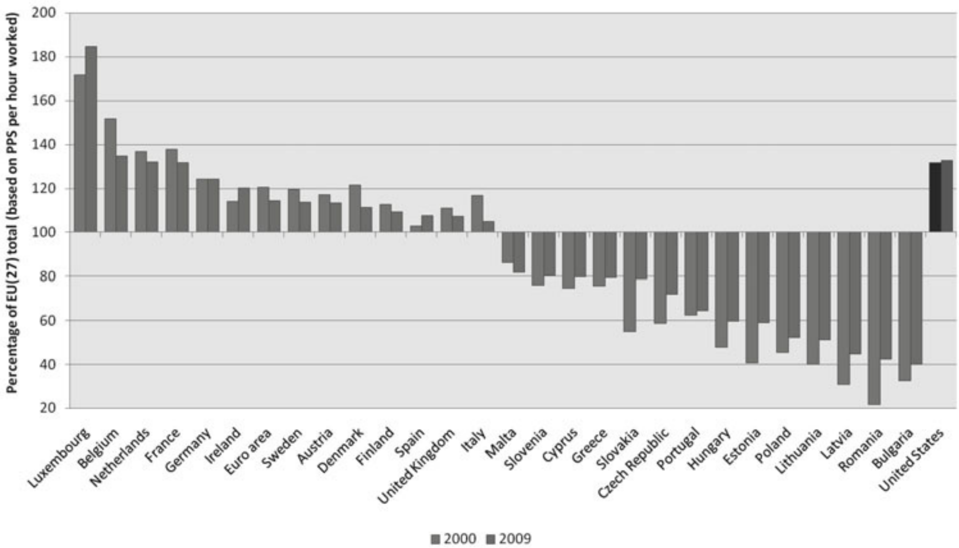
Data collected and collated for the Robert Schuman Foundation, © FRS

Today, agriculture accounts for only a marginal share of European economies, representing less than 2% of GDP. In the past 20 years, the share of agriculture in GDP has diminished by 59%; Ireland has had a particularly remarkable decline of 88%. Central and Eastern European countries experienced dramatic changes in the structure of their economies: though agriculture still represents a considerable share of GDP in some of these countries, especially in Hungary, Romania and Bulgaria, it has been diminishing rapidly in favour of the industrial and, especially, services sectors.

Since the 1970s, industrial production has no longer been at the core of the European economy. In the past 20 years, its share has diminished by 28% and now represents 24% of GDP. Deindustrialisation concerns all EU countries, but some more than others. Ireland, Finland and Austria, for instance, have kept the share of industry in their GDP relatively stable, while the United Kingdom, France and Greece have undergone a process of substantial deindustrialisation.

Today, it is the services sector that accounts for the biggest share of European GDP. "Services" include a variety of sectors: finance, transport, trade, real estate and information and communication services. These sectors are all, in one way or another, connected to industrial activities. Therefore, deindustrialisation does not necessarily mean "the end of industry" but is the expression of a major reconfiguration of global value chains: while production is located in economies where labour is cheap, the services related to this production are situated in economies like the EU. However, the current crisis has revealed the vulnerability of economies that are not in control of certain segments of the value chain. The EU is increasingly aware that it is not only important to promote the development of a knowledge economy, but also one in which production has a place.

I.1.5. Labour productivity (2000 and 2009)



Source: Eurostat
Data collected and collated for the Robert Schuman Foundation, © FRS

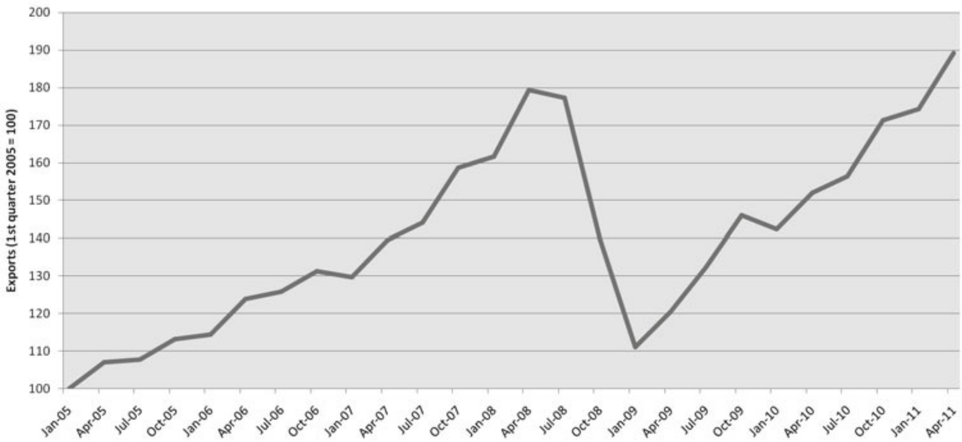
Re-industrialisation can only be achieved if European workers are sufficiently productive: the cost of a good – which in part determines the competitiveness of an economy – depends on the time needed to produce the good and on the salary of the workers who produce it. The more productive a country's workforce becomes, and the more it is able to produce large quantities of goods with a high added-value, the stronger its position will be on the international markets. On the whole, labour productivity in the EU lags behind the United States by one third, though the EU average masks substantial disparities within the EU.

Central and Eastern European Member States are less productive than those in Western Europe despite their low salaries. In 2009, labour productivity in Bulgaria was 42% of the EU average; in Lithuania it was 56% and in Poland, 54%. In contrast, labour productivity is very high in Luxembourg (189% of the European average), in the Netherlands (136%), in France (132%) and in Germany (127%).

The economic crisis has had a negative impact on productivity in the countries that are most hit by the crisis. In particular, layoffs have been detrimental to human capital and have reduced potential growth. These countries need to undertake a considerable effort to improve their productivity or risk being left behind indefinitely.

I.2. The European Union in International Trade

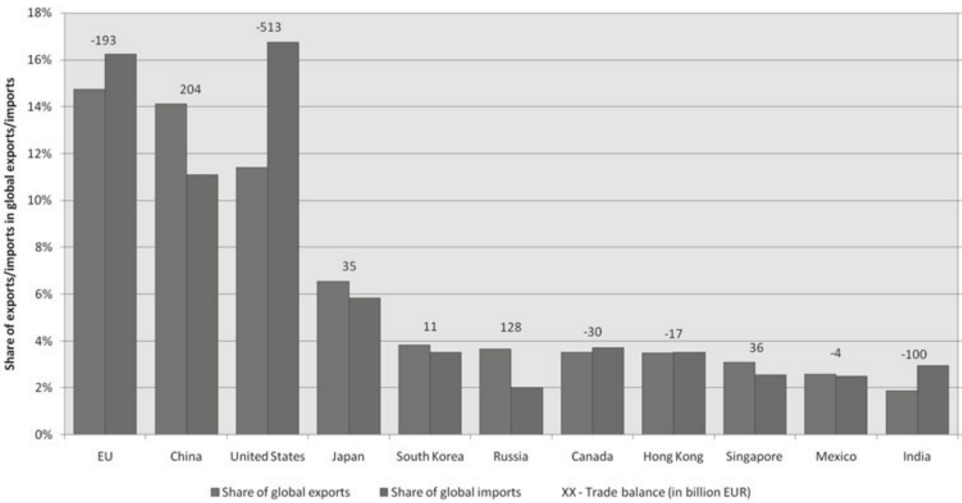
I.2.1. Development of world trade (2005-2011)



Source: WTO
Data collected and collated for the Robert Schuman Foundation, © FRS

In the space of one year, between mid-2008 and mid-2009, international trade plummeted by 33%; annual exports fell from $4 357 billion to $2 698 billion. International trade regained pre-crisis levels only at the beginning of 2011, which amounts to three lost years. This massive decline in trade, of a magnitude unseen since the crisis of the 1930s, was due to the sharp economic slowdown caused by the global financial crisis.

I.2.2. The EU in international trade (2010)



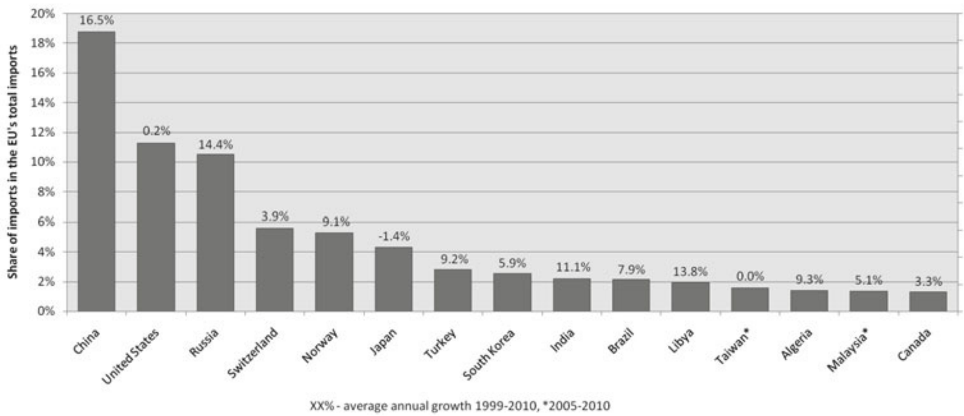
Source: IMF
Data collected and collated for the Robert Schuman Foundation, © FRS

The share of the EU in international trade is considerable, ahead of North America (13% of all exports) or Asia (30%). However, it has continuously declined for the last five years, from 44% to 37% of global exports. It is intra-EU trade, particularly, that has taken a blow (from 28% of global exports in 2005 to 22% in 2011). Hence, the decline of the EU share of international trade can be explained by a slowdown in trade among European countries. At the end of 2011, intra-EU trade still had not regained pre-crisis levels.

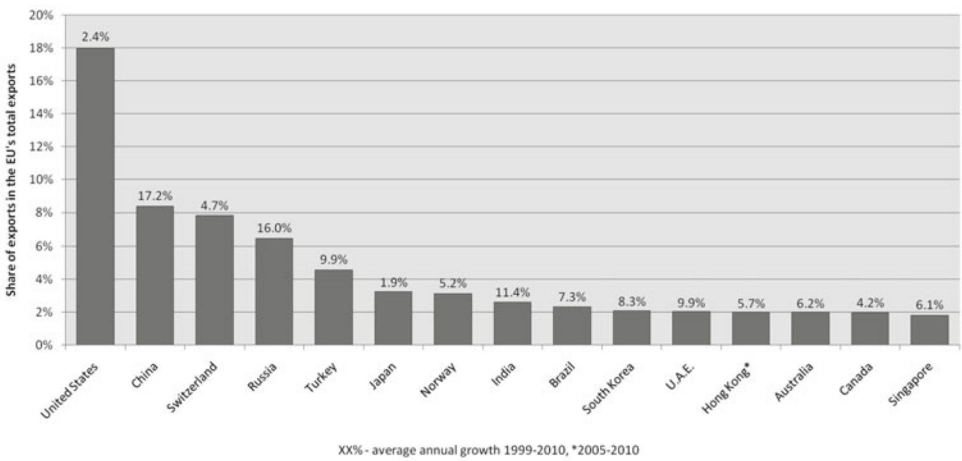
Excluding intra-EU trade, the EU has retained second position in global trade throughout the crisis, behind Asia and, in contrast to the United States, its trade deficit remains moderate (approximately €193 billion in 2011). The European economy thus remains competitive and an important player in global trade.

The fundamental problem is to be found in the growing imbalances between the United States and China which have led to the accumulation of a huge external debt by the United States and of a big trade surplus by China. These imbalances are considered to be the underlying cause of the destabilisation of the financial system in 2008. As far as the EU is concerned, the importance of these imbalances needs to be put into perspective: the EU's trade deficit corresponds to just 1.5% of its GDP.

I.2.3. Where do European imports come from? Where do European exports go? (2010)



Source: Eurostat
Data collected and collated for the Robert Schuman Foundation, © FRS



Source: Eurostat
Data collected and collated for the Robert Schuman Foundation, © FRS

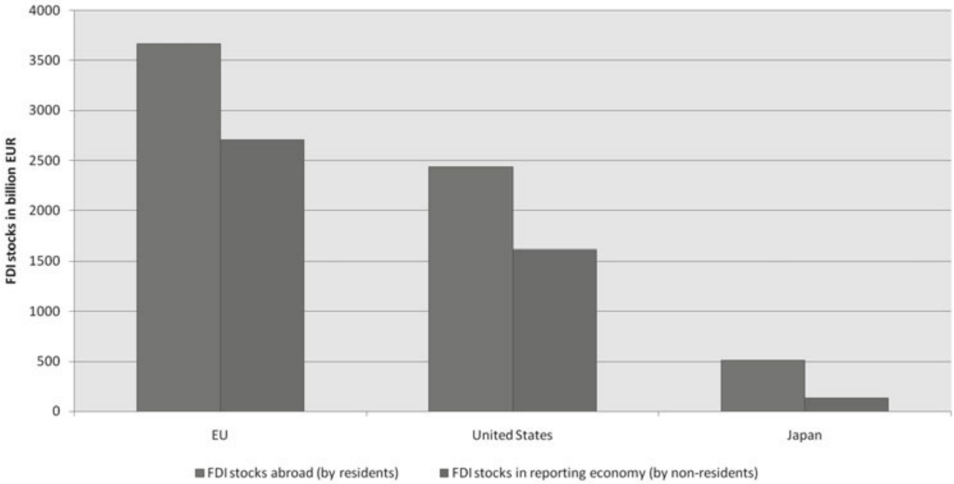
The EU's main trading partners are the United States (18% of exports) and East Asia (China, Japan, and South Korea together account for 26% of European exports). Other important trading partners are located at the borders of the EU, such as Switzerland, Norway, Russia and Turkey. The EU thus constitutes one part of a triangle comprising Europe, North America and East Asia which dominates international trade.

The EU's trade relations are not balanced: the EU has a trade deficit of €169 billion with China, but a trade surplus of €73 billion with the United States. Trade deficits exist especially with countries that export raw materials, such as oil and gas exporters Russia and Norway. The EU has a trade surplus with Switzerland and Turkey while EU trade is relatively balanced with India and Brazil.

Trade deficits are an expression of product specialisation that occurs in the process of globalisation. Each economy has progressively specialised in the sectors at which it is relatively more productive than other countries: raw materials from Russia, manufactured goods at low labour and assembly costs from China, high-tech products from Japan, etc. With policy initiatives like the Lisbon Strategy and Europe 2020, the EU is attempting to position the European economy in highly innovative sectors such as biotechnology and nanotechnology.

Currency exchange rates should reflect these trade balance situations and adjust in order to reduce imbalances. However, the functioning of the international monetary system is flawed, in particular with regard to the undervaluation of the Chinese Yuan.

I.2.4. Foreign direct investment of the EU and international comparisons (2009)



Source: Eurostat

Data collected and collated for the Robert Schuman Foundation, © FRS

The interdependence of economies causes companies to invest outside their home countries, often by buying factories or establishing joint-ventures with other companies to enter new markets. These activities are known as foreign direct investment (FDI).

The EU's prominent position is illustrated by its share in global FDI stocks: almost half of global FDI comes from EU Member States (43.8%). Apart from the United States (23.7%), there is no other economy that comes close to the EU's level of investment. Contrary to common wisdom, China has relatively few companies or shares outside of its own territory, with outward FDI 30 times less than the EU.

The EU is also an important destination for FDI: approximately one third of global FDI is invested here. The United States is the second most popular destination.

Only three economies have a positive FDI balance, i.e. they invest more in foreign countries than foreign countries invest in them: the EU, the United States and Japan. Hence, these economies have become the main shapers of globalisation by developing partnerships beyond their borders, opening up new markets and diffusing new technologies. Emerging countries have a negative FDI balance and a considerable part of their growth has been achieved thanks to investments that foreign countries are making in their economies.

Map – Intra community Trade, 2010

Map – The EU and World Trade in Goods: Trade in Merchandise, 2011

*Map – The Europ*ean Union in the World: trade agreements

I.3. The Demographic Weight of the EU and its Member States

I.3.1. The population of the EU and international comparisons (1950-2030)

	Population (in million inhabitants)			Share of world population (2010)	Share of EU population (2010)	Fertility rate (2005-2010)	International migrant stock (as % of population)		Net migration (2005-2010)
	1990	2010	Projections for 2030				1990	2010	
Austria	7.7	8.4	8.6		1.7%	1.38	10.3%	15.6%	160,000
Belgium	9.9	10.7	11.2		2.1%	1.79	8.9%	9.0%	200,000
Bulgaria	8.8	7.5	6.5		1.5%	1.46	0.2%	1.4%	-50,000
Cyprus	0.8	1.1	1.3		0.2%	1.51	5.7%	14.0%	44,166
Czech Republic	10.3	10.5	10.8		2.1%	1.41	4.1%	4.3%	240,466
Denmark	5.1	5.6	5.9		1.1%	1.85	4.6%	8.7%	90,316
Estonia	1.6	1.3	1.3		0.3%	1.64	24.3%	13.6%	0
Finland	5.0	5.4	5.6		1.1%	1.84	1.3%	4.2%	72,634
France	56.7	62.8	68.5		12.5%	1.97	10.1%	10.3%	500,001
Germany	79.1	82.3	79.5		16.4%	1.36	7.5%	13.2%	550,001
Greece	10.2	11.4	11.6		2.3%	1.46	4.1%	10.0%	154,004
Hungary	10.4	10.0	9.6		2.0%	1.34	3.3%	3.7%	75,000
Ireland	3.5	4.5	5.4		0.9%	2.10	6.5%	20.1%	100,000
Italy	56.8	60.6	60.9		12.1%	1.38	2.5%	7.4%	1,998,926
Latvia	2.7	2.3	2.1		0.5%	1.41	24.2%	14.9%	-10,000
Lithuania	3.7	3.3	3.1		0.7%	1.41	9.4%	3.9%	-35,495
Luxembourg	0.4	0.5	0.6		0.1%	1.62	29.8%	34.2%	42,469
Malta	0.4	0.4	0.4		0.1%	1.33	1.6%	3.7%	5,000
Netherlands	14.9	16.6	17.3		3.3%	1.75	8.0%	10.6%	50,006
Poland	38.1	38.3	37.8		7.6%	1.32	3.0%	2.2%	55,644
Portugal	9.9	10.7	10.3		2.1%	1.36	4.4%	8.6%	150,002
Romania	23.2	21.5	20.3		4.3%	1.33	0.6%	0.6%	-100,000
Slovakia	5.3	5.5	5.5		1.1%	1.27	0.8%	2.4%	36,684
Slovenia	1.9	2.0	2.1		0.4%	1.39	8.9%	8.0%	22,000
Spain	38.9	46.1	50.0		9.2%	1.41	2.1%	13.8%	2,250,005
Sweden	8.6	9.4	10.4		1.9%	1.90	9.1%	13.9%	265,649
United Kingdom	57.2	62.0	69.3		12.4%	1.83	6.5%	10.4%	1,020,211
EU (27)	**471.0**	**500.4**	**515.8**	**7.3%**		**1.55**	**5.6%**	**9.3%**	**7,887,689**
United States	253.3	310.4	361.7	4.5%		2.07	9.3%	13.9%	4,954,924
Canada	27.7	34.0	39.8	0.5%		1.65	16.2%	21.1%	1,098,444
Russia	148.2	143.0	136.4	2.1%		1.44	7.8%	8.7%	1,135,737
China	1145.2	1341.3	1393.1	19.5%		1.64	0.0%	0.1%	-1,884,102
Japan	122.3	126.5	120.2	1.8%		1.32	0.9%	1.7%	270,000
India	873.8	1224.6	1523.5	17.8%		2.73	0.9%	0.5%	-2,999,998
Brazil	149.7	194.9	220.5	2.8%		1.90	0.5%	0.4%	-499,999
World	5306.4	6895.9	8321.4			2.52	3.0%	3.1%	
Source: United Nations, World Population Prospects, the 2010 revision									

Data collected and collated for the Robert Schuman Foundation, © FRS

In 1950, the countries which today belong to the EU accounted for 14.7% of the world's population. By 2010, this share had dropped to only 7.3%, and is projected to further decrease to 6.2% by 2050. In contrast, India's share in the world population – which was similar to that of the future EU countries in 1950 – is expected to be 18.3% in 2050. As with the United States, Japan and Russia, the EU's relative share in the world population is expected to decrease substantially, whereas the share of India and, especially, Africa will increase.

The weak growth of the European population is due to a low fertility rate, which is below 2.1 children per woman, the rate considered necessary to keep the size of a population stable through natural population growth. However, this negative trend is partly balanced by a positive net migration rate. The influx of foreign labour is particularly important as part of a strategy to compensate for the ageing of societies in the EU, which have a shrinking proportion of young people in the population relative to older people.

In 2010, 48 million migrants lived in the EU, about as many as in the United States. This number corresponds to 9.3% of the EU's population. In 1990, it was only 5.6%. Immigration has become the main engine of population growth. The EU attracts migrants with its prosperity and the high level of protection it provides, especially to refugees. In return, migrants are an indispensable source of labour, particularly in sectors where there is a shortage of labour.

Only a small number of EU Member States have a negative net migration rate (Bulgaria, Romania, Lithuania, Latvia). It is noteworthy that some countries which used to be important sources of emigration in the 1950s, such as Spain and Italy, have recently become destinations for immigrants, although the current crisis reverses this trend again.

The countries with the largest migrant stocks relative to the size of their population are Luxembourg (mainly Belgians, French and Germans for obvious geographical reasons), Austria and Ireland.

I.3.2. The ageing of the population in the EU and international comparisons (2010)

	Median age (2010)	Old-age dependency ratio* (2010)	Share of the population aged			Life expectancy (2005-2010)
			under 15 years	15 to 64 years	65 years or over	
Austria	41.8	26.0	14.7%	67.7%	17.6%	80.2
Belgium	41.2	26.5	16.9%	65.7%	17.4%	79.8
Bulgaria	41.6	25.5	13.7%	68.8%	17.5%	72.7
Cyprus	34.2	16.4	17.8%	70.7%	11.6%	78.9
Czech Republic	39.4	20.9	14.0%	71.1%	14.8%	77.0
Denmark	40.6	25.1	18.0%	65.5%	16.5%	78.3
Estonia	39.7	25.5	15.3%	67.5%	17.2%	73.9
Finland	42.0	26.0	16.5%	66.2%	17.2%	79.3
France	39.9	25.9	18.4%	64.8%	16.8%	81.0
Germany	44.3	30.8	13.5%	66.1%	20.4%	79.8
Greece	41.4	27.7	14.6%	66.9%	18.6%	79.5
Hungary	39.8	24.0	14.7%	68.8%	16.5%	73.6
Ireland	34.7	17.4	21.2%	67.1%	11.7%	79.7
Italy	43.2	31.0	14.1%	65.6%	20.4%	81.4
Latvia	40.2	26.0	13.8%	68.4%	17.8%	72.3
Lithuania	39.3	23.2	14.9%	69.1%	16.1%	71.3
Luxembourg	38.9	20.4	17.7%	68.4%	13.9%	79.4
Malta	39.5	19.8	15.0%	71.0%	14.1%	78.8
Netherlands	40.7	22.9	17.7%	67.0%	15.3%	80.2
Poland	38.0	19.0	14.8%	71.6%	13.6%	75.5
Portugal	41.0	26.8	15.1%	66.9%	17.9%	78.6
Romania	38.5	21.3	15.2%	69.9%	14.9%	73.2
Slovakia	36.9	16.6	15.1%	72.8%	12.1%	74.7
Slovenia	41.7	23.6	13.9%	69.6%	16.5%	78.6
Spain	40.1	24.9	15.0%	68.1%	17.0%	80.5
Sweden	40.7	28.0	16.5%	65.2%	18.2%	80.9
United Kingdom	39.8	25.1	17.4%	66.0%	16.6%	79.6
EU	**40.9**	**26.0**	**15.6%**	**67.0%**	**17.4%**	**79.1**
United States	36.9	19.5	20.1%	66.9%	13.1%	78.0
Canada	39.9	20.3	16.4%	69.5%	14.1%	80.5
Russia	37.9	17.7	15.0%	72.2%	12.8%	67.7
China	34.5	11.3	19.5%	72.4%	8.2%	72.7
Japan	44.7	35.5	13.4%	64.0%	22.7%	82.7
India	25.1	7.6	30.6%	64.5%	4.9%	64.2
Brazil	29.1	10.4	25.5%	67.5%	7.0%	72.2
World	29.2	11.6	26.8%	65.6%	7.6%	67.9

* Number of persons aged 65 years or over per 100 persons aged between 15 and 64 years

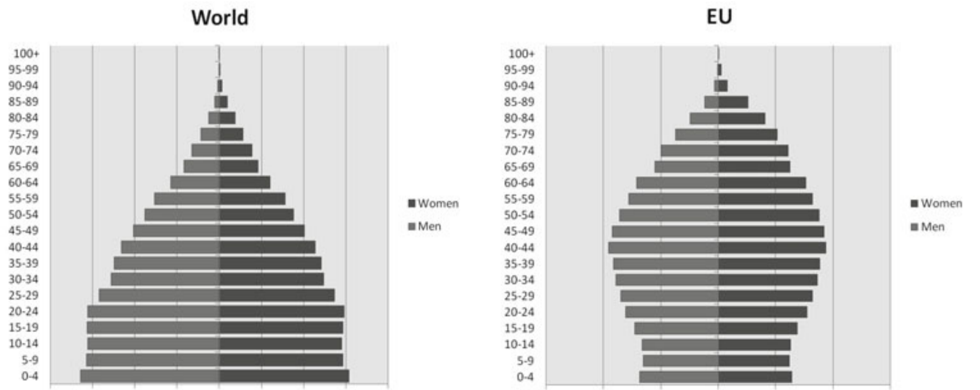
Source: United Nations, World Population Prospects, the 2010 revision

Data collected and collated for the Robert Schuman Foundation, © FRS

The median age in the EU is 40.9 years, while it is 25.1 in India, 29.1 in Brazil and 36.9 in the United States. 17.4% of Europeans are older than 64 years and therefore statistically considered as dependent on the working population which finances the retirement and health systems. The old age dependency ratio (i.e. the ratio between the number of people aged 65 or older and the working age population) is less favourable only in Japan (26 in the EU compared to 35.5 in Japan). In the EU, no country completely escapes this trend towards the ageing of populations, although countries like Ireland and Slovakia are much less affected.

Economies and societies must adjust to this trend. For instance, an increasing number of elderly people will require an expansion of special services such as home care. The ageing of the population will also pose enormous challenges for the funding of pension systems. Two basic models can be contrasted: on the one hand, public pay-as-you-go schemes involve the direct financing of current retirees by today's workforce; on the other hand, fully funded pension schemes require that citizens save money throughout their entire working life which they invest in pension funds and draw upon when they retire. Existing systems are generally mixtures of these two models, seeking to find a compromise between inter-generational solidarity and the financial sustainability of pension systems.

I.3.3. The age pyramid of the EU compared to the world (2010)



Source: United Nations, World Population Prospects, the 2010 revision
Data collected and collated for the Robert Schuman Foundation, © FRS

The comparison of global and European age pyramids provides a glaring illustration of the ageing of the population in the EU. While the world's population is young on average, the European age pyramid is out of shape, especially due to the high number of 40 to 55 olds relative to the young population. This is the result of two phenomena: first, the "baby-boomers" (1946-1964) are reaching the end of their careers, leading to a "daddy boom". In the 2010s, the generation of "baby-boomers" will thus occupy high-level posts in the economy and progressively leave the job market while, at the same time, the young generation is not sufficiently numerous to replace them. This situation is already critical for certain companies that have not recruited and trained sufficient personnel with adequate skills. As a consequence, enterprises risk losing know-how and productivity.

In the end, the younger generation might benefit from a larger capacity to act as participants in the economy, with considerable capital available. But they will also increasingly depend on the older generations which retain this capital.

Map – Population of EU Member States

Map – Internal migrations

Map – External migrations

Map – The EU and Asylum Requests

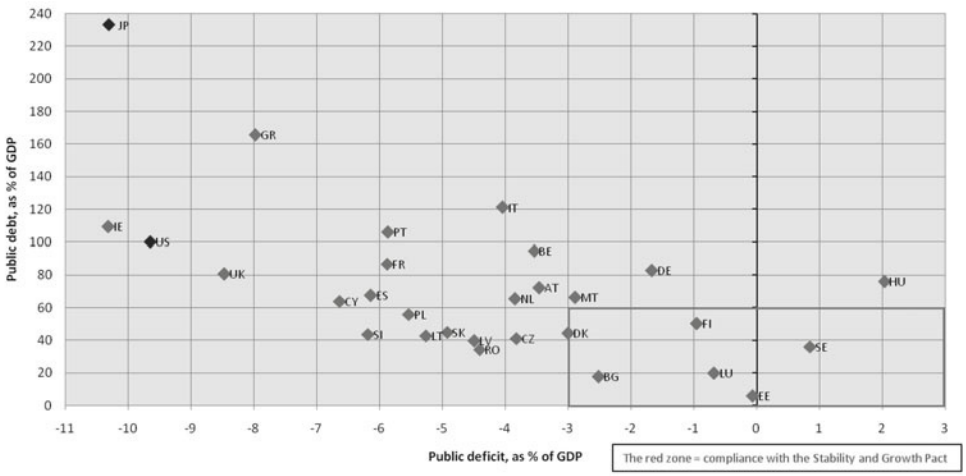
II. The European Union in the Face of the Crisis, at the Crossroads

II.1. From the Financial Crisis to the Crisis of Public Finances

The financial crisis of 2008-2009 started in the US subprime mortgage market. Subprime mortgages were designed to facilitate access to housing by those American households which did not have the necessary guarantees to be eligible for ordinary loans as made in the prime mortgage market. Subprime mortgages are high yield mortgages entailing a considerable risk of default on the part of the borrower. This risk was to be compensated for by rising real estate prices, a strategy that imploded when the real estate bubble burst.

The rise in interest rates in the United States between 2004 and 2007, spurred by the American central bank, the Federal Reserve, drove a considerable number of households holding subprime loans into bankruptcy and caused the value of subprime mortgages to plummet. The collapse of the subprime market caused considerable losses for the banks holding these assets and led to a banking crisis which led to the default of Lehman Brothers, an investment bank, on 15 September 2008 and subsequently spread globally. Banks could not lend money to enterprises which, as a consequence, had to slow down their activities. The banking crisis turned into an economic crisis.

II.1.1. Public deficit and debt in EU Member States, Maastricht criteria, and international comparisons (2011)



Source: IMF

Data collected and collated for the Robert Schuman Foundation, © FRS

If 2008 was the year of the subprime crisis, 2011 was the year of public debt. In 2009, governments made the choice to tackle the economic crisis by taking up large amounts of debt in the form of stimulus packages and through the working of automatic stabilisers which involve increases in social spending at the same time as public revenues fell sharply. Between 2007 and 2011, public debt in the EU increased by 32%.[2] It is projected to stabilise at around 70.5% of GDP in 2013, clearly above the debt ceiling set by the Maastricht criteria of 60% of GDP.

When considering some Member States individually, the situation is much more alarming. Gross public debt reaches 165% of GDP in Greece, 109% in Ireland, 86% in France and 80% in the United Kingdom. As a consequence, debt servicing costs have increased considerably. The French

2. Source: IMF.

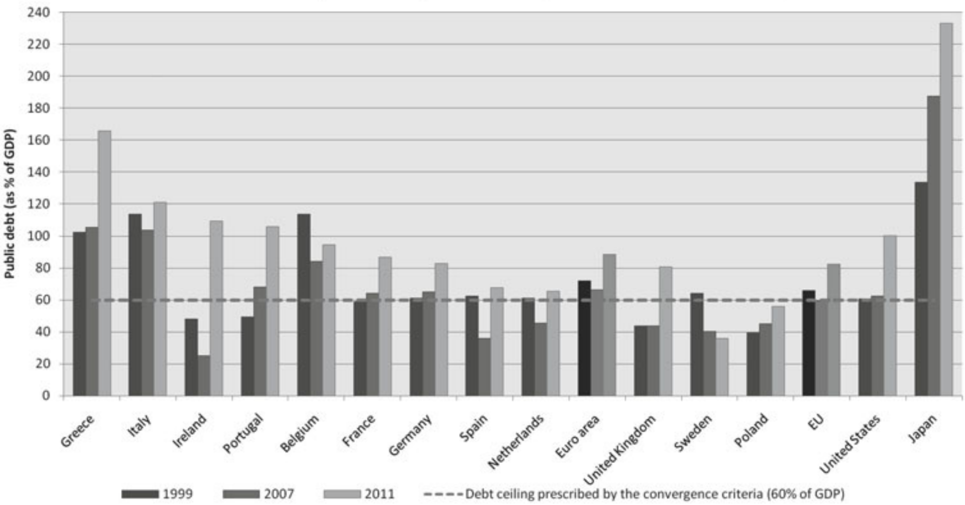
government expects to pay €48.8 billion in interests in 2012.[3] Interest payments are thus the second largest budget item, second only to education (€60 billion).

There is a real danger that as economic growth slows fiscal revenues can become insufficient to cover debt servicing costs: public debt then increases and public finances enter a downward spiral. This is already the case in Greece. Some countries, considered safe havens, benefit from the confidence of the markets and the ensuing of “race to quality”: in times of uncertainty, the demand for reliable assets increases and reduces the interest rates that safe havens pay on their debts.

In contrast, the most fragile countries are exposed to the – sometimes exaggerated – mistrust of the markets, causing an increase in the interest rates they have to pay to service their debts. They are caught in a vicious circle of indebtedness. Italy and Spain would have been victims of such a downward spiral in the summer of 2011 if the ECB had not decided to buy part of their debt in order ease the pressure on them.

3. Source: Agence France Trésor, with regard to the draft budget for 2012.

II.1.2. Development of public debt (1999, 2007 and 2011)



Source: IMF
Data collected and collated for the Robert Schuman Foundation, © FRS

Public debt differs greatly within the euro area. Yields for German bonds, considered the safest in the euro area, are practically negative in real terms since interest rates decreased to around 2%. In contrast, interest rates for Greek government bonds spiked to around 16%. The Portuguese and Irish rates remain high but have eased off slowly due to the efforts made in both countries to stabilise their budgets. The situation of big economies like France and Italy is the most alarming. The spread, i.e. the difference between the interest rates these countries have to pay compared to Germany's, keeps growing, illustrating the different trajectories that their economic development has taken. The growing divergence between the main economies of the euro area is an important factor contributing to the aggravation of the crisis.

In any case, public deficits remain significant and governments have been compelled to adopt austerity measures including tax increases or reductions in public spending, depending on the prevailing political context in each country.

The lack of a federal (or community) debt places Member States in a position of weakness with regard to the markets. The markets can speculate against the debt of single countries within the euro area, intensifying the parallel trends of growing mistrust, on the one hand, and the race to quality, on the other. The European Financial Stability Facility (EFSF) was set up to mitigate these problems by jointly guaranteeing public debts.

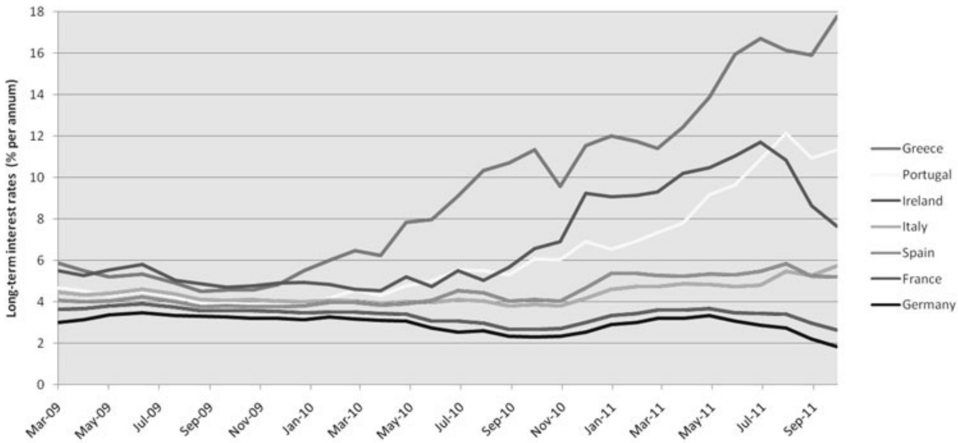
Although the launch of the EFSF lagged behind the reactions of the markets, it helped, in collaboration with the ECB, to stabilise the situation in the euro area and to win some time to find a more comprehensive and long-term solution.

The Greek debt has reached unsustainable levels and it is very likely that part of it cannot be repaid. The main creditors, which are German and French banks, have to prepare for a substantial haircut. European banks, still weakened by the global financial crisis, have to recapitalise if they are to absorb these losses, either directly on the markets or with the help of governments and the EFSF.

In this way, the financial crisis turned into a sovereign debt crisis, which is first and foremost a political challenge. The question that arises now is how to build common tools to help avoid the collapse of a country which could trigger a chain reaction in the euro area? In other words, how to create a system of European solidarity?

Map – Public Debt

II.1.3. Divergence in market interest rates in the euro area (2009-2011)



Source: OECD
Data collected and collated for the Robert Schuman Foundation, © FRS

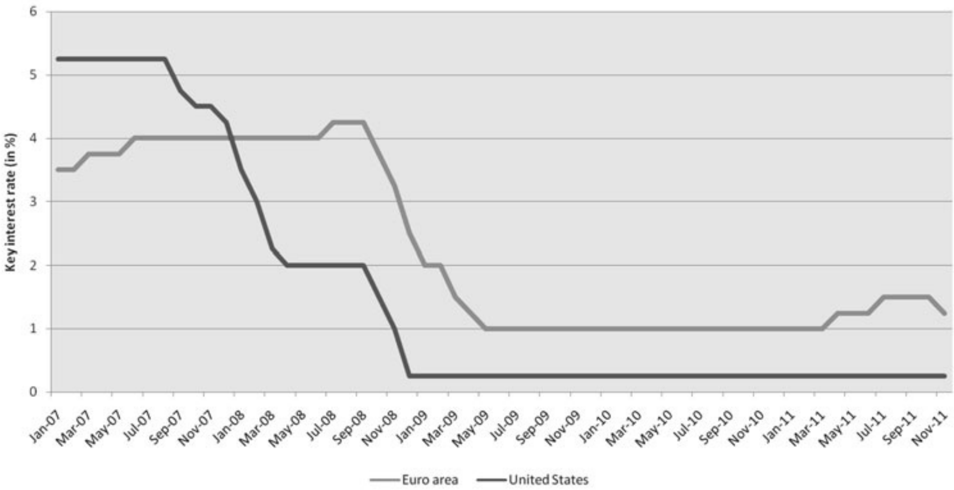
The interest rates at which governments borrow money on the markets are a measure of the confidence that investors have in their ability to repay their debt. The more a country is considered a risky investment, the higher the interest rates that investors demand and the more they will insure themselves against a potential default via credit default swaps (CDS).

When the euro area was created, interest rates converged, putting countries like Greece or Italy, which had difficulties in borrowing, in a comfortable position. Investors perceived the euro area as a united and coherent bloc sharing common risks.

In the current sovereign debt crisis, this is no longer the case. Each country of the euro area faces a different set of problems but no longer has the option to use monetary policy instruments such as currency devaluation or monetisation of debt as measures of last resort. Starting in 2009, markets no longer considered the euro area as a single, coherent bloc and interest rates began to diverge.

The long-term interest rates of countries like Greece increased to more than 17% – two-year interest rates even reached 50% in September 2011! An indicator that is followed with more and more interest is the spread, i.e. the gap between the interest rates of euro area countries, especially between the French and German interest rates which has reached unprecedented levels. Measures at the EU level, such as the creation of the EFSF or market interventions by the ECB, have not helped to reverse this trend.

II.1.4. Key interest rates of the ECB and the Fed (2007 – 2011)



Source: ECB, US Federal Reserve
Data collected and collated for the Robert Schuman Foundation, © FRS

The ECB has played a crucial role throughout the crisis, compensating for the inability of governments to react quickly to the developments on the markets. First, the ECB decided, like its counterparts in the United States and the United Kingdom, to support the banking system by reducing the key interest rate and by providing liquidity directly to financial institutions. In fact, the turbulence in the inter-bank market in 2008 made normal functioning of the banking system impossible, invoking the spectre of a new credit crunch which could freeze lending to the economy as a whole.[4]

The rapid intervention of central banks helped to dampen the recession. As a consequence, money supply increased spectacularly. Paradoxically, neither inflation nor the money supply measure M2[5] have really increased as the consequence of central bank policies. As in Japan in the 1990s, the Western economies are caught in a "liquidity trap":[6] uncertainty about the future makes households and enterprises cling to their cash as they refrain from investing it into assets with an unpredictable return. In other words, the money issued by central banks remains in the pockets of citizens instead of being used to stimulate the economy. This situation is even more astonishing when considering the historically low interest rates: the real interest rates of American bonds were even negative in 2010!

Central banks had to engage in unconventional measures in order to respond to an exceptional situation. These measures included, for example, unlimited access to liquidity granted to banks in 2008-2009[7], and the purchase of sovereign debt in 2010-2011. These measures, although only temporary, place central banks as "lenders of last resort" at the core of crisis management and confer on them an increased role in the supervision of financial markets. The ECB plays a pivotal role in the EU's recent reforms in financial supervision and regulation, which created new European regulatory authorities and a European Systemic Risk Board.

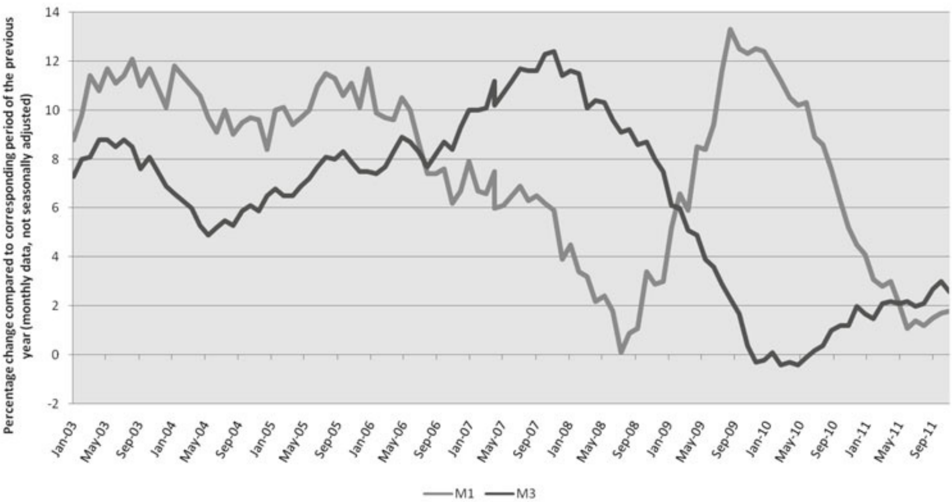
4. J. Stark, *The global financial crisis and the role of central banking*, Speech at Institute of Regulation & Risk, North Asia, Hong Kong, 12 April 2011.

5. M2 refers to all means of payment in circulation (bank notes, giro accounts, short-term loans).

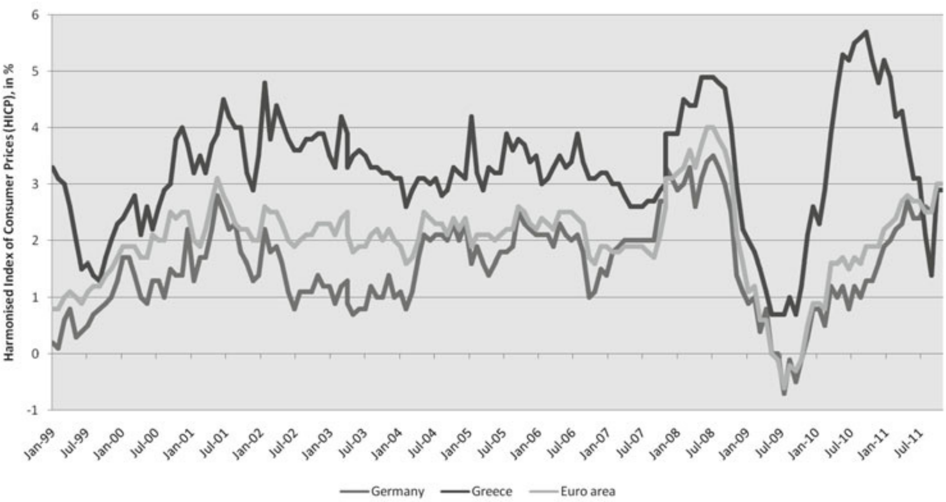
6. P. Krugman, *Yes, We're in a liquidity trap*, Blog The conscience of a liberal, 16 March 2011.

7. Collaterals are financial assets that banks can use as guarantees in exchange for liquidity from the central bank.

II.1.5. Money supply change in the euro area (2003-2011) and inflation in the euro area (1999-2011)



Source: Eurostat
Data collected and collated for the Robert Schuman Foundation, © FRS



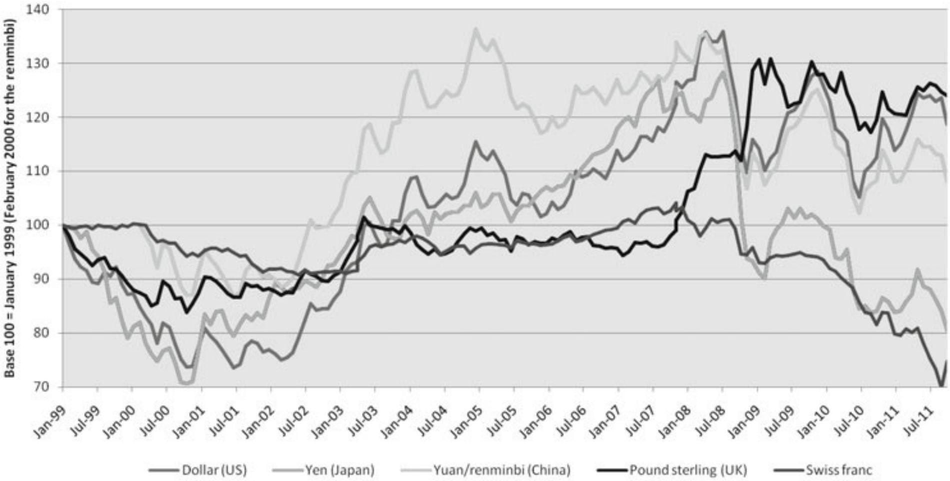
Source: ECB
Data collected and collated for the Robert Schuman Foundation, © FRS

The monetary aggregates M1, M2 and M3 comprise the whole range of means of payment, including cash, bank accounts or short-term loans. The subprime crisis has led banks to cut credit supply to enterprises. This is reflected in a marked slowdown of the growth in money supply. The ECB, like other central banks, has reacted by intervening on the inter-bank markets and by lending extensively to financial institutions in order to maintain a minimum level of liquidity in the euro area.

Since January 2010, money supply growth has again slowed substantially. At the end of 2011, it reached levels similar to those of 2008 when the global financial crisis was at its height. Two factors contribute to this trend: first, the implementation of the Basel III rules according to which banks have to increase the capital they hold; second, the uncertainties surrounding public finances in the EU. Both factors cause banks to tighten conditions of credit. At the same time, the ECB is buying sovereign debt.

Inflation currently remains limited, but the consequences of the monetary disarray will make themselves felt in 2012. Will inflation increase? Will there be new financial bubbles? Will European economies remain in a liquidity trap?

II.1.6. The exchange rate of the euro against main currencies (1999 – 2011)



Source: ECB
Data collected and collated for the Robert Schuman Foundation, © FRS

Since its creation, the exchange rate of the euro has followed a volatile trajectory; parity with the yen, for instance, varied by 50% since 2002. More important than the question of whether a currency is weak or strong, wide fluctuations in the exchange rate are detrimental to industrial enterprises, which hesitate to make important investments when they are unable to anticipate future revenues.[8]

Despite a shaky start, the euro rapidly established itself as an international currency, considered a safe value.[9] Central banks all over the world revert to the euro to diversify their reserves. The tight monetary policy conducted by the ECB has strongly contributed to the credibility of the new currency. As a consequence, its exchange rate consistently increased after the initial drop.

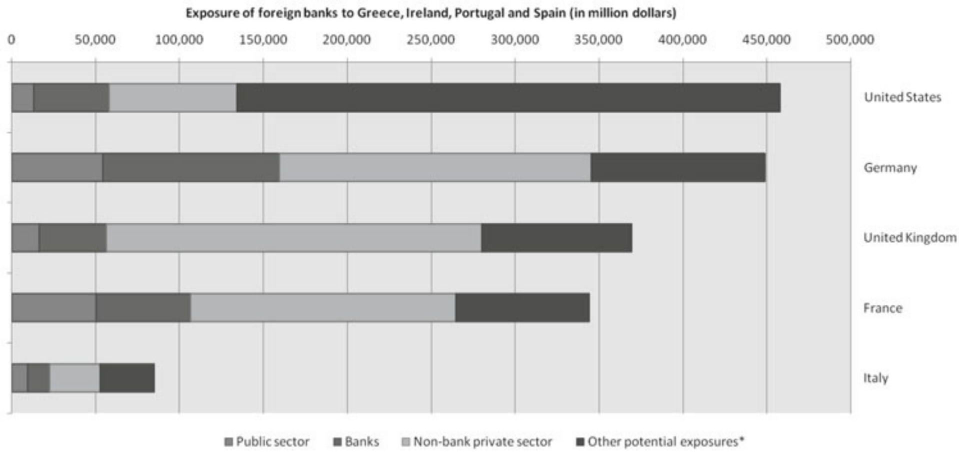
This increase accelerated with the intensification of the financial crisis in the United States, but stopped abruptly when Lehman Brothers defaulted. Since then, a hierarchy of currencies has emerged: the Swiss Franc, considered as one of the safest currencies in the world, has gained substantially in value. Investors are looking for assets in which they can have complete confidence: neither sovereign bonds nor company assets seem to offer this certainty anymore. Therefore, raw materials and strong currencies, such as the Swiss Franc and the Japanese Yen, are coveted as a safe alternative.

In this hierarchy, the euro positions itself as an intermediate currency, weaker than the Yen, but stronger than the dollar. This may seem unexpected given the gravity of the crisis that is currently unfolding in the euro area. However, contrary to the situation in the United States, public and trade deficits remain limited and the ECB conducts a conservative policy. Viewed from outside, the euro area still appears to be balanced and stable.

8. M. Didier, A. Bénassy-Quéré, G. Brandsbourg et A. Henriot, *Politique de change de l'euro*, Rapport du Conseil d'Analyse Economique, 20 December 2008.

9. F. Lirzin, "Quelle "diplomatie" pour l'euro ?", *Questions d'Europe* n°92, policy paper of the Robert Schuman Foundation, 10 March 2008.

II.1.7. Cross-exposure of banking systems in the euro area (2nd quarter 2011)

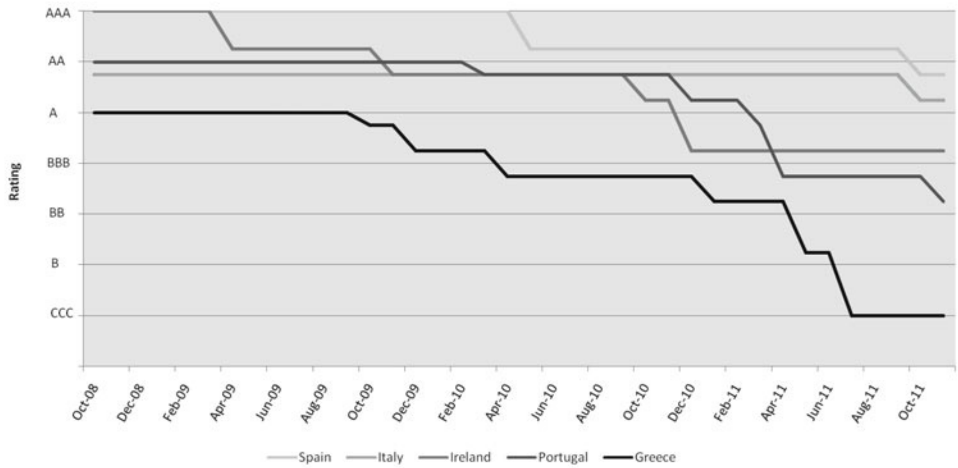


*Other potential exposures include, for example, derivatives and guarantees

Source: BIS
Data collected and collated for the Robert Schuman Foundation, © FRS

The sovereign debt crises in Greece, Spain, Ireland and Portugal are not confined to their national economies: foreign banks are also affected by this situation. The creation of a common currency provided an incentive to financial institutions to invest in other Member States and, in particular, to buy part of their sovereign debt. For instance, German banks hold €14 billion of Greek sovereign debt and French banks hold €32.6 billion of Spanish sovereign debt. In total, foreign banks hold €207 billion in sovereign debt which they risk losing in the case of sovereign default by countries at the periphery of the euro area.

II.1.8. The continuous downgrading of the countries in crisis by the credit rating agencies since 2008



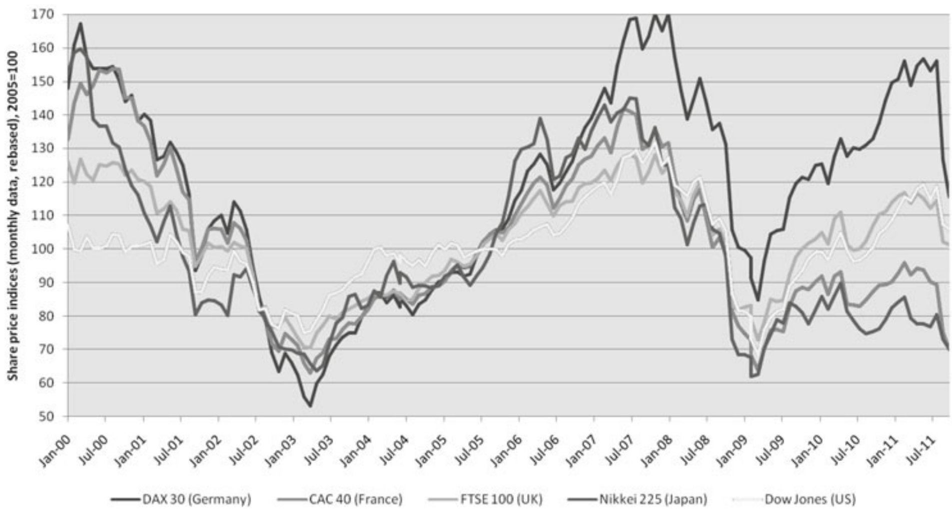
Data collected and collated for the Robert Schuman Foundation, © FRS

Although credit rating agencies have existed for a long time, it was especially during the last decade that they have gained a prominent place in the world of international finance, and an important influence on the economic policies of states. The increasing sophistication of financial markets made the evaluation of the quality of financial products by independent rating agencies necessary. What is more, current financial regulations are largely based on the ratings provided by these agencies.

With the deterioration of public finances, investors have become increasingly sensitive to the quality of sovereign debt. The more the rating of a country is downgraded, the less confidence markets have in its ability to service its debt and the more interest rates increase. Although the ratings initially only reflect and inform the opinion of the markets, ratings can also play a role in triggering self-fulfilling crises: the downgrading of a country, though at first a mere reaction to weakening fundamentals, can subsequently become itself the cause of exaggerated mistrust by the markets.

II.2. The Financial, Economic and Social Situation of the EU in the Crisis

II.2.1. Developments on stock markets (2000-2011)



Source: Eurostat

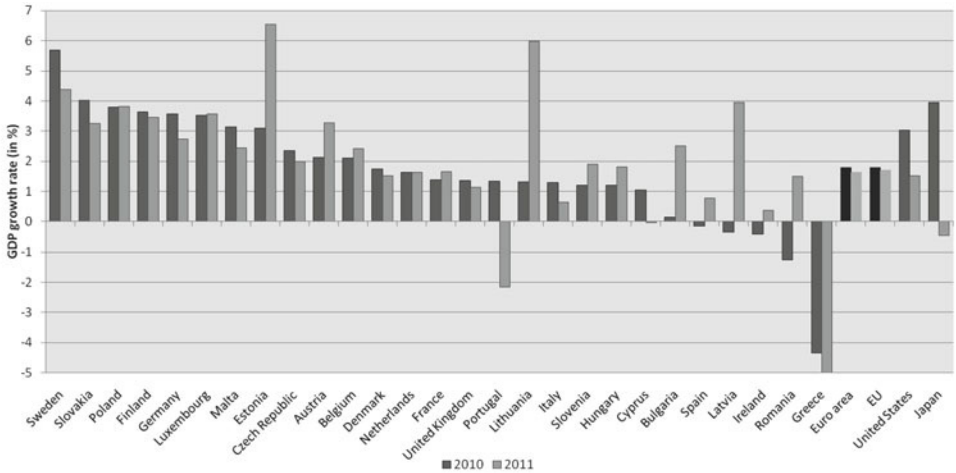
Data collected and collated for the Robert Schuman Foundation, © FRS

Stock indexes reflect the confidence that markets have in the future of companies. While the 1990s were characterised by a constant increase in the stock exchange values, the decade since 2000 was marked by strong volatility. At each crisis – be it the popping of the “internet bubble”, the subprime crisis or the crisis of the euro area – share prices dropped massively.

This situation is detrimental to enterprises – which suffer a loss in the value of their equity and a reduced capacity to borrow – as well as for their workers, whose income is partly invested in pension funds on the stock markets. Far from being like casinos, stock exchanges are a place where economic actors find the resources they need to finance their projects and to build their future. Hence, volatile stock markets introduce a considerable degree of uncertainty into the economy. This situation is true for most financial markets.[10]

10. M.-H. Grouard, S. Lévy, C. Lubochinsky, *La volatilité boursière : des constats empiriques aux difficultés d’interprétation*, study of the Bank of France, June 2003.

II.2.2. Real GDP growth in EU Member States and international comparisons (2010 and 2011)



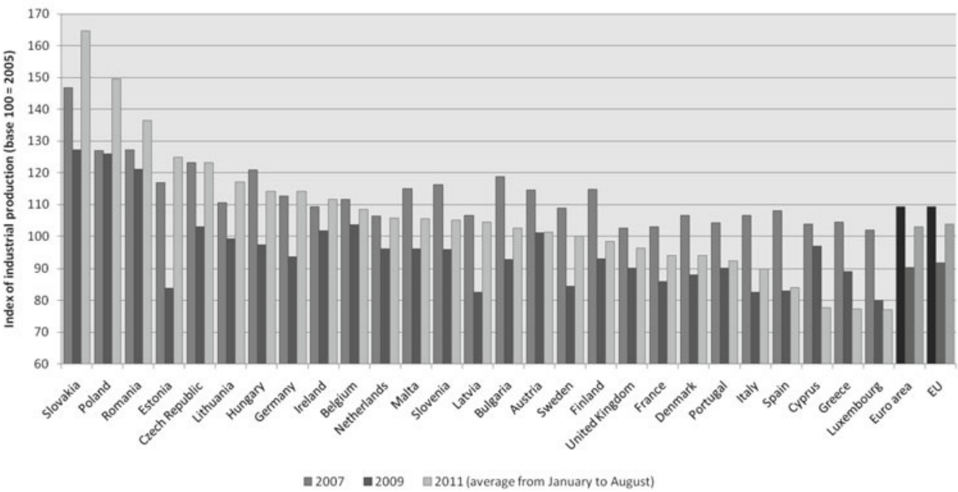
Source: IMF
Data collected and collated for the Robert Schuman Foundation, © FRS

GDP growth slowed in 2008 in the EU before falling 4.2% in 2009 and recovering again in 2010. Japan (-6.2%) and the United States (-3.4%) were also hit hard in 2009; half the world economy was in recession. The EU was not expected to reach its level of pre-crisis GDP before 2012; three years of growth have been lost.

In 2011, the world economy was propped up by strong growth in the BRICs (9.6% in China, 8.5 % in India, 5.0% in Brazil and 4.1% in Russia), while growth was low in the EU (1.6%). Some countries, like Greece and Portugal, even entered into double-dip recessions. The financial crisis was thus not simply a passing slowdown, but probably reduced potential growth in the EU: layoffs had a negative effect on human capital, the decrease in investments has reduced the capital stock of enterprises, and the turmoil in the financial system has weakened banks. The policies of austerity, adopted by governments with the aim of balancing public accounts, have had detrimental effects on consumption and production, and hence on GDP growth. All this indicates that the EU, as well as the United States and Japan, have entered a period of weak growth while some emerging countries are close to completing their process of catching up economically. In this regard, the crisis has accelerated the ongoing shift in the international balance of economic power.

The crisis of the euro area and the persistent difficulties of the US economy cause a great deal of concern among companies and markets. The world economy is at the crossroads: either solutions are found quickly and growth picks up again, supported by an increased rhythm of innovation, or no solution is found and the situation gets worse.

II.2.3. Index of industrial production (2007, 2009 and 2011)



Source: Eurostat
Data collected and collated for the Robert Schuman Foundation, © FRS

The sectors which are based on business models that involve high levels of household indebtedness, such as construction and automobiles, were hardest hit by the crisis. Industrial activity slowed in the EU, decreasing by 20% between January 2001 and April 2009. At the end of 2011, it still had not regained its pre-crisis level.

In some countries, industrial activity fell particularly sharply during the crisis, as, for instance, in Latvia (-35%), Italy (-26%) and Slovenia (-26%), but trajectories diverge widely. Industrial production in Germany, which fell by 24% during the crisis, has already surpassed pre-crisis levels by 1.5% in 2011. The situation worsened in Greece (-14.5% since April 2009), Cyprus (-14%), Spain (-0.5%) and Portugal (-0.5%).

II.2.4. Investment, consumption and savings in the EU and international comparisons (2007 and 2010)

	Savings		Investment		Household final consumption	
	as % of GDP					
	2007	2010	2007	2010	2007	2010
Austria	16.3	13.5	21.4	20.5	52.9	54.5
Belgium	16.4	16.2	21.7	20.2	51	52.9
Bulgaria	n.a.	n.a.	28.7	23.5	69	61.2
Cyprus	6.9	11.6	22.1	18.6	66.6	68.8
Czech Republic	10.3	10.3	27	24.4	47.7	50.3
Denmark	4.3	7.7*	21.7	16.6	48.4	49
Estonia	-1.8	9.6	35.5	18.8	54.1	52.1
Finland	7.2	11.3	21.3	18.8	50.4	54.6
France	15.1	15.6	20.9	19.3	56.5	58.2
Germany	16.8	17.1	18.4	17.5	55.9	57.5
Greece	n.a.	n.a.	24	16.6	69.9	74.5
Hungary	8.4	8.2	21.8	18	55	53.3
Ireland	7.6	13.4	25.5	11.5	47.7	50.8
Italy	14.8	12.1	21.5	19.7	58.6	60.5
Latvia	-5.8	4.2	34.1	19.5	62.4	63
Lithuania	-4.2	7.9	28.1	16.3	64.3	64.4
Luxembourg	10.9	13.6*	20.7	18.4	32	33.5
Malta	n.a.	n.a.	21.7	16.9	62	61.7
Netherlands	13.0	10.9	20	18.2	46.2	45.4
Poland	8.5	9.9*	21.6	19.9	60.5	61.4
Portugal	7.0	9.8	22.2	19	65.3	66.7
Romania	n.a.	n.a.	30.2	22.7	66.9	62.5
Slovakia	7.2	11.3	26.2	22.2	56.1	58.3
Slovenia	16.2	15.7	27.8	21.6	52.4	56
Spain	10.7	18.1*	30.7	22.9	57.4	57.7
Sweden	11.6	13.4	19.6	17.8	46.7	48.5
United Kingdom	2.6	6.0*	17.8	14.9	63.8	64.3
EU	**11.0**	**12.3**	**21.2**	**18.4**	**57.1**	**58.3**
* 2009						
Source: Eurostat						

Data collected and collated for the Robert Schuman Foundation, © FRS

Investment is the motor of growth, but for investments to be made, an economy needs to accumulate the corresponding savings. The money that households do not spend on consumption is used by enterprises to buy new machines or by public institutions to construct new infrastructure.

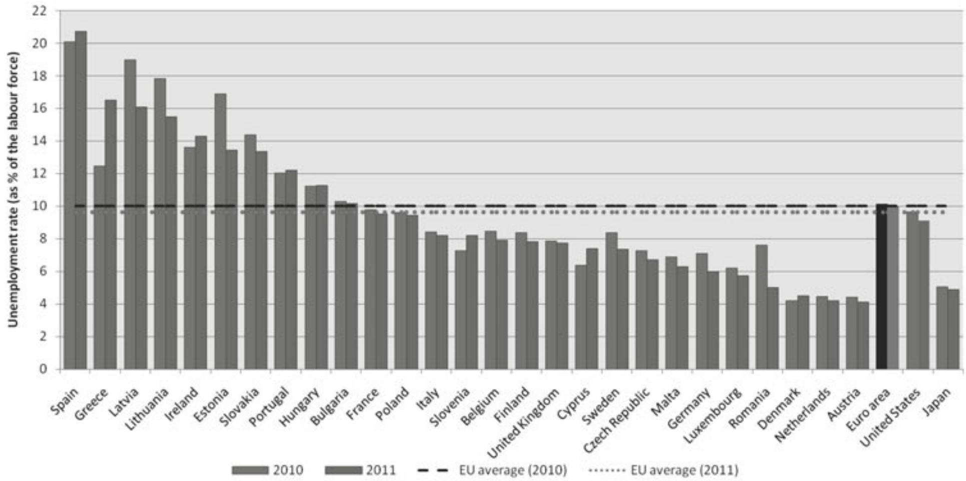
The EU has a stable savings rate of around 12%, which increases slightly with each crisis when households save more to hedge against future risks. Household behaviour depends on many factors, including the interest rate at which they can lend their money to financial institutions (the higher the interest rate, the more advantageous it becomes to lend). A propensity to save can also be culturally rooted. The Nordic countries, for instance, save relatively little (6% on average in Denmark during the last decade), while Germany, France or Belgium save more (about 16%). The crisis has caused some impressive changes: the savings rate in Ireland went up to 13.4% in 2010, three times higher than the 2002 rate of 4.6%.

With roughly similar levels of investment across all countries (20% of GDP), European countries have to "import" savings to make up for the difference between domestic savings and investment. The United States and Japan have savings rates that are even lower than in the EU. Therefore, the financial system channels savings from emerging countries in Asia to developed countries, especially from China where the savings rate is estimated at 50%.[11]

The economic crisis has caused a reduction of investment in the EU, dropping from 21.2% of GDP in 2007 to 18.6% in 2011. This decrease has been particularly severe in Ireland where investment fell by 60% between 2007 and 2011, as well as in Estonia (-42%), Greece (-40%) and Latvia (-39%). The decrease has also been strong in the United States (-20%). The lack of investment is a liability for the future as it negatively affects the potential growth of a country. France and Germany have not been significantly concerned by this problem so far.

11. M. Guonan et W.Yi , *China's high saving rate: myth and reality*, Monetary and Economic Department, BIS Working papers, n°312, June 2010.

II.2.5. Unemployment in EU Member States and international comparisons (2010 and 2011)



Source: IMF
Data collected and collated for the Robert Schuman Foundation, © FRS

The economic slowdown has prompted enterprises to downsize. First, companies often reverted to reduced working hours, before laying off temporary workers and, finally, reducing their permanent staff. This explains the time lag between the onset of the crisis and the rise in unemployment. Between 2008 and 2009, the unemployment rate increased rapidly across many EU Member States, and then stabilised at around 9.5%.

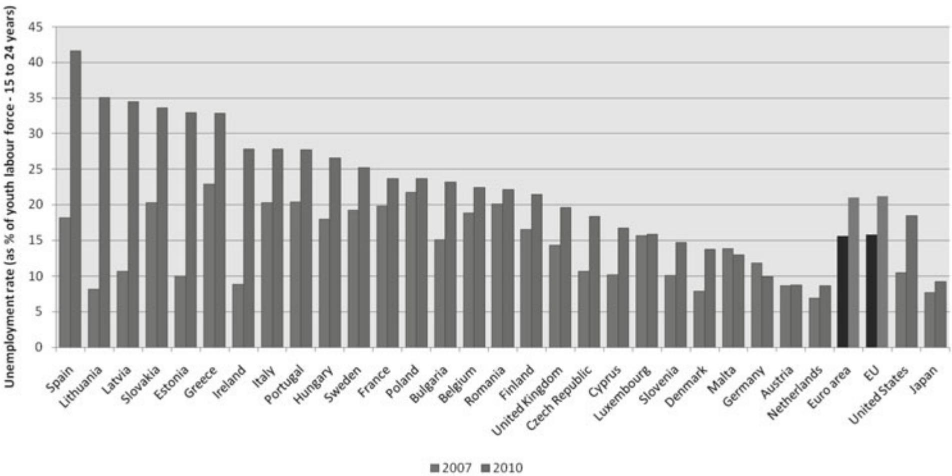
This number masks very different realities in Member States. For instance, unemployment only increased moderately in Germany between 2008 and 2009 (+0.1%), as a blip in a longer trend of decreasing unemployment, dropping from 11.2% in 2005 to 6.0% in 2011. The competitiveness of the German economy, which is export-oriented and capable of regaining momentum very quickly, is related to the reforms adopted during the early 2000s. Other "Northern" European countries, such as the Netherlands and Denmark, as well as South Korea, Japan and Switzerland are in similar situations.

In contrast, unemployment is very high in Spain (20.7% in 2011), Greece (16.5%), Ireland (14.3%), Portugal (12.2%), Hungary (11.2%) and Bulgaria (10.2%). Similarly, the Baltic countries have suffered a massive increase in unemployment, although their situation was slightly improving by the end of 2011.

Other countries, such as France (with 9.5% unemployment in 2011), Italy (8.2%), the United Kingdom (7.8%) and the United States (9.0%), have been facing rising unemployment. Given existing weaknesses of their economies at the end of 2011, a further increase in unemployment cannot be excluded.

The economic downturn has thus accentuated social tensions within countries and divergent performances between countries, with stronger Member States reluctant to help the weaker ones. Governments are weakened by the situation and rising unemployment provides fodder for the growth of populist and extremist political parties.

II.2.6. Youth unemployment in EU Member States and international comparisons (2007 and 2011)



Source: Eurostat
Data collected and collated for the Robert Schuman Foundation, © FRS

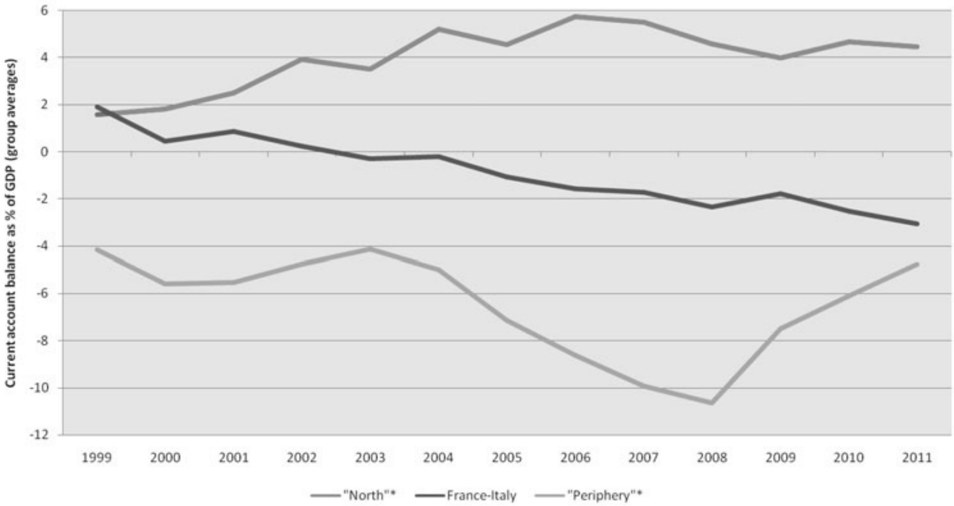
In Europe, more than anywhere else, young people (aged below 25 years) have difficulties inserting themselves into the labour market. Employers are often hesitant to give contracts for an unlimited period of time with a good salary to an inexperienced person they do not entirely trust. In Europe, youth unemployment has traditionally been high due to structural shortcomings of the labour market. As a result of the economic crisis, youth unemployment now hits record heights. The young generation was the first to be sacrificed in the economic downturn as temporary workers and the youngest employees are the least protected from being fired. However, the most senior workers are also concerned by the increase in unemployment. Considered less productive, but more expensive, enterprises lay them off. Having difficulties in finding a new job when the economy recovers, many of them undergo a period of long-term unemployment before being able to retire.

Youth unemployment is particularly high in the Mediterranean countries where the crisis and the subsequent austerity measures have reduced job opportunities and exacerbated poor conditions in the labour market. The youth unemployment rate is especially high in Spain (41.4%), Greece (32.8%), Italy (27.8%) and Portugal (27.8%). Similarly, the Baltic countries are in a very difficult situation. In Austria, the Netherlands and Germany, however, young people seem to have no significant problems finding a job.

The meagre job prospects for young people, in combination with a rising sentiment among young people of being "sacrificed", are at the origin of the current wave of social movements, such as that of the "indignados" in Spain. However, protests have not yet led to meaningful changes in national or European policies. The resulting feeling of frustration leads many to emigrate in order to try their luck in other European countries or elsewhere in the world.

II.3. Towards a Better Coordination of Macro-Economic Policies

II.3.1. Current account balances of the Member States of the euro area (1999 – 2011)



*The "North" includes Austria, Finland, Germany and the Netherlands; the "Periphery" includes Greece, Ireland, Portugal and Spain.

Source: IMF
Data collected and collated for the Robert Schuman Foundation, © FRS

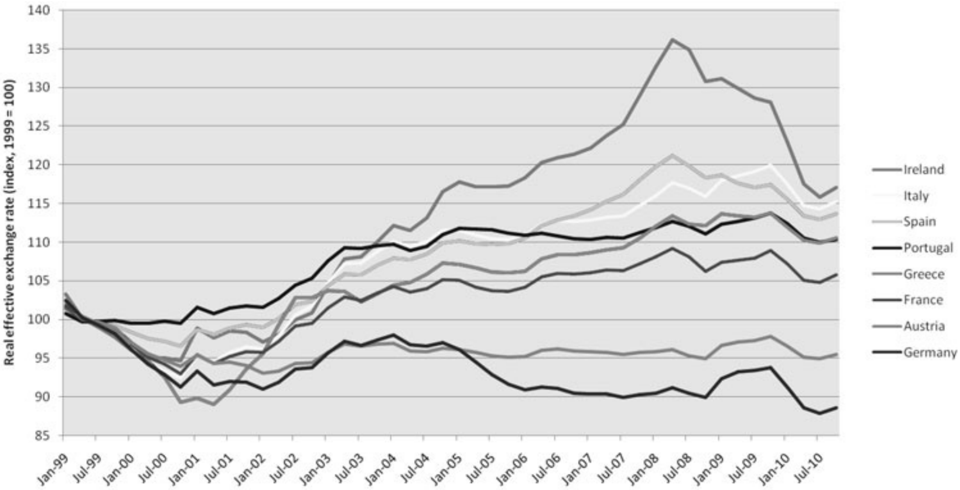
The current account balance is the balance between monetary flows resulting from the exchange of goods and services, income and current transfers. After 2001, current account balances in the euro area diverged markedly. On the one hand, the trade balances of Germany and the Netherlands turned highly positive due to their strong export performance, made possible by a policy aimed at reducing costs and supporting export-oriented industries. On the other hand, countries like Italy, Spain and Portugal, with growth strategies focused on non-exporting activities like services and construction, experienced large drops in their current accounts.

The divergence in current account balances creates significant financial flows from surplus countries in the "North" to deficit countries in the "South". This relationship between surplus and deficit countries is highly unsustainable since the latter have to repay the former and the flows will have to be reversed at one point. No current account imbalance is sustainable in a monetary union where currency devaluation is no longer an option.

This structural weakness of the euro area – which is a considerable source of concern for the markets – is the underlying cause of the crisis in the euro area. In the long term, a solution can only work if it includes the rebalancing of the euro area. This rebalancing implies a reinvigoration of export-oriented industries and a reduction of domestic consumption in deficit countries (including the austerity measures that the countries in crisis are currently required to adopt), but also a reduction of exports and an increase in domestic demand in surplus countries. However, countries like Germany and the Netherlands are reluctant to agree to curb their economies in favour of a rebalancing of the euro area, fearing that this would cause rising unemployment in their countries. Instead, they prefer a greater effort on the part of the deficit countries to balance their budgets and to increase their competitiveness. Growing political tensions might arise from these fundamentally opposed perspectives on how the burden of adjustment should be shared.

By hitting the construction sector in particular, the crisis has paradoxically contributed to reducing current account deficits in most of the Southern European countries, with the exception of France and Italy where the situation has become worse in 2011.

II.3.2. Divergence in real effective exchange rates (1999 – 2010)



Source: Eurostat

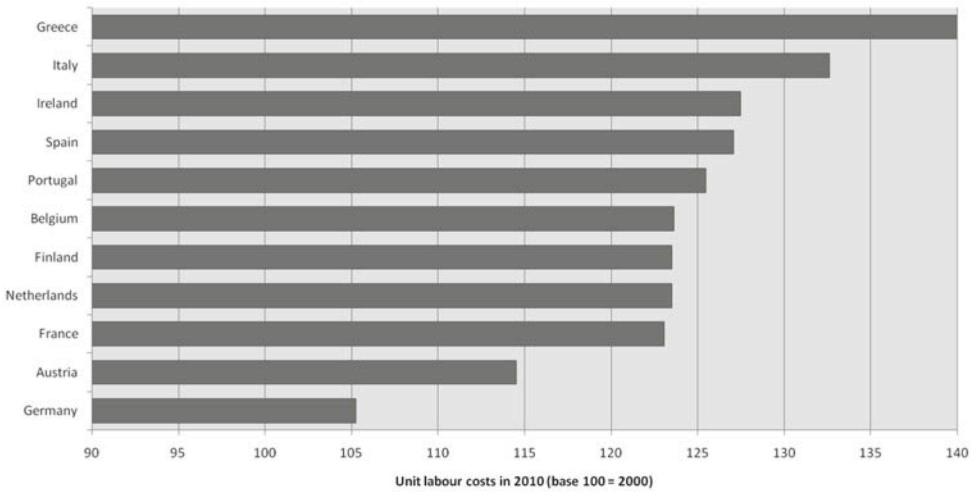
Data collected and collated for the Robert Schuman Foundation, © FRS

Real effective exchange rates take account of price level differences between trading partners. An increase in the real effective exchange rate implies a deterioration of a country's aggregate external price competitiveness.

After its creation, the euro's exchange rate against the other major currencies plunged by about 15%. Subsequently, the euro grew stronger, reaching an exchange rate that was 23% higher in 2009 than in 1999. More recently, the euro exchange rate followed a downward path caused by the uncertainties surrounding the crisis of the euro area.

Germany has adopted deflationist policies (keeping wages low) which have allowed it to have a real effective exchange rate 25% lower than that of the euro area as a whole: even if the exchange rate of the euro is high, prices in Germany remain competitive. German industry is therefore in a good position to export to the rest of the world. This is not the case for Belgium, Portugal, or Italy where it has become more difficult to export due to increased real effective exchange rates. As a consequence, the trade balances of these countries have deteriorated.

II.3.3. Unit labour costs (2000 – 2010)



Source: ECB
Data collected and collated for the Robert Schuman Foundation, © FRS

During the past decade, labour costs in the EU have followed very different trajectories across Member States: while they have increased by more than 30% in Italy and Greece, unit labour costs have risen less than 6% in Germany. It is rather normal that labour costs increase faster in economies which are going through a catching-up process due to productivity gains, but countries like Greece and Spain have not been able to control wage increases and have lost cost competitiveness as a consequence.

In contrast, Germany, under Chancellor Gerhard Schröder, adopted a reform programme, dubbed Agenda 2010, which included a number of measures aimed at reforming the labour market. That is why German industry was able to keep production of goods with high added value in Germany while production at the lower end of the value chain was relocated to Eastern Europe and other parts of the world.

At the same time, French industry concentrated its activities on the middle segment of the value chain while the production of more sophisticated products was shifted outside the country. France is thus more directly exposed to competition from Asian countries without having the competitive advantage of low wages.

While Germany maintained the share of industry in its economy, France de-industrialised heavily. A long-term solution to the crisis will need to include a European rebalancing of industrial policies and a readjustment of labour costs according to the type of industry existing in each country.

II.3.4. Taxation in the EU (2009)

	Implicit tax rate on consumption	Implicit tax rate on labour	Implicit tax rate on capital
Austria	21.7	40.3	27
Belgium	20.9	41.5	30.9
Bulgaria	21.4	25.5	20.7*
Cyprus	17.9	26.1	n.a.
Czech Republic	21.6	36.4	19.3
Denmark	31.5	35	43.8
Estonia	27.6	35	14
Finland	25.7	40.4	29.9
France	18.5	41.1	35.6
Germany	19.8	38.8	22.1
Greece	14	29.7	17.5**
Hungary	28.2	41	18.8
Ireland	21.6	25.5	14.9
Italy	16.3	42.6	39.1
Latvia	16.9	28.7	10.3
Lithuania	16.5	33.1	10.9
Luxembourg	27.3	31.7	n.a.
Malta	19.5	20.2	n.a.
Netherlands	26.2	35.5	15.4
Poland	19	30.7	20.5
Portugal	16.2	23.1	33.8
Romania	16.9	24.3	n.a.
Slovakia	17.3	31.2	17.1
Slovenia	24.2	34.9	21
Spain	12.3	31.8	27.2
Sweden	27.6	39.4	33.5
United Kingdom	16.8	25.1	38.9
EU	**18.9**	**36**	**n.a.**
Euro area	**18.5**	**38.2**	**28.6**

* 2007; ** 2005

Source: Eurostat

Data collected and collated for the Robert Schuman Foundation, © FRS

Taxation plays an essential role in the functioning of democracies and the dynamism of economies. On one hand, taxation finances public spending, especially in health and education. On the other hand, it needs to be carefully calibrated in order to avoid choking consumption or stifling the private sector. The challenge is to keep the golden mean between social justice and economic efficiency.

In the EU, as in other parts of the world, the tax burden is shared by different parts of society: the tax rate on consumption averages 20%, the one on labour averages 36%, and capital is taxed at an average of 30%.

Some countries have adopted fiscal policies that diverge substantially from the European average: in Ireland, the tax rates on capital (14.9%) and labour (25.5%) have been very low until the crisis, while the tax rate on consumption was above average (25% in 2007). This strategy helped Ireland to attract foreign companies, but these differences may intensify tax competition at the expense of public services.

Furthermore, imbalanced taxation can be disastrous in the case of a crisis. It was the decrease in fiscal revenues that has contributed to an explosion of Ireland's public debt. There are thus reasons to think about tax harmonisation in Europe in order to avoid detrimental competition and to reduce the risk of a collapse of fiscal revenues during times of crisis.

III. Reviving the European Economic Project: From an Obligation of Results to an Obligation of Means

At the beginning of the 1990s, the European economy was in a bad shape: unemployment was high and growth was low. In June 1993, the president of the European Commission, Jacques Delors, presented a special report on unemployment. According to the report, the high unemployment rates in Europe could neither be attributed to the shortcomings of the European Monetary System (EMS), the forerunner of the euro, nor to the rigidity of labour markets. Instead, the lack of competitiveness of European economies was pinpointed as the main cause of Europe's malaise.[12] Ill-prepared to compete with the United States and Japan for the production of manufactured goods, the EU became aware of the necessity to adopt a community policy promoting competitiveness.

Delors suggested implementing large investment programmes in infrastructure and high technologies. This approach was formalised in the Lisbon Strategy, launched at the European Council in March 2000. The over-arching objective was to make the EU "the most competitive and dynamic knowledge-based economy in the world" and to reach full employment before 2010. It was agreed to increase spending on R&D to 3% of GDP and the employment rate to 70%.

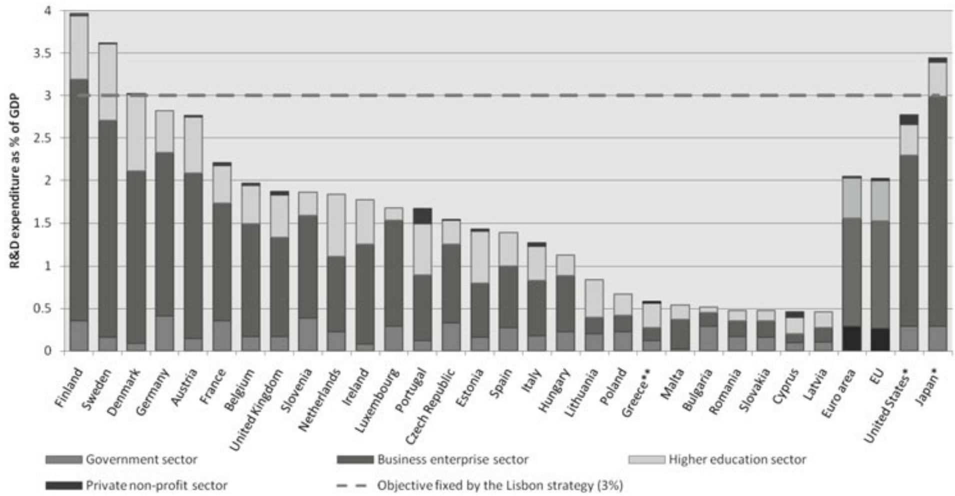
The governance mode used to implement the Lisbon Strategy was the Open Method of Coordination (OMC). According to this method, common objectives are agreed on at the European level, but Member States are free to decide on how they want to achieve these goals. Results would then again be jointly monitored and assessed with the help of the European Commission. Policy change would be encouraged through peer review and peer pressure. The structural funds (European Regional Development Fund – ERDF, European Social Fund – ESF, European Agricultural Fund for Regional Development – EAFRD) were mobilised to support the strategy.

Europe 2020, which was adopted on 17 June 2010, has replaced the Lisbon Strategy. It pursues three main objectives expressed in quantifiable indicators to be achieved by 2020:
– Innovation: increase investment in R&D to 3% of GDP;
– Environment: reduce greenhouse gas emissions by 20% compared to 1990 levels;
– Inclusiveness: raise the employment rate to 75 %, improve the level of education of the population, and reduce poverty.

12. P. Krugman, "Competitiveness – A dangerous obsession", *Foreign Affairs*, Volume 73, Number 2, March/April 1994.

III.1. The Innovation Challenge

III.1.1. Spending on R&D in the EU, the United States and Japan (2009)



*Data of 2008; **Data of 2007

Source: Eurostat
Data collected and collated for the Robert Schuman Foundation, © FRS

There is no avoiding the fact that the objective of spending 3% of GDP on R&D has not been achieved in the EU, with the exception of a few Member States such as Denmark (3.02%), Sweden (3.62%) and Finland (3.96%). As a whole, the EU (2.02%) lags far behind the United States (2.77%) and Japan (3.44%).

This suboptimal performance can be explained by two factors. First, the EU comprises countries which are at very different stages of economic development. The investment levels for R&D range from 0.46% of GDP in Latvia to 3.96% in Finland. The Central and Eastern European countries are in the middle of their catching-up process, with industry that is still focused on traditional and small innovative sectors. On average, the level of investment in R&D in the former communist countries is about 1% of GDP. For the “Northern” European countries it is about 3% (Germany, the Scandinavian countries and the Netherlands).

A second important reason explaining why the EU failed to achieve its target is the lack of R&D investment in the private sector, which is 1.25% of GDP in the EU, compared to 2.01% and 2.70% in the United States and Japan respectively. Since the level of public investment is approximately the same, it is sound to assume that the lack of private investment is the main cause of the EU’s underperformance in R&D spending. Since 85% of R&D investments are made in manufacturing industries,[13] the difference can partly be explained by different industrial structures: the ITC sector, in particular, occupies a much more prominent place in Japan and the United States. This sector happens to be one of the most intense in terms of investment in R&D. There is a relationship between the difficulties of European industries in positioning themselves in sectors with high added value, and the lack of investment in R&D, although it is difficult to identify the direction of causation.

This situation is alarming; in the long run, the EU risks being left behind in a number of technology-intensive sectors and becoming a laggard in the global race for innovation. In this case, the European economy would have to reposition itself on the markets for medium technologies and would be directly exposed to the competition of emerging countries.

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13. Rapport intermédiaire des Etats généraux de l’industrie, Ministry of Industry, 2010.

III.1.2. Summary of competitiveness and innovation indicators (2011)

	Global competitiveness indicator (2011)	Ranking according to the ease of doing business (2011)	Summary innovation index (2010)	Patent applications by residents (2007)	European high-tech patents (2007)	Share of high-tech exports in total exports (2009)
	ranking out of 142 countries	ranking out of 183 countries	on a scale from 0 to 1	per million inhabitants	per million inhabitants	in %
Austria	19	32	0.591	274.2**	33.6	11.7
Belgium	15	28	0.611	42.7	32.1	8.8
Bulgaria	74	59	0.226	27.6	0.2	4.6
Cyprus	47	40	0.495	3.5	3.9	20.1
Czech Republic	38	64	0.414	69.3	1.6	15.2
Denmark	8	5	0.736	304.0	40.1	12.3
Estonia	33	24	0.466	32.8	10.7	6.9
Finland	4	11	0.696	341.1	86.4	13.9
France	18	29	0.543	238.6	30.5	19.7
Germany	6	19	0.696	581.7	38.9	14.0
Greece	90	100	0.364	69.0	1.2	6.6
Hungary	48	51	0.327	68.5	3.8	22.3
Ireland	29	10	0.573	194.0	17.7	22.1
Italy	43	87	0.421	155.9	7.3	6.8
Latvia	64	21	0.201	49.8**	1.5	5.3
Lithuania	44	27	0.227	18.4	1.0	5.8
Luxembourg	23	50	0.565	31.3	13.7	41.8
Malta	51	n.a.	0.351	24.4	3.5**	43.8
Netherlands	7	31	0.578	126.9	45.1	18.4
Poland	41	62	0.278	62.8	1.0	5.7
Portugal	45	30	0.436	23.6	3.5	3.7
Romania	77	72	0.237	38.4	0.8	8.2
Slovakia	69	48	0.269	44.3	0.8	5.9
Slovenia	57	37	0.487	164.0	8.5	5.5
Spain	36	44	0.395	72.8	4.5	4.7
Sweden	3	14	0.750	276.2	84.0	14.8
United Kingdom	10	7	0.618	284.8	19.0	18.2
EU	**n.a.**	**n.a.**	**0.516**	**n.a.**	**20.2**	**16.9**
United States	5	4	0.672	800.2	27.9	22.6*
Japan	9	20	0.641	2610.1	45.0	17.4
Canada	12	13	n.a.	151.6	27.0	8.0
China	26	91	n.a.	116.1	n.a.	29.2
India	56	132	n.a.	4.79**	n.a.	6.2
Brazil	53	126	n.a.	20.1**	n.a.	3.0
			* 2008; ** 2006			
Sources:	World Economic Forum	World Bank	European Innovation Scoreboard	WIPO, World Bank	Eurostat	

Data collected and collated for the Robert Schuman Foundation, © FRS

For companies to be productive, they need a business environment conducive to economic activity. They have to be innovative in order to develop new products and offer them at the lowest price possible. Public authorities can contribute a lot to improving the business environment and attracting companies: they can build infrastructure, develop research and training facilities, or improve the tax regime, the labour market and access to finance.[14]

The Global Competitiveness Index takes into account all of these factors. Northern European countries are generally well placed. Sweden and Finland even surpass the United States. The list is headed by Switzerland and Singapore. The Central and Eastern European, as well as Southern European, countries perform less well. Greece is ranked 90th out of 142 countries. The World Bank's Ease of Doing Business Index yields similar results.

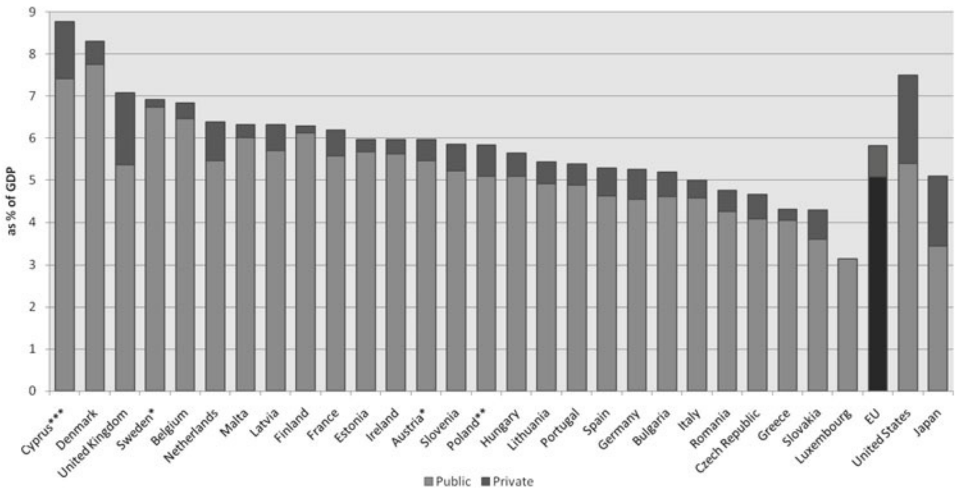
14. See M. Porter, *The competitive advantage of nations, states and regions*, conference in Malaysia, 7 July 2011. And more recently, the work done by the *Institute for strategy and competitiveness*, Harvard Business School, available at www.isc.hbs.edu/

A good business environment is necessary for innovation to flourish. For the European economy, it is vital to build a knowledge-based economy which remains at the forefront of technological progress. Otherwise, falling behind in the race for innovation would have serious social repercussions.

In the framework of the Lisbon Strategy and Europe 2020, the EU has compiled an "Innovation Scoreboard" comprising several indicators such as the share of R&D spending in GDP and the number of patents. It allows comparison between EU Member States and other important economies. According to the Scoreboard, only Denmark, Finland, Germany and Sweden are more innovative than Japan and the United States. Naturally, the economies in the EU that are least economically developed are the least innovative.

One can consider a range of different innovation indicators, including the share of human capital employed in sciences and technology, the number of patents, or the share of high-tech products in total exports, but the conclusion remains the same: the EU is not as innovative as it would like to be or as it should be. A profound innovation gap has emerged between EU Member States, especially between the "Northern" European countries and the less innovative Member States, including France, Italy, and Spain. While the former have adopted reforms necessary to develop and maintain a highly innovative industrial base (Germany, Ireland, Denmark, the Netherlands), the latter have not succeeded in positioning their economies in the most innovative industries and are more directly exposed to competition from emerging countries like China.

III.1.3. Public and private expenditure on education (2008)



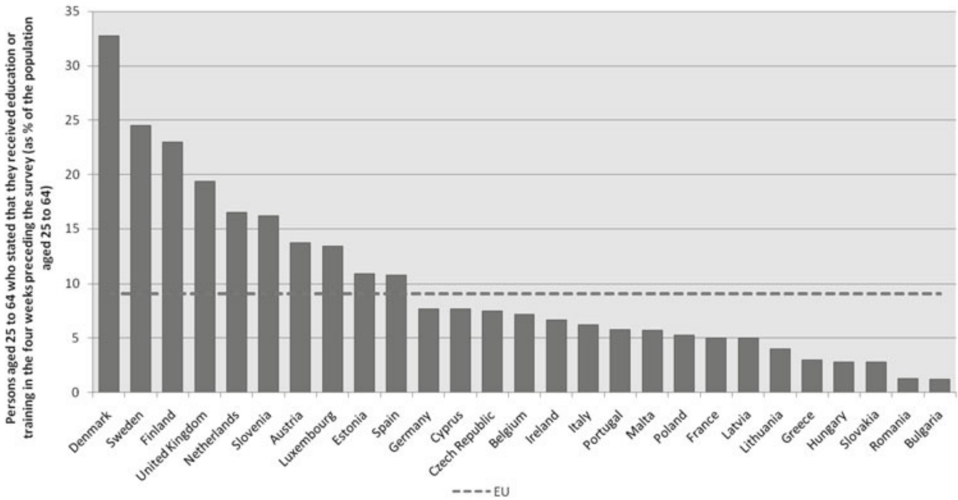
* Data of 2007, ** Data on private expenditure of 2006, *** Data of 2005
Data for Luxembourg does not include private expenditure on education.

Source: Eurostat
Data collected and collated for the Robert Schuman Foundation, © FRS

The level of education of an economy's workforce is a major element of its competitiveness. Work processes have become more and more complex, often involving the operation of robots and computers. Skills, therefore, must constantly be upgraded. The ability to adapt quickly and to take the initiative is crucial in a fast-changing working environment.

In general, efforts to improve education in the EU have intensified (+3.65% since 2004 in higher education). However, increasing spending on education does not automatically lead to a straightforward improvement of competitiveness and the creation of jobs.

III.1.4. Life-long learning (2010)



Source: Eurostat
Data collected and collated for the Robert Schuman Foundation, © FRS

In a rapidly changing world, skills need to be adapted and upgraded constantly. Within 20 years, almost the entire workforce has had to learn how to operate a computer. Life-long learning plays an essential role in the adaptation of the workforce to new work conditions. It also helps workers to orient themselves in a job market that is increasingly complex.

In the EU, the importance of life-long learning differs greatly across Member States.[15] While it is almost part of daily life in countries such as Sweden and Denmark, it is completely absent in countries such as Romania and Bulgaria. On average, one person in ten declared having attended training in the four months preceding a regular survey conducted by Eurostat. Some countries, like Belgium, Luxembourg and Spain, have made important efforts to improve the image of life-long learning and to make it more accessible and adapted to the realities of the job market. But establishing life-long learning more firmly in the professional lives of European citizens is a long and difficult process.

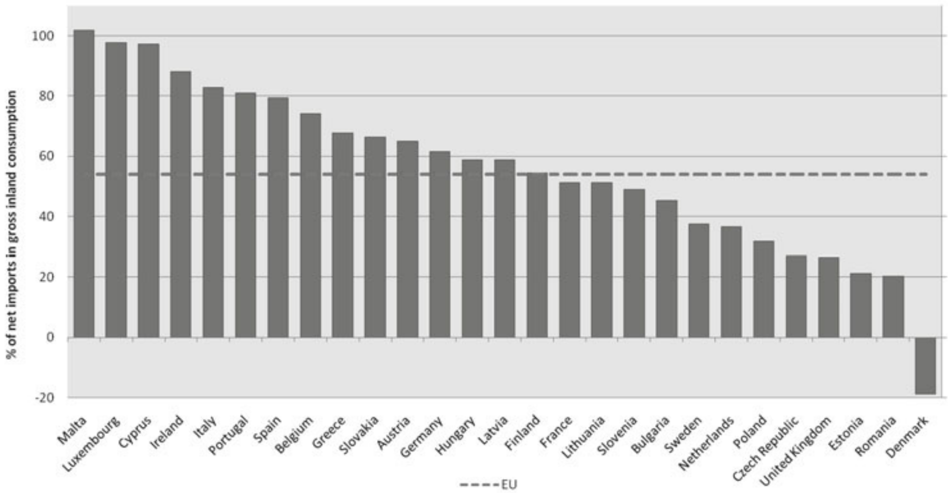
Map – Research and Innovation in the European States

Map – Industry in the EU Member States

15. See http://www.centre-inffo.fr/En-Europe.html to learn more about the different national systems of continuing education and training in EU Member States.

III.2. The Challenge of Resource Scarcity and Climate Change

III.2.1. Energy dependence of EU Member States (2009)



Source: Eurostat
Data collected and collated for the Robert Schuman Foundation, © FRS

Without energy, everything comes to a halt. Households, as much as enterprises, depend on the energy they buy. Until the beginning of the 20th century, coal was the principal source of energy, followed by oil in the middle of the century and, later, nuclear energy. Apart from oil-producing United Kingdom and Norway, Europe is a continent without substantial energy resources. Inevitably, the EU must import energy, more than half of its energy needs in 2009 (53.9%). This figure is still misleading since it does not include imports of uranium or fissile materials for the production of nuclear energy. Energy dependence might thus be even higher, especially for the countries using nuclear energy on a large scale, like France.

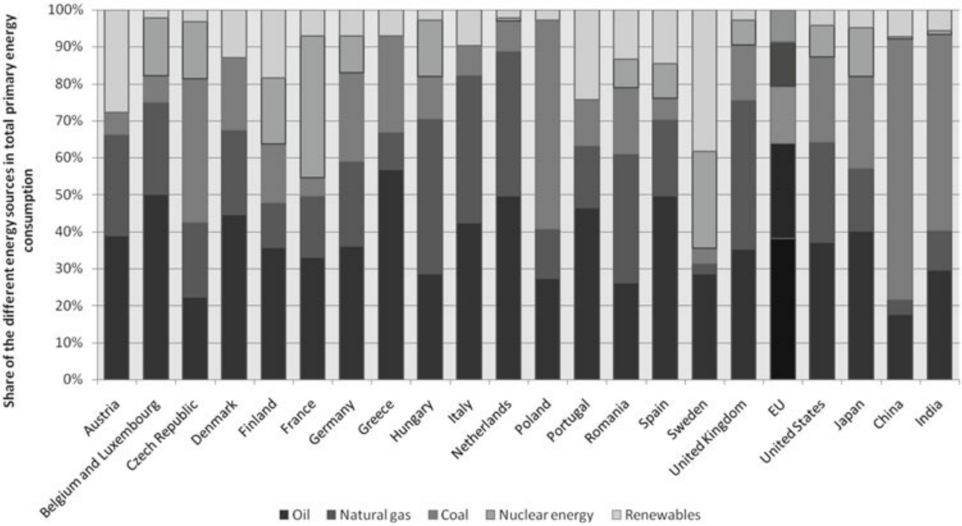
Energy security is not only an economic challenge, but also a geostrategic one. A full 45% of oil imports to the EU come from the Persian Gulf.[16] The EU can improve its energy security by securing these supplies through diplomatic relations with producer countries, constructing pipeline networks through the Baltic Sea, Caspian Sea, and Turkey and protecting strategic sea lanes. Volatility of energy prices can have a detrimental impact on economies, and price surges can lead to a sharp increase in inflation. At the moment, however, the danger for this to happen is limited by the value of the euro and the deflationist effect of the crisis which attenuates any price increases.[17]

Reducing energy dependence goes hand in hand with the objective of limiting greenhouse gas emissions and the production of radioactive waste. The development of renewable energies is at the core of this effort for EU Member States. Some traditional forms of renewable energy, such as hydroelectric power, already provide an important share in total energy production. New hydro locations, however, are harder to find and more likely to encounter opposition from local populations. Newer technologies such as solar and wind energy still have considerable potential.

16. C.-A. Paillard , "Union européenne et pétrole", *Supplement to the Newsletter n°186*, Robert Schuman Foundation, 2 November 2004.

17. J.-F. Jamet, "L'impact des prix du pétrole sur la croissance de la zone euro", *Questions d'Europe* n°85, Robert Schuman Foundation, 7 January 2008.

III.2.2. Energy mix in EU Member States and international comparisons (2010)



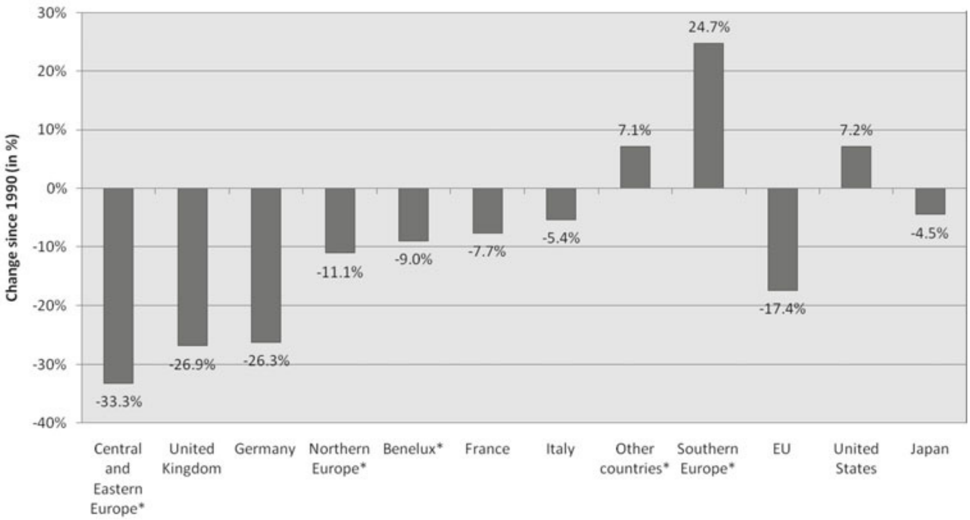
Source: BP Statistical Review of World Energy, June 2011
Data collected and collated for the Robert Schuman Foundation, © FRS

80% of primary energy consumption in the EU comes from energy sources that produce CO2 and other greenhouse gases (40% oil, 25% natural gas, and 15% coal). The remainder is generated by nuclear (12%), hydroelectric (5%) and other renewable energies (4%). This picture differs only marginally from the energy mix in the United States, which relies on fossil fuels for 90% of its energy needs.

However, the energy mix within the EU differs considerably from one Member State to the other. The share of nuclear energy, for instance, varies from 0% in a majority of European countries to 26% in Sweden and 38% in France. Mountainous countries, such as Austria, Sweden and Norway, have actively developed hydroelectric power. Others place more emphasis on renewable energy and take advantage of their coastal areas to build offshore wind parks, or use their sunny climates to produce energy from solar plants.

The EU has set the objective of increasing the share of renewable energies in gross final energy consumption to 20% by 2020. It is currently 10.3%. However, increasing the use of renewable energy technologies is fraught with problems. First, it takes energy to build the facilities that are then supposed to produce energy. Only in the last few years have solar collectors been able to produce more power during their life span than had been used to produce them in the first place. Second, the production of renewable energy installations is often located in China or Germany (for solar collectors) or in Denmark (for wind turbines); hence, in countries where there is no domestic production capacity for such technology, energy dependence, which is reduced by relying more on renewable energy, is replaced by a new industrial dependence on the main producing countries. Therefore, EU Member States have adopted policies to support the development of local production capacities, so far with mixed results.

III.2.3. Greenhouse gas emissions (1990-2009)



**Central and Eastern Europe:* Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia; *Northern Europe:* Denmark, Finland, Sweden; *Southern Europe:* Greece, Malta, Portugal, Spain; *Other countries:* Austria, Ireland.

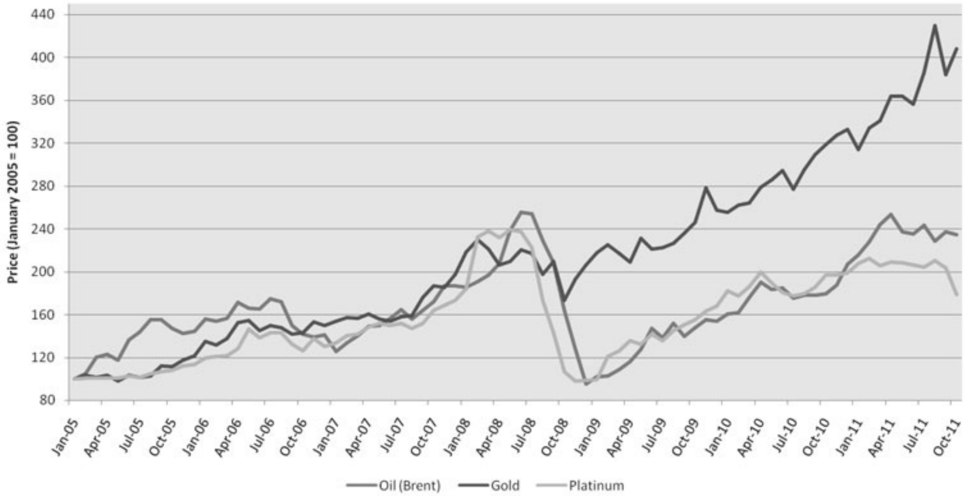
Source: UNFCCC
Data collected and collated for the Robert Schuman Foundation, © FRS

Apart from reducing the economic constraints imposed by the progressive exhaustion of fossil fuels, the use of renewable energies also helps in pursuit of another objective: the reduction of greenhouse gases and, thus, the limitation of global warming. At the 2009 United Nations Climate Change Conference in Copenhagen, the 194 countries that had ratified the Framework Convention of the United Nations on Climate Change from 1992 reaffirmed the objective of limiting global warming to a 2°C rise. Although not all countries have signed the document that was supposed to provide the successor framework to the Kyoto Agreement, European countries have committed themselves to implement it. Since 1990, CO2 emissions in developed countries have, on the whole, stagnated, while they have strongly increased in emerging and developing countries.

The EU has developed the EU Emission Trading Scheme (EU ETS) as one important tool to reduce greenhouse gas emissions. According to this scheme, businesses can buy and sell emission quotas which give the right to pollute. Thereby, the costs of pollution are internalised for producers who change their operations due to the new costs. The EU ETS is the first international system for emission trading in the world. It encompasses more than 11,000 installations, which together are responsible for more than half of the CO2 emissions in Europe.

Since 1990, the EU has reduced its CO2 emissions by 17.4%, while emissions have increased by 7.2% in the United States. The Eastern and Central European countries have substantially reduced their emissions due to the transition process of de-industrialisation following the end of the Cold War. In contrast, emissions in economies which have undergone a process of economic catch-up, like Spain, Ireland and Greece, have risen sharply. Germany has considerably reduced its emissions (-26.3%), partly because of the collapse of the East German industry after reunification.

III.2.4. Change in commodity prices (oil, gold and platinum) (2005 – 2011)



Source: ECB, World Gold Council, Platinum Today
Data collected and collated for the Robert Schuman Foundation, © FRS

The world has experienced three oil crises: two in the 1970s as a consequence of the decision of the Organisation of the Petroleum Exporting Countries (OPEC) to increase prices (1973) and of political events in the Middle East (1979), and most recently the surge in oil prices between 2005 and the onset of the current global financial crisis. Between 2005 and 2011, the price of oil multiplied by 2.7 but it is difficult to determine whether this increase is primarily caused by constraints on the supply side or by rising demand from fast-growing emerging countries. So far, the impact of high oil prices on growth and inflation has been limited. The share of energy costs in the total production costs of manufactured goods has decreased and European economies are less dependent on fossil fuels than they used to be.

Rapid economic development in large emerging countries, along with the growing demand for rare and precious materials such as platinum and rare earths for industrial production, has led to a general increase in the prices of raw materials. For instance, the gold price has quadrupled in the last six years. Along with the price increases has come a shift in the geostrategic position of producer countries. China, for instance, produces approximately 95% of the world's rare earths, which are used in the production of many goods such as computers, batteries and neon tubes.

Finally, the rise in the price for gold can be explained by the fact that gold is considered a safe haven of investment during times of economic stress. During crises, gold – or in the words of J.M. Keynes, the "barbaric relic" – constitutes a value refuge that investors revert to when other assets are perceived as unsafe and they want to hedge against sharp increases in inflation.

III.2.5. The impact on production costs (gas and electricity prices) (2011)

	Gas price (industry)		Gas price (households)		Electricity price (industry)		Electricity price (households)	
	EUR/Giga Joule				EUR/kWh			
	2011	Change since 2000*	2011	Change since 2000*	2011	Change since 2000*	2011	Change since 2000*
Austria	n.a.	n.a.	14.22	82.2%	0,09**	62.2%	0.14	51.9%
Belgium	8.58	94.0%	12.69	70.6%	0.10	33.1%	0.16	34.2%
Bulgaria	7.98	127.9%	9.96	77.0%	0.06	56.0%	0.07	68.2%
Cyprus	n.a.	n.a.	n.a.	n.a.	0.16	82.8%	0.17	104.9%
Czech Republic	8.36	177.8%	12.60	253.0%	0.11	134.9%	0.12	159.4%
Denmark	9.43	105.3%	16.47	84.1%	0.09	73.6%	0.13	75.9%
Estonia	7.31	151.0%	9.07	131.1%	0.06	32.4%	0.07	54.0%
Finland	9.34	106.1%	n.a.	n.a.	0.07	82.0%	0.11	67.6%
France	9.86	129.7%	13.43	92.1%	0.07	27.3%	0.10	7.1%
Germany	11.58	142.2%	12.08	74.4%	0.09	33.3%	0.14	18.1%
Greece	n.a.	n.a.	n.a.	n.a.	0.09	64.4%	0.10	77.5%
Hungary	8.95	227.0%	12.46	319.8%	0.09	82.7%	0.13	114.6%
Ireland	9.90	175.5%	11.69	60.7%	0.11	69.3%	0.16	99.2%
Italy	8.24	99.0%	12.25	39.3%	0.12	68.3%	0.14	-5.7%
Latvia	8.12	133.7%	9.59	168.0%	0.10	128.3%	0.10	96.5%
Lithuania	9.74	131.6%	9.98	116.0%	0.10	90.0%	0.10	87.7%
Luxembourg	11.58	134.5%	12.72	124.1%	0.10	35.4%	0.15	37.4%
Malta	n.a.	n.a.	n.a.	n.a.	0.18	166.7%	0.16	165.2%
Netherlands	7.49	84.4%	11.57	105.8%	0.08	25.7%	0.13	38.6%
Poland	9.11	62.6%	10.46	97.9%	0.10	95.7%	0.11	61.3%
Portugal	9.38	36.2%	15.75	15.1%	0.09	40.4%	0.10	-15.0%
Romania	4.23	84.5%	4.14	2.8%	0.08	98.3%	0.08	29.5%
Slovakia	9.22	73.1%	10.78	76.3%	0.12	80.5%	0.14	34.0%
Slovenia	11.19	134.1%	14.23	158.0%	0.09	47.2%	0.11	30.0%
Spain	8.09	99.8%	12.62	37.9%	0.11	70.1%	0.16	78.4%
Sweden	11.75	131.8%	18.35	140.4%	0.09	136.5%	0.14	116.0%
United Kingdom	6.47	83.2%	11.24	69.1%	0.09	41.4%	0.14	29.3%
EU	**8.84**	**47.0%**	**11.95**	**41.3%**	**0.09**	**39.3%**	**0.13**	**25.9%**
* Change since 2001-2005 for countries for which data from 2000 is not available; ** 2008								
Source: Eurostat								

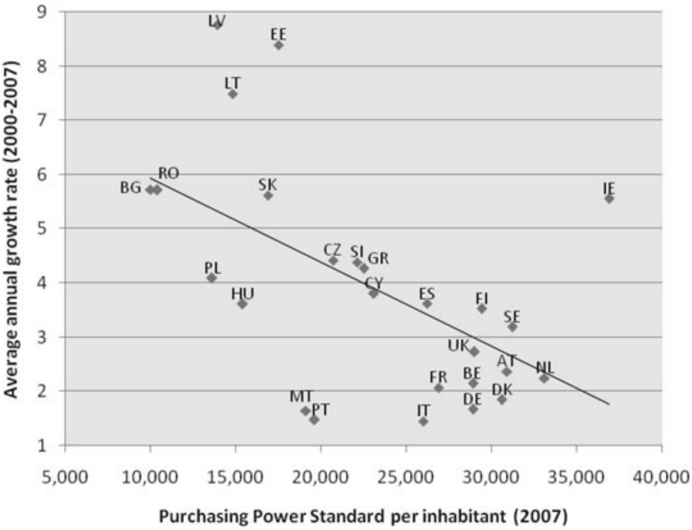
Data collected and collated for the Robert Schuman Foundation, © FRS

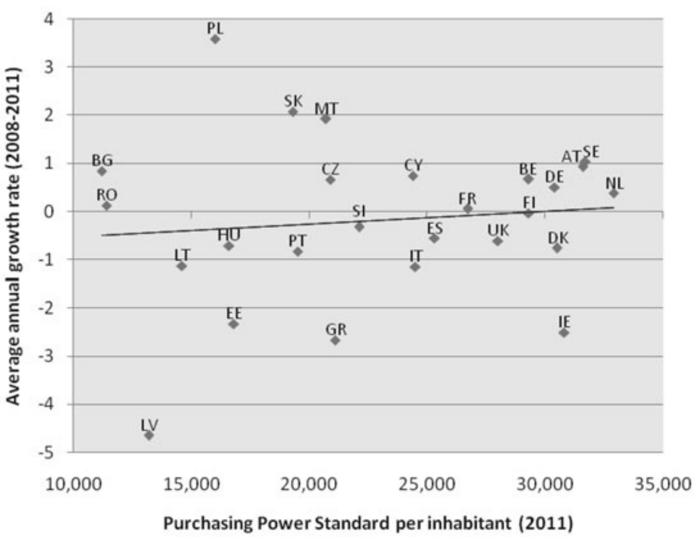
The rise in raw material prices has also led to higher energy costs, but to a lesser extent than could be expected. Industrial electricity prices, for example, depend on many factors other than raw material prices, such as taxes or an economy's energy mix. Finally, the price increase varied a great deal within the EU between 2000 and 2011, from 25% in the Netherlands to 136% in Sweden. The same variability is valid for household prices.

III.3. Social Challenges

Objectives such as the promotion of economic growth or the protection of the environment ultimately follow the same rationale: to ensure that European citizens can enjoy a high standard of living. Inclusiveness is central in this regard as it aims to enable as many citizens as possible to benefit from growth and prosperity. It involves reducing poverty and inequality, creating jobs and improving education and training.

III.3.1. GDP per inhabitant and average annual GDP growth before and after the crisis





Source: IMF, Eurostat
Data collected and collated for the Robert Schuman Foundation, © FRS

Although living standards in the EU are among the highest in the world, inclusiveness remains an important issue given that large disparities exist within the EU.

A cursory glance at the GDP per inhabitant (i.e. the proportion of a country's income that each citizen would have if income was distributed equally) reveals a high inequality between Member States. GDP per capita ranges from €11 500 in Romania to €39 900 in the Netherlands (expressed in purchasing power standard). These differences stem from the different historical development of each country: GDP per inhabitant is highest in the founding members of the EU, Germany, France and the Benelux countries, in the Northern European countries, Finland, Denmark and Sweden, and in Austria and Ireland.

It is part of the ambition of European integration that participation in the single market will allow poorer Member States to catch up with the economies of richer countries, thereby leading to a harmonisation of living standards in the EU. The reality is much more complex: some countries have been able to take full advantage of their participation in the European market and the monetary union. Ireland, for example, has developed within the last few decades from an economy that was largely poor and agricultural to one of the richest EU Member States. The current crisis, however, has hit economies that have always been considered successful in closing the gap to richer EU Member States – such as Ireland and Spain – particularly hard.

Others did not succeed in adjusting their economies to competitive pressures arising from the opening of their economies to the single market and globalisation. Economic development in Portugal, for example, has made little progress. In short: there is no automatic convergence arising from EU membership. In the end, successful catching up depends on the capacity of new Member States to reform and proactively to take advantage of the possibilities offered by European integration.

Roughly speaking, three groups of countries can be distinguished: first, the Member States which form the core of the euro area (Germany, France, Benelux and Italy) which had only moderate economic growth during the last decade; second, new Member States which achieved high growth rates in their process of catching-up (Czech Republic, Hungary, Poland); finally, countries in an intermediate position experienced a high-growth period based on flawed fundamentals which were exposed by the crisis (Greece, Spain, Ireland).

III.3.2. Poverty and inequality in EU Member States and international comparisons (2009/2010)

	Inequality of income distribution			Poverty	
	Gini coefficient (2010)	Ratio between the income of the richest and the poorest 20% of the population (2010)	Gender wage gap (2009)	At-risk-of-poverty rate (threshold: 50% of the national median equivalised disposable income) (2010)	People at-risk-of-poverty or social exclusion (threshold: 60% of the national median equivalised disposable income)
Austria	26.1	3.7	25.4	6.2	16.6
Belgium	26.6	3.9	9**	7.9	20.8
Bulgaria	33.2	5.9	15.3	15.2	41.6
Cyprus	28.4*	4.2*	21	8.8*	22.2*
Czech Republic	24.9	3.5	25.9	5.2	14.4
Denmark	27.5	4.7	16.8	7.6	18.3
Estonia	31.3	5	30.9***	9.4	21.7
Finland	25.4	3.6	20.4	5.5	16.9
France	29.9	4.5	16	7.4	19.3
Germany	29.3	4.5	23.2	9.2	19.7
Greece	32.9	5.6	22**	12.4	27.7
Hungary	24.1	3.4	17.1	6.0	29.9
Ireland	28.8*	4.2*	15.7	7.3*	25.7*
Italy	31.2	5.2	5.5	11.6	24.5
Latvia	36.1	6.9	14.9	14.8	38.1
Lithuania	36.9	7.3	15.3	14.5	33.4
Luxembourg	27.9	4.1	12.5	8.0	17.1
Malta	28.4	4.3	6.9	7.7	20.6
Netherlands	25.5	3.7	19.2	4.9	15.1
Poland	31.1	5	9.8	10.5	27.8
Portugal	33.7	5.6	10	11.3	25.3
Romania	33.3	6	8.1	15.0	41.4
Slovakia	25.9	3.8	21.9	7.8	20.6
Slovenia	23.8	3.4	3.2	7.3	18.3
Spain	33.9	6.9	16.7	14.4	25.5
Sweden	24.1	3.5	16	7.0	15
United Kingdom	32.4*	5.2*	20.4	10.2*	22*
EU	**30.5**	**5**	**17.1**	**10.0**	**23.4**
Euro area	**30.2**	**4.9**	**17.1**	**9.8**	**21.5**
United States	37.8	n.a.	20.1	17.3	n.a.
Japan	32.9	n.a.	30.7	15.7	n.a.
Canada	31.9	n.a.	20.4	11.4	n.a.
*2009, **2008, ***2007					
Sources: Eurostat, OECD					

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The EU is one of the richest and most egalitarian regions in the world. The Gini coefficient, which measures income inequality (a coefficient of 0 indicates perfectly equal distribution of income and a coefficient of 100 indicates that all national income is controlled by one person), is 30.5 in the EU, compared to 37.8 in the United States.

Despite this relatively favourable income distribution, poverty is a reality for many citizens in the EU. Nearly one quarter (23.1%) of the population is at risk of poverty or social exclusion. The situation is especially dire in the poorest Member States (46.2% in Bulgaria, 43.1% in Romania). Almost one tenth (8.1%) of the population is even threatened by material deprivation, including in the richer Member States (5.4% in Germany). The economic crisis has certainly contributed to an aggravation of social problems, especially in the Baltic countries.

Finally, the wage gap between men and women is another dimension of inequality; on average, men earn 17.1% more than women. This gap is partly due to the fact that men and women work in different kinds of jobs. In northern European countries, for instance, women are more likely to work part-time than women in other countries and, therefore, earn less. Cultural reasons also play a factor.

III.3.3. The social challenge of ageing societies in the EU (2009/2010)

	Life expectancy at 65 years (2010*)	Average exit age from the labour market (2009*)	At-risk-of-poverty rate for retirees (2010*)	Public expenditure on pension systems (as % of GDP)	
				2010	projections for 2050
Austria	19.8	60.9	13.6	12.7	14
Belgium	19.5	61.6	16.1	10.3	14.7
Bulgaria	15.4	64.1	30	9.1	10.8
Cyprus	19.5	62.8	47.8	6.9	15.5
Czech Republic	17.4	60.5	6.6	7.1	10.2
Denmark	18.4	62.3	16.6	9.4	9.6
Estonia	17.3	62.6	17.9	6.4	5.3
Finland	19.7	61.7	17	10.7	13.3
France	21.2	60	7.6	13.5	14.2
Germany	19.5	62.2	13.4	10.2	12.3
Greece	19.7	61.5	19	11.6	24
Hungary	16.5	59.3	4	11.3	13.2
Ireland	19.7	64.1	15.5	4.1	8
Italy	20.2	60.1	12.3	14	14.7
Latvia	16.3	62.7	21.2	5.1	5.8
Lithuania	16.4	59.9	13.3	6.5	10.4
Luxembourg	19.6	59.4	5.4	8.6	22.1
Malta	19.9	60.3	18.7	8.3	12
Netherlands	19.5	63.5	5.7	6.5	10.3
Poland	17.6	59.3	12.8	10.8	9.1
Portugal	18.9	62.6	18.5	11.9	13.3
Romania	15.8	64.3	12.8	8.4	14.8
Slovakia	16.3	58.8	6.7	6.6	9.4
Slovenia	19.2	59.8	18.3	10.1	18.2
Spain	20.8	62.3	16.3	8.9	15.5
Sweden	19.8	64.3	15.6	9.6	9
United Kingdom	19.6	63	24	6.7	8.1
EU	**19.1**	**61.4**	**13.8**	**10.2**	**12.3**
Euro area	**19.8**	**61.2**	**12.3**	**n.a.**	**n.a.**
*or data for the most recent year available					
Sources:		Eurostat		Economic Policy Committee	

Data collected and collated for the Robert Schuman Foundation, © FRS

Life expectancy has been consistently increasing, jumping from 82.9 years in 2002 to 84.1 years in 2011 for people currently of age 65. As a result, societies in Europe are growing older. This trend holds for the entire EU without exception and poses new challenges. For example, 13.8% of retirees are at risk of poverty due to inadequate pensions. The situation has improved since 2000, but remains critical in countries like Bulgaria, Greece and Latvia. Pension systems, whether based on pay-as-you-go systems or fully funded pension schemes, differ greatly in generosity and efficiency across EU Member States. However, the relatively good standard of living that retirees enjoy today in countries like France and Hungary cannot be taken for granted in the future.

Public spending on pensions, which accounts for 10.2% of GDP today, is projected to increase to 12.3% by 2050. In some EU Member States, it will reach considerably higher levels: 15.5% in Spain, 14.7% in Italy and 14.2% in France. Will governments be able to maintain current levels of generosity, or will private pension funds replace public systems? The volatile nature of financial markets puts the efficiency of pension funds into question. In many countries, the amounts saved are not sufficient to pay future pensions.

III.3.4. The labour market in EU Member States (2010)

	Employment rate (15 to 64 years)				Employment rate (15 to 24 years)	Employment rate (55 to 64 years)
	Total	Change since 2000	Men	Women		
Austria	71.7	4.7%	77.1	66.4	53.6	42.4
Belgium	62	2.5%	67.4	56.5	25.2	37.3
Bulgaria	59.7	18.5%	63	56.4	22.2	43.5
Cyprus	69.7	6.1%	76.6	63	33.8	56.8
Czech Republic	65	0.0%	73.5	56.3	25.2	46.5
Denmark	73.4	-3.8%	75.8	71.1	58.1	57.6
Estonia	61	1.0%	61.5	60.6	25.7	53.8
Finland	68.1	1.3%	69.4	66.9	38.8	56.2
France	63.8	2.7%	68.1	59.7	30.3	39.7
Germany	71.1	8.4%	76	66.1	46.2	57.7
Greece	59.6	5.5%	70.9	48.1	20.4	42.3
Hungary	55.4	-1.6%	60.4	50.6	18.3	34.4
Ireland	60	-8.0%	63.9	56	30.5	50
Italy	56.9	6.0%	67.7	46.1	20.5	36.6
Latvia	59.3	3.1%	59.2	59.4	26.4	48.2
Lithuania	57.8	-2.2%	56.8	58.7	19.2	48.6
Luxembourg	65.2	4.0%	73.1	57.2	21.2	39.6
Malta	56.1	3.5%	72.4	39.3	44.8	30.2
Netherlands	74.7	2.5%	80	69.3	63	53.7
Poland	59.3	7.8%	65.6	53	26.3	34
Portugal	65.6	-4.1%	70.1	61.1	28.5	49.2
Romania	58.8	-6.7%	65.7	52	24.3	41.1
Slovakia	58.8	3.5%	65.2	52.3	20.6	40.5
Slovenia	66.2	5.4%	69.6	62.6	34.1	35
Spain	58.6	4.1%	64.7	52.3	24.9	43.6
Sweden	72.7	-0.4%	75.1	70.3	38.7	70.5
United Kingdom	69.5	-2.4%	74.5	64.6	47.6	57.1
EU	**64.1**	**1.1%**	**70.1**	**58.2**	**34**	**46.3**
Euro area	**64.2**	**4.1%**	**70.4**	**57.9**	**33.8**	**45.7**
United States	66.7	-10.0%	71.1	62.4	n.a.	60.3
Japan	70.1	1.7%	80	60.1	n.a.	65.2
Source: Eurostat						

Data collected and collated for the Robert Schuman Foundation, © FRS

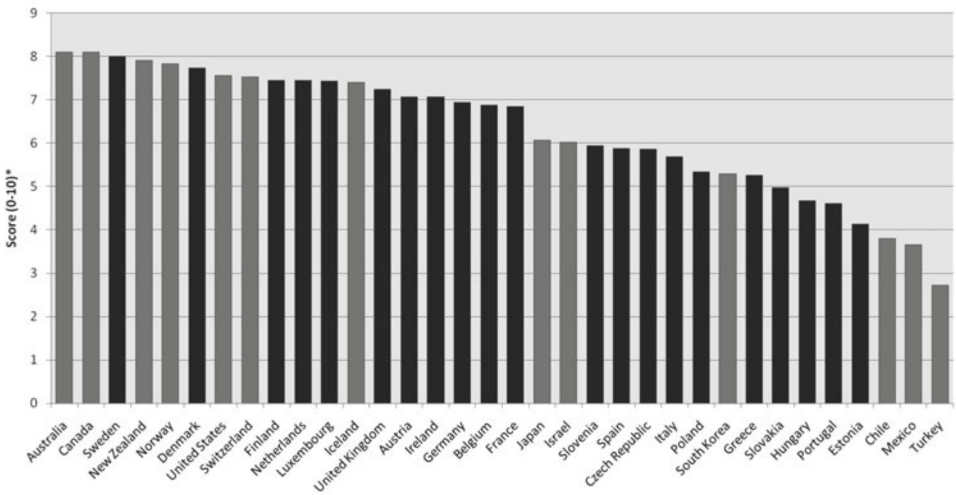
The current economic crisis has affected the labour market in the EU, but this market had already lacked dynamism before the economic downturn. Since the year 2000, the average employment rate in the EU has been 64.5%, compared to 69.4% in Japan and 71% in the United States. This figure indicates that over a third of the people of working age do not work, either because they do not find work or because they do not want to work. Structural unemployment is very high in the EU because of rigid labour markets which make it difficult to fire and hire. Minimum wages, though providing protection against large numbers of working poor, also increase unemployment as the job market excludes those whose qualifications and productivity do not justify a wage above the legal minimum.

Some countries have adopted strategies to improve employability of workers. These include, for example, having more recourse to part-time work like in the Netherlands where almost half of the workforce is employed part-time.

The low employment rate in the EU can be explained by the exclusion of certain categories of the population from the labour market, especially the young and the old. Only 34% of young people in the EU have a job (compared to 40% in 2000). The numbers look much better for certain countries like the Netherlands (63%), Switzerland (62.5%) and Germany (46.2%), but worse for countries like Greece (20.4%), Italy (20.5%), the Baltic countries (between 20 and 25%), the Central and Eastern European countries and Spain (25%) which have "sacrificed" the young generation the most.

Similarly, the employment rate for seniors (55 years or older) was only 46.3% in the EU compared to 60.3% in the United States and 65.2% in Japan. On average, EU workers leave the labour market at the age of 61.4 years. The EU finds it difficult to integrate its senior citizens into the job market, while the ageing of the population weighs heavily on public budgets and the labour supply. However, the situation has improved; the employment rate for seniors has increased from 37.8% in 2000.

III.3.5. The OECD's Better Life Index (2011)



*The index is composed of indicators sorted by 11 topics which have an impact on the well-being of individuals (for example, education, housing and the environment). The graphic depicts the total score assuming that all topics have an equal weight, 10 being the best score.

Source: OECD
Data collected and collated for the Robert Schuman Foundation, © FRS

There is an old saying that, "money doesn't buy happiness, but it certainly helps". The Better Life Index is a composite indicator that summarises a range of fundamental parameters having an influence on the quality of life of individuals, including health, education, security, life expectancy and income. Launched on the occasion of the 50th anniversary of the OECD in 2011, the index stands in the tradition of the recommendations made by the Stiglitz-Sen-Fitoussi report to focus more on the actual well-being of citizens instead of on traditional measures of GDP. The GDP per inhabitant in Equatorial Guinea, for example, is similar to the one of Greece, but infant mortality in Equatorial Guinea is 30 times higher than in Greece. The Better Life Index is thus not just about measuring wealth, but also about how wealth is used.[18]

The "Northern" countries score highest in the index. The quality of the education and health systems, as well as housing, contributes the most to the well-being of citizens. The score with regard to working conditions and income varies from country to country with, for example, remuneration being a weak point in Finland and working conditions in Ireland.

Southern and Eastern European countries score much lower in the index, particularly Greece, Portugal, Hungary and Estonia. Past and ongoing economic crises have certainly contributed to this result by negatively influencing income and working conditions. In addition, a general discontent with public services in exists in these countries.

The only factor which is rated positively across all EU Member States in the Better Life Index is the environment.

18. Boarini Romina, Asa Johansson et Marco Mira d'Ercole, "Alternative Measures of Well-being", *Statistical Brief* n°11, OECD, September 2006. Voir aussi : www.oecdbetterlifeindex.org/

III.4. The EU Budget

By constructing the EU, Member States have not simply chosen to coordinate their policies, but have created tools to conduct common policies on the European level. The budget devoted to these tools is €147.5 billion in 2012. This is a sizeable sum, but, in reality, it represents only around 1% of EU GDP, whereas the American federal budget amounts to 31.9% of GDP.[19]

In contrast to the United States, the EU is not a federation. Bar certain exceptions, it does not have the authority to levy taxes. Only the European Commission can issue bonds guaranteed by its own budget – this was done, for example, when financial aids were accorded to the countries that were most hit by the crisis in 2010, but remains rather exceptional.

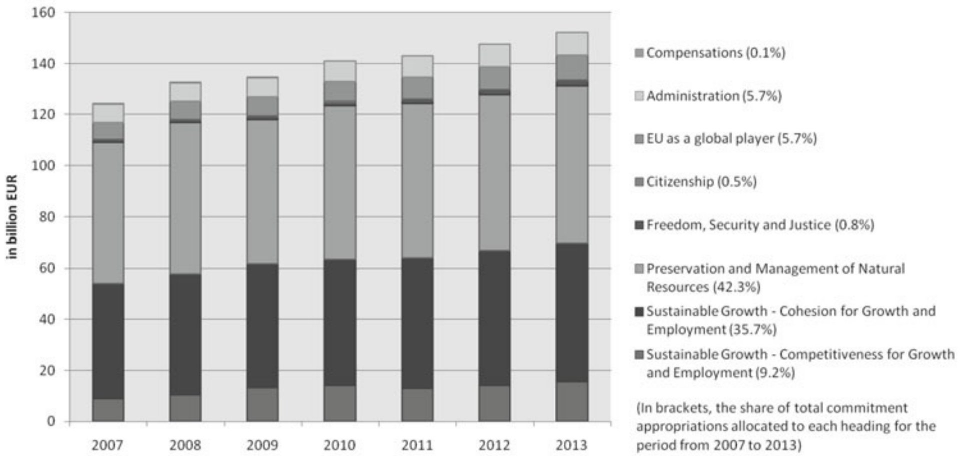
The limited federal character of the EU is clearly shown by the fact that a considerable part of its budget is managed, according to the principle of subsidiarity, at the national or regional levels. While the broad guidelines for instruments such as the European Regional Development Fund and the European Social Fund are set at the European level, their budget is directly administrated by national governments or authorities on the sub-state level.

The small EU budget also reflects a deliberate choice by Member States to retain the management of public policies which are closely linked to the exercise of their sovereignty. Apart from the Common Agricultural Policy (CAP) and some large research programmes, there are only a few budget items whose management is delegated entirely to the European level. It is hardly imaginable, for example, that France would delegate the administration of the budget for social policy to the European Commission.

Nevertheless, the idea of fiscal federalism now takes centre stage as part of the solution to the crisis of the euro area. So far, however, neither the Treaties nor the EU budget allow for fiscal transfers between Member States. The lack of any such possibility makes the euro area very vulnerable to asymmetric shocks, i.e. sharp economic downturns that only affect a limited number of countries but not the entire currency area. The European Financial Stability Facility (EFSF) provides a solution for liquidity crises, but not for problems of solvency in which case fiscal transfers would be necessary. This question is at the heart of the debate about aid that could be made available to Greece.

19. Y. Bertoncini and A. Barbier-Gauchard, *Tableau de bord des dépenses publiques de l'Union européenne et de ses Etats membres*, Rapport du Centre d'Analyse Stratégique, 8 June 2009.

III.4.1. The financial framework of the EU (2007 – 2013)



Source: European Commission
Data collected and collated for the Robert Schuman Foundation, © FRS

The financial framework of the EU for 2007 – 2013 determines the general guidelines of the European budget for the concerned period. In particular, it defines the ceilings, i.e. the maximum amount that can be spent each year for the different budgetary items. In total, the EU budget for 2007-2013 amounts to €975.8 billion.

The financial framework is structured around three main objectives which correspond more or less to the targets of the Europe 2020 strategy:
– Employment (European Social Fund, ESF)
– Competitiveness (European Regional Development Fund, ERDF)
– Environment (European Agricultural Fund for Rural Development, EAFRD, and the Common Agricultural Policy, CAP)

These funds are applicable in different ways to different EU countries, depending on their level of economic development.

In addition to these expenditures, the financial framework also includes funding for the promotion of citizenship, for “freedom, security and justice”, for external policies, and for the administrative costs of the European institutions.[20]

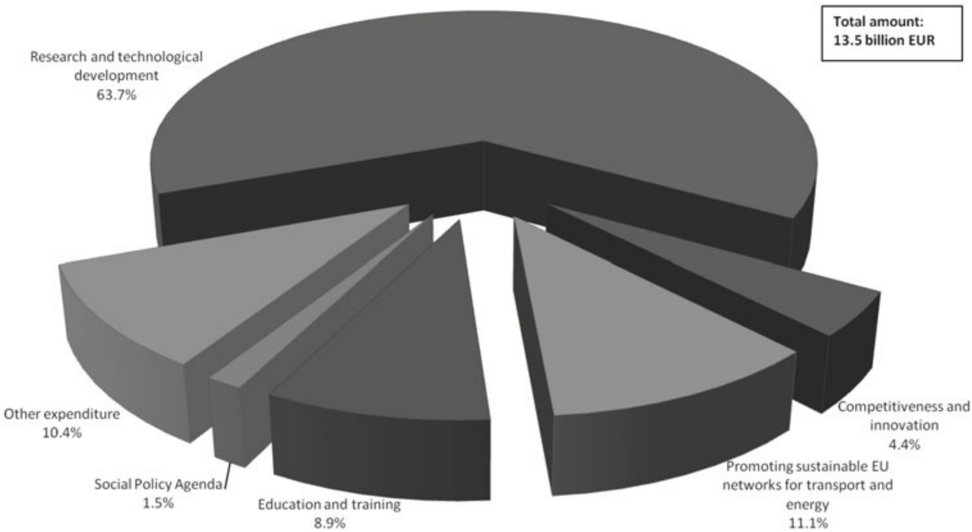
The revenues come primarily from direct contributions from the Member States and differ according to the size of their economies. These contributions make up 75% of the total budget; the remaining part comes primarily from customs duties and a standard share of the harmonised value-added tax base of each country.

The EU budget is an important means of redistribution between Member States. The net contributors to the budget, i.e. those who pay more into the budget than they get back from it, are France, Germany, the Netherlands, Austria, Sweden and the United Kingdom.

Map – EU Budget, 2011

20. For more information on the budget see: http://ec.europa.eu/budget/

III.4.2. EU budget allocated to improving competitiveness (2011)



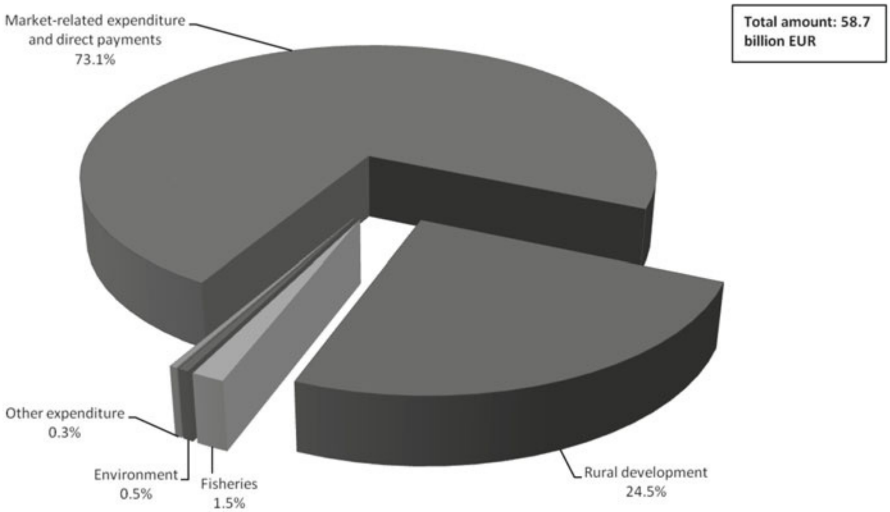
Source: European Commission
Data collected and collated for the Robert Schuman Foundation, © FRS

The Europe 2020 strategy builds on the objectives set by the Lisbon and Gothenburg strategies, particularly the goal to increase investment in R&D to 3% of GDP. In its effort to increase competitiveness, the EU concentrates on three areas in particular:
– The creation of an internal market in which goods, services, capital and people can move freely;
– the funding of innovation projects through the ERDF;
– the funding of research projects through the Framework Programmes for Research and Technological Development (currently the 7th framework programme).

The Framework Programmes for Research and Technological Development are managed at the European level, coordinating projects involving enterprises and research institutions from different countries. In contrast, the ERDF supports projects at the local level that are directly administered by national governments or local authorities. ERDF projects are not entirely funded by the ERDF, which only tops up public and private funding. It therefore works as a lever to stimulate other funding in innovation. Funding in competitiveness is primarily focused on R&D, but also supports sustainable transport and energy networks, training and inter-territorial cooperation. The ERDF aims both at achieving convergence for new Member States and competitiveness for all Member States.

The ERDF draws on different financial instruments such as venture capital, development funds, and guarantee funds which share a number of characteristics: first, they are not managed by public administrations, but by specialised funds; second, it is possible to use the funds more often than once since they are loans and not subsidies. It is very probable that the next generation of European funds in the period from 2014 – 2020 will be designed according to this type of financial instruments.

III.4.3. EU budget allocated to the common agricultural policy, the environment and rural development (2011)



Source: European Commission
Data collected and collated for the Robert Schuman Foundation, © FRS

The agricultural policy is one of the EU's oldest policy areas and traditionally the one with the largest budget: 42.3% of the current budget is allocated to it, with most of it (73.1%) dedicated to the Common Agricultural Policy (CAP).

Created by the Treaty of Rome in 1957, the CAP was established in 1962 with the objective to feed a continent that had suffered years of privation following the Second World War. With the help of the CAP, the EU achieved self-sufficiency in food by isolating European agriculture from world markets. Prices for agricultural products were set at the Community level, above world market prices, in order to guarantee stable incomes to farmers and to encourage productive investments. Competition was shut out by controlling imports and exports.

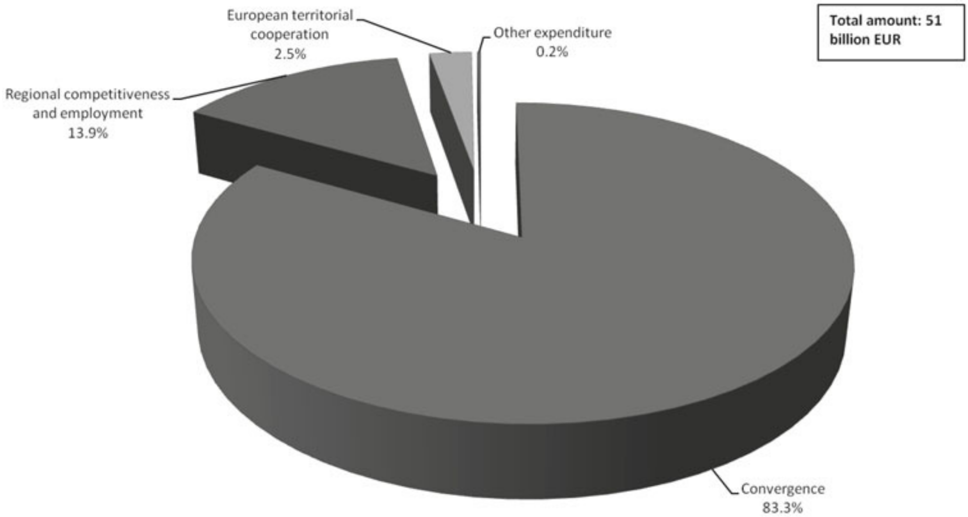
However, from the 1980s onwards, the CAP caused substantial over-production, which created downward pressure on prices. At the same time, the CAP was increasingly criticised in a context of progressive liberalisation in international trade. The CAP became unsustainable in its original design and has been the subject of several reforms.

Since the 1st of January 2007, the creation of two new funds – the European Agricultural Guarantee Fund (EAGF) and the European Agricultural Fund for Rural Development (EAFRD) – has made possible a clear distinction between the CAP's different objectives: EAGF, administered by the European Commission, is employed for market interventions through direct payments to farmers which are subject to certain environmental and health standards; the EAFRD, administered by the Member States, is used to improve the competitiveness of the agricultural sector, while promoting at the same time the protection of the environment and the rural landscape.

The successive reforms of the CAP have been made in response to criticism expressed by non-European countries who considerer that the CAP distorts competition to the detriment of farmers, in particular in developing countries, who do not benefit from generous state subsidies. The EU has proposed abolishing export subsidies by 2013 as part of a broader agreement to be reached in the Doha trade talks.

A tool similar to those for agriculture also exists for the EU's fisheries policy: the European Fisheries Fund.

III.4.4. EU budget allocated to cohesion policy (2011)



Source: European Commission
Data collected and collated for the Robert Schuman Foundation, © FRS

The EU is characterised by large economic disparities between Member States. The crisis in the euro area shows that convergence is not automatic and that too much divergence within the single market and the monetary union weakens economic and political cohesion.

The structural funds aim at promoting a harmonious development of all European regions, permitting new Member States to catch up economically with the richer Member States while improving competitiveness across the entire EU.

The policy relies on three funds:
– the European Regional Development Fund (ERDF): infrastructures, innovation and investments;
– the European Social Fund (ESF): training and employment;
– the Cohesion Fund: environmental and transport infrastructures and the development of renewable energies. It is reserved for Member States with a GDP per inhabitant below 90% of the EU average (Portugal, Greece, Spain, and Central and Eastern European countries).

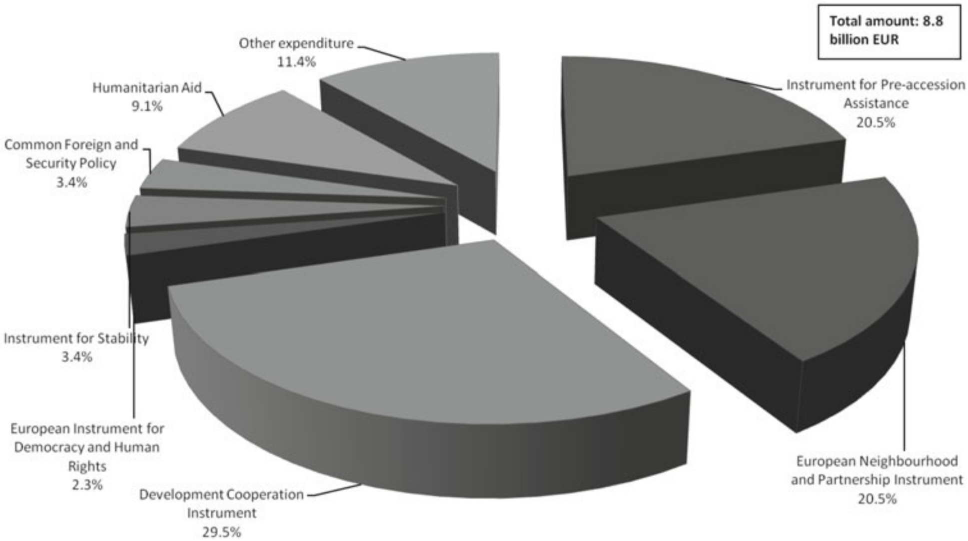
Additional funds promote territorial cohesion in the framework of the Programmes of Community Action such as INTERREG which is designed to stimulate cooperation across borders of EU Member States.

In November 2010, the European Commission published its fifth report on economic, social and territorial cohesion.[21] The disbursement of cohesion funds is generally well received and efficient and should be renewed in 2013. The consistency of the intervention strategies of these funds should be strengthened, both between regions and between funds, and the process of monitoring results and performance is to be encouraged. In particular, the conditions for obtaining funds could be negotiated with the Member States; for instance, the respect of the Stability and Growth Pact could become a condition for receiving funds. On the sub-state level, this is a cause for concern since regions could be punished for policy failures at the national level. Finally, financial tools, such as those already established within the framework of JEREMIE and JESSICA should be multiplied: investments should take precedence over subsidies.

Map – Use of the Structural Funds by the European Union Member States

21. European Commission (2011), *Quelle politique de cohésion après 2013 ? Eléments sur l'état des discussions*, Note stratégique, Edition May 2011.

III. 4.5. The EU as a global player (2011)



Source: European Commission
Data collected and collated for the Robert Schuman Foundation, © FRS

Even though the budget allocated to the EU's external policies makes up only a small part of the total budget (9%), the financial instruments funded through this budget line are an essential tool for the EU to develop its sphere of influence.[22] The EU's sheer size and the nature of its competencies confer on it important responsibilities on the global level. Although the ambition of the EU is not necessarily one of a "global power", it still needs to defend its economic and commercial interests while seeking cooperation with other countries and regions in order to promote peace and growth.

An important share of this budget is allocated to developing the EU's relations with its neighbourhood, whether for countries preparing their accession to the EU or for the countries in the Southern Mediterranean. The Arab Spring shows how important it is for the EU to build constructive, open and long-term relations with its neighbours.

Humanitarian aid is also an important aspect of the EU's external action. For instance, the Commission is strongly engaged in Haiti and is a main contributor to projects involved in the reconstruction of the two main road transport corridors.

Finally, the Common Foreign and Security Policy (CFSP), is included in the EU's external budget line. Catherine Ashton is the first High Representative in charge of the CFSP since the entry into force of the new provisions laid down in the Lisbon Treaty. She represents the EU and is responsible for coordinating the EU's external policies, including international crisis management. To that end, she is supported by the newly established European External Action Service (EEAS), which now constitutes the core of EU diplomacy.

22. European Commission (2004), *A World Player. The European Union's External Relations*, July 2004.