



CAPITAL & ECONOMICS

The European Union's Coming Challenges

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OVERVIEW

The European Union has been in a state of near permanent uncertainty since late 2009, with the focal point for most of the last few years being the Greek debt crisis and its potential to cause a domino effect of economic collapse through the rest of the European Union. While the Greek crisis has calmed for now, many other challenges remain.

European economic growth slowed in 2015 despite nominally favourable conditions. The potential slowdown in China, a key E.U. trade partner, could impact the European economy further. Unemployment, especially youth unemployment, remains high. Multiple European countries still have high levels of public debt. The continent is struggling to cope with unprecedented levels of migration from the Middle East and Africa. Europe's relationship with its neighbor Russia has been worsening. At the same time, a combination of upcoming elections and a British referendum on E.U. membership are creating uncertainty about the European Union's future direction.

These challenges and more will need to be addressed within the next decade, while many are more immediate. Below, we take a look at some of the most significant potential issues, and what their implications may be.



IN DEPTH

The migration challenge

The summer of 2015 saw the media full of images of migrants and refugees attempting to storm European border crossings, and of overloaded boats capsizing in the Mediterranean. E.U. governments are attempting to reach agreement on how to care for those that make it to the continent, but the underlying causes are far more difficult to address.

Europe's migrant crisis will continue for as long as its near neighbourhood remains unstable – across Africa, the Middle East, Ukraine and beyond. And as populist anti-immigration political parties are keen to point out, Europe's growing housing shortage and high unemployment rates are unlikely to be helped by the arrival of hundreds of thousands of refugees.

In the short-term, the impact of the migrant crisis could be significant. Already some are suggesting reintroducing border controls within the Schengen passport-free travel zone. This in turn could slow supply chains across the continent as trucks are stopped and searched for illegal immigrants, and chip away at the concept of free movement of people within the E.U., one of its fundamental principles, and a valuable contributor to Europe's flexible labor market.

But longer-term, increased immigration could be a benefit. Like much of the developed world, Europe's population is aging. With a total fertility rate of 1.55, the population of the E.U. is in decline – Eurostat projecting that the continent's old-age dependency ratio will double to 51 percent by 2080, with its working age population falling by 12% by 2050, creating significant medium- to long-term challenges for social security, jobs, healthcare, pensions and growth.

Migration from outside Europe could help reduce the negative impact of this population decline – though few politicians are willing to make the case for more immigration at a time of continued economic hardship and high unemployment.

The economic challenge

By late 2015 the Greek crisis appeared to have semi-stabilized following renegotiations and a fresh general election. However, the fundamental problem remains: According to recent Eurostat figures, Greece's debt stands at 177.1 percent of GDP, and many of the underlying challenges have yet to be addressed – not just in Greece, but in the governance of the Eurozone as a whole.

Many analysts have pointed to the lack of joint pooling of sovereign risk and responsibility and the lack of any system of fiscal transfers or banking union across the single currency zone as the biggest underlying cause of the crisis. Yet progress towards closer European monetary and political integration will continue to prove extremely difficult when a treaty change would require the agreement of all 28 E.U. member states.

Meanwhile, Europe is also experiencing a growth crisis, with Eurozone growth slowing to 0.3 percent in Q2 2015 despite low energy prices, which had been expected to provide a boost. Growth is projected to remain well under 2 percent for at least the next two years, according to the European Central Bank, primarily due to weakness in France and Italy, two of Europe's biggest economies.

These growth concerns will do little to help relieve European unemployment, which stands at 9.5 percent across the E.U., and 11 percent across the Eurozone, rising to as high as 25.2 percent in Greece, . Meanwhile, youth unemployment stands at 21.4 percent E.U.-wide, 23.2 percent in the Eurozone, is over 50 percent in Greece and Spain, and over 40 percent in Italy, threatening a long-term lack of labor force experience that could damage future growth potential even further.

At the same time, there are growing fears over Europe's economic powerhouse, Germany. With China the number two destination for E.U. exports (and the number one source of imports), the growing slowdown in the People's Republic could hit Germany hard, while the Volkswagen emissions scandal threatens to damage Germany's valuable automobile industry, a significant employer and source of exports. The planned Transatlantic Trade and Investment Partnership trade deal with the U.S. could help boost growth – but its ratification is far from certain, as all 28 E.U. member states as well as the U.S. still need to agree to its terms.

The leadership challenge

To tackle this combination of short, medium and long-term crises will take a clear strategy. Yet while the European Union may have had a clear purpose when its predecessor, the European Economic Community, was founded in 1957, nearly 60 years on its path is less clear.

The debate about Europe's direction is likely to increase in the run-up to the U.K.'s planned referendum on continued E.U. membership, due to take place before the end of 2017. But with Britain not part of the Eurozone, the U.K.'s demands do not include anything to do with reform of the Eurozone to prevent another debt crisis.

Meanwhile, appetite for fundamental European Union reform remains low in other member states. The last major treaty change, the Treaty of Lisbon of 2007, took six years to negotiate and ratify – largely due to the need for unanimous agreement. With E.U. member state governments continually changing, demands often shift with the tides of domestic politics.

Meanwhile Europe's de facto leader, German Chancellor Angela Merkel, is likely to become less of a force on the pan-European stage over the coming years. Her party's domestic support is waning, and with German federal elections due by late 2017 her focus is likely to shift to domestic issues, leaving a leadership vacuum at the head of the European Union. Thanks to a combination of the nature of the E.U.'s institutions and the state of domestic politics in the other E.U. member states, there is no obvious candidate to take the lead.

Positive signs?

But despite these ongoing challenges and the slow pace of European Union reform at a macro level over the last few years, there are some silver linings to all the clouds.

The migration crisis has led to increased recognition of the need for European countries to work together to solve mutual problems, while the debt crisis has highlighted flaws with the Euro that are beginning to be (albeit slowly) addressed. The Eurozone's extended economic slump compared to the rest of the developed world's recovery has led to fresh efforts from the European Commission to focus on policies that encourage research and development, the growth of digital, and innovation. The recent crises may not be over, but they are leading to a growing pan-European recognition that the European Union project needs fresh attention if it is to bring the prosperity it has long promised, where previously it was very much business as usual.

After the protracted negotiations that led to the Lisbon Treaty nearly a decade ago, the appetite for further E.U. reform was tiny, despite there still being much work to do. Until recently, the likelihood of serious reform seemed minimal – but now there are signs that we could be entering a fresh round of thinking about what the European Union is and should be doing. With the world constantly changing, this can only be a good thing.

TALKING POINTS



"The refugee crisis... has revealed the deep underlying rifts within Europe, the lack of solidarity between member states and commitment to liberal values. A Europe that is growingly divided, that closes its borders, and that fails to live up to its responsibilities will not be able to face up to the huge security and social challenges of the next decades." – András Simonyi, Managing Director, Center for Transatlantic Relations, John Hopkins University



"A couple of years ago I pressed a senior German diplomat on how his country would respond to the deteriorating situation in Europe. He said that Berlin's approach was to hold on and work the crises. Arguably, not much has changed since then, whether in Germany or in Europe as a whole. Tactics substitute for strategy, and muddling through is touted as vision. The problem is that crisis management is not enough." – Andrew A. Michta, Professor of National Security, U.S. Naval War College



"Where [the European Union is] at the moment they need to use all available tools. That means growth and job-friendly fiscal policies for those that can afford it, monetary policy that is innovative and quite aggressive, and it means, absolutely, structural reforms that they have been talking about. They have to just get on with it and do it." – Christine Lagarde, Managing Director, International Monetary Fund



"From the way we make European laws to the fine details of how we manage our mutual independence, the EU has always been changing. The question now, as ever, is simply what's next on the agenda." – Richard Corbett MEP

FURTHER READING

- How can Europe Create a More Prosperous Future? – World Economic Forum Agenda, 16 September, 2015
- The Eurozone Recovery is Losing Momentum – The Economist, 14 August, 2015
- Germany: Reinstating Leadership in Europe – Europe's World, 21 September, 2015
- Europe's Economic Challenge Not Just About Greece – BBC, 18 August, 2015
- How Exposed is Europe to a Chinese Economic Slowdown? – Forbes, 25 August, 2015
- Europe Doesn't Have Enough Immigrants – BloombergView, 4 September, 2015
- Europe 2020 – The European Commission's economic growth strategy
- Political Risk Map – Aon's interactive global guide to political risk
- Aon Global Risk Alerts – country-specific overviews, updated as needed

