Next Generation Democracy

Wider Europe

Track 2 - Business and the Economy

Regional Trends 2000-2015 & Projections 2015-2030

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NOTE TO THE READER

NGD regional reports for Track II, 'Business and the Economy', analyze trends and projections in democratic governance from a predominantly economic perspective, on the basis of a multidimensional template specifically formulated by the Club de Madrid and the Bertelsmann Stiftung for this purpose. These reports jave been prepared by the Bertelsmann Transformation Index (BTI) team and complemented and fine-tuned as a result of extensive exchanges between International IDEA relevant staff, the CdM Secretariat and, more significantly, NGD regional partners and relevant stakeholders from each region, from sources such as the Round Table discussios that took place in the respective regions.

The template for NGD Track II reports is based on BTI and Bertelsmann Sustainable Governance Indicators (SGI) wich provide an overview of the quality of the market economy (including both economic performance and social developments) as it relates to democratic governance. The BTI team has contextualized and interpreted other economic indicators, particularly those provided by the World Bank´s Doing Business project. The assessent covers the past ten to fifteen years, and the projections sections, which have been drafted by NGD regional partners, represent an attempt to foresee key challegnges and opportunities in the respective field for the next fifteen years.

The relevant BTI and SGI indicators for each section are as follows (see full range of indicators at https://www.bti-project.org/en/index/methodology/):

- ***Economic competition***: 7.1 Market-based competition; 7.4 Banking system.
- ***Legal certainty***: 9.2 Private enterprise – market principles; 9.1 Property rights; 3.3 Prosecution of office abuse.
- ***Market Access***: 9.2 Private enterprise – protection of private companies and privatization processes; 7.2 Anti-monopoly policy; 7.3 Liberalization of foreign trade.
- ***Inclusiveness & Non-discrimination***: 10.1 Social safety nets; 12.2 Education policy; Labor market policy – information from BTI indicators 6, 7.1 and 10.2.
- ***Strategic capacity and Efficiency***: 8.1 Price stability/monetary policy, Macrostability, fiscal / debt policies; 12.1 Sustainability / environmental policy; 17.1 Effective use of support of international partners.
- ***Consensus-building***: 16.1 Actor consensus; 16.4 Civil society participation in shaping economic policies.

These reports constitute the second major step of the NGD process following the discussions on Track I reports, wich will progressively organize transformative practices and ideas, and will draft NGD regional agendas in reaction to signals of democratic decline, advancing democracy worldwide.

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Introduction

The last 15 years of economic performance in the region Wider Europe have been largely overshadowed by the impact and aftermath of the global economic crisis that began in autumn of 2008. Prior to the crisis, most European economies had experienced an extended period of economic growth, with average annual growth rates hovering around 4 percent at the turn of the century (1999 – 2001, sample average), reaching 5 percent (2005 – 2007, sample average) in the boom period right before the crisis. During this boom period, inflation rates reached an average 3.5 percent and unemployment rates a near 10 percent.

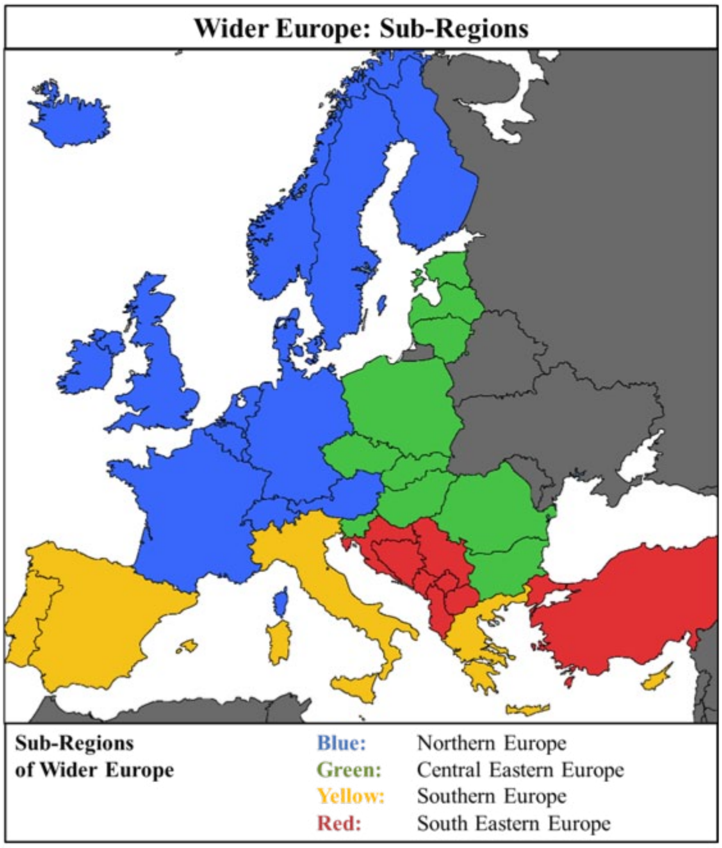


Figure 1: Sub-regions

The global recession of 2009 and the ensuing financial turmoil hit almost all countries of the Wider Europe sample severely. Only four countries out of 39 did not suffer a recession with negative growth rates. All others faced GDP contraction in magnitudes unheard of in the post-World War II period[1]. Collapsing world markets across almost all industrial and financial sectors hurt the relatively open and trade-reliant European economies in particular, ushering in a massive slump in economic activity. Since then, economic recovery has been sluggish in all but a few countries. Only 15 of the 35 countries in Wider Europe that fell into recession have since reached pre-crisis GDP levels and only nine of these have managed to overcome the crisis-induced losses of per capita income. While the crisis affected the European economies rather uniformly, the immediate crisis reactions and mid-term consequences in the four years since 2009 have differed largely among the countries of the Wider Europe sample. To suitably capture these differing experiences, the rather large sample is split into four sub-regions: Northern Europe, Southern Europe, Central Eastern Europe and South Eastern Europe. These groups form geographical clusters that perform more or less consistently, which should allow for a comprehensive picture of economic performance in Wider Europe.

1 Only the former socialist states in Eastern Europe had experienced comparable economic developments during the post-transition recession in the early 1990s.

The countries of ***Northern Europe***[2] belong to the richest economies worldwide (GDP per capita of more than $45,000 on average) and feature fairly equal income distributions, relatively low unemployment levels and highly developed institutional frameworks. Following a period of sustained growth from 2000 to 2007, these countries experienced a deep recession in 2009 with an average economic contraction of 4.4 percent. This decline in GDP was largely due to these countries' high level of involvement in global trade; the average share of exports to GDP in these countries lies around 60 percent. The recession was accompanied by low inflation rates and an increase in unemployment (about 2% on average between 2007 and 2009). The immediate policy reaction to the crisis included distinctively **Keynesian measures** marked by major fiscal stimuli and several rescue packages for troubled banks.

In turn, this led to a significant increase in public debt as a percentage of GDP from 27 percent in 2007 to 2013, on average. Most of the sub-region's countries have successfully overcome the recession, but only **Austria, Germany** and **Switzerland** have managed to return to their pre-crisis GDP per capita levels. These German-speaking countries constitute a clear exception in terms of post-crisis development, featuring reduced unemployment, lower than average debt and an overall strong performance in the aftermath of 2009. The sub-region's other countries still struggle with either reaching pre-crisis GDP levels or have managed to reach pre-crisis GDP but still face losses in per capita income.

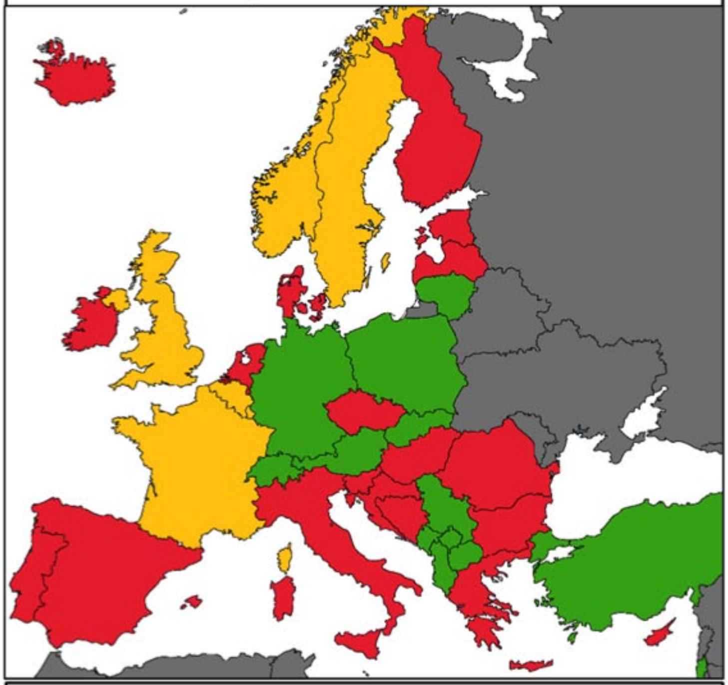
Those countries have achieved only sluggish growth since the crisis, with most countries being close to or in a double-dip recession in 2013 (average growth of 0.7% from 2012 to 2013). **Ireland** and **France** in particular have faced severe difficulties. Ireland, Europe's star performer a decade ago, slipped into a deep crisis with a highly stressed banking sector, exploding private and public debt and a sharp rise of unemployment. Ireland was the first EU member state to turn to the credit line offered by the European Union via the **European Stability Mechanism (ESM)** and implement harsh austerity policies. Having exited this rescue program in late 2013, Ireland is now showing signs of recovery. France, on the other hand, was not hit particularly hard by the crisis in terms of GDP growth, but it has struggled with persistently high unemployment levels, especially among its youth (around 25% in 2013). This, and soaring public debt, point to severe structural weaknesses in the French economy.

The **Southern European**[3] economies clearly face the worst economic problems in post-crisis Europe. While initially not hit harder than any other countries, they have found themselves in a protracted recession since 2009, grappling with negative growth rates, extremely high unemployment levels (almost 20% on average) among youth in particular (40% – 60% of 15 to 24 year-olds are without a job), and unsustainably high levels of public debt. Economic developments in these countries prior to the crisis, combined with unsound fiscal policies driven by low interest rates (a factor of eurozone membership), account in large part for their post-crisis difficulties. In these countries, steady increase in income and production as well as foreign capital inflows were accompanied by increasing real wages and prices.

This prolonged period of economic growth resulted in real appreciations (nominal depreciation which would cushion these effects was impossible due to eurozone membership) and ultimately in a loss of productivity and competitiveness.

2 Austria, Belgium, Denmark, Finland, France, Germany, Iceland, Ireland, Luxembourg, Netherlands, Norway, Sweden, Switzerland, UK
3 Cyprus, Greece, Italy, Malta, Portugal, Spain

Wider Europe: Economic Performance



Crisis Resolution In Wider Europe		
	Green:	Above pre crisis GDP
	Yellow:	Reduction of GDP p.c.
	Red:	Reduction of GDP level

		2000	2007	2009	2013
Northern Europe	GDP p.c. ($)	42,707	49,096	46,293	47,353
	GDP Growth	3.7%*	3.7%*	-4.4%	0.7%
	Unemployment	5.1%	5.1%	6.8%	7.1%
Southern Europe	GDP p.c. ($)	28,583	31,952	30,754	28,687
	GDP Growth	3.6%	3.0%	-3.5%	-1.7%
	Unemployment	8.6%	6.9%	9.5%	17.5%
Eastern Europe	GDP p.c. ($)	14,863	22,632	21,275	23,292
	GDP Growth	3.4%	7.0%	-8.1%	1.65%
	Unemployment	12.3%	6.6%	10.1%	10.3%
South Eastern Europe	GDP p.c. ($)	10,727	13,962	14,039	15,200
	GDP Growth	5.2%	5.8%	-1.8%	2.5%
	Unemployment	16.8%	17.9%	17.0%	18.7%

Figure 2: Economis Performance (averages 1999-2001 and 2005-2007)

EU and IMF- prescribed remedies called for a policy of austerity and institutional reforms in order to bring about internal depreciation and thereby regain competitiveness on global markets. This policy was accompanied by massive financial support through the ESM, thereby allowing the **European Central Bank** to sustain debt and avoid introducing expansive monetary policy in order to stimulate economic activity. The outcome of this approach is not yet clear, as **Portugal** and **Spain** are showing signs of recovery and have left the ESM scheme, while **Greece** remains in a desperate situation. Spending cuts in Greece have ushered in a severe decline in living standards, a strong increase in out- migration and political tensions manifest in the successes of political forces opposing further austerity measures. **Italy**, which continues to grapple with the effects of the crisis but has yet to call for an ESM bailout, poses perhaps the most crucial case for the future of the eurozone. Should matters in Italy worsen considerably, the EU economic institutions could be pushed to their limits, generating further turmoil in the European Union. Much depends on Italian Prime Minister Matteo Renzi's reform attempts, which appear promising though difficult to implement.

Economic performance in **Central Eastern Europe**[4] was extraordinary in the years prior to the crisis with an average increase in GDP per capita of 52 percent from 2000 to 2007. These countries' Income levels in these countries, particularly in urban centers such as **Bratislava, Prague** or **Warsaw** approached Western standards.

4 Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia

This boom was fueled by large inflows of foreign direct investment and led to deep integration into world markets (export and import shares of more than 50% of GDP). Reliance on foreign capital and heavy involvement in international trade accounts in part for the crisis' strong impact on these countries' economies. In 2009, GDP in Central Eastern European economies contracted on average by more than 8 percent and by 15 to 18 percent in the **Baltic states**. Collapsing world markets slowed production and general uncertainty in financial markets prompted an abrupt halt to inflows of international capital. **Poland**, however, constitutes a remarkable exception here, since it is the only country that weathered the crisis without GDP contraction. While still burdened by high youth unemployment and considerable disparities between rural and urban areas in particular, Poland's performance is nonetheless remarkable. The Baltic states, facing the worst immediate setbacks, responded to the crisis by introducing strong austerity measures with deep spending cuts that reduced pensions and unemployment benefits in particular. While these measures accelerated declining living standards for many and fueled a massive flow of out-migration, the Baltics also managed to spur economic growth and reduce unemployment considerably. Other countries, most notably **Hungary** and **Slovenia**, continue to face worsening economic conditions and have thus far failed to overcome the economic slump.

The group of **South Eastern Europe**[5] consists almost exclusively of relatively poor countries with GDP per capita levels of around $10,000. These countries are much less developed than the other countries of Wider Europe and face several institutional weaknesses (e.g., corruption, deficient legal systems, low level of socioeconomic development) as well as economic problems such as consistently high overall unemployment (18%, on average) and youth unemployment (35%). Nonetheless, these countries experienced a sustained growth period between 2000 and 2007 that significantly increased living standards, although the **former Yugoslavian states** of South Eastern Europe still lag far behind when compared in particular to their Central Eastern European neighbors. Like other poor nations less integrated into the global economy, the sub-region's poorer countries suffered less compared to the rest of Wider Europe in terms of GDP contraction as a result of the crisis. Furthermore, excepting **Bosnia and Herzegovina** and **Croatia**, each country hit by the crisis has since regained their initial loss in GDP per capita. Croatia, an EU member state since 2013, constitutes a special case in this regard, since it clearly is the most advanced country of the group. In 2009, the Croatian economy faced a steep decline in GDP, struggling since then with sluggish growth and soaring unemployment among youth in particular. **Turkey**, by contrast, has recovered quickly from the initially strong effects of the crisis and has continued to catch up showing strong economic growth, declining unemployment and high inflation rates. **Israel** stands out as another example of a country also hit less severely by economic contraction and featuring strong economic indicators, such as a low unemployment rate of 6 percent.

5 Albania, Bosnia and Herzegovina, Croatia, Israel, Kosovo, Macedonia, Montenegro, Serbia, Turkey

I. Values and Institutions

1. Economic competition (2000-2015)

The single market of the EU guarantees free movement of goods, services, labor and capital as well as the absence of tariffs within the EU. Several external agreements with non-EU members **Switzerland, Norway** and **Iceland** ensure that these countries face very few barriers in accessing the common market. Several EU members have even integrated institutionally through the formation of a common currency area, the eurozone. As in other areas, the state of affairs in terms of economic competition throughout the sample of Wider Europe is heterogeneous: While the group of Northern European countries offer a benchmark for economic development in most fields, the other groups within the sample lag (in some cases far) behind in several aspects of institutional and economic development.

Economic competition in **Northern Europe** is characterized by well-functioning markets in almost all economic areas. The firms of the Northern European economies, which usually enjoy competitive advantages as a result their superior product quality, sophisticated production processes and high innovative capacity, are very well suited for success in the single European market. In addition, these countries benefit from some of the best infrastructures in the world, the large number of local suppliers and the fact that organized crime and corruption do not play major roles in economic life. Inflation in these countries has been moderate over the past fifteen years, and the European Central Bank (ECB) and other largely independent central banks conduct successful anti-inflation policies. The financial sectors of some countries of Northern Europe are still suffering from the financial crisis of 2008/09 and the associated budget crises in Southern Europe, which most Northern European banks were heavily involved in. The Icelandic and Irish banking sectors in particular, which have faced severe domestic banking crises in the aftermath of 2009, are still ailing. But there are also questions regarding the soundness of banks in the **United Kingdom, Belgium, Denmark** and the **Netherlands** and, to a lesser degree, in **Austria, Germany** and **France**. Northern Europe's financial sector, however, still provides a wide range of financial products and services to business throughout the sub-region (with availability and range being more restricted in Ireland and Iceland), particularly when compared to other parts of Europe and the world.

The economies of **Southern European** suffer from institutional weaknesses which, combined with deep integration into European structures, have led to various structural problems. The firms from Southern Europe face fierce competition on the single European market both in terms of product quality (companies in Northern Europe have competitive advantages) and in terms of production costs (companies in Central Eastern Europe have lower costs here). Success in this environment is difficult for Mediterranean companies struggling with structural and institutional deficiencies that have become all too apparent since the debt-fueled boom from 2000 to 2007 was brought to an abrupt end by the 2009 global economic crisis. As high inflation rates continued and real wage increases mounted, these economies lost competitiveness vis-à-vis other European countries. Since they are members of the eurozone, they could not simply improve their competitive position with a nominal depreciation. In this regard, the deep integration into European markets and structures became an obstacle to economic development in Southern Europe, since most of the sub-region's firms were not able to develop the competitive advantages needed for success. They were either not innovative enough to compete with Northern European high-quality products or their costs had grown too high to compete with low-cost production from Central Eastern Europe or non-European countries.

These structural deficiencies in combination with several institutional weaknesses, such as insufficient anti-corruption mechanisms (in Italy and Greece in particular), insufficient anti-monopoly policies on a national level and an unfavorable institutional environment for FDI account for the current malaise. Since political actors have excluded nominal depreciation (which would involve an exit from the eurozone) as a crisis remedy, Southern European economies can regain competitiveness only by introducing structural reforms and reducing price and labor cost. This is and will continue to be a very painful process accompanied by massive losses in living standards and growing political tensions, particularly if the burden is imbalanced and lower and middle income groups bear the brunt of the sacrifices. Severe turbulences throughout Southern Europe's financial markets are another consequence of the crisis that have raised questions about their banks' soundness and slowed the flow of capital from banks to companies. This represents yet another obstacle to regaining a competitive edge. There is ground for optimism as some Southern European countries feature favorable assets such as a very good infrastructure (i.e., **Portugal**) or above-average supplier quality and quantity (particularly **Italy**, but also **Portugal** and **Spain**). These assets, in combination with support from EU institutions and the IMF in implementing necessary reforms, could facilitate this difficult process.

For the **Central Eastern European** countries, the 20 years since transition from a socialist to a capitalist system have represented – despite initial setbacks – a period of steady and tremendously successful economic catch-up. These countries rapidly established market competition both macro- and microeconomically through large-scale deregulation and privatization. As a result, these countries possess much more favorable institutional frameworks than do comparable regions (e.g., South Eastern Europe or CIS). The rapid integration into European structures, which resulted in EU accession in 2004 and 2007, and large western influence via massive FDI inflows, have fostered this process of economic advancement and led to a considerable boom in economic activity that continued up to the 2008/09 crisis. The Central Eastern European countries have been (and are) deeply integrated into global trade, and benefit from access to the single European market. Within this context, they profited from competitive advantages resulting from a (relatively) low-cost environment, a favorable institutional framework and geographical proximity to sophisticated large buyer markets in Central Europe. This was accompanied by the existence of a solid banking sector and functioning capital markets which, in addition to the large inflow of foreign capital, secured capital availability during the growth period until 2009.

Since the crisis of 2009, which hit the region particularly hard, some countries of Central Eastern Europe hae faced difficulties. The soundness of banks in **Hungary, Lithuania, Romania** and especially **Slovenia**, for example, is questionable which, in turn affects the availability of financial services in those countries (except Lithuania). However, **Czech** and Slovakian banks are considered to be generally healthy and show sound balance sheets. Financial services in both countries as well as in **Poland** and the **Baltic states** are fairly widespread. A closer look at the nature of competitive advantages in each state yields heterogeneous findings. Whereas competitive advantages in the **Czech Republic, Estonia** and **Slovenia** derive primarily from unique products and processes as well as a relatively high capacity for innovation (which is also present in Lithuania), competitive advantages elsewhere in the sub-region derive from low labor costs. This heterogeneity is also evident when comparing the intensity of local competition, which is high in the Baltic states, **Slovakia** and the Czech Republic, and less so in the other countries, particularly **Bulgaria** and **Romania**.

The quality of infrastructure in most Eastern European countries approaches the highest standards, and organized crime in these countries imposes few costs on businesses. Exceptions here are Poland and, once again, Romania, Bulgaria and Slovakia, where infrastructure lacks quality to a certain degree and organized crime harms economic life to a considerable extent. Furthermore, with the exception of **Estonia**, anti-corruption mechanisms are insufficient in each of the group's countries, which serves as a constraint to business. The 2009 economic crisis and the years following bore a significant negative impact in some countries and exposed several institutional weaknesses, particularly in Slovenia. Several countries in the sub-region – Bulgaria and Romania in particular – continue to lag behind in terms of economic development. All in all, however, Central Eastern Europe enjoys high quality frameworks of economic institutions that are integral to fostering economic development, particularly in comparison to other regions with similar initial contexts (South Eastern Europe, CIS) or those competing on the same markets (Southern Europe).

After the collapse of the Eastern bloc, **South Eastern European** countries found themselves in an economic context similar to that of their Central Eastern neighbors that involved establishing market competition as the guiding principle of economic life. There were several hurdles to success in this regard, the most significant perhaps being the Balkan Wars of the 1990s. Economic development has been sluggish in the former Yugoslavian states (except Slovenia), where living standards remain low and structural deficiencies in economic frameworks persist. This lagging economic development is accompanied by institutional shortcomings such as an underdeveloped infrastructure, organized crime imposing high costs on business, and ineffective anti-corruption mechanisms. EU accession is a long-term goal, but with the exception of **Croatia** and **Slovenia**, none of the former Yugoslavian states have surpassed potential candidate (**Bosnia and Herzegovina, Kosovo**) status or recognized candidates (**Albania, Macedonia, Montenegro, Serbia** and **Turkey**).

The banking system in former Yugoslavia is underdeveloped and financial services are comparatively scarce. FDI inflows are considerable, despite the fact that in most countries (except **Macedonia**), taxation and rules or regulations discourage investment to a great extent. Companies draw competitive advantages almost exclusively from low labor costs. Consequently, production processes are labor intensive and innovative capacity is low. All in all, the fundamentals of market-based competition remain underdeveloped in former Yugoslavia, which results in lagging economic development, especially in comparison to their Central Eastern European peers. Notable exceptions include EU member Croatia, which in almost all regards performs more like the group of Central Eastern Europeans and, of course, **Israel** and **Turkey**. Israel could in most areas be considered a fully developed economy. Turkey, despite its shortcomings, enjoys a significantly more facilitative institutional framework and accounts in part for the country's impressive economic performance in recent years.

2. Legal certainty (2000-2015)

The legal framework of the **Northern European** countries is solid and acts as a benchmark for the rest of the world. Property rights are well defined, intellectual property is protected effectively and legal institutions are generally efficient in settling disputes between different entities as well as in challenging government actions and regulations. This holds for the entire group of Northern Europe except for outliers in some fields. The efficiency of the legal framework in settling disputes in **Belgium** in **France**, for example, is rated lower than that of the other countries. The same holds for its efficiency in challenging regulations in **Denmark, Austria** and, again, Belgium. Despite these minor deficiencies, however, the rule of law is guaranteed in Northern Europe and acts as a blueprint for a legal framework fostering economic activity. The only country that consistently scores worse in overall evaluations of the legal system is France (and to a lesser degree Belgium and **Luxembourg**), where the inadequate implementation of rules and regulations in particular and the prevalence of administrative discretion bear a negative impact on legal certainty. One further limitation of several Northern European countries' legal frameworks is – according to World Bank assessments – the legal protection of lenders' and borrowers' rights, which is insufficient in **Austria, France, Germany** and **Iceland**, and is particularly weak in **Belgium, Norway, the Netherlands** and Luxembourg. But on the whole, legal certainty in Northern Europe is very high and the legal framework supports economic activity.

Legal certainty in **Southern Europe** is assessed to be reasonably high, but the legal framework in many of the region's countries hinders economic development in specific ways. **Spain, Portugal** and **Greece** score relatively high on the corresponding Sustainable Governance Indicator (SGI) for legal certainty, although uncertainty has been a byproduct of unforeseeable outcomes of reform efforts in response to the crisis. More shortcomings have been identified in **Italy**, where inconsistent and frequently shifting legal regulations hamper legal certainty. Moreover, protection of general property rights and intellectual property is deemed to be weak in Southern Europe, especially in Greece, Spain and Italy. Concerning the protection of lenders' and borrowers' rights, contries across the group (except **Cyprus**) score equally poorly. Probably the most significant constraint on economic activity throughout the sub-region, however, is the lack of efficiency in settling disputes and challenging government regulations in legal frameworks. Italy, for example, ranks 135th and 143rd out of 144 countries in the corresponding global rankings of the World Economic Forum[1]. Greece, Portugal and Spain also rank near the bottom on these points as well. Weak legal frameworks throughout the sub-region thus stifle economic development and aggravate the structural crisis.

The performance of legal frameworks across the **Central Eastern European** sub-region varies. **Estonia** stands out as a clear positive outlier. Legal certainty is high in Estonia, where both physical and intellectual property are well protected, and the legal system effectively settles disputes and cases in which government actions are challenged. The effectiveness of Estonia's legal framework is on par with that observed in Northern European countries, which is a remarkable achievement given the country's Soviet Union legacy. According to the SGI, legal certainty in other Baltic states as well as **Poland, the Czech Republic** and **Slovenia** is also comparable to that seen in Northern European countries. However, in terms of property rights protection, judicial independence and the extent to which the legal framework effectively resolves disputes and challenges to government actions, countries in the sub-region such as **Bulgaria, Slovakia** and **Romania** generally perform poorly. Performance is particularly weak in **Hungary** where

1 The corresponding indicators of the Global Competitiveness Report are “1.11. Efficiency of legal framework in challenging regulations” and “1.10 Efficiency of legal framework in settling disputes”

the legal system has been increasingly hollowed out in recent years. The chaotic nature of constantly shifting legislation over the last three years have fundamentally undermined efficiency and legal certainty. However, with the exception of the Czech Republic and Slovenia, countries in the sub-region protect and ensure the rights of borrowers and lenders effectively.

South Eastern Europe also features legal systems with functional shortcomings. Weak legal frameworks in the former Yugoslav states inhibit economic development and are particularly inefficient when it comes to settling disputes or challenges to government decisions. In the **Balkan states**, where corruption is widespread, the protection of property rights and prosecution of office abuse are poorly managed. **Macedonia** is the only exception here and scores higher than the rest of the group on indicators of the Global Competitiveness Report assessing the rule of law. The institutional design of legal systems in the Balkan states do, however, feature sound protections of lenders' and borrowers' rights. According to World Bank rankings, the former Yugoslav states perform much better in this regard: **Albania, Montenegro** and Macedonia even achieve the highest possible scores for this indicator. Overall, legal frameworks in South Eastern Europe are weak and do not foster economic activity. **Israel** and **Turkey**, by contrast, perform better in this regard. Israel's legal framework is effective and comparable to those established in Northern European countries, and Turkey – though burdened by problems such as widespread corruption – offers a framework that is relatively conducive to economic growth.

Projections (2015-2030)

Economic Competition

In November 2015, the European Commission estimated growth in the eurozone for 2015 at 1.6%, 1.8% for 2016 and 1.9% for 2017. Expected growth rates for the EU as a whole are slightly higher at 1.9% for 2015, 2% for 2016 and 2.1% for 2017[2]. These projections show considerably different patterns for different countries. Growth rates over the coming two years are relatively sustained in Central Eastern Europe, ranging between 2.5% and 3.5% in most countries there. Similar growth is expected in **Spain**, while **Ireland** is projected to be the fastest growing economy in Europe during this period. **Sweden** and the **UK** feature relatively high growth – between 2% and 3% – with European Commission, European Economic Forecast Autumn 2015, op.cit. growth rates in **Italy** and **France** picking up on a lower level – between 1% and 1.7%. The **Greek** economy is expected to contract by 1.4% in 2015 and 1.3% in 2016 before expanding by 2.7% in 2017.

Over a longer timeframe, estimates differ widely. Some estimate the EU to feature an average growth rate close to 2% between 2021 and 2030, against an average rate of 3% for the world over the same period[3]. The **European Commission** projects an average growth rate of 1.4% for the EU between 2013 and 2060, assuming the convergence of member states around an annual growth in total factor productivity (TFP) of 1%. Should the TFP growth rate dip below 1% (e.g., 0.8%), average annual GDP growth would be at 1.2% through 2060. As the working-age population is expected to decrease and can be compensated for only partially by higher employment rates, labor productivity growth

2 European Commission, European Economic Forecast Autumn 2015, op.cit.
3 PwC, The World in 2050. Will the shift in global economic power continue?, February 2015 http://www.pwc.com/gx/en/issues/the-economy/assets/world-in-2050-february-2015.pdf

(driven by TFP growth) will be the only source of GDP growth[4]. By yet other estimates, annual GDP growth in the EU could average 1.55% (2015-2020), 1.46% (2020-2025) and 1.39% (2025-2030). These projections presume a 1.3% annual growth of labor productivity, which is lower than the average 1.6% growth rate seen before the onset of the economic crisis in 2007. If, however, the labor productivity growth rate reaches 1.6% in 2030, GDP growth would reach 1.9% by 2030[5].

When looking at the 2010 levels of GDP per capita of countries in Northern, Central Eastern and Southern Europe and their expected growth rates from 2010 to 2030, two periods can be distinguished. Central Eastern European countries are expected to continue to feature high GDP per capita growth rates for the period between 2010 and 2020, progressively filling the gap expected in Northern European countries. This convergence does not include countries in Southern Europe, whose GDP per capita growth rates are expected to remain very low during the same period. From 2020 to 2030, GDP per capita growth is projected to pick up in Southern Europe and to remain stable in Central Eastern Europe, thereby accentuating the convergence trend at the EU level[6].

Long-term projections, however, remain speculative since they are sensitive to underlying assumptions and do not incorporate possible exogenous shocks that could suddenly disrupt growth projections. The current and optimistic medium-term projections are fueled by a favorable macroeconomic environment of low oil prices and high interest rates, which will not persist indefinitely. Furthermore, developments in other parts of the world, such as problems in emerging economies like **Brazil, China** or **Russia**, might impact negatively on medium- and long-term growth in Wider Europe, while the home-grown structural crisis, especially in the Southern European countries, is not yet overcome, as evidenced by the tumultuous July 2015 events regarding a bailout for **Greece**. These events demonstrated how political developments in a single member state can aggravate tensions and potentially halt economic recovery.

Should economic recovery gain traction, however, Wider European countries might prove able to deal with underlying structural problems, particularly with respect to the eurozone's institutional design. A favorable environment might allow European countries to tackle other structural issues in their political and economic systems (e.g., a lack of political integration on the European level) and move away from short-term crisis resolution. This could involve further eurozone integration, but would not necessarily require a parallel reform of EU institutions and economically relevant policies. However, a sustained growth process could also conceal the need for those structural reforms, thereby reducing the political will to deal with these problems. In the end, the long-term development of the Wider European economies critically depends on the will and ability of the European governments to work jointly on collective solutions to their structural problems in order to sustain the path to recovery. To date, however, they have demonstrated little will to introduce the necessary forward-looking economic and social policies.

4 European Commission, The 2015 Ageing Report, op. cit.
5 Gros and Alcidi, op. cit.
6 Gros and Alcidi, op. cit.

II. Access and Inclusiveness

1. Market Access (2000-2015)

For most countries in Wider Europe, EU membership ensures access to a vast common market featuring the free movement of goods, services, labor and capital across the union. This constitutes a huge institutional advantage for the region and has been a key factor in Central Eastern Europe's impressive economic development and the solid economic environment enjoyed by Northern European societies. On the national level, however, market access is not in all countries guaranteed to a sufficient degree. The countries of **Northern Europe**, where domestic competition is widespread and national anti-monopoly agencies (together with supranational supervision by EU institutions) efficiently prohibit the abuse of market power and the establishment of cartels, again outperform the other groups in this respect. Tariffs do not exist within the EU and further measures to liberalize foreign trade with other regions (e.g., TTIP) are undertaken. According to the Global Competitiveness Report, despite EU harmonization efforts, non-tariff trade barriers effectively continue in some countries of the group. In **Germany, France** and S**witzerland** (which has bilateral agreements with the EU), health and product standards or other requirements limit the competitiveness of imported goods on domestic markets. Financing is readily available in most of the sub-region's countries. Capital can be acquired through bonds issued by domestic equity markets, and venture capital as well as loans are comparatively easy to obtain. This is less true of **Iceland** and **Ireland** where domestic capital markets continue to suffer from the impact of their respective financial crises. Overall, credit conditions tightened in Wider Europe, but the availability of capital in Northern European capital markets is still relatively high, which eases market access for new companies.

Companies from **Southern Europe** are often not competitive enough to operate in the single European market. National anti-monopoly policies – despite EU supervision – have not been promoting domestic competition, especially in **Italy** and **Greece**. In Italy, business conglomerates predominantly in the north of the country constitute a significant entry barrier for new firms that are located in other parts of the country. **Spain** and **Portugal**, on the other hand, offer better environments for market entrants. Trade barriers, including non-tariff trade barriers, are low in Southern Europe, a fact to which the consistently high import quotas of these countries can be attributed. Turmoil on their financial markets has made the availability of capital scarce in Southern Europe which, in turn, constitutes a significant obstacle to market access.

In **Central Eastern Europe**, once again, market access varies across the sub-region. In some countries, corporate activity is dominated by a few firms and anti-monopoly policies are not always effective, particularly in **Bulgaria, Romania, Slovakia, Slovenia** and **Hungary**, according to the Global Competitiveness Report. EU harmonization has resulted in the liberalization of trade in Central Eastern Europe and non-tariff trade barriers do not hamper foreign trade in most or the sub-region's countries (except Bulgaria, **Lithuania** and Romania). This secures easy market access for foreign competition and has contributed to the high degree of integration into the global economy and the EU economy in particular. In most of the sub-region's countries, there are various sources providing capital finance. Whereas loans and venture capital are easily available in **Estonia, the Czech Republic** and **Slovakia**, financing business activity in the sub-region's other countries is much more difficult. **Slovenia**, for example, is grappling with a severe domestic financial market crisis, and the availability of financing in **Hungary** and **Poland** is rather limited. Furthermore, the domestic equity markets in Central Eastern Europe are underdeveloped and do not offer much potential for financing by issuing shares on stock markets.

In **South Eastern Europe**, market access is much more difficult than elsewhere in the region. Monopolies persist in former Yugoslav markets, and policies targeting the alleviation of monopolistic tendencies are largely ineffective. Trade has been largely liberalized, primarily thanks to several EU agreements, but non-tariff trade barriers persist. **Croatia** constitutes an exception here, as it has successfully abolished most non-tariff trade barriers. In **Albania, Croatia** and **Serbia**, the availability of financing is generally limited. **Macedonia** and **Montenegro** fare better in this regard, since loans and venture capital are easier to acquire than in the rest of South Eastern Europe. Macedonia, moreover, offers better conditions for market access in general, since monopolistic tendencies are not as pronounced there as they are in the rest of the sub-region's countries. **Turkey** and **Israel**, again, offer different environments. In both countries, finance in all forms (i.e., loans, venture capital or funds raised on domestic capital markets) is widely available. Turkey conducts rather successful anti-monopoly policies, while there is strong monopolistic competition in Israel. Both countries have, however, comparatively high barriers to non-tariff trade.

2. Inclusiveness & Non-discrimination (2000-2015)

According to the SGI, policies in **Northern Europe** targeting social inclusion and welfare are quite effective. The Scandinavian countries traditionally score high in these ares of the SGI ranking. Throughout **Scandinavia**, social policies do much to prevent exclusion and poverty, which results in significantly lower Gini index values for these countries. The other countries of Northern Europe also feature successful social policies. Shortcomings do, however, persist and include problems with ensuring the social inclusion of immigrants in **Austria, France** and **Belgium** or the significant reduction of welfare state benefits in **Germany**. Income disparities in France and Germany are therefore much larger than those observed in Scandinavia. Outliers in terms of social inclusion are Ireland and the **United Kingdom**, where higher income inequality and poverty rates are prevalent. Their decidedly more liberal welfare state policies do not cushion market results as strongly as those of the other countries in Northern Europe. Some attempts to mitigate these high levels of inequality, however, have been undertaken and have resulted in a moderate reduction of Great Britain's Gini index value.

Northern European labor markets were hard hit by the economic crisis beginning in 2008. Most of the sub-region's countries have since recorded significant increases in unemployment, though rates remain below 10% in each of the sub-region's countries exceept **Ireland** and France. Rising youth unemployment rates have also been a problem in the sub-region. In **Belgium, Finland, France, Ireland, Luxembourg, Sweden** and the **United Kingdom** some 20% of the working population between the ages of 15 to 24 are not employed, which points to structural problems in these countries' labor markets and education systems. Outliers in terms of labor market development include Norway and the German-speaking countries **Austria, Germany** and **Switzerland**. Unemployment rates in these countries have hovered around 5% since the beginning of the 2008-onwards economic crisis and either did not increase during that crisis or have (in the case of Germany) even fallen significantly since then. Long-term unemployment, however, remains high in **Germany**, where around 45% of all unemployed are without a job for more than a year. This might point to structural issues in accessing the labor market, and appears to be a problem in **Belgium, France, Ireland, the Netherlands** and **Switzerland** as well, where long-term unemployment rates have surpassed 33%. Despite these problems, however, the labor markets in most Northern European countries appear to be relatively healthy, especially compared to other parts of Wider Europe. The one exception in this regard is France, where unemployment rates are above 10%, long-term unemployment exceeds 40% and youth unemployment rates are nearly 24% (all in 2013), signifying deep structural problems and the urgent need for reform in French labor markets. One reason for these problems might be the generally confrontational nature of labor-employer relations in France: while all other Northern European countries feature rather cooperative relations between firms and the workforce, France is ranked 129th out of 144 countries in the corresponding ranking of the Global Competitiveness Report[7]. In their assessment of French labor market policy, SGI experts identify several weaknesses including the absence of smooth transitions from schools to employment, a dual labor market and generally heavy labor market regulation.

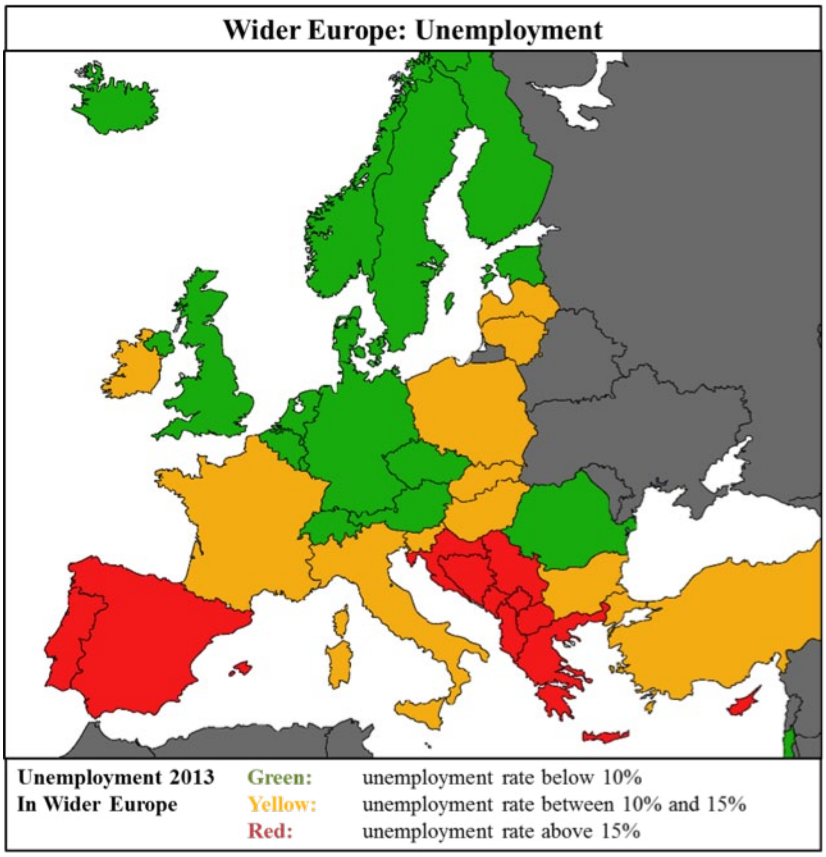


Figure 3: Unemployment in Wider Europe

In assessments of education policy, mixed results can be observed for Northern Europe. **Finland, Iceland, Sweden, Switzerland** and the **UK** score comparatively high on the corresponding SGI indicator. In **Austria** and **Germany** in particular, parents' educational status has a considerable impact on the success of children at universities. However, vocational training and education schemes are effective and likely have contributed to the strong labor market performance observed in both countries. On the whole, the educational systems of Northern Europe meet the needs of a competitive economy quite well. The worst performer in this regard is once again France, which appears to be the least inclusive country of Northern Europe. The relatively low degree of inclusion has likely contributed to the country's overall troublesome economic performance in recent years and on the labor market in particular.

7 The corresponding indicators are "7.01 Cooperation in labor-employer relations"

Social inclusion and non-discrimination are considerably less developed in Southern European economies. Across the sub-region, social inclusion policy is weak, income inequality is high, labor markets suffer deep structural crises and the quality of educational systems is far below that observed in Northern European countries. These deficiencies are especially apparent in **Greece**, where inequality and poverty worsened considerably in the wake of major cutbacks to welfare provisions. The Greek labor market is in deep crisis as well, with unemployment at 27% and youth and long-term unemployment each approaching 60%. Ranking only 111th out of 144 countries in terms of Quality of the education system on the Global Competitiveness Report, Greece's educational system is performs poorly.

The state of inclusiveness and non-discrimination in **Italy, Portugal** and **Spain** is also alarming, while **Malta** and **Cyprus** perform much better, particularly with respect to education. Social inclusion policies in Italy, Portugal and Spain are ineffective. Long plagued by an economic divide between the wealthy north and a structurally weak south, Italy continues to grapple with regional inequalities. And while social inclusion fares better in Spain and Portugal, the negative effects of the global economic crisis have exacerbated poverty in these countries. Spain's labor market, similar to Greece's, suffers from high total unemployment (27% in 2013) and high youth unemployment (58% in 2013). Unemployment rates are also exceptionally high in both Portugal (17% total unemployment and 38% youth unemployment, both in 2013) and Italy (12% total unemployment and 39% youth unemployment, both in 2013). Weak educational systems across Southern Europe account in part for these countries structural labor market crises, though the educational system in Portugal performs much better than that in Italy, Spain and Greece. These institutional weaknesses of the Southern European labor markets and educational systems call for structural reforms currently underway in these countries, with Portugal and Spain performing better than Italy and Greece. Just how effective these reforms will prove remains unclear.

The extent to which social inclusion is ensured in **Central Eastern Europe** varies considerably from country to country. In terms of income inequality, the **Czech Republic, Hungary, Slovakia** and **Slovenia** stand out with remarkably low Gini coefficients. These countries feature income equality levels as high as those seen in egalitarian Scandinavian societies. High levels of inequality in **Poland** have been significantly reduced over the last ten years, in part thanks to the country's extensive welfare policies. Social inclusion policy is effective in the Czech Republic, Poland and Slovenia, and less so in Slovakia and Hungary. SGI experts, for example, criticize the social exclusion of Slovakia's Roma population and the further impoverishment of low-income people and a weakened middle class in Hungary. Income inequality as measured by the Gini coefficient is much higher in **Bulgaria, Romania** and the **Baltic states**. These countries possess welfare state regimes providing only few social benefits for citizens, which has contributed to a mass outflow of migrants from the Baltics in particular since 2008.

Labor market performance also varies considerably across Central Eastern Europe. Unemployment has not increased considerably in the Czech Republic, Poland and Romania throughout the 2008-onwards economic crisis. However, unemployment increased by 3 to 6 percentage points between 2008 and 2013 in Bulgaria, Hungary, Slovakia and Slovenia. In the Baltic states, unemployment increased on average by 10 percentage points from 2007 to 2009 as a result of the massive contraction of economic activity in the crisis years of 2008/09. Since 2009, however, the Baltic economies have recovered, having significantly reduced unemployment to current rates of 11% in Latvia and **Lithuania** and less than 9% in **Estonia**. These successes can in part be attributed to very flexible labor markets

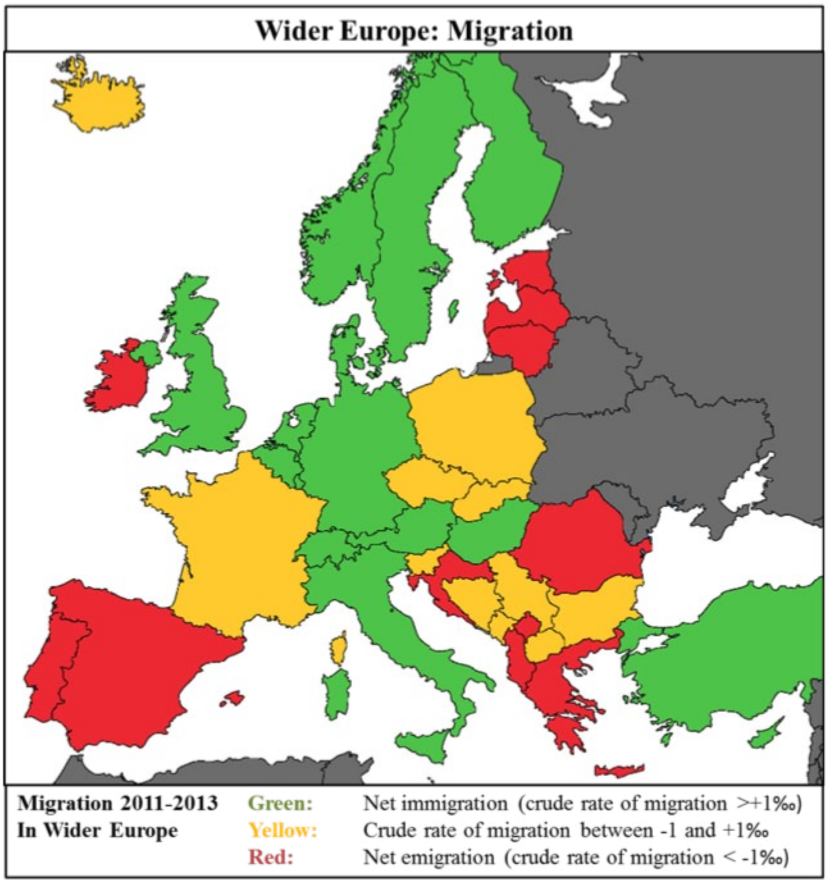


Figure 4: Migration Patterns

in these countries, but also to massive flows of out-migration (e.g., net migration rate in Lithuania was at 2% in 2010). All Central Eastern European countries feature high levels of youth unemployment (25% on average). In Bulgaria, youth unemployment increased from 16% in 2009 to 30% in 2013, and in Hungary and Slovakia youth unemployment also increased massively (from 18% in Hungary and 20% in Slovakia in 2009 to 27% and 33% in 2013 respectively). These countries' weak educational systems, which receive poor scores from SGI experts and the Global Competitiveness Report, account in part for these exploding figures. Lithuania, Slovenia and most notably Estonia fare much better in this regard. Estonia's education policy received the highest SGI score and Estonian students consistently perform well in international studies such as the PISA assessments. Bulgaria, Hungary, Romania and Slovakia clearly lag behind in this regard, which constitutes a heavy institutional burden.

In **South Eastern Europe**, poverty rates and the degree of income inequality are higher in spite of social safety nets being in place. Unemployment is very high across the sub-region (18% on average in 2013) and particularly high among youth (almost 40% on average in 2013). In **Bosnia and Herzegovina, Macedonia** and **Serbia** in particular, overall and youth unemployment are extremely high (overall unemployment on average at 26% in 2013 and youth unemployment at 54% on average). This can in part be attributed to sub-standard educational systems in all the former Yugoslav states excepting **Slovenia**. Income inequality in **Turkey** is quite high as well. The Turkish government, however, rather successfully resorted to poverty reduction measures, which led to a decline in the Gini coefficient and poverty rates. Unemployment rates in Turkey are below the South Eastern European average as well and fell considerably from 14% in 2009 to 10% in 2013. Israel, with its much higher income level than the rest of the sub-region, offers the best labor market figures, with unemployment in 2013 at 6.3% and youth unemployment at 10%. Income inequality on the other hand is very high in Israel and is accompanied by social polarization, most notably between the country's Jewish and Arab communities.

An assessment of ***migration patterns in Wider Europe*** yields some interesting results. In many of the region's countries, migration has been directly afffected by the developments over the course of the economic crisis of 2008/09 and the subsequent budget crises in the Mediterranean countries. While **Portugal, Spain** and **Greece** had been net immigration countries until 2009, this situation has reversed since the crisis came into full effect. Other countries such as **Latvia** and **Lithuani**a in particular have experienced similar migration patterns. These countries have been subject to much higher out-migration flows as a result of the economic crisis, with net migration between 2008 and 2010 for Latvia at a staggering -1.45% of the population and for Lithuania at -1.35%. In both cases, a massive increase in poverty in the absence of social safety nets has been driving this development. For **Germany**, the country with arguably the best post-crisis performance, the opposite trend can be observed: net migration was at +0.47% between 2011 and 2013, while it had been close to zero in all previous periods. The interpretation of these shifts in migration patterns is rather ambivalent. On the one hand, it can be seen as a welcome adjustment mechanism within Wider Europe that helps cushion the negative effects of economic problems such as unemployment in the crisis countries and skilled labor shortage in boom-countries. On the other hand, the massive migration inflow of a potentially high-skilled workforce from the periphery to the center could exacerbate the structural problems faced by countries in deep crisis.

In addition to these migration trends within Wider Europe, particularly the Mediterranean countries face large numbers of asylum seekers and immigrants arriving from Africa, many of whom are trying to reach Northern European countries. Especially in **Italy**, this contributes to net migration rates which are among the highest in the sub-region (+0.9% 2011 – 2013), despite the problematic economic situation of the country. The handling of this influx, often perceived as a threat, is still unresolved within the **European Union**, since relevant legislation is not being applied and no sustainable agreement has been reached so far. Another issue that triggered mass migration into Wider Europe is the disastrous situation in **Iraq** and **Syria**, where the persistence of mass persecution, civil war and the lack of humanitarian assistance, and more recently the terror of the so-called Islamic State have driven a massive exodus of asylum seekers toward Europe. Turkey has observed the largest inflow of refugees from Syria. While net migration rates for Turkey hovered around zero in the years preceding 2008, from 2008 to 2010, they increased an average 0.26% year-to-year and 0.12% year-to-year from 2011 to 2013. **Israel** experienced net migration between 2010 and 2014, possibly because of the intensifying conflicts within the country.

The surge of asylum-seeking refugees in Wider Europe is likely to be permanent since global conflicts have intensified remarkably and the international community seems unable to cope with the situation in the region. The economic situation in Africa and other troubled regions has yet to improve. This influences social and economic developments in Wider Europe, the outcomes of which depend on whether adequate policies are designed and implemented.

Projections (2015-2030)

Europe faces the challenge of an aging population and shrinking workforce, which is likely to reduce its growth potential (labor supply is a factor here) and add to the burden of public finances[8]. The median age in Europe grew from 39.2 years in 2004 to 42.2 in

8 D. Gros and C. Alcidi, The Global Economy in 2030. Trends and Strategies for Europe, CEPS, European Union,

2014, and the UN projects a median age of 44.7 by 2030. The share of the European population aged over 65 stands today at about 18.5% and is projected to grow to 24% by 2030 and 28% in 2050. With the share of the population under 15 years of age essentially stable (it is expected to decline somewhat from 15.6% in 2013 to 15% in 2050), the share of the working-age population is expected to contract sharply from almost 66% in 2015 to 61.2% in 2030 and to 56.9% by 2050[9]. The old-age dependency ratio in Europe is consequently projected to grow from 26 in 2010 to 52 in 2060 (from one old person for every four workers to one for every two workers[10]). According to Eurostat, it will grow from almost 29 in 2015 to 39 in 2030. Conversely, the support ratio – the number of workers available to support both the young and the elderly – is expected to fall in Europe from 2.2 in 2010 to 1.6 by 2030[11].

The total workforce of the EU (15-64) stands at 339.1 million in 2015 and is expected to fall to 334.4 million in 2020 and to 324.4 million by 2030. This represents a decrease of 4.3% or about one million per year. Trends differ, however, across the EU, with the workforce of Nordic countries growing by 4.3% between 2015 and 2030 and that of the UK by 3.1%, while the workforce of Southern European countries would shrink by 4.3% for the same period. Some of the biggest reductions are projected to occur in **Greece** (-13.1%), **Portugal** (-10.5%), **Spain** (-7.8%) but also **Germany** (-10%)[12].

Current demographic trends are expected to entail an increase in age-related public spending (which includes pensions, health care, long-term care and education) of about 1.8% at the EU level from 2013 to 2060, mostly related to health care and long-term care[13]. In this context, the EU's Europe 2020 strategy aims to achieve an employment rate of 75% by 2020, which peaked at 70.3% in 2008 and fell to 68.4% by 2013 as a result of the economic crisis. Based on current trends, it would rise to nearly 72% by 2020. Eurostat reports that for the 75% rate to be achieved by 2020, 18 million more people will have to enter employment. This would require raising in particular the employment rates of women, older workers and migrants[14]. The employment rate of those between 55 and 64 has been growing significantly in Europe since 2000 and stood in 2012 at 48.8% overall, though only 41.7% for women. But national disparities are consideralbe within this age group, ranging from a rate of 60% in Sweden to 13% in Hungary in 2010 for the 60-64 age group[15].

Rising employment rates, in particular those of women and older workers, are expected to offset the decline in working-age populations between 2012 and 2022. From 2023 onwards, however, the impact of aging and a sluggish increase in employment rates will mean that the number of employed people in Europe will start falling[16].

2013. http://www.ceps.eu/system/files/Global%20Economy%20in%202030_small_0.pdf

9 Eurostat, Population Structure and Ageing, June 2015, http://ec.europa.eu/eurostat/statistics-explained/index.php/Population_structure_and_ageing

10 D. Sinclair, J. Watson, B. Beach, Working Longer: An EU perspective, International Longevity Centre – UK, September 2013. http://www.ilcuk.org.uk/index.php/publications/publication_details/working_longer_an_eu_perspective

11 Gros and Alcidi, op. cit.

12 Eurostat, Population projections, http://ec.europa.eu/eurostat/data/database?node_code=proj. Authors' calculation drawing on the database.

13 European Commission, The 2015 Ageing Report, European Economy 3/2015. http://ec.europa.eu/economy_finance/publications/european_economy/2015/pdf/ee3_en.pdf

14 Eurostat, Europe 2020 indicators – employment, December 2014. http://ec.europa.eu/eurostat/statistics-explained/index.php/Europe_2020_indicators_-_employment#Conclusions_and_outlook_towards_2020

15 Sinclair, Watson, Beach, op. cit.

16 European Commission, The 2015 Ageing Report, op.cit.

Unemployment is expected to decline from 9.5% in 2015 to 8.9% in 2017 in the EU and from 11% to 10.3% in the eurozone[17]. By some long-term estimates, unemployment in the EU could fall to about 6% in 2030 (assuming a 1.4% GDP average growth rate between 2013 and 2030 and given the expected decline of the labor force). Should the growth rate until 2030 exceed the estimate and reach 1.9%, the unemployment rate would stand at 4%[18].

In the context of falling unemployment rates in all EU member states, the European Commission estimates a stark reduction of unemployment between 2013 and 2030 in **Spain** (from 26.5% to 12.3%), **Greece** (from 29% to 13.7%), **Croatia** (from 18.8% to 10.3%), **Portugal** (from 17% to 8.4%) and **Cyprus** (from 16.9% to 10.1%). Unemployment would also fall very significantly over the same period in **Bulgaria, Ireland, Italy, Slovenia** and **Slovakia**, among other countries[19]. These projections, of course, are contingent upon economic growth, but reasonably optimistic projections remain uncertain due to possible exogenous factors and persistent structural problems in European economic systems.

The current, very high inflow of migrants and refugees to the countries of Wider Europe poses fundamental challenges to each state. Economic development and social inclusion in European countries critically depend on how migrants' integration into society is conducted. On the one hand, the successful integration of these often young and motivated individuals into European labor markets could mitigate the problems facing aging European societies and shrinking workforces. On the other hand, failed integration could generate parallel societies, and mass unemployment might aggravate the already tense situation of social inclusion in Wider Europe.

17 European Commission, European Economic Forecast Autumn 2015, Institutional paper 011, November 2015. http://ec.europa.eu/economy_finance/publications/eeip/pdf/ip011_en.pdf

18 Gros and Alcidi, op. cit.

19 European Commission, The 2015 Ageing Report, op.cit.

III. Management and policies

1. Strategic capacity & Efficiency (2000-2015)

Strategic capacity and efficiency among **Northern European** policymakers is well developed, as is reflected in SGI scores[20]. In most of these countries, economic policy provides a reliable economic framework and fosters international competitiveness. Moreover, taxation and budgetary policies are quite efficient. Indeed, the Nordic countries in particular receive very high marks on these issues, with **Germany, Luxembourg, the Netherlands** and **Switzerland** also scoring well. However, as reflected by the corresponding SGI ranking, tax policy in **Austria** and **Belgium** performs relatively poorly as a result of measures that place too much pressure on wages and thereby reduce incentives to work while disproportionally burdening the working population. Furthermore, the **United Kingdom** possesses an overly complex tax system that offers too many opportunities to avoid taxes, which in some cases borders on tax evasion for the rich. Budgetary policies are in most countries assessed to be efficient. Some countries however, such as Belgium and the UK but also **Austria**, Germany and the Netherlands, amounted levels of public debt that are well above the 60% threshold of the **Maastricht criteria**, which put debt sustainability at risk. However, credit rankings for all Northern European countries (except **Iceland** and **Ireland**) suggest that current public debt levels are sustainable.

Despite this strong overall performance, there are two major exceptions with respect to economic policy in Northern Europe: **France** and **Ireland**. Irish policymakers still struggle with the aftermath of the deep crises that have hit their real estate and financial markets that led them to apply for a bailout under the auspices of the ECB, EU and IMF. Since then, Ireland has succesfully implemented reforms demanded by these institutions to reduce its excessive public debt. Nonetheless, Ireland's budget deficit was still at 7.5% in 2013. For **France**, the current bleak economic outlook calls for structural supply-side reforms which need to be undertaken to solve its numerous structural problems and increase the country's growth potential. Yet reform efforts in France are to date insufficient. The tax system heavily reduces incentives to work since high tax rates burden the population as well as firms. Moreover, the budgetary situation in France is unsustainable with increasing deficits and public debt levels calling for fiscal consolidation. However, successive French governments have to date continued to ignore these calls. Given the country's relevance as Europe's second biggest economy, the success or failure of urgently needed economic and governmental reforms is key to Wider Europe's future economic development as a whole.

The deep structural crisis in **Southern Europe** has revealed that economic policies in the sub-region in the years preceding the global financial crisis were a failure. Instead of introducing necessary economic reforms in the years up to 2008, Southern European policymakers opted to continue fueling an economic boom through excessive government spending. This strategy has clearly backfired. Northern Europe, however, failed in this regard as well. The political decision to include the Mediterranean countries and **Greece** in particular – which are structurally very different from a country such as **Germany** – has generated several problems given the institutional framework of the eurozone. Excessive borrowing was encouraged, since the stability mechanisms designed to prohibit unsustainable debt policies have not been adhered to and were in practice abolished by French and German policies in the early 2000s. Also, the financial markets

20 The corresponding SGI indicators are "1.1. Economic policy", "3.1. Tax Policy" and "4.1. Budgetary Policy"

anticipated the ineffectiveness of a no-bailout clause which, in turn, fed low interest rate levels in Southern Europe and encouraged public borrowing.

The economic crisis starting in 2008 with its worldwide slump in economic activity and sudden stop of credit flows exposed structural weaknesses of the Southern European countries and led to doubts of government solvency, first in **Greece** and later in **Portugal** and **Spain**. This forced these countries to call their European partners for help, which came in the form of financial aid by provisional arrangements, later institutionalized as the European Stability Mechanism. It was, however, not unconditional. Greece, Portugal and Spain were in return forced to introduce harsh austerity measures and reforms to overcome their structural weaknesses and to increase long-term competitiveness. These reforms are supervised by the ECB, EU and IMF, and financial aid is only granted if reform efforts are deemed satisfactory. Consequently, governments of Southern Europe lost a great deal of their sovereignty.

Austerity policies, which have resulted in considerable hardship and losses in living standards among large numbers of people, have been called into question by many economic scholars and are contested by populations acrose Southern European countries. Criticisms include a lack of necessary measures to reactivate economic activity and concerns that austerity policies aggravate the crisis and structural problems, especially on the labor market. In 2015, this opposition to austerity was manifest in Greece's election of the Syriza party and Alexis Tsipras as Greek prime minister. Greece remains dependent on financial aid, and an autonomous economic policy appears to be impossible or at least difficult.

Only time will tell if austerity and structural reforms without fiscal stimulus will prove effective in improving economic situation in Southern Europe. **Portugal** and **Spain** more successfully engaged in the required reforms so far and are subsequently refinancing on the capital market again. Economic conditions in these countris are still far from favorable, though both are showing the first signs of recovery. Further shocks on international capital markets could very well bring an abrupt end to this recovery. Italy's economic situation – although alarming – is not as grave as that seen in Greece, Portugal and Spain. Structural reforms, however, are also desperately needed, since economic competitiveness and labor markets in **Italy** are weak, and the country's public debt level is the fifth highest worldwide. The Renzi administration's promise of reform efforts have yet to prove successful. Italy's fate could prove crucial for Wider Europe's further economic development, since the sheer size of the Italian economy is likely to overburden European institutions should a bailout of Italian public finances be necessary.

As in all other areas, the perfomance of **Central Eastern European** governments' strategic capacity and efficiency differs throughout that sub-region. SGI experts give high marks to the **Baltic states** and **Poland** with regard to their economic policies, which are cited as contributing to Poland's impressive economic performance and the Baltic states' remarkable recovery from the crisis. Governments in **Estonia, Latvia** and **Lithuania** have maintained fiscal discipline and successfully implemented structural reforms conducive to a reliable economic environment. Additionally, Estonia encouraged sustainable growth through its successful innovation policy. Economic policymakers in **Bulgaria, the Czech Republic, Romania** and **Slovakia** implemented austerity measures that helped them avert budget crises like those seen in Southern Europe, though they nonetheless face other persistent problems. Bulgaria, for example, which pursues sound monetary policies and maintains tight budgets and low taxes, continues to struggle with excessive bureaucratic red tape and stifling regulations. In addition, according tot the Global Competitiveness Report, wasteful government spending is a problem in all countries in Central Eastern Europe, excepting the Czech Republic and Estonia. And with the exception of Estonia, high levels of government regulation and taxation issues negatively affect incentives to work across the sub-region.

In addition to these shortcomings, more severe shortcomings in economic policy are identified for **Hungary** and **Slovenia**. Hit hard by the global economic crisis, Slovenia continues to struggle for recovery and has languished under a double-dip recession involving substantial GDP contraction in 2012 and 2013. Public debt increased as a result, and the pursuit of fiscal consolidation and structural reforms were taken up with significant delay. Slovenia therefore now faces a situation comparable to that of the ailing Southern European economies, with government solvency in doubt and the need to regain competitiveness vis-à-vis its eurozone partners. So far, however, Slovenia has pursued its reform efforts without calling for help from the ESM and has avoided being subject to external reform supervision. Hungary's economic policy has been the subject of much criticism by international organizations and research institutes. It is characterized by an increasing role of the state and a critical stance toward foreign direct investment, multinational companies and the financial sector. This, combined with frequent, unpredictable policy changes has created an unfavorable investment climate that has driven down investment inflows and is likely to result in severe losses of competitiveness. Furthermore, a high tax level and a lack of fiscal discipline contribute to this negative economic environment.

BTI experts rate policymakers' strategic capacity and efficiency in South Eastern Europe as relatively sound. Anti-inflation policy and the establishment of macroeconomic stability are conducted quite well, at least in comparison to the BTI sample of developing economies. However, several shortcomings stand out: **Albania, Croatia, Montenegro** and **Serbia**, for example, have amounted relatively high levels of public debt and subsequently receive low country credit ratings. Furthermore, economic policies in Croatia and Serbia have helped create a negative investment climate. According to assessments by the Global Competitiveness Report, government spending in both countries is wasteful, taxation reduces work incentives significantly and government regulation constitutes a substantial burden for economic activity. Hit hard by the economic crisis, Croatia responded with a strategy of fiscal consolidation. The effectiveness of this policy, however, is questioned by SGI experts, who criticize inn particular the Croatian tax system. By contrast, **Macedonia** and to a lesser degree Albania and Montenegro offer a much more favorable environment for economic development. Regulation is not experienced as a great burden for business activities, the governments are more efficient in providing goods and services, and the tax system creates less disincentives.

Economic policy in **Turkey** faces different challenges than the other countries of South Eastern Europe, since it features a much larger population and domestic market. Evaluations of Turkish economic policy are mixed. On the one hand, government spending is relatively efficient and public debt is fairly low. Yet, on the other hand, Turkey's political economy suffers from a tax policy which, according to the Global Competitiveness Report, significantly reduces incentives to work and, according to SGI experts, lacks both horizontal and vertical equity. **Israel** scores significantly better and is again on the level of Northern European countries in terms of economic policymaking.

2. Consensus-building (2000-2015)

The economic crisis starting in 2008 and the ensuing structural crises in Southern Europe and some other countries deeply affected consensus-building across **Wider Europe**. Political tensions have greatly intensified, signs of economic recovery remain elusive and the social and economic consequences of the crisis have polarized views on how best to resolve it. The consensus within and between different European societies as well as within European institutions and the public opinion toward the EU has suffered greatly.

First and foremost, public trust in domestic policymakers eroded rapidly in the crisis-hit countries. In Southern Europe, this is especially the case in **Greece, Italy** and **Spain**. In the eyes of the Central Eastern European public, the policymakers of **Bulgaria, the Czech Republic, Hungary, Romania, Slovakia** and **Slovenia** are the least trustworthy. The ethical standards of Northern European politicians are rated much higher, although **France** is falling behind in this regard. In addition to this loss of credibility and trustworthiness of domestic policymakers, tensions between the rich Northern European and crisis-ridden Southern European societies arose strongly over the course of the budget crises in the Mediterranean countries and the following bailout by European institutions. Popular stereotypes play a large role in public debates and negatively affect the relationships between these countries today. Examples include the stereotype of undisciplined southerners who lack the necessary work ethic to build a competitive market economy or that of northerners who impose a political agenda on Southern Europe that exclusively serves the needs of financial institutions at the expense of the population. Additionally, trust in the EU's supranational institutions suffered a great deal and several countries now question whether the benefits of EU membership outweigh their costs.

This tense political environment has fueled the gains made by euroskeptic and populist parties in recent elections, particularly during the elections of the European parliament in 2014. In Northern Europe parties such as France's Front National, Denmark's Dansk Folkeparti or Germany's Alternative für Deutschland openly question the solidarity with Southern European crisis countries and promote populist demands. Traditionally, euroskepticism is especially strong in the **United Kingdom**, where the UK Independence Party won the most seats in the election of the **European Parliament**. At the time of this writing, the British government is considering scheduling a referendum on a possible EU-exit for as early as June 2016. Although theoretically sustainable from an economic point of view, a potential "*Brexit*" could severely undermine the functionality of EU institutions. Once the precedent of an EU-exit is established, other countries could use it as a credible threat in any further negotiations within the EU which, in turn, would undermine the EU's decision-making ability as a whole.

While the success of euroskeptic parties in Northern Europe is noteworthy and might cause problems for Wider Europe as a whole, the developments in Southern Europe in this regard are even more remarkable. The success of Syriza in **Greece** underscores the momentum political parties opposing further austerity have gained in Southern Europe, even though the party ultimately accepted the "neoliberal" bailout agreement's conditions and won a second round of elections. Podemos in **Spain** is another such party rooted in a social movement that has contributed to change the country's political landscape, which was based on a sort of two-party system until the elections in 2015. These developments point to the extent to which consensus-building in Wider Europe is faltering. The future course of economic policy is debated fiercely and faces strong opposition in all regions of Wider Europe. Given that the lower and middle classes in certain countries will feel the effects of austerity most profoundly, achieving a degree of political legitimation is critical.

Projections (2015-2030)

The European Commission expects the level of aggregate general government deficits in the eurozone to decrease from 2% in 2015 to 1.5% in 2017 and from 2.5% to 1.6% in the EU for the same period. These projected declines are based on the expectation that as economies recover and less monies are spent on interest, government spending will decrease and thereby lower deficits. At the same time, government revenues are also expected to shrink in the face of recent reforms across EU member states reducing taxes on labor. The general government debt-to-GDP ratio is expected to decline from 94% in 2015 to 91.3% 2017 in the eurozone and from 87.8% to 85.8% in the EU for the same period. A variety of factors can take effect here, including prospects for growth in emerging economies, geopolitical risks and levels of domestic investment in Europe[21].

These reasonably good prospects imply that consensus within and toward the EU on major issues will not erode further. The aforementioned challenges of reforming the eurozone and integrating the continued inflow of refugees, make it more important than ever to achieve a solid consensus on how to overcome the challenges facing Wider Europe.

21 European Commission, European Economic Forecast Autumn 2015, op.cit.

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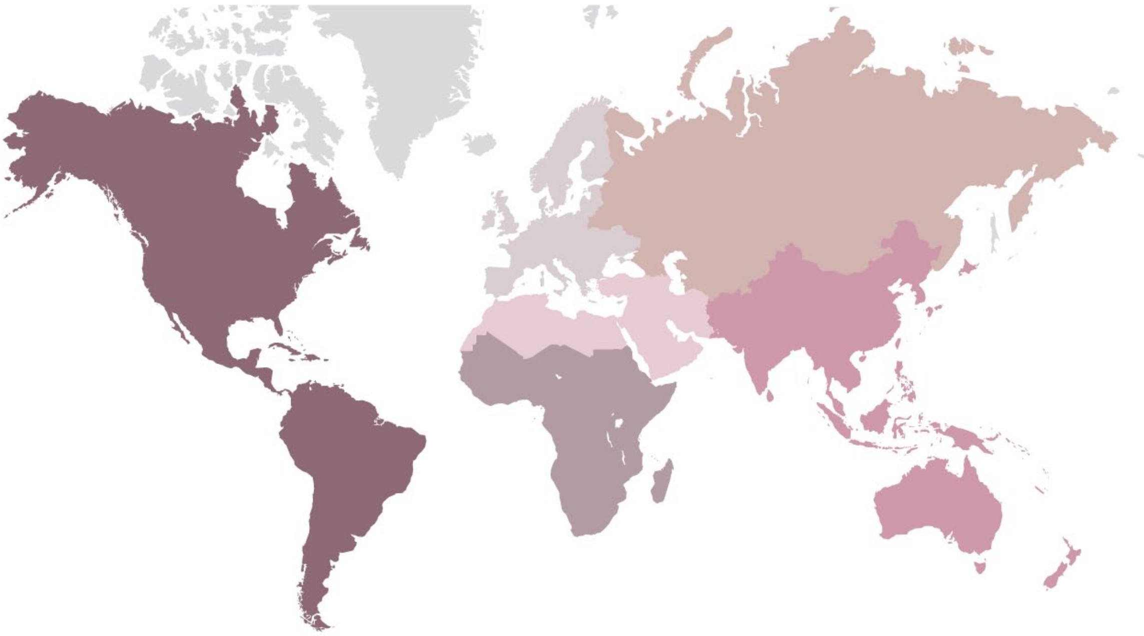

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