



Executive Summary

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A Study of Policy-making

Global and European Governance

- Global governance trends

- Governance in Europe

Policy Issues and Politics

- Budgets and government debt

- Financial regulation and macro-economic stability

Trade and technology on an unequal playing field

Energy needs, climate change and sustainable development

Demography, employment and migration

Health, education, social inclusion and income inequality

The quality of democracy – policy making and European integration

- Political pathways to EU break-up or federal Europe

Conclusions



The New Era

Lessons of the crisis

Interconnectedness

Weakened polity

Global imbalances, net and gross capital flows

Debt: household and sovereign

Bank balance sheets/nominal GDP: “financialisation”

Growth of sovereign debt market

Major trends in the world economy

Climate change

Demography

Shift in economic power from West to East

Transformational technologies



The Model

A world model, in this case divided into 16 blocks.

Aggregate demand and technical progress are the principal drivers.

The macro-model does not have an equilibrium path to which the world economy tends to return in the medium or long term. Being an open disequilibrium system, a wide variety of outcomes may be simulated with different growth rates and end points.

Simulations of the model are geared towards 'what if' scenarios rather than forecasts and their probability distribution. The model is designed to illuminate the scale and plausibility of policy changes that may be needed to achieve given objectives and assess the scale of spill-overs and side-effects.



The model

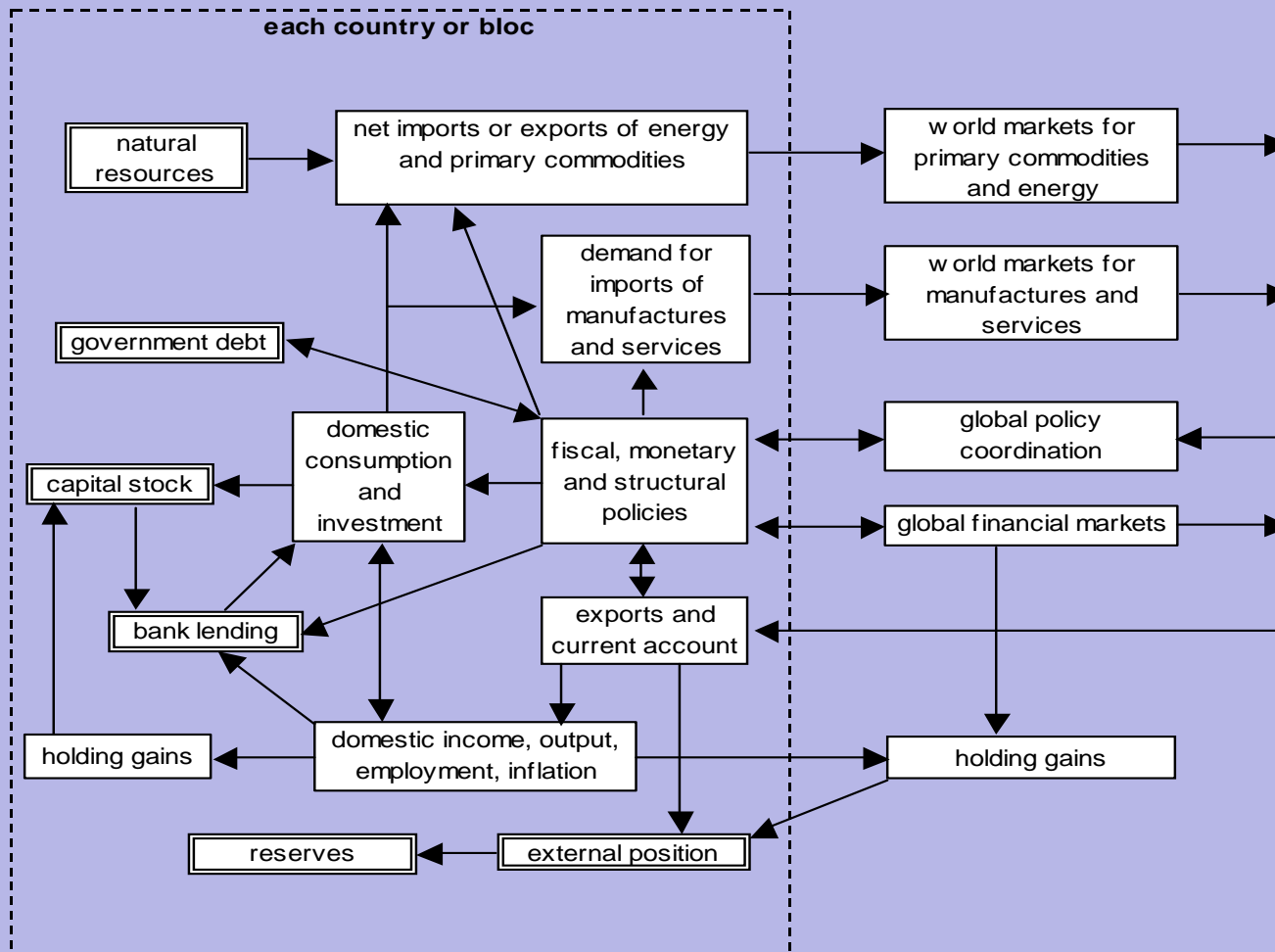
Linkages between blocks

world markets for primary commodities and energy. The world price of oil on the other hand is solved endogenously.

world markets for manufactures and services which are demand-driven with market shares responsive to long-term structural changes and changes in relative costs of production.

global financial markets determining exchange rates, interest rates, bond yields and stock prices. An important aspect of global finance is the phenomenon of 'contagion'.

international policy coordination including regulation. Specific assumptions are incorporated in model scenarios by defining policy objectives for relevant blocs.





The model

Europe is divided into five blocs:

North: Denmark, Finland, Norway and Sweden;

South: Greece, Ireland, Italy, Portugal and Spain, plus a number of small territories;

East: Albania, Bulgaria, former Czechoslovakia, former Yugoslavia, Hungary, Poland and Romania;

West: Austria, Belgium, France, Germany, Luxemburg, Netherlands and Switzerland;

and the United Kingdom.

In the rest of the world China, India, Japan and the United States appear as individual countries. Other countries are represented in ten country groups.



Governance

The role of the state

Failures of national and international bodies in the crisis

Leave it to the market?

Who will conduct policy?

structure of governance: international institutions, nation states, companies, national and multinational, trades unions and other civil society organisations

The analysis of prospects to 2030 in this study has been constructed within a framework of differentiated scenarios that seek to capture the challenges and possibilities for financial, economic and social policies under defined governance hypotheses.



Governance: Global and European

Scenarios

Global

- Reduced government
- US-China hegemony / accommodation
- Regionalism
- Multi-polar collaboration

European

- Struggling on / Muddling through
- Eurozone break-up
- Multi-speed Europe
- Towards a federal Europe



Global contexts and hypotheses for Europe

The report does not examine all possible combinations of global and European settings. Chosen pairings are set out in the following table.

<i>Scenario</i>	<i>Hypothesis for Europe</i>	<i>Global context</i>
1	Struggling on	Reduced government
1a		US-China accommodation
2	EU break-up	Reduced government
2a		US-China accommodation
3	Multi-speed Europe	Regionalisation
4	Towards Federal Europe	Regionalisation
4a		Multi-polar collaboration



Policy-making

The content of policy

GDP growth the key to employment, productivity growth and investment.

Low growth, low investment and unemployment can become endemic and mutually reinforcing.

Constraints

Sovereign debt

Household debt

Finance

Interactions in international trade, payments and finance



Financial regulation and financial stability

Macro-financial issues cannot be separated from macro-economic policy: domestic fiscal balances, monetary policies, and international balances. Hence the problems go far beyond what have in the past been regarded as purely regulatory matters.

Systemic risk

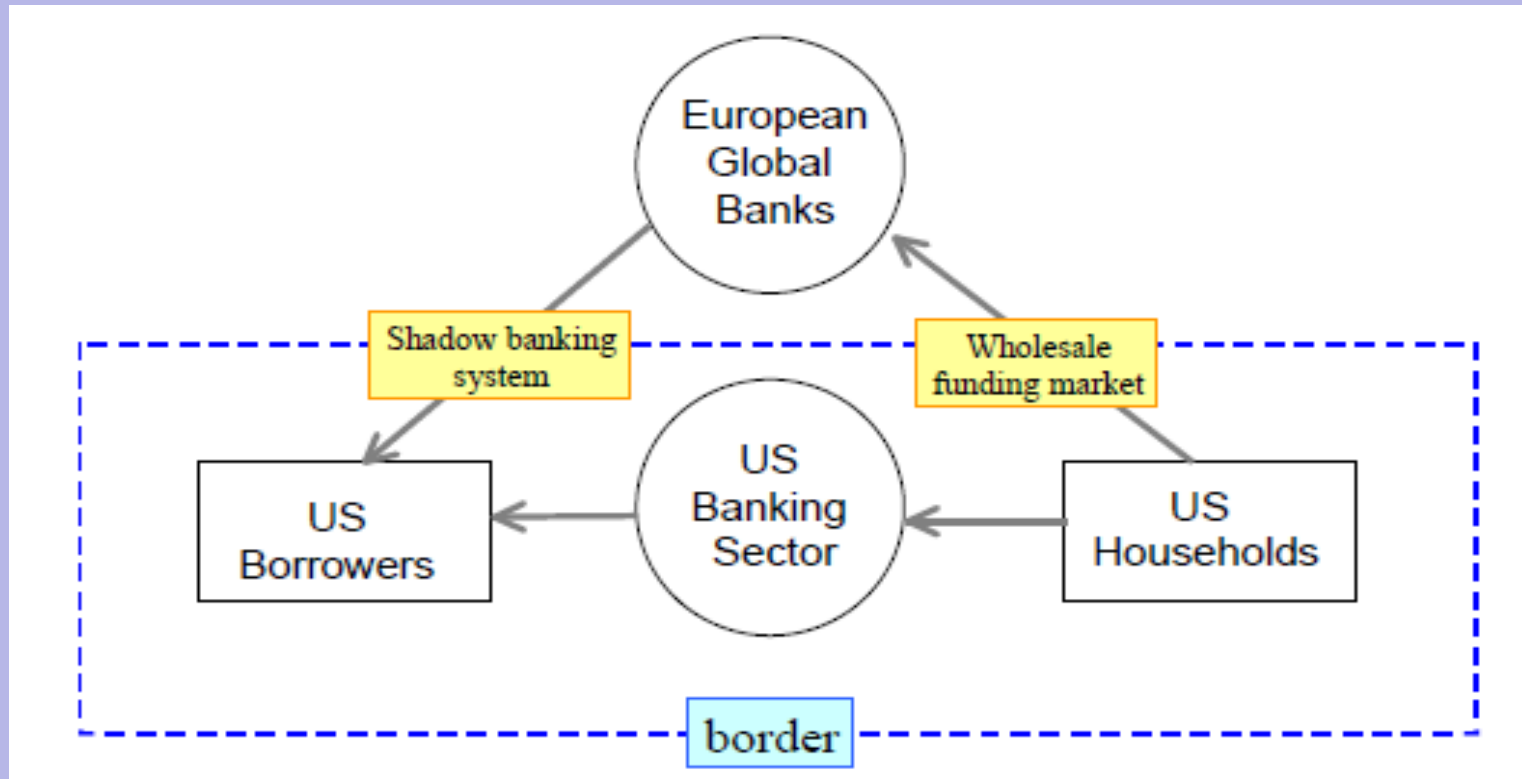
This characterisation of systemic risk has focussed on three key components: (1) “too big to fail”, (2) systemically important financial institutions (sifis), leverage collars and liquidity regulation, and (3) increased interest in the structure of linkages between financial institutions.

Systemic risk is deemed to arise not from the macro-system as such, but from the complex, but in principle, observable, micro-economic linkages between the agents.

Perhaps the most important macro-linkage of all, the state of confidence in the financial system, is unobservable.



Regulatory arbitrage





Technology

Issues that may particularly affect Europe's position in the world economy over the next two decades include macro-economic and social developments such as:

- changing patterns of consumption, employment and business organisation in Europe related to ageing of a relatively high-income population
- adaptation of Europe's social model to the changing economic context
- improved cohesion and growth performance in Europe and mitigation of the North-South divide
- development in neighbouring countries and regions (CIS, Middle East and Africa)
- performance relative to the US in education, R&D etc.
- ability to maintain lead positions in the area of business services
- whether Europe can maintain high-tech, high-quality specialisations within vertically-integrated value chains increasingly dominated by emerging economies.



Climate change

Climate change and energy security are long-term issues, for which the main challenges may arise after the 2030 AUGUR horizon. However, the next two decades are crucial since the directions taken in this short- to medium-term risk creating lock-ins of carbon and/or oil dependency. Indeed, institutions and embedded technologies make the transformation away from oil consumption and, more generally, away from carbon intensive economies a slow process.

If this transformation does not occur during the next 20 years, there is a risk that (1) economies are vulnerable to oil prices shocks that may occur when producers reach depletion constraints (possibly after 2030, as in our scenarios), and (2) it would be infeasible or extremely costly to limit climate change to the 2°C target.



Demography and well-being

Economic dependency ratios (ratio of all economic dependents to the total employed population) by 2030, four scenarios

	<i>North Europe</i>	<i>West Europe</i>	<i>UK</i>	<i>South Europe</i>	<i>East Europe</i>
<i>Starting point: 2012</i>	1.16	1.30	1.26	1.71	1.67
<i>Struggling on</i>	1.31	1.41	1.38	1.77	1.72
<i>EU break-up</i>	1.50	1.56	1.54	1.80	1.80
<i>Multi-speed Europe</i>	1.13	1.12	1.23	1.41	1.33
<i>Towards Federal Europe</i>	1.13	1.11	1.23	1.40	1.33



Health, education and income inequality

Austerity measures to mitigate the financial crisis do not contribute to quality of education and employment of young people or healthy ageing. But Europe will hardly be able to maintain its position in global trade and services if these problems are not addressed.

Given that public services remain a crucial support for European well-being with social cohesion and support for democratic systems underpinned by redistributive schemes and universal entitlements, the way in which services are cut and the distributive impact of adjustments between classes and age groups will be crucial for how democracy and governance evolve.



Reduced government, struggling on

Long-term real GDP growth (% p.a.)

	<i>1990-2010</i> <i>Historical</i>	<i>2010-2030</i> <i>“Reduced government”</i>	<i>Change</i>
World	3.3	3.5	+0.2
Africa	3.6	5.4	+1.8
Other Asia	4.2	5.0	+0.8
East Asia	5.3	4.0	-1.3
America	2.7	3.2	+0.5
Europe	1.8	0.8	-1.0

US-China “accommodation”

<i>Hypotheses</i>	<i>“Reduced government”</i>	<i>“US-China accommodation”</i>	<i>Difference</i>
China	5.5	7.1	+1.6
Japan	0.8	1.0	+0.2
East Asia High Income	2.0	2.2	+0.2
Other East Asia	3.2	3.2	-
USA	2.2	2.9	+0.7
Central America and Caribbean	4.1	4.0	-0.1
South America	5.5	5.2	-0.3
Other Developed	2.5	2.3	-0.2
Other Asia	5.0	4.8	-0.2
Africa	5.4	5.4	-
Europe	0.8	0.9	+0.1
World	3.5	3.9	+0.4



US-China accommodation: EU break-up

Change in GDP compared with “struggling on” scenario (%)*

	2015	2020	2030
Europe	-5	-9	-16
Africa	-1	-1	-2
Other Asia	-2	-2	-2
East Asia	-3	-4	-5
America	-2	-4	-5
World	-3	-4	-5



Regionalization/multi-speed Europe

Long-term real GDP growth, 2010-2030 (% p.a.)

<i>Hypotheses</i>	<i>“Reduced government”</i>	<i>“Regionalization”</i>	<i>Difference</i>
World	3.5	3.9	+0.4
Africa	5.4	5.1	-0.3
Other Asia	5.0	5.6	+0.6
East Asia	4.0	4.1	+0.1
America	3.2	3.8	+0.6
Europe	0.8	2.0	+1.2



Multi-polar collaboration and multi-speed Europe

Long-term real GDP growth, 2010-2030 (% p.a.)

<i>Hypotheses</i>	<i>“Reduced government”</i>	<i>“Regionalization”</i>	<i>“Multi-polar collaboration”</i>	<i>Gain from collaboration</i>
World	3.5	4.0	4.4	+0.4
Africa	5.4	5.0	6.1	+1.1
Other Asia	5.0	5.6	6.1	+0.5
East Asia	4.0	4.1	4.6	+0.5
America	3.2	3.8	4.1	+0.3
Europe	0.8	2.0	2.5	+0.5



Political economy 2030

Consideration of the scenarios outlined above suggests the potential for political movement in one of two directions.

The break-up of the eurozone, and hence of the EU itself, imposes such severe economic costs that governments will undoubtedly take every possible step to avoid it.

The movement towards a federal Europe, though attractive in economic terms, is politically highly improbable, and within the context of the scenarios plays the role of a benchmark rather than a likely future path.

This leaves “struggling on” and “multi-speed Europe



Struggling on

. The “struggling-on” scenario results in a 50% decrease in the trend growth rate of the EU, with stagnant or declining employment rates persisting throughout the region.

A sustained period of close to recession low growth has disturbing implications. During extended and deep periods of economic crisis that the effect on support for political extremism is pronounced.

It is therefore reasonable to presume that anti-establishment parties are more likely to achieve successes in countries which are suffering from *extended and pronounced* recession. That is exactly what “struggling on” portends.



Multi-speed Europe

“Multi-speed Europe” is not a negation of the commitment to building an effective and coherent European polity. Nor is it the precursor to break-up. On the contrary it provides a mechanism whereby powerful European institutions can manage a set of economic and financial policies that permit intra-European adjustment without the improbable construction of a federal Europe.

The essence of the policy stance is that managed and defended exchange rate changes between the eurozone states can alleviate the deflationary pressures of “internal adjustment”. The result is growth of 2% per annum for Europe as a whole, sharp reduction in government debt, and a catching up in southern Europe that places the eurozone on a far more balanced footing going forward. There is still a eurozone, but the zone has managed internal flexibility.