A think piece on Achieving Europe's Goals at a time of Economic Crisis

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Table of Contents

Executive Summary

The EU economy has been in trouble since the 2007/8 financial crisis. EU policy attention now aims on re-igniting GDP growth, often at the expense of wider EU policy goals. The pressing economic challenges which the EU faces are well-known:

- High unemployment, 11.5%, and particularly high youth unemployment, 21%[1]
- Increasing economic inequality with declining real wages year on year in many nations for the last decade Low or stalled growth in GDP.
- Weak private and public investment
- National fiscal constraints from high levels of government debt and fiscal deficits.

President Juncker has described his Commission as the 'Last-Chance Commission': because of the pressure it faces to prove the worth of 'Europe' to its citizens, as frustration with economic conditions and governance grows. Part of the Commission's solution to euro-scepticism is to limit its width of its actions.

EU policy makers have the tools

The good news is that the EU institutions - uniquely - have the tools to create the conditions that will deliver prosperity in EU in the 21st Century. At the moment, the current EU economic policy does not deploy them all. Yet full deployment of the breadth of EU policy could simultaneously bring economic wealth and tackle wider societal challenges.

There is evidence to suggest that the route to lasting, inclusive growth lies in bolder policy action across the full range of policy areas under the EU's competence, rather than less.

A programme to meet the challenges of global trends

Bolder policy change would bring greater success in economic, social and environmental goals, because a large part of the existing policy shaping economic activity in the EU is out of date.

Exponential global population growth, its urbanisation and the resulting economic capacity expansion continue to drive profound changes to the global economy and its resources, on top of the impact of progress in technology and its wider diffusion.

Though the world has changed, the EU's current market structures were created by regulatory decisions which were appropriate at the time those decisions were made, but which no longer seem to fit the conditions we now know the EU will be facing.

The implications of this for the EU are illustrated in the following trends:

[1] Eurostat figures September 2014

- Average EU annual GDP growth is in structural decline, for fundamental reasons. The OECD has illustrated that, on past trends, average growth (not counting cyclical growth) would be zero by around 2024.
- The EU economy is mainly geared to short-term returns, neglecting the long-term investment which will deliver lasting success and prosperity.
- Real wages have been falling in the many parts of the EU (with wage growth lower than inflation). This comes from a combination of policy choice and increased competition for work from excess trained labour in competitor countries, or from increased robotisation - trends which appear set to continue.
- Income disparity in the EU has been rising, for structural reasons, with negative impacts on society, politics and productivity growth.
- Where this is GDP growth, this does not necessarily translate into increased average numbers of jobs (and particularly not full time jobs). Evidence suggests the relationship between GDP and job growth will not hold - on average - in the future.
- The EU relies on environmentally and economically unsustainable use of resources and fossil fuels in its global supply chain, with global pressures on natural, and environmental resources, degrading many resource stocks.

These outcomes are the lifeblood of the growing state of discontent in the EU with national and EU governments. They are reflected in the popularity of Syriza, Podemos, Pegida, Le Front Nationale, UKIP and other populist or extremist parties.

They are signs that the existing market structures (and the regulations that support them) and are not adequate. This is where the EU policy maker's opportunity lies.

The type of reform which could deliver the EU's goals

Market structures create the 'playing field' which shapes how firms produce, how choices are made about employment and wages, and all other aspects of economic decision making. These structures are a matter of political choice, rather than being determined by arcane laws.

It seems that the way our markets are set up - the micro-economic issues - rather than the macro-economic issues (which are a sum of the micro-economic activities) are the cause of the underlying problem with the EU economy. In particular, they hold back the innovation in productivity which must be the true driver of EU prosperity.

Updating the regulations which shape the market, so that the market shapes economic activity towards the EU's goals, in light of global trends, is both possible and could increase productivity, build wealth and reduce inequality.

This would be policy reform of the markets, but not the type of 'neo-classical' form of structural reform, which aims only at increasing flexibility in markets, based on the abstract idea of perfect, efficient markets which was disproved so notably by the financial crisis.

The solution lies in a programme of structural market reform that would adapt 'The Market' so that it is set up to deliver the goals of EU citizens, including those working in industry.

The programme of market reform which the EU needs is the type of market reform already sketched out in recently adopted EU political strategies, in the Europe 2020, and the Flagship Initiatives it contains, but on a grander scale. More, rather than less, is needed.

The great benefit of this form of reform is that it would stimulate investment in productivity. These types of reform measures can create new markets for private innovation investment that can tackle the short and long-term solutions to European nations' economic and societal problems. The scale of stimulated could exceed the 315 billion euros hoped for in the Commission's Investment Plan.

This would be a programme of 'micro-economic market reform, which complement the macro-economic strategies currently in favour in the Commission. And it could be achieved without any significant increases in public spending.

For policy makers, the shaping of market structures to deliver innovation is a tried-and-tested effective way of creating new wealth, employment and international competitive advantage. Europe's now-lost lead in mobile phone technology was due to first adoption of communication protocols. Current European innovation investment in a commercial generation of electric cars comes out of strong EU level business-regulator co-operation.

The Nature of Success

The set of conditions are now in place which would allow the EU institutions to take steps to bring about this change. It is, perhaps, a unique opportunity, where the problems of the EU are evident enough to justify bold action. The EU institutions are the only form of governance which has the institutional, regulatory tools and competences to shape EU markets to align them with our present and future needs.

The stumbling blocks lie in the inertia in citizens and businesses expectations about the continuation of the existing regulations, and resistance to change from those who stand to potentially lose from change.

Progress will require new ways to creating momentum to move from existing structures, and finding the means for potential losers to turn change to their advantage. There are routes available to do this. They would have the following elements:

- The creation of a consensual process between policy makers, visionary business leaders and civil society which creates clear reform goals for delivering innovation that achieves long-term societal challenges.
- The shaping of this process so that the EU's path to progress, innovation and prosperity is less hindered by the voices protecting the existing market

structures and forms of economic organisations that were designed for the last century.

- Increased consideration on how markets and governments can be arranged to help the individuals and regions facing unwanted change to adapt to the future routes to prosperity.
- The contemporaneous reconsideration of the financial, corporate governance and fiscal structures which currently constrain long-term investment enhancing productivity towards societal goals. Changes here can free inspiring business leaders from constraints that hold back their investments.

The key to success lies in the creation of a set of strategies for micro-economic market reform, which make the links between financial and fiscal structures and economic outcomes, which are sufficiently strong to facilitate demand for new products and services, and which reduce resistance through having clear goals for societal prosperity, including those of increasing employment.

For this, the EU need not expand its competences, it must only use them. The regulatory tools within EU policies for: energy, product, competition, transport, environment, finance, agriculture, fiscal affairs, the digital economy, health, and climate, can redefine markets.

The Commission can extend its programme of Better Regulation, expanding its goals, to create alignment of the EU's regulatory framework with the EU's citizens and business' future needs, aiming for reform, not deregulation.

The result would be an integrated set of strategies for sustainable prosperity for 2020 and beyond, a complement to the macro-economic reforms, a practical delivery mechanism for societal goals.

Europe has changed. The challenges it faces, its technologies, its politics and its external competition have changed profoundly. This think-piece describes what those changes mean for strategies to solve the significant challenges facing EU citizens, and how these also point to a new policy solution

Advantages for many agendas

The programme of micro-structural reform suggested here offers solutions to several of the current challenges which the EU faces:

- Politically, it offers the chance to create a new European vision, one which is close to the people, and establishes a role for the European Institutions as their past role fades. It creates the opportunity for the European Commission to take a role which reduces criticism that it is becoming a tool of the most powerful Member States, and set out a pan-European programme.
- Economically, it creates the foundation for short-term growth in economic activity and lasting prosperity, compared to long-term decline under the existing strategies. The EU is currently burdened by regulatory structures which shape markets to tackle last century's challenges.

- Socially, it offers a route by which unemployment can be reduced and economic activity aligned with what citizens want, including greater social equality. It gives EU citizens the chance to feel that the EU has a positive role in the world, that their working activity is creating solutions for the world's challenges.
- Environmentally, it offers the way to shape economic activity so that we can prosper within the global ecological constraints which we have already exceeded, and the way that EU innovation can provide the technological solutions, and the business models which can save the world's severe and increasing environmental problems.

The route forward starts with a deeper look at the structural issues holding back short and long-term, sustainable prosperity in the EU and understanding that policy makers can change the foundations of the market to meet current challenges. The vision to look through the surface of current political debate will be an essential tool for the policy makers that Europe relies on for its future.

1 Introduction

1.1 Dissatisfaction

The countries of Europe face deep and lasting economic, social and global environmental challenges. Current EU economic plans offer only part of the solution.

Economic problems continue to fuel dissatisfaction with government, politicians and, particularly, with the EU governance institutions. President Juncker has described his Commission as the 'Last-Chance Commission' - the last chance the European Institutions have to demonstrate their value to the European citizens, before they are hamstrung by anti-European, nationalist sentiment.

But the EU Institutions - the Commission, European Parliament and Council - are struggling to find adequate solutions within the scope of their political powers. The Juncker Commission's 'Investment Plan' has been proposed, with the aim of stimulating more than 315 billion euros of (almost entirely) private investment. Yet, the Fund has been seen by many as a reminder of the inability of the EU institutions to raise funds, and has been sharply criticised as ineffectual by others, including the German Vice-Chancellor.

The European Commission and the European Parliament do have the tools to rescue Europe and the European project. The new Commission has the political expertise and structure to deliver these solutions. The solution would require an additional strategic strand to the Commission's proposed Work Programme.

1.2 A different form of Structural Market Reform

This think-piece points to a complementary, more solid solution to the EU's woes. A solution which can contemporaneously alleviate societal problems, set the basis for lasting prosperity, and create a strengthened mandate for the European Institutions, without indulging in fiscal laxity.

The solution is a programme of structural market reform to stimulate investment in productivity. It differs from the usual calls from structural reform, by not aiming at increasing flexibility in markets. Instead, it would reform market structures so that markets better deliver the goals of EU citizens, including those of industry leaders, and increase synergies. There is an opportunity for an EU reform programme which increases productivity and builds wealth, whilst reducing inequality.

1.3 Thinking Ahead

The analysis below describes how this market reform could provide solutions, how existing policy lines of the European Institutions can be reinforced, and why the present European Parliament and Commission are uniquely placed to seize the opportunity.

Europe has changed. The challenges it faces, its technologies, its politics and its external competition have changed profoundly. This paper describes what those changes mean for strategies to solve the significant challenges facing EU citizens, and how these also point to a new policy solution.

Sections 2 and 3 describe why change is needed. Sections 4, 5 and 6 sketch out a solution.

2 Reassessing Europe's Challenges

The pressing economic challenges which the EU faces are well-known:

- High unemployment, 11.5%, and particularly high youth unemployment, 21%[2]
- Increasing economic inequality with declining real wages year on year in many nations for the last decade Low or stalled growth in GDP.
- Weak private and public investment
- National fiscal constraints from high levels of government debt and fiscal deficits.

Many economic policy makers and commentators find the cause and solution for these economic problems in weak demand:- Growth is weak because consumer purchasing has declined, and private investment has been put on hold, partly as a result. Governments, many of whom have spent more than they received in recent years, are constrained in their actions to increase economic demand by debt-funded spending.

There are several, inter-related factors behind the current situation, including:

2.1 Disappeared Drivers of Consumption Growth

The EU's (and the OECDs) past growth has been partly driven by financial engineering increasing the availability and affordability of debt, and its corresponding uptake by increasingly indebted private individuals and governments. In some countries, levels of personal debt are unsustainable as soon as interest rates increase, as they must. Spending has often been based on perceptions of increasing wealth from bubbles in private fixed assets (particularly property).

A continuing wave of national fiscal tightening means that public borrowing can no longer continue to support consumption, or even investment, at the same levels. On the contrary, many people call for reductions in net public expenditure to pay back

[2] Eurostat figures September 2014

high levels of public debt. And public incomes - often reliant on real wage growth for tax revenues - remain low.

This leaves productivity growth as the only sustainable route out of stagnation.

2.2 Falling Real Wages

The real value of wages (compared to prices) has been held back in much of Europe over recent years. The causes are an excess of labour in the EU, and an excess of labour in our trading competitors' labour markets as they industrialise, urbanise and their population grows. Competition for work drives a race to the bottom in wages. This is particularly severe for less skilled jobs and is becoming more severe for white-collar jobs: which are exposed to increased competition from increasingly skilled workers in BRIC and developing countries.

This trend in wages appears likely to be permanent, as things stand. Competition in from international labour markets for internationally traded goods and services will ever increase. At the same time, the range of services and goods which is open for international competition will increase: legal and medical skills are now outsourced to what were once called 'developing' countries; China produces more than 1 million PhDs a year, with the potential of eclipsing EU research strengths.

In addition, increasing robotisation is estimated to put millions of middle-class jobs at risk in the next 20 years, as IT advances give robots and computers abilities that rival, and outcompete people. This includes intelligent IT systems providing the services now given by doctors, accountants and taxi drivers[3]

Falling wages have also been coupled with reduced employment security. There are ever more Europeans on temporary contracts, working as self-employed in jobs which were previously in companies, and more part-time work: now 20% of employment. Within jobs, there is increasing inter-generational inequality. Insecurity also reduces consumer spending.

Falling real wages leads to redistribution of incomes towards individuals who own savings and capital, and away from those who spend more, or take debt. These trends are prevalent: Thomas Piketty has recently shown how many capitalist systems tend to concentrate wealth over time[4]. This has severe economic, social and political consequences:

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[3] Frey C and Osborne M. 'The future of employment: how susceptible are jobs to computerization?' Oxford Martin School, Sept 2013.
[4] Piketty T. 'Capital in the 21st Century', 2013.

2.2.1 Economic

As lower income groups spend a higher proportion of their income, when their incomes fall, consumption growth in the economy falls.

Evidence suggests that concentration of wealth in the top 10% of society leads to lower capital investment levels than more equal distribution of wealth across income classes. Inequality therefore weakens investment in productivity.

Increasing inequality impacts on economic productivity. The OECD has this year estimated that increasing inequality has reduced growth in OECD countries by a cumulative 8.5% GDP in the 25 years up to 2010.[5] This is mainly because inequality reduces investment in skills in lower income groups. Studies point out that employment insecurity also drives reduced investment by individuals in their own skills (as they may not get the chance to profit from their investment). So productivity drops further.

2.2.2 Social and Political

Dissatisfaction has increased in the EU. Subjective happiness studies show increases in dissatisfaction are found in the recently disadvantaged income groups, age groups and gender groups[6].

As the legitimacy of government rests on its adherence to delivering social justice, national and EU governance is being rejected: populist parties are shifting policy-making towards short-term, wealth-harming policies, endangering future recovery.

Syriza's win in the Greek Elections, the popularity of Podemos in Spain, of the National Front in France, the rise of the anti-islam movement Pegida in Germany, or of UKIP in the UK can all be seen to have roots in rejection of the current state of affairs.

2.3 Barriers to Private Investment

Private investment has been held back in the EU. This is partly due to uncertainty about future markets and policies. Billions of euros of cash in corporates are not being invested, but returned to shareholders in share buy-backs. Shareholders investing in the stock markets or property induce little flow of funds to the real economy. Re-capitalisation of the banks after 2008 has still not led to major increases in their lending.

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[5] OECD (2014), "Focus on Inequality and Growth - December 2014". www.oecd.org/social/inequality-and-poverty.htm

[6] Eurofound (2013), "Third European Quality of Life Survey – Quality of life in Europe: Subjective well-being", Publications Office of the European Union, Luxembourg

This weakens economic demand, and more deeply, misses potential improvements in improvements in the productivity of the economy. The majority of economic commentators and think tanks, including the OECD and the IMF support the European Commission's line that investment in productivity enhancing areas is the route towards economic recovery.

This is why the Commission's new 'European Fund for Strategic Investments', aims to trigger the flow of more than 315 billion euros of currently idle private investment. The Fund has been introduced with the aim is to identify a pipeline of infrastructure projects that are worth investing in. Yet it may do no better at bringing in additional private investment than previous EU rescue packages, as it fails to tackle an important barrier to private investment:

- Investors want to invest in innovative technologies or businesses which offer lasting capital growth, rather than in existing forms of infrastructure which offer only annual interest payments.

The current content of the Investment Plan put together by the Commission from submission by Member States is heavy on pre-planned or long-postponed public projects - like road construction - which offer little to excite dormant private capital. The Plan can be seen as a reflection of the extent of stagnation in investment ideas under existing market structures.

3 Where current economic policy falls short

There are reasons to believe that, by itself, the economic policies so far announced by the European Commission will not be significant enough to change the EU's economic fortunes. These reasons include:

3.1 The EU economy has structurally declining GDP growth

The EU economy is facing a prolonged and serious crisis, not only short-term problems from weakness in demand. 7 years after the start of the global financial crisis, the EU's economy remains weak. This long-term malaise is not unique to the EU. The OECD has plotted the long-term decrease in growth rates in OECD countries (see Fig 1) and extrapolated current trends to indicate that, by only 2024, OECD countries should expect zero *average* per capita annual growth. This level of growth would undermine most government fiscal policies, and their ability to fund public spending.

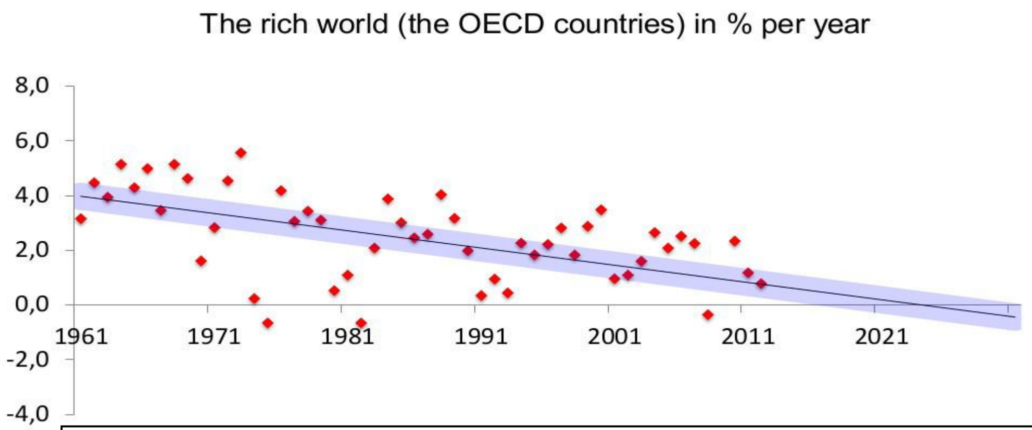

Figure 1: Extrapolated Trends in OECD Per Capita Growth Rates (left hand axis, % per year), OECD data

Part of the explanation is that, a greater proportion of EU GDP now comes from services (rather than manufactured goods). Services have lower scope for productivity gains compared to manufacturing, so average productivity decreases. Reduced scope for productivity growth means reduced future scope for per capita GDP growth.

3.2 Saturated Markets hold back Innovation in Productivity

For manufactured consumer goods, most of the technological opportunities for significant value- enhancing innovations have been taken. There is now little scope, under current conditions, for the radical innovation which has powered the past era's societal progress (e.g. the invention of time-saving devices like the washing machine, or transport systems). This limits growth.

Another reason holding back growth: we see saturation in the markets in many of the EU that really matter to people - like cars, or household goods. Most people now have these in the EU, so market growth is small.

Market innovation often focuses on technological ways to capture value for shareholders from pre-existing activities e.g. social activities, or in finding new ways to demonstrate status. In short, the opportunities under the current economic structures have mainly been seized.

3.3 Growth is not the solution to unemployment under current conditions

For most economists, 'growth' is the key goal, and the solution to other economic and social problems. The 'Growth and Jobs' catchphrase of EU policy is based on the assumption that delivery of growth in GDP will bring about a resurgence of jobs. This hope is partly based on past observations of demand for jobs increasing as economic demand rises.

Now, there are fears of 'jobless growth' - increases in spending in the EU which lead to little increase in employment. There is enough evidence to suggest that the global economic conditions in which the EU works have changed so significantly, that one of the central assumptions of EU economic policy has now unravelled.

The evidence on the recovery of some of the EU's economies up to 2014 suggests that growth has brought some jobs - but that these jobs are much more likely to be part-time, insecure jobs, and that job statistics hide a large number of the people working part-time who would like to work full-time.

Figure 2 - from a paper by IDDRI[7] - investigates the relationship between growth (x-axis) and unemployment rates - and finds a very weak correlation. The x-axis shows growth in GDP between 1961 and 2007, whilst the vertical axis shows the civilian unemployment rate as a %. The best fit line shown on the graph has a correlation coefficient of 0,08 indicating that - over this longer period - there is no significant correlation between growth and unemployment rates. Even if growth in the EU were likely, other solutions are needed.

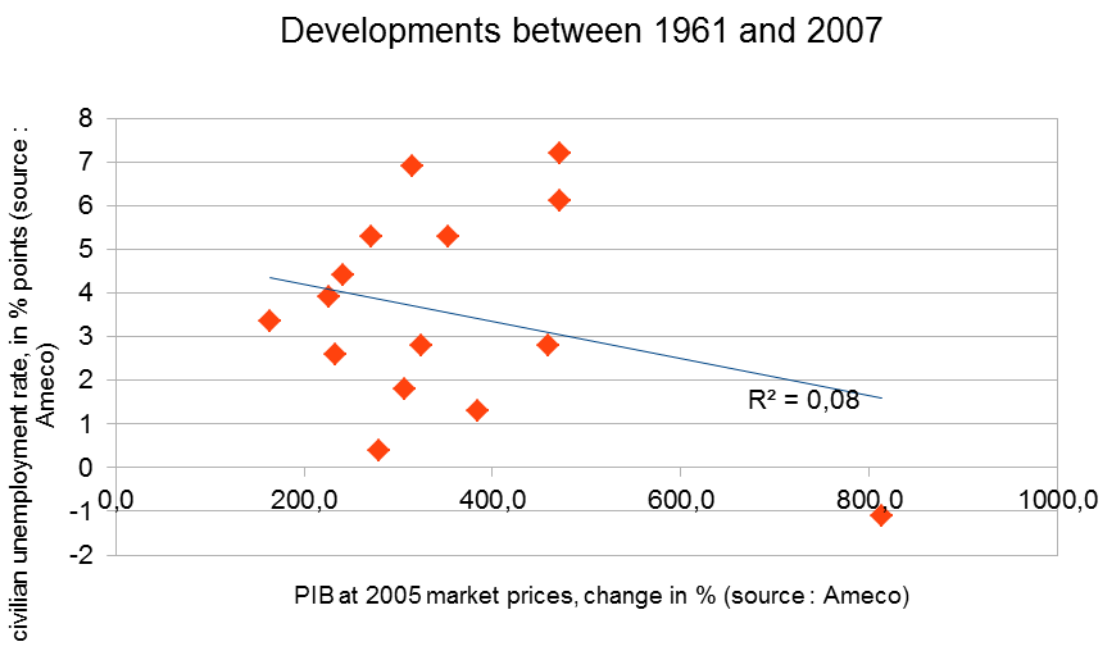

Figure 2: The link between unemployment and GDP (IDDRI)

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7 Les politiques de l'emploi face à la croissance faible, Chancel L; Demailly D, Working Papers N°02/2014. Iddri, 2014

3.4 EU economic policy aims at short-term consumption, rather than building Europe's wealth and long-term success

The EU's relative economic weight and our competitive advantages are eroding. Technologies move on, and growth in the global economy is degrading the natural resources on which much EU production and consumption depends, and further changing the basis of competition.

Some of the key inputs into global production and quality of life are changing. Resource prices are on upward trends for the first time in a century[8].

Continuation of existing greenhouse gas emission trends is likely to warm average temperatures by more than 2 degrees by 2100[9], and will require a total decarbonisation of global energy supplies (probably by 2050). Water shortages inside and outside the EU will change production patterns. Human pressures have already undermined the global ecosystems - on which human society relies - to the extent that 50% of the world's wild animals have disappeared in the last 40 years[10]. These megatrends will shape the production and consumption patterns of the future.

Yet, across the EU, economic policy often focuses strongly on increasing Europe's competitiveness in ways which damage our future ability to compete. 'Competitiveness' often translates into price competiveness in current international markets. Faced with calls from individual industry sectors for cheaper inputs, to increase their price competitiveness, regulators have shaped market regulation and industrial policy to attempt to compete with global competitors on their terms, rather than creating the conditions for international competitors to compete on EU terms.

This strategy eases short-term competitive pressures, but creates a race to the bottom, which leads the EU further and further from its societal goals, towards the structures and standards which form the basis of low-cost competition in developing countries. This strategy exacerbates the EU's vulnerability to many of the megatrends' consequences - including the impacts on the lowering of wages.

3.5 The EU's market structures are not delivering societal goals

The weakened economic fundamentals and the lasting and growing state of discontent in the EU are clear signs that the existing market structures (and the regulations that support them) are not adequate.

Market structures create the 'playing field' which shapes how firms produce, how choices are made about employment and wages, and all other aspects of economic

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[8] Swilling, Fischer-Koswalski et al, 'Decoupling natural resource use and environmental impacts from economic growth,' International Resource Panel, 2011

[9] IPPC 5th Assessment report 2014

[10] WWF 'The Living Planet Report', 2014. http://www.worldwildlife.org/pages/living-planet-report-2014

decision making. They are the set of laws and regulations which determine product requirements, which change the effective relative prices of different inputs into production, which shape or incentivise what firms do and what consumers buy. The way the markets have been set up in the EU is no longer working.

It seems that the way our markets are set up - the micro-economic issues - rather than the macro-economic issues (which are a sum of the micro-economic activities) are the cause of the underlying problem with the EU economy. In particular, they hold back the innovation in productivity which must be the true driver of EU prosperity.

As the world has changed, the market structures are created by regulatory decisions which were appropriate at the time those decisions were made, no longer seem to fit the conditions we now know the EU will be facing. Decision makers now have better information, and better understanding than previously about how to improve the market structures.

3.6 Current market structures hold back innovation and growth, and Europe's next generation of visionary businessmen

Innovation delivers productivity increase and prosperity. As mentioned above, there is plenty of evidence that innovation in the EU is not held back from lack of ideas, or technologies. In many sectors, productivity enhancing technologies are ready to be deployed and further developed. The block to innovations becoming commercially scaled up is the lack of a good investment case under existing market structures, regulation and policy.

Energy technologies have been a good example of the influence of market structures. Renewable technologies are now thriving in many EU countries, with most new investment in energy in the EU going into renewable generation. The technologies offer global export markets, an economy-boosting reduction in energy imports and a global means to avoid damages from climate change.

Yet for many years, the package of subsidies, taxes and regulation of markets which determines the price and non-price barriers for renewable energies has determined the rate of expansion of the technology by creating market conditions in which either they or traditional alternatives appeared more or less attractive.

Business leaders have recently pointed out how the constraints of the current EU economic system hold back their companies from investing in wealth-creating areas. Several have been calling for reform.[11] A 2013 survey of 1000 global CEOs from 27 industries across the world by the consultancy firm Accenture illustrated the problems which even multinational CEOs face in bringing about change[12]. Of those interviewed or surveyed, only 32% believed that the global economy is on track to meet the

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[11] http://www.mckinsey.com/Features/Capitalism
[12] The UN Global Compact Accenture CEO Study on Sustainability 2013

changing demands of a growing population within global environmental and resource constraints. 84% of CEOs believe that business should lead efforts to define and deliver new goals on global priority issues, though 67% did not believe that business is doing enough to address global challenges.

These CEO stated that they feel are constrained by market expectations and believe business value for change is not available under current conditions. To ameliorate the situation, 85% of these CEOs demanded clearer policy and market signals. They believe that only with greater government intervention—at global, national and local levels—can they move from sporadic incremental advances in tackling global challenges to a collective and transformative impact.

3.7 Economic problems have political solutions, but the European Institutions appear increasingly trapped

The word 'crisis' comes from the Greek 'krisis' meaning 'a separation', in this case the separation of the economic systems' performance from the desires of its citizens. As the shape of the market system inside the EU is a matter of regulatory choice, and that choice is political, the continuation of the economic crisis can be seen to have a political cause.

This opens the door to a political solution. The political solution relies on political institutions having sufficient legitimacy and widespread support to work effectively. The EU Institutions are on the verge of losing that support, perhaps permanently.

3.7.1 Anti-European Sentiment

The European Institutions were formed with a vision, as a response to the need for peace. Reasons for their recent decline in popularity are much debated, but can be seen to be a symptom of deeper dissatisfaction within society, political misrepresentation of the EU's work, and a perception of a waning rationale for EU co-operation as markets become international. Others find an unsatisfying gap between EU claims of influence over EU economic policy, and final delivery on EU economic goals.

In response to anti-European sentiment, the Juncker Commission has promised to be more focussed, particularly on economic issues. It has the appearance of being especially focused on macro-economic issues, and enhancing the macro-economic drivers of international competitiveness.

This may bring the EU institutions deeper into the trap they are seeking to escape, for 3 reasons:

3.7.2 Declining Potency of the EU institutions

The European institutions' most significant power is the proposal and adoption of legislation. These are legislative tools which shape the market conditions for the firms and citizens of the EU, amongst other goals. The Juncker Commission is putting forward a narrative of future constrained use of legislation, and a deregulatory notion of 'Better Regulation' which is a response to anti-european sentiment: an effective reduction in the potency of the EU institutions.

Perceptions of potency also matter for future legitimacy. In focussing on the economic - particularly on growth - the Commission ties its apparent potency to economic success which is beyond the scope of its power to deliver, if its only significant focus is on macro-economic tools and competiveness-pursuing market liberalisation. This perception would further threaten the perceived value of the institutions. It limits the EU institutions' practical ability to deliver on wider citizen's goals.

3.7.3 Declining Rationale for the EU

Peace is taken for granted. Enlargement seems complete. For an EU population looking for a better future, and their place in the world, the EU lacks a vision that they can relate to as people, or which adds to what they believe markets and their nation can deliver.

A focus on GDP growth as the goal of the European institutions removes any emotional or human aspect to the EU's rationale. The 'growth' lacks a destination, or even a direction, so loses salience. To those who feel marginalised, it sounds like a corporate agenda. For the wealthier, income growth is just what they except, with no great joy in achieving it. Pursuit of a successful economy is essential. Pursuing that goal without a definition of what a successful economy looks like may further alienate citizens.

3.7.4 The European institutions squeezing their own space

To the extent that the EU attempts to meet the competitive challenge of the international markets head on by reducing production costs by transferring production costs elsewhere in society, it weakens the EU.

By equating EU market structures with international competitors, the EU institutions shape the structures and nature of EU production, employment, technologies and consumption goods and therefore society. This erodes the distinctive nature of 'Europeaness' - the cultural differences from other parts of the world. Yet, this 'Europeaness', already weak, is the glue which holds the European institutions together.

So, such policies further erode the rationale for the EU's existence. Rather than strengthening the EU institutions' political position, it turns them into a proxy vehicle for international market forces, squeezing the role of the EU, between national governments and trans-national, global economic governance. This is reducing the legitimacy for their future action, and weakening their political support.

4 A sketch of a solution

4.1 Recognising 'the market' is a derived structure

The chance of an enhanced solution for Europe's problems can be found in criticism of current market structures. Criticism of economic structures is now acceptable. The financial collapse of 2007/8 opened many people's eyes to the perspectives that:

- the performance of markets in delivering society's goals depends on how they are designed;
- the design of the market depends on the regulations and policy which set the rules and boundaries of how the market operates; and that
- there are different ways to regulate to design markets and that some perform better for society's goals at different times than others.

These statements apply equally to the markets in which European citizens consume and produce goods and services. Although it is common to say "the market allocates goods efficiently", this is a simplification: there is no natural, pre-existing 'market'.

Such a simplification is understandable: the full set of interactions and influences which drive the economic activity of Europe's 510 million citizens is too complex for anyone to fully understand. Everyone relies on simplifications and presumptions to simplify that complexity into a manageable, comprehensible understanding of the world, which then serves as a guide to policy. There is a wide choice of simplification - some of which are more, or less, useful for policy guidance, depending on how the world has changed. One of those simplifications is that 'the market' exists almost as if it were a natural force. Unpicking this simplification opens the door to improved solutions for the EU.

Although it doesn’t feel like it to the individual citizen of firm, all markets are created by norms, codes and regulations, and each of these norms or laws is a matter of societal choice. Laws decide how products can be traded and what standards they should meet, and what the ongoing relationship is between buyers and sellers. Policy also decides the ways in which products can be manufactured, and consumed. It decides how information flows between people trading, how market power can be used or abused. And it has a huge influence on the prices of goods, services and inputs into production, like labour: taxation is usually around 40% of a country's GDP - choices about the where the burden of that tax falls radically affect relative prices, directly and indirectly.

So the incentives delivered by market structures, and the 'market forces' which decide on the allocation of economic resources are also matters of social choice. A new policy which would 'distort the market' is doing no such thing - it is just changing a past decision about the shape of the market. The 'status quo' market is the aggregate results of past decisions.

There are many possible different 'market economies'. This is why firms lobby political processes. When society decides how the market should operate, lobbying firms want it to operate in their favour.

But what happens when the status quo market structures, the aggregate of past decisions, are not delivering society's wishes full-employment, equality, long-term wealth and security or global environmental protection? That seems to the current situation.

4.2 Market reform

It is possible to stimulate economic activity, increase the strength and viability of the EU economy, and deliver on EU's citizens' political desires, without resorting to public borrowing or bubbles from monetary expansion.

This solution is - the closer alignment of EU market structures with the goals of EU citizens to induce investment in productivity gains**.**

Although this sounds modest, changes to current market structures through regulatory changes would have profound effects. They would remove the blocks to innovation in current markets. New markets would be created that would reward investment in innovation, and so induce investment, and the development of new technologies and business models. That investment would be targeted - by market processes - into areas which improved EU societal wealth, whilst taking into account global megatrends.

It is a solution which could uniquely be undertaken at EU level, and which would rely on the greatest tools which the EU possesses - its regulatory power and its cadre of high-quality officials - to create the conditions that induce investment.

Current markets don't reflect our full range of preferences for society, because when we shop, we don't express our desires for full-employment, equality, long-term wealth and security or global environmental protection. People also make clear differentiation between what they want for themselves (when asked individually, or when purchasing) and what they want for society as a whole (of which they are part).

4.3 Aiming at Wealth and Productivity

Economic theory is often contested, but it is widely agreed that the ability of an economy to deliver prosperity to its citizens is based on 2 elements:

- The size and nature of the inputs into the economy - the 'capital stock', which includes the resource base and the labour which we control or can pay for; and
- The productivity of the forms of societal organisation and technologies which turn those inputs into something of experiential value.

There are various different classifications of what counts as a 'capital' input into the economy. Many economic organisations - including the World Bank[13], OECD[14] and the European Commission have developed categorisations of capital which include man-made capital (like machines), human capital (healthy, skilled workers), social capital (ways in which society organises itself), natural capital (resources, including ecological resources). All of these contribute to the prosperity of EU citizens. (This explains why inequality and climate change can impact on GDP growth.)

Current economic policy often focuses on GDP growth, which is a constructed metric of growth in national income. (It is a measure of 'flow' rather than a 'stock', or wealth. It is often assumed that increasing income will also increase wealth, and this is often the case. How well it does that in reality, depends on how the income is created - and how much of the capital stock is run down. Usually, some of the capital - particularly natural resources, and recently in the EU, social and human capital, has been reduced (or liquidated) in an effort to increase short-run income.

A better assessment of the productivity of an economy is the extent to which it increases wealth - by turning one form of capital into another which is more valuable. Wealth is a much better metric of the economic strength of a region, and its ability to compete and provide lasting prosperity. The extent to which creation of income reduces other forms of capital is one indication of its sub-optimal productivity - yet EU consumption and production frequently does this (something known as externalities to economists).

Updating and reforming market structures has the potential for two significant beneficial effects:

- By better aligning market incentives and structures with societal goals, productivity of the economy towards those goals will increase. Perverse incentives which currently encourage inefficient, or wealth reducing, activity would be reduced, so that in sum, a greater aggregate of valuable goods and services could be produced from the EUs accessible wealth.
- Reformed market structures could provide the potential space for the flourishing of new markets for innovations. It could create the incentives, and the market certainty which stimulated large-scale private investment in innovation, and so deliver the outcome sought by economic policy makers as the remedy to the EU's economic malaise.

The second bullet above is a 'Schumpterian' approach to economic policy, named after the famous early 20th Century economist, and Finance Minister of Austria who

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[13] E.g. http://www.worldbank.org/en/topic/environment/publication/changing-wealth-of-nations

[14] E.g. the Better Life Index: http://www.oecdbetterlifeindex.org/

examined how innovation drives economies by supplanting old technologies and approaches with new, improved means of production.

This solution would be fully in line with some analyses of how economies function in the long-term. These analyses see waves of prosperity being driven by the development of new technologies; figure 3 below. This view has been particularly developed by Prof. Perez[15].

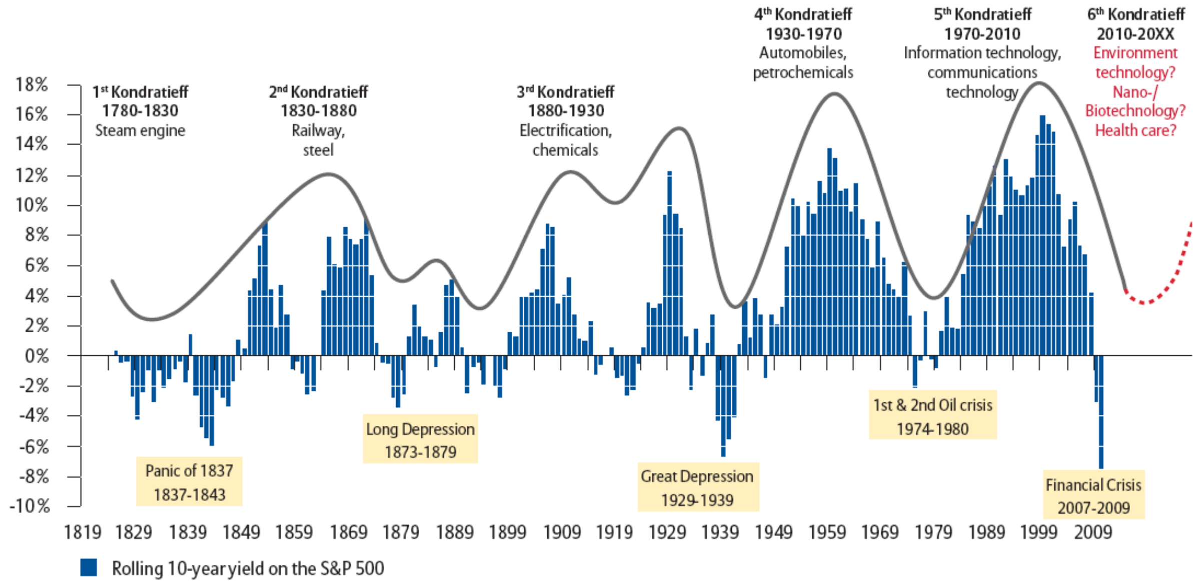

Figure: Kondratieff cycles – (Source: Allianz Global Investors'The Sixth Kondratieff - Long waves of prosperity', 2010.

Shaping an economy to deliver wealth would incentivise the development of the next set of technologies that are needed to create prosperity in future conditions. This requires the development of market structures which are suitable to incentivise the most beneficial activities in those future conditions.

This requires the stable macro-economic conditions aimed for by current policy, and requires complementary micro-economic market reform, designed to serve the interests of future successful firms, rather than existing firms. This would aim at a growth of the parts of the economy needed to succeed in the future, rather than supporting expansion of the existing economic activities.

This would allow our best industry leaders to see how their organisations could provide the innovations of the future. It would allow them to re-invigorate European capitalism by profiting from a reorientation of their organisations towards societal goals, a move many would like to make, but which they are constrained by market structures from taking.

[15] E.g. 2004. "Technological revolutions, paradigm shifts and socio-institutional change" in E.Reinert, ed. *Globalization, Economic Development and Inequality: An alternative Perspective*. Cheltenham: Edward Elgar, pp. 217-242, available on http://www.carlotaperez.org/pubs?s=orgchg&l=en&a=technologicalrevolutions

Reform could be based on the short and long term goals of the EU citizens, which certainly include increases in material incomes, supported by success of EU products and services in international export markets.

4.4 What nature of reform is necessary?

The prevailing market structures in the EU aim at growth in incomes, rather than increasing wealth. They are peppered with incentives which create a misalignment between economic activity and development of economic wealth. The misalignment has been increasing as megatrends change the nature of our economy. Some of the areas of misalignment became particularly clear at the time of the financial crisis. The major barriers are:

- There is weak appreciation of how feedbacks in the socio-economic system impact on aggregate wealth - for example the impact of inequality on health, and coincidentally on working productivity.
- The impacts of production and consumption on wealth (particularly our access to natural resources, ecological resources, social capital) are often not well reflected in prices, though it is relative prices which shape decisions on economic activity and innovation.
- The available infrastructures, and economic organisations, have been based on past decisions, and serve past economic interests, often to the disadvantage of potential break-through innovations.
- Financial incentives tend to be set up to drive maximisation of short-term goals, at the expense of longer-term investment. This affects managers, politicians, financiers, employees (who are less likely to invest in their own skills if they are insecure) and consumers (whose preferences become increasingly short-term, as their incomes and security decline).

One example of the current misalignment came from the international sporting and leisure goods company, Puma. In 2010, they ran a parallel accounting exercise, which placed a value on all the forms of natural capital which they and their supply chain used up in the manufacture and distribution of their products, so including non-renewable natural resources and environmental damage. They found that if all types of capital depreciations were included, the costs of their production would increase by 145 million euros, a value which was comparable in scale to their corporate earnings before tax.

An example of the short-term incentives created by markets is the relatively recent pressure from financial markets to deliver quarterly performance reports. These have been found to distort decisions within companies, to prioritise the short-term, ahead or more productive investments which require upfront costs. Unilever, in 2012, bucked the market by refusing to deliver quarterly reports, for this reason.[16]

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[16] http://www.mckinsey.com/features/capitalism/paul_polman

Another example is the interpretation of 'fiduciary duty' by pension funds and insurance investors. Together these institutions hold 8.2 trillion euros of EU citizens wealth (July 2014[17]) and invest these funds in line with principles like 'fiduciary duty', which means that they invest them for the benefit of the people giving them the finance. The interpretation of 'fiduciary duty' is a matter of convention, and has increasingly been interpreted as short-term financial gain, rather than the duty to invest in those innovations which delivers increased wealth and societal benefit in the future for the collective pension fund beneficiaries.

4.5 Better Regulation

This type of market reform would be a bolder form of EU Better Regulation. It would involve the examination and reform of the policies currently shaping the market. It would include the deregulation of those policies which were holding back the EU from innovation towards societal goals.

Importantly, it would be Better Regulation and market reform beyond the sense that those terms are currently used in policy circles. Those terms typically apply to actions to make regulation more 'fit for purpose' where the 'purpose' is implicitly the reduction of financial costs for existing forms of economic production.

Better regulation could involve re-examining the policy choices which lead to the current set of incentives and prices for production and consumption, and choosing to better aligning those prices, public infrastructures, and social institutions with the EU's future needs.

Yet, as an activity at EU level, it would remain fundamentally deregulatory. Its scope would be limited to the scope of the market-shaping regulations which are within the EU institutions mandate, and it would very likely involve the repeal of several regulations and policies.

There is still a crucial role for Better Regulation which removes badly designed and obsolete regulation, administratively burdensome, or unnecessary for achieving EU policy goals.

A deeper, wider form of Better Regulation strengthens the already strong case for identifying the policies which are truly important for delivering EU goals, and allocating policy making resources to these areas, and away from olive oil containers.

4.6 Potential advantages

In addition to the economic benefits already mentioned:

- Providing new markets for new innovations which deliver on EU goals

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[17] *www.ecb.europa.**eu**/press/pdf/icpf/icpf14q1.pdf?*

- Providing investment opportunities for investors to trigger investment of idle, private capital; and
- Improving the productivity of the EU economy, and its ability to deliver prosperity
- Align economic activity and innovation in areas that give EU entrepreneurs first-mover advantage in important global markets of the future.

This market reform offers the opportunities to reduce other social and political problems affecting Europe. It can:

- Create a vision of European societal future, which citizens can connect to, is unique to Europe and belongs to European citizens.
- Prove the value of the EU institutions, by allowing them to tackle the current economic crisis with a role and tools available to no other institution.
- Align future market activity with actions which deliver greater wealth to EU citizens, including those in low income groups, reducing some of the inequality which currently holds back the EU. (As lower income groups enjoy a greater proportion of their quality of life from public goods, including, for example, environmental quality, greater alignment of market activity with the stock of these goods will reduce inequality).
- Reduce future pressure on national governmental budgets to step into the gap left by market activity to deliver public goods.

4.7 Identifying potential goals

Identifying the range of citizens' desires is a key role of politics. It should be left to the future political process.

Yet, policy makers already know the things which move people. People's fundamental drivers and desires have not changed significantly over time, although the conditions for achieving them have changed. Complementing political research, sociological research has identified the categories of human needs and desires which seem to lie behind many of the desires. For instance, according to researcher Manfred Max-Neef, people seek a cascade of needs:

- physical and mental health;
- affection and relationships;
- a sense of identity and the ability to contribute;
- increased comprehension (through curiosity); leisure;
- creativity and freedom; and
- a sense of security that the opportunities to satisfy these other needs will continue.

Research into the conditions under which people and communities are satisfied consistently shows that the opportunities to satisfy these kinds of needs are central drivers of citizen's satisfaction.

A process for identifying the direction of market reform should be steered by civil society, a process of engagement with citizens and democratic representatives.

Often, these are politically uncontroversial, except in the distribution of benefits between social groups.

More disagreement comes in identifying the linkages between the achievement of the goals and the conditions which will deliver them. An example is the now discredited notion that increasing the wealth of the richest in society would increase productivity of the economy as a whole (the 'trickle down effect').

However, at EU level, discussion of goals of market reform would be limited to areas of existing EU competence, and would side-step many of the most controversial issues. The process could focus on shaping markets to increase wealth, taking into account short-term and long-term societal goals.

It may, therefore, shape markets so that economic activity increases its aggregate productivity and the pace at which it makes progress at improving (or reversing negative trends in):

- Health and well-being, including promotion of healthy lifestyles and increasing community strength
- The use (particularly the import) or global natural resources, including energy, for EU production and consumption (including greenhouse gas emissions).
- The use of soils, water and ecosystem services for food production and leisure
- The time, safety and resource efficiency of mobility
- Life-long learning and skills training
- The performance of urban infrastructures

To achieve these goals, the EU would need to consider changing global conditions, including the potential for future export markets, which will provide future wealth streams for EU citizens.

The creation of market conditions to meet EU citizens' needs appear likely to create the lead-markets in the EU for future export markets, as large parts of the rest of the world increase their incomes and seek the better quality of life experienced in the EU. The creation of a particular lifestyle or product in the EU may also self-generate future markets in other parts of the world.

The single market is now sufficiently large to support innovation by firms purely for the EU market, exclusively or in addition to global markets. Indeed, this may be the only way to keep EU competitive advantage in any of the global markets, as extra EU technological capacity and skills increase in BRICS to rival the EU.

One example is the market for technologies which achieve improved air quality. Currently in the EU, poor air quality is estimated to cost 23 billion euros each year in damage to health, buildings and crops, including 400 000 premature deaths. Creating the market conditions for the growth of economic activity which tackles this cost would induce technological and business model development which would extend the EU a market lead in the vast future markets for improved air quality in the BRICS countries. The huge populations of China and India have been identified by the WHO as suffering the greatest burden from air pollution. In China in 2014, only 3 of 74 cities monitored by central government met even existing national standards.

5 Implementation

5.1 A minor transformation of current EU policy activity

The kind of market reform which is required is, in many senses, the normal activity of policy making. Most EU policies consider problems and attempt to realign or reshape the operation of markets, and market rules and norms in ways which direct economic activity, or consumption in an improved direction. Addressing market, and regulatory failure, is the core rationale of policy intervention. Some policies aim at improving the way markets operate - for example removing blocks to accurate information flows. Other policies often aim to achieve their goals by inducing some innovation development (for example, in telecommunications).

For a long time, EU (and national) policies have aimed at changing market conditions to assist future economic activity, or tackle societal problems. The Europe 2020 Strategy (successor to many previous strategies, most recently the Lisbon Strategy and the EU Sustainable Development Strategy) sets some transformational goals for the future, based on perceptions of global megatrends. EU Innovation policy is increasingly based on foresight activities to predict how innovation should be aligned with future change, and how it can be aligned to deliver societal goals. The Innovation Union Flagship Initiative of 2010 aims at changing framework conditions to support investment in innovation. Its major implementation programme, Horizon 2020, includes explicit focus on achieving identified 'societal challenges' through innovation.

Market reform as a solution to the problems Europe faces would not require a great change in the nature of policy: it would need a significant change in the pace and extent of reform, and some change in direction. There are existing brakes on policy reform. Successful implementation could remove these.

Many of the building blocks of the processes which could deliver these reforms are already in place. A few additional actions could facilitate the implementation of the reforms needed.

5.2 Identifying the hurdles

The politics of market reform programmes are, quite appropriately, strongly influenced by the managers and employees most affected. These tend to lobby for their existing goals.

Current industrial goals are themselves highly shaped by the current market conditions. These conditions shape what activities the sector finds profitable, and they shape the forms of financial and accountancy practices, their corporate governance, the characteristics of their existing product, the technologies they use for production and their allocation of different forms of labour or capital into their production.

This means that the lobbying by these companies - in line with *current* corporate and sector goals - will necessarily aim to tie legislators to past decisions, and only allow incremental market change. This is the core of the trap which currently blights the EU and holds back investment.

In addition, industry input into policy formation at EU and national level is influenced strongly by representation from collective industrial organisations. Their positions tend to be built on consensus between their members, and are highly influenced by those who stand to lose most from change. As a result, the position the representative organisations take usually protect their weakest, least innovative members, rather than recommending the decision considered as best for the economy as a whole. This blocks reform and sets the EU on a route to a dangerously outdated economy.

Resistance to imposed change by consumers can also hold back policy reform, but tends to be less organised.

The results of this kind of political block could be seen in a comparison of the US and EU auto industries during the decade following 2000. In the US, auto manufacturers were mainly successful in blocking regulation setting efficiency standards for their cars, and the other market conditions which would make more efficient cars attractive to consumers. Many focussed on increasing profits by producing SUVs which could be sold at greater profit, and required little investment in innovation. When oil prices increased, US auto companies could not compete in their domestic market with more efficient, innovative vehicles from more highly regulated markets in Europe and Japan. Of the 3 big auto manufacturers, 2 went into bankruptcy in 2009, with the US government allocating 80 billion dollars to rescue the firms.

5.3 Negotiating the hurdles

The key to unlocking policy reform needs to be found in processes which free corporate leaders and politicians from the constraints of past decisions on market structures. This could have 2 elements:

- Consensual discussion between business and regulators on *the full set* of market conditions which would facilitate businesses to deliver societal goals; and
- Greater weight given to the views of the visionary, entrepreneurial business leaders who want to shape their organisations to deliver future wealth for Europe.

The process for market reform would then include discussion on reframing conditions which currently shape business incentives and rewards. This means not only the product or production standards, but the web of market regulation and industrial and consumer policy which directly and indirectly influences their decisions. This starts with the ways in which the financial system influences incentives in business activities and the performance metrics. It includes the regulatory regimes around:

- Corporate governance
- Accounting practices
- Reporting in the financial markets
- Incentive structures within investment institutions (like pension funds)

Changes here might aim at aligning incentives from corporate finance and governance with long-term societal goals.

The reform process could also include consideration of:

- the current allocation of the burden of taxation which is highly influential on relative prices
- reconsideration of subsidy structures,
- removals of product regulations which create barriers to disruptive technologies
- appropriate future infrastructure investments
- changes in market operation (for example in the energy market) to make them appropriate for fresh business models.

A successful process would allow business leaders and politicians to envision the future, without being trapped in the past, and on the basis of that vision, plot the conditions for the investments which would lead growth in the economy in the most productive direction. These are not new policy themes. The difference would lie in how goals are set and policies are co-ordinated.

Reform is often slowed by perceptions that it will reduce the value of capital investments, with the concern that this damages the value of funds held by pension and investment funds, so reducing the wealth of average pensioners. For economy wide market reform, aimed at increasing the productivity of the economy, the opposite is true. Pension and insurance funds hold a wide range of assets, across the economy - and when the average productivity increases faster than it might do without reform, the average wealth of their assets will increase faster, with gains from innovative companies out pacing losses on less innovative companies.

5.4 Creating market reform plans to deliver investment

A suitable reform process would deliver a set of strategies for market reform, each focussed on the delivery of a particular area of societal need by the economy (for example mobility) and the ways in which that need could be best met, considering other societal goals. Each market reform strategy could describe the set of market conditions needed to deliver on those goals, and the route map for co-ordination of the policies which implemented them.

Each strategy could have the following elements:

- Identification of the EU citizens' several relevant goals in this area
- An analysis of how the current market structures diverge from the conditions which would deliver on those goals

- Examination of the inter-relations and feedbacks between different goals and how achievement of one goal can be shaped to efficiently reinforce achievement of another
- Identification of the new market conditions needed for innovation
- Identification of the nature of the policies and regulations which would need reform to create those market conditions.
- Consideration of the likely positive and negative impacts of the change
- Measures to ensure that there are sufficient means to support individuals and communities to innovate in their skills to adapt to changed market conditions.
- A decision on the optimal pace of change, based on technological and organisational constraints facing the most innovative EU firms.

5.5 Structuring the market reform process

At EU and national level, policy makers already work with a wide-range of stakeholders to form strategies, creating a mutually agreed goal for the future, and discus the market and policy conditions which are needed to support and shape economic activity to reach that goal.

One recent example at EU level is the CARS21[18] process (now followed by the CARS2020 process.) This brought together policy makers, industry and some other stakeholders to create a consensual strategic vision of the EU automobile sector and make the policy recommendations which would support it. The CARS21 group involved the leading EU automobile manufacturers and nine European Commissioners, between them covering many policy areas.

At national level, industry policy frequently involves roadmaps for sectoral change - for instance, the voluntary long-term agreements used by the Dutch government to support energy efficiency in Dutch industry.

The market reform solution which the EU could now deliver could follow similar processes to those already used, amended to be appropriate, as described below:-

5.5.1 Leadership

One of the critical barriers to this form of market reform is the need for co-ordination of sufficient political and economic actors around support for collective action to change market structures, which none of them can individually imagine bringing about. It requires the creation of a discussion where organisational leaders who have existing relationships which would be damaged by unilateral change, are able to talk about mutual change with other leaders, for example CEOs talking to their institutional shareholders.

[18] http://ec.europa.eu/enterprise/sectors/automotive/competitiveness-cars21/cars21/index_en.htm

Creation of these conditions for discussion requires great political leadership, from elected and appointed political leaders, but also from business leaders and civil society.

From each of these areas, leadership will need to accept the possibility of redefining their own goals, whilst in a process of consensual participation that acknowledges others' needs.

Two key aspects of leadership would be:

- The articulation of the need and benefits for significant reform
- The identification of the interlinkages between different market structures and forms of capital in shaping productive economic activity and so the rationale for collective action

5.5.2 Credibility

The credibility of the process would depend on the participation of sufficiently politically powerful players to support collective action in the face of resistance to change.

5.5.3 Participation

Although a process should include information from all affected, participation in the leadership and decision making of the process would need to focus on the visionary leaders and entrepreneurs who are currently held back by existing regulation. These are the leaders whom the EU needs to listen to, if it is to change its policies to stimulate more investment in innovation. In any given area of business, this might be those businesses which are in the most future looking half of the European firms in the market.

With much innovation coming from SMEs, means to include SME views on the conditions which they would need could usefully be included.

5.5.4 Thematic Organisation

Strategic discussions could best be organised around how value-chains, rather than industrial sectors. Discussions could start from how a vision on how to improve the service those value-chains deliver to society and involve all the actors along the value chain - or significantly influencing its operation, including the financiers. This would allow discussions to move beyond existing sectoral interests. It is similar to the approach already adopted by the Commission for the Innovation Union Communication, and other parts of the EU2020 Strategy.

5.5.5 Goal-setting

In the CARS21 process, markets were shaped primarily to deliver the existing industrial sector's goals. Sufficiently strong market reform plans would need to start with the aim of creating the markets which deliver citizens goals.

This needs to start with a consensual strategic vision of what European citizens want, and ideas of how technologically this can be best delivered, in light of global trends.

5.5.6 Transition assistance for individuals

In an economy which is already in constant flux, market reform strategies which promote faster innovation will create greater flux, in employment and in the skill sets needed for future markets. Even where the EU as a whole will benefit, regional variations will mean - just as with the current status quo - some communities would stand to lose some of their current sources of employment.

As is currently the case, market reforms would need to be accompanied by ways to redistribute some of the benefits from the winners from change to those individuals and communities which do not - in ways which assist individuals and regions to adapt to change and create wealth for themselves. The faster rate of change would provide a stronger role for the European Structural funds.

Transition support is needed for people, and to support innovation in firms, but not to compensate organisations or corporate managers which are not sufficiently innovative or whose capital investments become obsolescent. Transfers of funds to such firms will continue to act as a break on EU productivity growth, holding it in the past.

5.6 Step-wise progress

Market reform may progress step-wise. Innovative technologies and business models could be supported by partial reform of markets, creating changed conditions for a segment of a market, whilst the rest of the market remains as it was.

Such an approach has been used for the successful promotion of renewable power - creating market support schemes which generated a part of the energy market that was conducive to renewable power.

Through the use of the single market, the creation of sub-markets which promote innovation within larger product or service markets could take the EU forward. Those sub-markets could still be sufficiently large and homogenous to support significant investment into innovation.

6 The window of opportunity

The creation of market reform strategies would be a political and administrative challenge. Although it builds substantially on existing policy making processes, it requires some enhancement in the way which the European Institutions work. These changes could only be delivered when a large number of conditions are in place at the same time.

6.1 Necessary Conditions are currently met

For it to be possible to bring about this form of Better Regulation, or market reform, the following conditions would need to be in place:

1. Agreement by European political leaders and European business leaders about the depth of current and future problems in the real economy and society.
2. The possibility to bring about changes across a single market that is sufficiently large to support and reward innovation.
3. The existence of a political process with sufficient transnational influence to be able to seriously engage the transnational corporations which shape European markets.
4. A set of Commissioners with sufficient political leadership skills to be able to lead difficult, consensual processes for the shaping of reform packages.
5. A strong understanding and basis for co-operation between the European Parliament and the European Commission.
6. A fresh European Parliament, with Members and leadership ready to seize new opportunities and practices.
7. A structure of the European Commission which facilitates co-operation between the status quo siloed policy areas.
8. An appreciation of the need for the European Institutions to offer something more than they have been offering the EU citizen, and a stronger rationale for their trans-national role between the region, nation and the G20.
9. The availability of idle private capital, and skilled human resources, whose engagement can be triggered.
10. A society and economy with high, latent capacity for innovation and entrepreneurship, by large and particularly by small businesses.
11. A stable society, characterised by social integration, with sufficient public capacity to support individuals' reskilling into new economic activities, so able to politically support change.
12. Sufficient scientific information about the new feedbacks between economic activities, social inequality, environmental quality and citizen wellbeing so to provide decision makers with the basis for aligning market structures with EU citizen's goals, as global megatrends play out.
13. Sufficient civil servants with the skills to manage the strategy and policy making process.

Currently, uniquely, all of these conditions are met. There is a window of opportunity, before Europe declines, politically and economically. Taking the points above in numbered order:

1. Since the financial crisis, political and business leaders have sought solutions that can strengthen the real economy by triggering demand and productivity, without basing that on unsustainable borrowing.
2. The EU single market covers 508 million people, is ever more integrated, and covers just under 20% of world GDP[19].
3. The European Institutions provide a unique form of policy co-ordination which influences a greater share of world GDP than any other geographically-based political governance, making it a true partner for multinational corporations.
4. The Juncker Commission has greater high-level experience than any previous team: including 5 former Prime Ministers, 4 former Deputy Prime Ministers and 19 former National Ministers.
5. President Juncker and 4 other Commissioners were MEPs, and the deep understanding between the European Parliament and the Commission was built around deals on the 'spitzenkandidat' procedure for President Juncker's nomination.
6. Around 50% of current MEPs were not sitting in the Parliament at the start of 2009, opening the potential for the EP to take new approaches.
7. The form of the College of Commissioners has been restructured, with 6 Vice-Presidents charged with co-ordinating the work of a number of Commissioners - an unprecedented move to allow policy co-ordination.
8. President Juncker is not alone in noting that his is a 'Last-Chance Commission' if it cannot offer EU citizens what they want, in the face of rising scepticism.
9. 24.5 million EU citizens were unemployed in October 2014, including 5 million people under 25 unable but willing to put their talents to use, representing a pool of available skills.
10. The shape of the EU society and economy has consistently produced some of the greatest inventions, scientists and entrepreneurs, and contains many of the world's greatest universities and research establishments and is home to just under a ¼ of the worlds R&D, whilst being 7% of global population.[20]
11. The EU's success is based on the highest levels of per capita social expenditure in the world, creating a degree of political stability and support for losers from change which facilitates political support for progress.
12. Scientific knowledge has never been able to tell us more about our society, economy, natural resources and ecology of our region and planet. Civil servants used to working with ongoing processes with sustainable development often have excellent awareness of the interconnections between different societal goals.

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[19] http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/File:Share_of_world_GDP,_2002_and_2012_%28%25,_based_on_current_international_PPP%29.png

[20] http://www.nsf.gov/statistics/seind14/index.cfm/chapter-4/c4s2.htm

13. Within the European Commission, more than 700 officials have been trained in participatory process leadership since 2006, at all levels of hierarchy. However, the burden of current work, for example in reviews and reports on existing policy constrains administrative capacity. To resource a changed approach, the Commission would need to cut back existing forms of policy work.

This appears to be a remarkable opportunity for the EU to take steps to solve multiple economic, social and political challenges, complementing its existing strategies. Only a few changes are needed:

6.2 What is still needed

1. The enhancement and creation of existence of networks and fora where cross-sectoral discussions are the norm, from which new political processes for market reform can be shaped.
2. A commitment to step-by-step market reform processes and the creation of those processes at EU level.
3. Leadership by visionary European political and business leaders, who have the skills to bring together the many political, civil and business representatives to tackle the current economic problems.
4. Support for political processes by research into the inter-linkages between different forms of wealth, and the conditions under which aggregate EU wealth can be improved in the short and long-term.

7 Conclusions

The EU economy has been in trouble since the 2007/8 financial crisis. This has focussed attention on re-igniting GDP growth, at the expense of wider EU policy.

Signs of recent potential improvements are not indications that some fundamental challenges to the achievement of EU economic and societal goals remain unimproved. These challenges mainly derive from profound changes to the global economy driven by global population and economic capacity expansion at exponentially increasing annual increments.

Current EU economic policy will help. It does not go far enough in creating market structures which the EU economy needs to deliver prosperity in the 21st Century.

The EU institutions can induce the private investment which would provide the short and long-term solutions to European nations economic and societal problems.

They could do this through the bolder reform of the regulations which shape EU economic activity. This would not require increases in public spending, but induce private capital through the creation of new markets for investment in innovation.

The European institutions are the only form of governance which has the institutional, regulatory tools and competences to shape EU markets to align them with our present and future needs.

Such a programme of market reform offers solutions to the many current challenges the EU faces:

- Politically, it offers the chance to create a new European vision, one which is close to the people, and establishes a role for the European Institutions as their past role fades. It creates the opportunity for the European Commission to take a role which reduces criticism that it is becoming a tool of the most powerful Member States, and set out a pan-European programme.
- Economically, it creates the foundation for short-term growth in economic activity and lasting prosperity, compared to long-term decline under the existing strategies. The EU is currently burdened by regulatory structures which shape markets to tackle last century's challenges.
- Socially, it offers a route by which unemployment can be reduced and economic activity aligned with what citizens want, including greater social equality. It gives EU citizens the chance to feel that the EU has a positive role in the world, that their working activity is creating solutions for the world's challenges.
- Environmentally, it offers the way to shape economic activity so that we can prosper within the global ecological constraints which we have already exceeded, and the way that EU innovation can provide the technological solutions, and the business models which can save the world's severe and increasing environmental problems.

Uniquely, the set of conditions are now in place which would allow the EU institutions to take this strategy. The EU institutions could collectively create a consensual process which creates a set of strategies for micro-economic market reform, which complement the macro-economic strategies currently in favour in the Commission. The EU has the regulatory tools at its disposal, need not expand its competences, but needs to engage in a more fundamental programme of Better Regulation, with an enhanced goal, compared to the current agenda.

There are three keys to this strategy delivering on its potential:

- Aligning market structures to deliver the forms of wealth that meets the future needs of EU citizens, given global trends. That meets societal challenges.
- Unlocking the potential of business, through change in the financial, governance and accounting practices which currently constrain their market activity
- Creation of a process under which the current generation of visionary, entrepreneurial EU business leaders can shape market conditions to future needs in consensus with civil society, unhindered by weaker, less-innovative corporate managers.

This form of market reform solution is already sketched out in current EU political strategies, in the Europe 2020, and the Flagship Initiatives it contains.

All that is lacking is political leadership and the appropriate processes. This requires recognition of the depths of the challenges facing Europe, and the ability to unite political forces behind a solution, by pointing to the interdependencies between the EU's societal goals.

It requires the creation of cross-cutting policy processes which empower the visionary, entrepreneurial business and societal leaders of our times to shape the European future. Crucially, within those processes it requires contemporaneous reconsideration of the financial, corporate governance, fiscal and market structures which currently constrain productivity enhancing productivity.