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The European Union marks its 55th birthday this week. It's young and it's still evolving. To its credit it has done all, and more, that was expected of it in the past. It bought peace to Europe after 300 years of war.

It transformed a war torn, derelict economy into the largest and one of the most powerful trading blocks in the world; bringing prosperity to 500 million European citizens.

Nevertheless, it can't live in the past. Today Europe is facing its greatest crisis since the end of the Second World War. The problems are very complex, but can be likened to a vegetable, with outer layers and a core in the centre.

<u>First, the outer layer ...... The crisis with the economy</u>
(Actually not one crisis, but three concurrent crises)
- crisis in banking and financial services sector
- excessive public debt among the member state governments
- a global recession.

The above three points are not the fault of the EU. (The EU had no powers to stop irresponsible behaviour among the banking sector; nor could it stop the member state governments building unsustainable levels of debt).

But in consequence of the above Europe now has 25 million unemployed, 50% youth unemployment in some countries and economic growth has stagnated.

It could be argued that the EU was far too slow to respond to the crisis. More to the point: the real conclusion should be that the EU didn't have the powers to deal with the crisis; the architecture of the EU is not fit for purpose. The EU is now putting in place all the processes needed to address these failings (for example banking supervision and regulation powers).

<u>Second layer ….. the Euro</u>
The problem is the Euro was always a political project never a fiscal instrument. Fiscal instruments have rules, processes and disciplines. Had these been in place countries like Greece almost certainly wouldn't have been admitted to the Euro zone in the first instance.

Important those shortcomings are addressed. This inevitably means greater integration among the Euro zone member states. Fiscal controls handed to the European Central Bank, supervisory role for the ECB, move toward harmonisation of tax rates and social policy (eg retirement age). Euro zone will act as a national currency.

This is a move into areas "no one has been before". All nations must balance benefit from membership of a monetary union with loss of sovereignty/ ECB control.

UK not members of the Euro, nor likely to be within our lifetimes (unlikely countries like Sweden, Denmark or Czech Republic will want to either).

Outcome is important to the UK. 50% of our trade is with the other 26 EU states. Centre of gravity of the EU will be among the Euro zone countries, important that all legislative arrangements are not to the exclusion and rights of the minority non Euro countries.

<u>Third layer ….. the core of the body: competitiveness</u> (the elephant in the room)
Competing in a Globalised world; by contrast to our competitors Europe (and the UK) has:

- <u>Aging population</u>: More over 60's than under 16's in the country today. Long term consequences (and cost) of healthcare and pensions. Competitors like China don't have these costs! EU today; 9% of world population, 25% World GDP, and 50% world welfare spending.
- <u>Energy dependency:</u> High energy dependency, most imported, will only ever become more expensive in future.
- <u>Infrastructure:</u> Falling behind in world order. We need cross border energy connectivity, broadband and digital economy infrastructure and single market investment. UK ranks 28th in world infrastructure index.
- <u>Debt:</u> Very high level of Government debt imposes high burden of tax cost (eg on industry). Government debt as % of annual GDP - Euro zone 90%, USA 103%, Japan 226%.

Consequence of it all means three things:

1. World domination of the west now challenged. Will our children and grandchildren enjoy the same expectations in terms of improved jobs, growth, health care, education and pensions?
2. Europe <u>HAS</u> to change. Architecture not fit for purpose and the priorities are wrong. Are the European governments capable of making the changes required? Are the European people prepared to accept the changes required to keep pace with the rest of the world? (Greece a very good example).
3. Perception – too many Europeans see EU as the <u>CAUSE</u> of Europe's problems, rather than offering the <u>SOLUTION</u> to the problems.

Europe's economy today setting out on a journey; difficult to predict what result looks like, and difficult to predict how long the journey will take. Let me have a stab at what Europe looks like in ten years time. Four points that I will make:

1. The EU will not disintegrate. German debt to history, Merkel not going to allow EU to disintegrate.
2. The Euro will still be here. It will have more members than now (all EU member states, with the exception of UK and Denmark, are obliged to join 'when circumstances are right to do so', although some eg Greece might not be there).
3. Competitiveness will still be the challenge. To develop a truly competitive economy we most need radical budgetary reform. Current spend pattern is very recognisable from the original priorities of 55 years ago, and yet the world we live in and the problems we confront are totally different. (For example, at a time when we have 25 million out of work, is it right that we devote 40% of our spend to the CAP?) The key to future prosperity is about technology, about sustainable energy solutions, digital economy, R&D and high quality education and our spending needs to reflect that. Question, can Europe change?
4. There are two very different economies emerging in Europe: A 'North Sea' economy and a 'Mediterranean' economy. Two groups of countries, two very different cultures. Divided by very different traditions, instincts, disciplines and culture. Long term are they compatible? (In my opinion) no reason why the EU can't have one geographic external boundary, but two different economic zones operating within that.