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Pascal Lamy
and Eric Labaye

Solving Europe's economic conundrum

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How should policy makers undertake the reforms necessary to revitalize the continent's economy and restore the confidence of voters? The McKinsey Global Institute wants your ideas.

European leaders have a long list of crisis measures and short-term worries to deal with, from the ongoing refugee crisis to the risk of Britain voting to leave the European Union. While the focus on daily issues is understandable, it's important that leaders not lose sight of the longer-term priorities for the European economy. The restoration of stronger growth is sorely needed to meet the aspirations of European citizens and thereby to restore confidence in the common future of European nations.

At a time when growth in China and some emerging markets is slowing, Europe should be in a position to pick up some of the slack in the global economy. After years of sluggishness following the 2008 financial crisis, the sharp fall in oil prices since 2014—combined with a favorable euro exchange rate and the European Central Bank's quantitative-easing program—provide Europe with a rare window of opportunity to tackle the big challenges ahead. Corporate investment, subdued since the 2008 crisis, is finally picking up.

Still lacking, however, is a concerted push by policy makers to use this window to create the conditions for sustainable, faster growth. The European public is eager to break out of the current frustrating economic cycle. Indeed, in 2014, when the McKinsey Global Institute (MGI) undertook a survey and conjoint analysis of 16,000 Europeans in eight countries, it found people were clearly willing to make tough trade-offs, including working longer hours or accepting some changes in social protections in return for improvements in incomes and better public services such as healthcare or education.

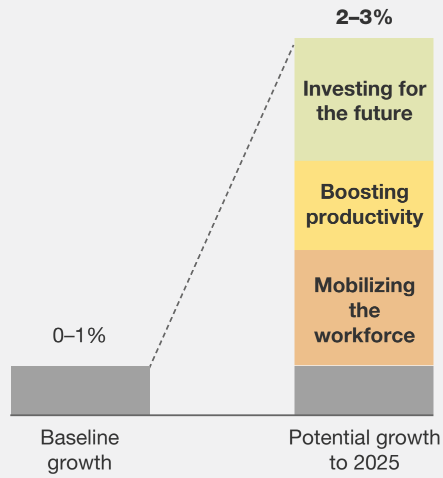
There's no secret about what needs to be done. If Europe is to revitalize the economy, a combination of pan-European steps will be required to stimulate investment and job creation; at a national level, key structural-reform measures will need to be implemented. These include measures outlined in the June 2015 MGI report *A window of opportunity for Europe*[1]: mobilizing the workforce, including making labor markets more flexible; boosting productivity, including stimulating competition; investing for growth, including in education and innovation; and

[1] The McKinsey Global Institute (MGI) report was written by McKinsey directors Richard Dobbs in London, Eric Labaye in Paris, Sven Smit in Amsterdam, and Eckart Windhagen in Frankfurt, along with MGI senior fellow Jan Mischke in Zurich and consultant Matt Stone in London.

Exhibit

Action on three areas of reform can raise Europe's growth rate.

Annual GDP growth for 30 countries[1] in Europe, estimated



[1]EU-28 plus Norway and Switzerland.

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improving EU competitiveness. This combination could create sustainable annual GDP growth of as much as 3 percent, more than double the eurozone's current performance (exhibit).

Europe needs to act now—and not just so it can play its rightful role in today's global economy but also because its aging population will act as a significant brake on economic growth. By 2050, the EU labor force could shrink by 42 million, or 12 percent, dragging down growth and prosperity unless there is a sharp rise in productivity to compensate for it or a continued increase in immigration.

For years now, the policies that could lead to a revitalization have been discussed and advocated repeatedly by various European institutions, including the European Central Bank and the European Commission, as well as at meetings of government ministers and heads of state of all 28 EU members. Yet moving from theoretical discussion to practical application in individual countries continues to be difficult. Some countries have made significant reform moves, including Spain. But political obstacles to deep reform continue to hamper the continent; many leaders fear that implementing economic change that will make a difference in the longer term would hurt their short-term electoral prospects.

While the headlines are often gloomy, Europe is in fact far from being a spent force. It generates 25 percent of global GDP, and its countries include world leaders on key social and economic measures—such as Germany's trade competitiveness, the United Kingdom's strength in services, France's world-class transport infrastructure, and Denmark's energy efficiency. From a corporate perspective, too, it is alive and kicking: there are more European companies in the Fortune Global 500 (142) than American ones (128).

The need for new ideas and fresh input into how to overcome this fundamental issue of the European political economy is the spark behind the MGI Essay Prize. We hope it will generate original approaches to the conundrum about reforms that are acceptable to voters and will restore their confidence in European integration. This is especially important as Europe struggles to maintain its cohesion and counter growing public disgruntlement and political fragmentation. The Essay for Europe prize will focus on the very real—and often understated—strength and on the opportunities that the continent has to maintain and strengthen its global role. Seizing those opportunities will be fundamental if the continent is to renew the faith of its citizens in the greater European ideal. □

For more on the McKinsey Global Institute Essay Prize - An Opportunity for Europe, visit www.essayforeurope.com.

Pascal Lamy, who is chair of the panel of judges for the Essay for Europe prize, is president emeritus of the Jacques Delors Institute and former director general of the World Trade Organization. **Eric Labaye** is a director in McKinsey's Paris office and chairman of the McKinsey Global Institute.