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Europe Beyond The Millennium
– Making Sense of Tomorrow

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Foreword

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What will Europe be like for business in ten years' time? Which forms of business will be successful? What can chief executives do now to ensure success in the future? I know from my conversations with business leaders across Europe that these are some of the key questions which they face today. Yet while many develop a vision for their company, it is more difficult in these times of exponential change to be visionary about changes in the world in which businesses operate.

Ten years ago, few would have predicted the fall of the Berlin Wall and revolutionary change in eastern European society, the reinvention of the Left throughout Europe but also the rise in nationalism, and a single currency covering 11 countries.

It is simply not enough to look at the past and extrapolate – after all navigating by looking only in a rear view mirror is not the easiest way forward. Though much may remain the same in the future, there will undoubtedly be some major unforeseen shifts which could have a tremendous impact on business. It is those firms that are able to cope successfully with the discontinuities and shocks – firms with leaders who expect the unexpected – which will have the brightest prospects.

This report aims to help firms prepare themselves for the future. It is not Accenture's attempt to produce a business horoscope. The scenarios are not predictions – rather they are attempts to construct coherent stories about possible futures, to enable business leaders to consider the environments within which they may soon have to operate.

In developing these scenarios, we have eschewed the crystal ball, and relied on rather more robust methods. Over the past 18 months, Accenture has been researching in depth, the forces and trends influencing the future of Europe, drawing on the help of experts from industry, politics and economics throughout Europe. Analysis of these forces and trends has enabled us to identify the major influences shaping Europe over the next ten years.

These forces and trends, complex and inter-related, are not all driving Europe in the same direction. Global competitive pressures and free-market capitalism are pushing towards a 'shareholder' socio-economic model, while continental corporate and financial structures and some of the EU's labour market directives tend towards the 'stakeholder' model. Similarly, while Europe deepens its Single Market, expands to embrace countries from Central and Eastern Europe and moves towards political and economic integration, countervailing forces in national and regional politics, fears over loss of national sovereignty and currency incompatibilities seem to be pulling the Union apart.

So how do businesses prepare themselves for the impact of these forces on their markets, the way they conduct their business, the competitive environment and the very shape of their enterprises? To help understand the possibilities, we have identified three scenarios – 'Competitive', 'Conscience' and 'Patchwork' Europe, each of which paints a picture of a different European future. We do not attempt to say which outcome is the most likely, or indeed even which is the preferable option. Reality will probably lie somewhere in between.

Nonetheless, as you look at and compare these possible futures, I hope that you will find fresh insight which will help you prepare for the challenges of tomorrow and so set your priorities for action today.

Vernon Ellis

Vernon Ellis is Accenture's managing director for Europe, Middle East, Africa and India.

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Europe Beyond The Millennium

The date is 2008 and the place is Europe. This is where we go about our lives and conduct our business. But what sort of place is it? We have developed three scenarios which set out different views of what Europe could be like in ten years' time:

Competitive Europe: a shareholder model of capitalism within an integrated and enlarged Europe with a Single Market and single currency. Powerful central institutions promote competition, having abolished subsidies and removed trade barriers. The labour market is very lightly regulated, and the gap between rich and poor is widening. Mergers, acquisitions and new entrants transform the corporate landscape.

Conscience Europe: a stakeholder model of capitalism within an integrated and enlarged Europe with a Single Market and single currency. Powerful central institutions direct both economic and social policies, with the aim of ensuring high minimum social and environmental standards, and protecting vital industries against foreign competition. Companies treat staff as long-term assets, although high social costs also mean there is an emphasis on capital-intensive investment.

Patchwork Europe: a fragmented Europe, where power has become devolved to national and sub-national bodies. Different 'regions' have emerged, from city-states through to loose cross-border groupings, each pursuing different socio-economic models. Europe comprises a patchwork of very different environments for business, with some regions espousing undiluted free-market capitalism, while others apply a new kind of communitarian socialism and a third group practice more traditional forms of interventionism. Trade barriers have reappeared, as have different currencies.

These scenarios are not predictions of the future – rather, they are different possible views of what might happen, based on a consistent combination of

relevant forces and trends. By looking at these alternative possibilities, companies can consider what they need to do now to be ready to cope with future developments, and to succeed, whatever happens.

Several themes are common to all three scenarios:

- New technologies and the rise of eCommerce clearly have a role to play in enabling businesses to get closer to their customers – increasing market penetration, reducing the cost of customer contact and improving service.
- The quality of a company's staff is often the key differentiator, making it essential in every scenario that people are treated as long-term assets.
- No effort should be spared to reduce costs and increase productivity.
- Businesses must be alive to alliances that may enable them to exploit changes within and across industries and across political boundaries.

When a series of working groups involving executives from some of Europe's leading companies and Accenture partners discussed how their businesses would fare under the different scenarios, the main challenges facing business leaders over the next ten years were, by common consent, achieving true customer focus, and having the right people, skills and culture. Also important were industry relationships, delivery channels and operational flexibility, with costs and productivity an ever-present concern.

The working groups then considered the initiatives most urgently required over the next ten years. Great importance was attached to creating a new business culture and new skills, improving innovation and speed to market, and building new organisational models. But again, there was common consent that the two most urgent initiatives should be to build a new customer/market approach, and to optimise process productivity and efficiency.

In considering how to succeed within each scenario, questions business leaders might consider include:

- How will the demands and values of my customers change?
- How will my markets extend and expand?
- How will my supply chain and value chain change?
- How will critical success factors differ?
- How will my management approach vary?
- What role should my business play in the wider community?

Clearly there will be particular issues facing particular industries, and we have not attempted to highlight these here. Instead, in the next sections of this report we set out the three scenarios in more detail. In thinking through these possible futures, companies can assess the challenges ahead, and set their own priorities for action today.





Competitive Europe

An enlarged, integrated Europe with a Single Market and single currency. Powerful central institutions promote competition, having abolished subsidies and removed trade barriers. The labour market is very lightly regulated, and the gap between rich and poor is widening. Mergers, acquisitions and new entrants transform the corporate landscape.

The Euronews

Tuesday, 8 January 2008 - published in London and New York www.euronews.com € 3



Trans European General Workers Union demonstrates against wage discrimination outside Euro parliament



Berlin In a mass show of strength, 200,000 TEGWU members from across the EU besieged the European Parliament yesterday in a last-ditch attempt to stop a new bill making minimum wages illegal in Europe. The bill, being passed under the Social Chapter, forces national parliaments to scrap any legislation regulating the pay of workers. The demonstrators, the majority of whom were women in part-time, service sector jobs, were protesting about the feared reduction in pay which would result. In response, Silvio Berlusconi, leader of the majority European Conservative Democrats, argued that European jobs will continue to go to South America and South East Asia 'if we continue to price our labour out of the global market place'. Introduced by Employment Commissioner Portillo, the bill looks set to pass with a clear majority despite the concerns of the TEGWU and the minority European Social Democratic Party.

has made clear its worries about the lack of investment in the skills of the lowest paid and the potential development of a huge pan-European underclass disenfranchised from the mainstream. Part-time and temporary service sector jobs made up 80% of new jobs created in the EU last year. However, these concerns have been brushed aside by the Commission, which is concentrating on attracting inward investment through deregulation and minimising the cost base for global firms. And they point with pride to the huge inward investment program being undertaken by a consortia of US and Japanese information technology companies.

Ukraine joins EU

Berlin In colourful ceremony of accession in Berlin yesterday the Ukraine became the first ex-CIS nation to join the European Union, adding 50 million consumers to the single market. The new Euro-rules mean that the Ukraine has also become part of the Euro-zone. Existing EU members now have 1 year to join the Euro-zone or leave the EU, while new EU members must also join the currency. While this only affects Greece of the existing members, it effectively toughens the membership criteria for aspiring nations. The success of the Ukraine's application appeared to be on a knife-edge for some time, not only because of the difficulties of meeting the Euro convergence criteria, but because of the political backdrop, with President Lebed of Russia indulging in some loud sabre-rattling. This proved in the end to have more to do with the impending Russian Presidential elections. Lebed proved wary of being seen to damage Russia's own application, acknowledged as crucial to Russia's future development.

Texas Utilities raises stakes after takeover of Polish Utilities company Polvac

New York In a widely-predicted move, ambitious US firm Texas Utilities has made its first foray into the newly-opened utilities markets of the former CEE nations by purchasing outright the remaining shares in Polish energy company Polvac. The share capture, the first to be carried out entirely by a computer program, was made through the new eLink between the NYSE and EASDAQ. Texas Utilities has been positioning itself for some time to take advantage of the expiry of the 5 year time-ban protecting the utilities companies of new EU members from outside ownership. A spokesman claimed that Polvac, an efficient gas and electricity producer, would help Texas take on the Euro-giants Deutsche Power and Generales Des Eaux 'in their own backyard'. Both the German and French companies took advantage of their EU status to bend the rules by running alliances and partnerships with former CEE utilities and Texas now claims that this lulled them into a false sense of security about the future. Let battle commence and to the consumer the spoils. Texas, noted worldwide for its emphasis on customer service, is already promising the first year's electricity free to consumers who switch.

Scenario one

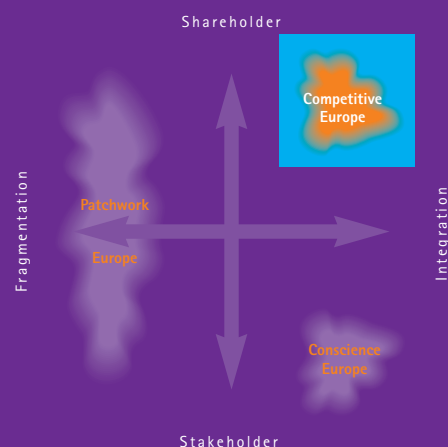
Competitive Europe

Europe is a good place to be in 2008 – for those people who are members of the new European cosmopolitan class, well-educated, well-off and well-networked. But life is not so good for the poor, who are increasingly impoverished, lacking not just money but also access to ever more important information networks. There is a similar divide in terms of companies: the extremely competitive environment has created new business opportunities, but only for companies that are lean and nimble.

A successful, strong Euro – now adopted by all EU member states after the non-participants were given an ultimatum to join EMU or to leave the EU – has acted as a particular spur for competition across Europe. The EU has gained new members and there have been further moves towards the completion of the Single Market. This has in turn provided a strong basis for European firms to compete more effectively in the global marketplace.

The days of big government are over, and power has gravitated towards the European Union institutions – not as the providers of services or subsidies but as the facilitators of an environment in which business can flourish. These institutions, now based in Berlin, have pushed much less of a social agenda in recent years, but where they do have authority they exercise this with great vigour. The failure of Member States to implement directives properly is no longer tolerated, particularly where this is seen to impact on the Single Market programme. The Commission now has real teeth when it comes to competition policy. The thresholds for involvement of the Commission have been lowered, and its resources for investigating possible anti-competitive actions strengthened greatly.

Individualism and entrepreneurialism are now the dominant cultural forces throughout Europe. There is an increased emphasis within firms on competitiveness, profitability and taking advantage of the Single Market. There has been a process



Strong central power

Single currency

Privatisation

Competition

Individualism

Free trade

No subsidies

of 'competitive chaos', with industry convergence and the reinvention of markets being accompanied by the emergence of cross-sector players. By 2005, privatisation of formerly state-owned monopolies was virtually complete, and after much jockeying for position amongst established firms and new entrants there is now intense competition between a small number of major companies in markets such as utilities, telecommunications and transport. Mergers, acquisitions, joint ventures and alliances have led to massive economies of scale for multinationals – though hand in hand with this has come the growth of innovative small businesses in niche markets.

Companies must now have a commercial focus in everything they do, making management more effective by assigning work on the basis of projects to be completed, and building rewards on results. At the same time, companies are much more conscious of their relatively dominant role in society and the prominence – and exposure – this brings with it. They see it in their long-term interests to show responsibility towards the communities they are in, particularly over matters in which there is a high media risk, such as the environment. The first focus tends to be on action in the community which has fairly direct pay-back to the companies themselves, such as vocational education – although as governments have reduced social security spending significantly, a number of major companies have seen it to be in their 'enlightened' self-interest to plug some obvious gaps.

The culture of competitiveness has had an impact on corporate governance. There have been moves towards an equity culture with a focus on return on capital: there is now a shorter-term approach aimed at achieving a fast pay-off for shareholders. Pensions funds in the EU have adopted strategies of holding minority shares in companies but become the dominant investors overall, just as they have long been in the US. The increased pressure for swift returns has destabilised the traditional 'insider' system of control, with financiers sitting on the board, and led to the break-up of long-run relationships. The welfare state is greatly diminished, particularly with a major move away from state provision for both pensions and long-term care. Combined with the final round of privatisations, this has served to increase the size and volume of pension funds. The successful implementation of the single currency has dramatically increased the number of portfolios run on a pan-European basis. Indeed, the elimination of foreign exchange fluctuations, stable and low interest rates, lower transaction costs and transparent pricing have all combined to substantially reshape the financial services industry.

The global impact of Anglo-American capitalism has undermined continental European stakeholding permanently, and as a result there has been a dramatic shift in labour relations. There is now much greater uncertainty in terms of employment, with a greater use of short-term contracts and part-time and casual labour. Much of the national and EU employment regulation has been swept away, on the basis that it was seen to be a burden on European firms, which inhibited their ability to perform on the global stage. The prevailing political philosophy is generally that

everyone should be encouraged to work, with those social security payments which still exist tending to be in-work benefits, so creating a link with employment. There are increasing numbers of both very high and very low paid employees. It is not only the latter group which has experienced a harder life in recent years: senior managers must now live with uncertainty in extremely dynamic markets and constantly changing/reinvented supply chains.

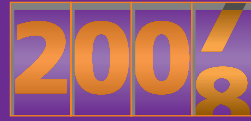
A few years ago, immigration was actively encouraged in order to tackle the demographic problem of an ageing population. This has proved to be successful in the short-term, particularly as a way of tackling the skills gap in Europe – many of the immigrants are highly qualified. However, a long-term solution still seems as far off as ever. In addition, there are now some danger signs, with increasing social conflict – many poorer members of society resent the success of the immigrant population, which is becoming the focus of growing social conflict.

Given the nature of society, consumer demand is increasingly polarised between the high-income and the low-income markets – this means that firms need to be clear about which market segment they are targeting. Successful companies nowadays are ones which are flexible and customer-focused, ready to respond to demand with customised solutions. The increasing focus on the individual customer, enabled by the development of eCommerce, has led to the provision of 'whole person' services with firms catering for the needs of individual people across a whole range of markets, rather than being constrained by traditional industry boundaries.

Chief executives need to focus on and exploit their company's core competences so that they gain the maximum competitive advantage. They must maintain quality while minimising their cost base, and are increasingly looking towards more flexible forms of organisation, including outsourcing those functions which do not provide a competitive advantage, and using shared services.

Businesses that want to succeed in the global economy have found that they must rationalise production and supply chains. They need to consider the possibilities for joint ventures, alliances, mergers and acquisitions so that they can maximise the power of their brands, win new customers and retain existing ones. Both competition and opportunity may lie in other industries, and business leaders have to be prepared to explore new ways of exploiting their core competences, whether inside or outside their traditional area of activity.

The enlargement of the EU has created growth in both the resources base and the consumer market. Many companies are now looking at investing and moving plant towards the CEE countries and elsewhere, to take advantage of natural resources and the labour costs which are even lower than in the rest of the EU. But this migration has not been a one-way process – at the same time as manufacturing has moved eastwards, a growing number of CEE citizens have moved northwards and westwards.



Conscience Europe

An enlarged, integrated Europe with a Single Market and single currency. Powerful central institutions direct both economic and social policies, with the aim of ensuring high minimum social and environmental standards, and protecting vital industries against foreign competition. Economic growth is slow, but stable. EU government invests heavily in innovation and education. Companies treat staff as long-term assets, although concern exists over high social costs.



Scenario two

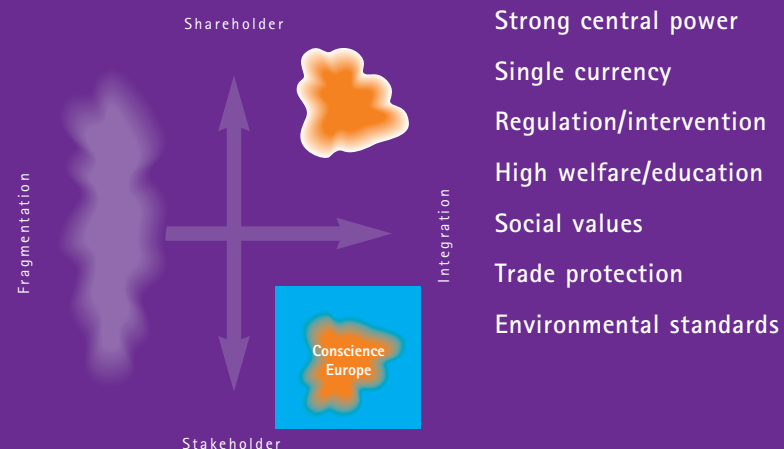
Conscience Europe

By 2008, Europe has seen much growth – in the number of member states, in the amount of regulation, and in the social role of Government – although it now has a slower (if more stable) economy. The European Union has not only gained new members, but also more power – the old 1990s argument about widening *or* deepening proved to be misguided, when the Union became wider *and* deeper. This influx of new members, and political changes within existing Member States, meant that new cultures and philosophies developed. In particular, Anglo-American approaches to both the role of Government and the governance of firms have become less influential.

The institutions of the EU are more powerful than ever before. After a slow start, more emphasis was given to sorting out the mechanisms governing the expanded Union, and this paid off through greater efficiency in decision-making on tough issues like the Common Agricultural Policy and the so-called 'pensions time bomb', with a resultant increase in confidence in the EU. In recent years we have seen more active Government at the national level, although it is increasingly clear that it is in the institutions of the EU in Berlin where the real power lies.

There has continued to be a political realignment in many EU countries over the last few years, with perhaps the most popular philosophy at present being what has been termed 'The Fourth Way', in which Government increases its involvement in social welfare to levels not seen for 30 years and at the same time takes a vigorous approach to the scrutiny of firms and markets. Mergers and acquisitions now tend to be investigated thoroughly, not just in terms of their impact on competition but also with regard to factors such as employment – many are now subjected to a 'social impact assessment' by the authorities.

Welfare and tax regimes have been harmonised – it was successfully argued that the previous differences in these areas represented barriers to the successful



completion of the Single Market, with some countries competing unfairly. Labour costs have risen substantially in recent years, with above inflation increases in the European minimum wage now required by law in order to narrow the gap between rich and poor.

The European Commission is strongly involved in both transport and environmental issues, again on the grounds that these have an impact on the Single Market. Improved transport networks are seen as the way to make European economic integration a reality, though these have required substantial subsidies. With regard to the environment, the Commission sees its role as collecting money rather than just paying it out. It argues that for too long companies have not been picking up the bill for the environmental externalities of their behaviour and it aims to levy stringent new taxes on polluters – though some industries have been excluded or given certain protection so that the additional costs do not render them so uncompetitive that jobs are lost.

Businesses have had to learn to work inside an expanded but tightly regulated environment and to manage high social and labour costs. These are boom times for EU policy experts, political lobbyists, strategists and lawyers – all are needed to ensure that firms understand and make the best use of EU legislation, structural funds and grants.

Much of companies' and industries' interaction with the community is concentrated on lobbying Government to protect business interests. Business and society generally expect Government to take the leading role in meeting the needs of the wider community. For their part, companies see a greater emphasis on partnerships and participation in Government and EU-led initiatives. Given the high level of public expenditure, it is vital for individual companies that they get a share of the cake in areas such as infrastructure, training and research. This again requires an emphasis on lobbying and relationship building with Government at all levels.

Some good news comes with the fact that this is a fairly stable environment in terms of public policy – business might not like the degree of regulation, but at least there is a high degree of certainty. This is a world in which entrepreneurship is not encouraged as strongly as it might be – everything is just a little too comfortable – but nor is insecurity as prominent as it was in the past. There is less incentive for change, since there are few new entrants and the pace of both cross-industry convergence and global competition has slowed dramatically.

Compared with ten years ago, businesses now tend to take a more far-sighted view of supplier relationships, investment and other commercial decisions – 'sustained and long-term investment for sustained and long-term return' is now the dominant philosophy. They treat employees as long-term assets, and match sensible recruitment programmes with career planning that will enable them to retain their best staff. There is a strong emphasis on education and training, with

the EU providing funds in order to improve Europe's skills base – although some business leaders have expressed concern that the link between such training and the needs of business is not always clear.

At the same time, companies tend to be wary of strategies which risk retaining too many staff in the event of an economic downturn, and hence investment tends to be capital-intensive where possible. Of course, investment in people rather than capital is often unavoidable, and some firms have responded to the high social costs by trying to move parts of their operations outside Europe, where regulation is less onerous – although the EU has taken steps to discourage such action.

Expansion of the EU has seen growth in the consumer market. However, income re-distribution has led to the creation of a larger middle class. When combined with the impact of more rigid standards for many products and services, there has been an homogenisation of product markets, resulting in a diminished range of choice. Regulation is at its toughest in sensitive areas such as health care, where a growing number of politicians are questioning the appropriateness of private sector involvement.

The growth of the EU, in terms of both the number of members and degree of solidarity between them, has been accompanied by elements of a 'Fortress Europe' approach, with restrictions on foreign competition, particularly when such competition is thought to have major employment implications. Again this is justified in terms of the Single Market – it is said to be unfair that other countries can compete by having lower social standards.

This in turn causes problems with EU companies' access to overseas markets, as regulatory measures are put in place by way of retaliation. Many European businesses are still happily profiting from their protected home market, but there are signs that being shut off to an extent from markets outside Europe is resulting in less innovation – the level of patents in leading-edge products continues to fall. European business may be becoming less competitive – we could soon see a vicious circle, where the isolation of Europe leads to less innovation, and this in turn leads to even greater isolation because protectionism is seen as the only way to protect EU jobs.

'Fortress-busting' has become the name of the game for high-tech global businesses based outside the EU – and their consumers. Fed up with Europe's high prices and limited choice of goods, savvy consumers now surf the Internet for cheap, foreign-produced CDs, Hollywood films banned under the European civilisation quota rules, and other products which can be downloaded electronically without a Customs official in sight.

200%

Patchwork Europe

The fragmentation of the EU has seen power devolve to national, regional or city-based institutions. Europe comprises a patchwork of different socio-economic models, with some regions espousing undiluted free-market capitalism, while others apply a new kind of communitarian socialism. Trade barriers have reappeared.



Scenario three

Patchwork Europe

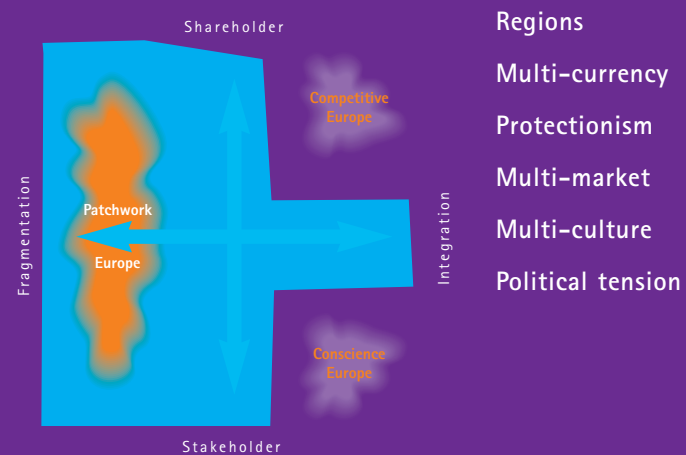
In the mid-late 1990s, pro-EU politicians accused their rivals of trying to create an unworkable 'two-speed Europe'. In 2008 many look back on these times fondly, for we now have something more like a 20-speed Europe. Business leaders need to be familiar with a vast array of different political structures, supply chains, and cultures.

The Euro still exists, though it covers only a handful of countries. Every time Europe hit economic problems, they were blamed on EMU, and the backlash in some countries was so strong that a number of the original participants withdrew and re-established their own currencies – although this caused further difficulties, given the high costs involved with such action. Others are soldiering on, but this is a confused and unstable environment for business.

All this has led to a far more insular and protectionist approach to trade. This is not to say that there are no rules governing the Single Market. All EU Member States still say that they are committed to the creation of a truly effective Single Market, but these fine words do not seem to be followed in practice. The number of cases brought against Member States by the European Commission for breaches in regulations governing issues such as state aid and public procurement, and for failure to implement new directives properly, has soared. There is an increasing amount of regulation at a European level, but a declining level of national compliance.

There are de facto restrictions on the flow of labour and capital. This is a major problem for large businesses, who have always benefited from the advantage over smaller rivals of being able to transfer skills and knowledge effectively across borders.

Although many industries are protected, there is little consolidation across Europe, so that opportunities exist in many areas for enterprising small businesses to exploit technologies such as the Internet to source, supply and sell across borders.



The accession of poorer countries which rely heavily on agriculture and old heavy industries, combined with the pensions time bomb, has put great stress on the finances of the Union. Arguments have raged about Member States' own responsibility for tackling these issues, with the UK and Denmark demanding that the EU should not provide financial aid to those countries which have not already acted to scale down the state role in welfare provision, and other countries querying why newer members should be given extra help to transform their economies at a time when longer-serving members are also facing economic difficulties.

The result is an absolute block on further social development of the Union, and a reversion to something which has not been seen since the early Thatcher years in the UK, an evaluation of the impact of EU membership in terms of contributions paid in and grants paid out. No country has left the EU so far, but in the course of budget negotiations a couple have threatened to do so and all moves towards further widening have been frozen.

Creating effective relationships with government is hard for business, because power is located in so many different places. The institutions of the EU have struggled to retain their authority since enlargement, as their mechanisms were designed for a smaller and less diverse membership, but they do still play an important role on some issues.

National governments are still important, but recent years have seen the development of multi-layered political structures, with strong regional bodies, including not only the return of the city state in some cases but also the creation of cross-border groupings. These bodies often have a different political perspective from that of relevant national governments – some pursue highly aggressive free market agendas, while others are much more interventionist and a third group seek public-private partnerships at every turn. This has led to some political tension and raises the sensitive issue for companies of how to establish good working relationships with one layer of government without offending another. In this complex political world, companies are spending more on professional lobbyists than ever before.

This complexity in turn affects the way firms relate to what in some parts of Europe are still referred to as 'stakeholders' – employees, customers and local communities. Firms need different identities in different places: the more sophisticated ones have become 'multi-local', giving the impression in each area of a special commitment to that particular locality, with a series of different identities to fit in with the prevailing political and consumer culture.

Community involvement is much greater in some areas than in others – where the political culture favours unbridled capitalism, there is relatively muted involvement, probably limited to initiatives like local training provisions which

give relatively quick and direct benefits; but in other places there is much more high profile sponsorship of community initiatives, with a focus on corporate responsibility and a sensitivity around issues such as the environment and executive pay.

It is not only political structures which are multi-layered – companies must manage at the most appropriate level. This will vary from region to region. Multinationals prosper, but only if they have political, legal and strategic competence in each marketplace. HR management and investment will require a longer-term strategy in some areas and a shorter-term approach in others, depending on the nature of the local or regional economic environment.

But a broader view is still important. The winners will be those companies that can transcend political, cultural and geographic barriers, even while maintaining a range of appropriate identities for external audiences. Those firms that manage to transfer skills and knowledge across borders will have a major advantage over their competitors, both national and multinational.

However, many businesses' reaction to this complex picture has been to wonder whether they might be better off somewhere else. Central and Eastern European countries are now seen by many as prime candidates for investment, since they offer fewer operating restrictions and promise better returns – they have in effect become the engine of growth for Europe. The outward looking nature of these economies, in stark contrast to the introverted stance of most EU members to their west, means that they are increasingly seen as a better base for competing in the global economy. Inward investment in these countries has continued to rise rapidly, at a time when most other countries have seen falls in such investment.

The three scenarios – Competitive, Conscience and Patchwork Europe – have emerged from exhaustive research, in which we have examined in depth, the forces and trends influencing the future of Europe. Over the past 18 months, we have drawn on a wide range of information sources, as well as the views of observers and experts from industry, politics and economics throughout Europe. We tested our thinking with an informal forum of our own senior strategists and other business leaders, who gave invaluable comments on our initial findings.

In order to develop coherent scenarios about possible European futures, we looked at how Europe would be affected in two main dimensions – political and socio-economic. These dimensions of change form the axes of the scenario framework. The horizontal axis of the framework runs from political fragmentation to political integration, while the vertical axis runs from a shareholder socio-economic model to a stakeholder socio-economic model.

Fragmentation ←————→ Integration

Fragmentation or integration?

The political dimension ranges from fragmentation to integration. A fragmented Europe could be one in which there are different political models, with different approaches to major issues, not only between countries but also within them. This could mean a rise in the power of the regions, at the expense both of the nation state and of the current EU institutions in Brussels. In contrast, we could see a more integrated Europe, where the move towards Economic and Monetary Union is accompanied by a greater intertwining – both economically and culturally – of EU Member States. This could result in changes to the nation state, but this time in favour of greater power held in Brussels. Along this axis, between fragmentation and integration, there are numerous variations. One possibility, for instance, is a version of subsidiarity that involves a degree of regional fragmentation but also significant control from Brussels, with less power centrally within Member States.

This is how key areas of the European marketplace for businesses would look at each end of the fragmentation-integration axis:

EU institutions

In a fragmented Europe, these lack real power, with authority resting largely at local, regional or national level. In an integrated Europe they tend to have a much greater role, both in terms of legislative powers and practical political authority; political lobbying centres round them instead of national institutions.

Single Market

With fragmentation, not only does the Single Market fail to be completed but trade barriers are re-established, with Member States seeking national advantage either by openly flouting the rules set in Brussels or by simply manipulating them to their own advantage. Integration, on the other hand, brings a new vigour in tackling the remaining barriers to trade, and an enthusiasm to spread the perceived benefits of free trade to an ever wider area.

Single currency

A fragmented Europe sees the demise of the single currency and the retention or re-establishment of separate national currencies. An integrated Europe sees a



single currency covering all EU members, a currency so firmly entrenched that there is little serious political demand for a return to separate currencies.

Width of membership

In a fragmented Europe disagreement about distribution of EU funds prevents further widening of the Single Market. In an integrated Europe, a clearly agreed strategy for widening membership means accelerated growth in the Single Market.

Intra-EU relationships

On the left of the axis we see complicated and multi-layered relationships between regions, national governments and Europe. Decision-making processes are highly complex. On the right, with stronger institutions, there are simpler and clearer lines of communication. The limits of power are clearly delineated between regions, national governments and Europe, making decision-making much easier.

EU values

With fragmentation comes a range of social, political and cultural values, varying greatly between and within Member States. These include not only left and right in political terms, but perhaps deeper splits between those bound to long-established traditions and religions and those with a more modern, secular meritocratic outlook. There are fragmented consumer markets. With integration comes a more united view, with less polarisation and greater agreement on both ends and means. Businesses face more homogenous cross-European consumer markets.

Shareholder or stakeholder?

The socio-economic dimension ranges from a shareholder model to a stakeholder model. The shareholder model is based on free-market capitalism, with a laissez-faire approach not only to economic issues but also to social problems. This is a world in which individuals take responsibility for their own lives, with little or no support for those who cannot or will not take advantage of opportunities. The other end of the axis is the stakeholder model, where market forces are tempered by government intervention and powerful social institutions, and there is more income redistribution. This is a world in which there may be fewer opportunities for individual success but there are also fewer dangers of individual failure.

This is how key areas of the European marketplace for businesses would look at each end of the stakeholder-shareholder axis:

Government role

In the shareholder model, government stands back from most issues, advocating raw competition and greater individual responsibility for future financial provision and healthcare. In the stakeholder model, government is very active, particularly in terms of social policy: the state runs services itself, guarantees individuals' future financial security and intervenes in markets on social rather than competition grounds.

Governance

A shareholder approach emphasises short-term success and the survival of the fittest, with the threat of hostile takeovers playing a key role in motivating managers. A stakeholder approach means the combination of a longer-term strategy with a high degree of social partnership, and particular emphasis on worker involvement.

Human capital

At the top of the axis, we may see private companies taking a much more direct role not only in the development of existing staff but also in the human capital of the future, through finance for new universities or innovation centres, while the state withdraws from all adult and at least some school education. At the bottom of the axis, government takes complete responsibility for education, the aim being to maximise benefits to all social classes through a 'one size fits all' approach. Companies participate in government-directed training schemes, but within clear guidelines.

R&D/infrastructure

A pure shareholder approach means much innovation and dynamism in terms of ideas, but little long-term investment to develop these and bring them to market. With a stakeholder approach comes a more far-sighted investment strategy, but a less flexible and more institutionalised approach to developing ideas.

Income distribution

At the top of the axis there are great differences in income between the richest and poorest people in society. At the bottom there is much less of a spread, with most people clustered round the average income.

Labour markets

In a shareholder model, power rests with employers, with little legal protection for employees on issues such as working hours and unfair dismissal. Short-term contracts are one facet of a general lack of job security. As a result the social costs of employment are minimised. In a stakeholder model, the employer-employee relationship is highly regulated, with the creation of numerous rights for employees, supported by powerful trade unions. The social costs of employment are high.

Shareholder



Stakeholder

Major Trends

Our analysis of the political and socio-economic axes was based on detailed research (set out in the rest of this report). We identified five broad areas where we could group the major trends which will help shape the future of Europe. These five areas are the Economy, People, European Union, Technology, and Values, and a summary of our findings follows.

The Economy

- Global competitive pressures on business demand unprecedented innovation and agility.
- A successful single currency stimulates greater political and economic integration in Europe, while creating several possible areas of strain.
- Freer trade increases competition, while a deeper Single Market and continuing privatisation force more businesses to restructure.
- Central and Eastern European countries achieve sufficient stability and access to EU markets to provide an engine of growth for Europe.
- To guard against unfair competition within the Single Market, the EU reinforces the Social Chapter to protect employment standards.
- Despite greater openness in financial reporting, corporate governance in continental Europe remains more planned and less entrepreneurial than the US and UK systems.
- To defend living standards, the EU drives up public and private investment in learning and skills.

People

- Ageing populations and high unemployment lead to a transformation of Europe's welfare states.
- Increasing female employment, associated with a shift from manufacturing to services, puts pressure on social and family structures.
- Skilled and non-skilled workers migrate.

European Union

- New, poorer members join the EU, their progress dependent upon the willingness of existing members to fund them.
- Authority is increasingly exercised through central EU institutions.
- Tensions on Europe's borders increase the need for common defence and security.
- The regions grow in importance.

Technology

- The performance of European knowledge-based firms and the development of new technologies continues to be influenced, and in some cases held back, by national cultures and by an under-developed financial infrastructure.
- Virtual communication networks enable business to compete and transform demand.
- The growing number of cash-rich super consumers creates new markets for high-technology, customised goods and services.

Values

- Europe is increasingly a 'post-traditionalist' society, in which personal autonomy is highly sought, and values and lifestyles are seen as matters of individual choice.
- In the quest for non-material values, environmentally aware consumers make growing demands of businesses and politicians.
- A new cosmopolitan class emerges – well-educated, well-off and well-networked – and increasingly polarised from the have-nots (lacking money or information or both).
- The European Union lacks a strong European identity in the face of increasingly powerful national and regional attachments.
- Racism and xenophobia have a growing appeal to the minority who want to defend what they have against 'outsiders'.

The Economy

Competition across Europe has intensified in recent years, driven by liberalised international trade and the deregulation and privatisation of national economies. Technological change, the convergence of computing and communications, and improvements in international transport infrastructure have also combined to make competition fiercer. Each of these trends can be expected to continue in Europe over the next decade, encouraged by the introduction of a wide single currency area and the enlargement of the European Union.

Implications

- Global competitive pressures on business demand unprecedented innovation and agility.
- A successful single currency stimulates greater political and economic integration in Europe, while creating several possible areas of strain.
- Freer trade increases competition, while a deeper Single Market and continuing privatisation force more businesses to restructure.
- Central and Eastern European countries achieve sufficient stability and access to EU markets to provide an engine of growth for Europe.
- To guard against unfair competition within the Single Market, the EU reinforces the Social Chapter to protect employment standards.
- Despite greater openness in financial reporting, corporate governance in continental Europe remains more planned and less entrepreneurial than the US and UK systems.
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Global competitive pressures on business demand unprecedented innovation and agility.

The process of globalisation can be expected to continue, with barriers to free trade gradually coming down. Tariffs on manufactures are now down to an average of 3.8 percent in advanced countries, and trade has been growing faster than world output. The agreements made in the Uruguay round of trade negotiations have been reinforced by the new World Trade Organisation (WTO) dispute settlement mechanism.

The WTO had 132 members at the end of 1997 (up five from 1996) and another 32 countries have applied to join. New applicants include Russia and China, and although there have been occasional setbacks, there have also been notable breakthroughs. For example, China has agreed to reduce its import tariffs on some of its industrial and farm products, and while the details have yet to be finalised, China has already agreed to cut import tariffs on about 160 of 400 items.

Multinational firms, key players in most European economies, will be seeking to tap large opening markets such as China and India. They can be expected to use their influence to achieve further liberalisation.

Trade has also been liberalised within the European Union. The legislative programme for the Single Market is now largely complete, with Die Presse reporting more than 95 percent compliance in Denmark, Finland and Sweden. In the road transport industry, public sector contracts are becoming more open to foreign bidders, and much technical regulation is being harmonised.

Progress is inevitably patchy. Agreements on financial services and basic telecommunications services have only recently been resolved, months after the Uruguay round of GATT. The multilateral agreement on investment was not completed by its April 1998 deadline. Short-term electoral pressures are always liable to lead governments to back-pedal on agreements already made, or use environmental or social clauses as pretexts for reintroducing protection.

Problems also remain within the European Single Market. Many companies complain that countries have been slow to incorporate Single Market regulations into national law. Liberalisation of the gas market, the European Company Statute, and further measures on public procurement are among the Single Market measures still being refined. The 1994 report by the EU's Economic and Social Committee concluded that there remained 62 substantive obstacles to the free circulation of goods, services, capital and people throughout the Union. The Spanish government's decision to bail out Iberia with £440 million was a reminder of the ease with which short-term political considerations can still prevail.

A recent IMF World Economic Outlook found that the European Union as a whole is a much less open economy than member states considered independently. Nonetheless, the EU remains committed to an open world trading regime, and has provided a formidable lobbying force within GATT to keep contracting parties up to the mark. The accession of the Scandinavian countries has strengthened the EU's free trade lobby.

A successful single currency stimulates greater political and economic integration in Europe, while creating several areas of strain.

Eleven countries will be part of the Single Currency euro-zone from 1st January 1999. The debate, which for so long was dominated by concerns about whether the project would go ahead, is now firmly focused on whether it will succeed.

Advocates of monetary union contend that it should lead to low, stable inflation and interest rates. With lower transaction costs, the reform of tax systems and labour markets should result in higher growth and employment in the long-term. It should also decrease the number of external shocks to EU economies, not least by establishing greater monetary and fiscal co-ordination between them.

Achievement of these advantages, however, depends on convergence in the performance of EMU economies – in particular their response to monetary policy and to the loss of exchange-rate adjustment mechanisms. Fiscal discipline and labour market reform are also seen as essential. If the response of different countries to interest rate changes varies unduly, then the resulting strains could ultimately make maintenance of a single currency untenable.

These are some of the potential causes of strain:

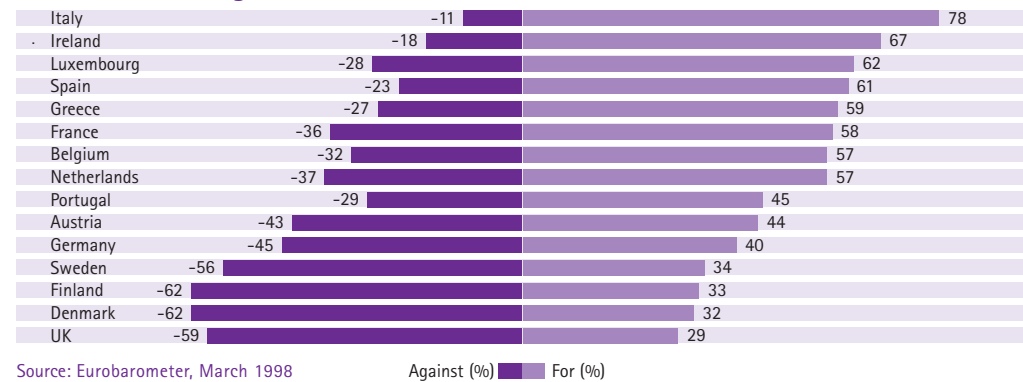
- As deficits are limited by treaty, a country faced with a deepening recession while already close to its deficit limits could find itself pursuing deeply unpopular policies.
- Loss of exchange rates as a mechanism for adjusting to economic shocks or long-term divergence could be critical for some countries. The UK, Finland and Sweden, for instance, have all had reason to adjust exchange rates in response to asymmetric shocks over the past two decades.
- The EU lacks US mechanisms for short-term stabilisation, such as large fiscal transfer payments between Member States. In the case of longer-term economic divergence, fiscal stabilisation is almost certainly impractical. In the absence of exchange rate differences, this will have to come through adjustments elsewhere in the economy – and primarily in the labour market.

- The EU has real wage flexibility of about one half of the US, and labour mobility between EU countries is low by comparison with the US. This makes labour market adjustments slow to occur.

Concerns over these issues, along with the short-term measures taken to bring budget deficits into line with the Maastricht criteria, and the divergence in average debt ratios, prompted 155 German-speaking economists in February 1998 to air their misgivings about the Euro. In particular, they foresaw pressure to relax the application of stability pact rules – which would undermine the stability of the Euro. Consequently, they called for an ‘orderly postponement for a couple of years’ of implementation of monetary union. The near-universal response has been that these concerns, although valid, are outweighed by the economic and political havoc that would follow from any postponement. Any such postponement, it is felt, would need to be long-term if any real changes were to be made – and might therefore force the abandonment of the project altogether, an option which is seen as almost politically unthinkable.

Public opinion will also be a crucial factor, and so far, opinion poll evidence is mixed. The latest Eurobarometer study (below) indicates two main groups of countries – those where pro-Euro sentiment significantly outweighs anti-Euro sentiment, and those where the anti significantly outweigh the pros. The pro-group, which includes Italy, Ireland, Luxembourg, Greece, France, Belgium, the Netherlands and Portugal, has majorities ranging from 67 percent to 16 percent in favour of the Euro. The anti-group includes Sweden, Finland, Denmark and the UK, with anti-majorities ranging from 22 percent to 30 percent. Fitting into neither of these groups are Austria and Germany, with pro- and anti- opinion broadly in balance.

The Euro: For or against?



Taken together, these results give a 51 percent-37 percent balance in favour of the single currency across Europe – a ratio that has been broadly consistent since 1993. Of the 11 countries in the first wave of monetary union, only Austria, Germany and Finland do not have a significant majority in favour of the Euro.

It remains possible that the single currency could be abandoned once begun if the employment/inflation consequences were bad enough. Even without a total breakdown, the consequence could be that by 2002, a four-speed Europe emerges comprising the EMU bloc, EMU aspirants (closely linked by exchange rates and interest rates), other EU countries (countries not wishing to join EMU and those prone to inflationary and devaluation pressures) and those Eastern European countries whose EU membership has been agreed in principle but which are still far from achieving the Maastricht criteria.

Freer trade increases competition, while a deeper Single Market and continuing privatisation force more businesses to restructure.

Elimination of exchange rate uncertainty and transaction costs between members of the monetary union should promote investment and trade. Estimates suggest that EMU could lead to savings in transaction costs equal to 0.5 percent of GDP. Within the single currency area, this will mean further removal of constraints on cross-border flows of money, products and services. Investors will be encouraged to diversify their holdings across Europe, improving the allocation of investment resources to the best opportunities. Treasury operations will be simpler, eliminating many foreign exchange conversion and hedging transactions (at a saving of up to 2 percent of sales for many trading companies). Competition amongst providers of these financial services will become particularly intense. More mergers can be expected, and only the strongest institutions in this sector will survive.

On the other hand, growth in funded pension schemes is likely to increase savings and boost the importance of pension funds as sources of capital and investment. Similarly, a consequence of the continuing privatisation programmes will be a further shake up in, but expansion of, relevant sectors within Europe’s financial markets.

The removal of long-term exchange-rate flexibility (much more difficult to hedge than short-term changes) will give firms more confidence to rationalise and consolidate their physical assets across borders. Pan-European pricing differentials will become more transparent, and unjustifiable discrepancies in the prices of traded goods will become subject to arbitrage. Mercedes-Benz cars, for instance, currently have a pricing spread of 10 percent around Europe – and there are many more startling differentials.

Transition to the new currency will be costly – estimated at \$30 million per company for Europe’s 300 largest companies and \$150 billion overall. Companies will simultaneously be facing changed and more competitive conditions and a peak of investment in conversion, which for many will also coincide with Year 2000 investments. As the new currency is phased in over three years, there will be more than usual confusion over pricing, as different contracts are priced in different currencies, over sourcing, as more firms start to trade across borders, and (for many) over accounting, as late into the transition period, full accounts must be kept in two currencies.

In recent years, privatisation agendas across Europe have been driven both by microeconomic policy and by European treasuries’ need to raise revenues – not least to meet the Maastricht convergence criteria. For many European countries the privatisation agenda provides an opportunity to bolster public finances. For example, the sale of 25 percent of Deutsche Telekom has netted the German Government \$10 billion. The British Telecom sale brought \$21.7 billion into the UK Treasury, and the sale of KPN in Holland could ultimately provide the Dutch Government with an extra \$8 billion. Since constraints on fiscal deficits are built into EMU and ageing populations are projected to add further pressure on expenditure, the latter trend at least might be expected to continue.

Whatever the reason, given the speed and degree to which European Governments are embracing privatisation programmes, at the end of a decade there will be significantly fewer enterprises subject to public ownership and control. In Western Europe, privatisations in 1997 were worth \$54 billion – an increase of \$11 billion from 1996. Even in France, where the Socialist government pledged to reject ‘privatisation of public services’, clarification has been made to the effect that this does not apply to the entire public sector, and is likely to exclude telecoms, electronics and aeronautics. As cross-border competition increases, those firms

remaining in the public sector will place greater pressure on their governments for freedom of manoeuvre, and increasing numbers of public-private partnerships will ensue.

If, however, European Finance Ministries concentrate on maximising privatisation receipts at the expense of introducing competition into their national markets, then the benefits in terms of corporate and economic performance will be less, real changes in the European marketplace will be slower, and they may have less competitive success outside their reserved markets. In sectors which are privatised but remain as monopolies, a parallel development will be a strengthening of the regulatory network, as separate regulators are set up in each Member State. The use of general powers to deter abuses of competition can also be expected to increase, both at EU and member-state level.

Central and Eastern European countries achieve sufficient stability and access to EU markets to provide an engine of growth for Europe.

The Central and East European countries are, in effect, the EU's hinterland. Ultimately they offer potential access to expanding middle-class consumer markets on the border of the current EU. Even in the short-term they offer wide-ranging business opportunities. An emerging entrepreneurial class is driving structural change, liberalisation of trade, privatisation, and a more efficient exploitation of natural resources. Success in economic reform and open access to EU markets should drive economic expansion, leading to an enlarged and more prosperous EU and providing a motor for the growth of the EU and wider European economy. Failure, on the other hand, could be a source of instability on the border, and lead to a wave of immigration into Europe which would put the EU's international structures under pressure.

Workers in these countries are mostly well educated, but unevenly skilled, with a legacy of low productivity and ignorance of new technologies and management techniques. Their key advantage lies in wage costs. Although wages in Poland and the Czech Republic are already rising for the most highly-skilled workers, the World Bank has estimated that it will take about 20 years for the CEE countries to reach the average income level of the EU countries in 1994, even at current impressive growth rates.

Wage differentials can be expected to make CEE economies attractive locations for EU firms to establish operations, and also to enable attractive opportunities for local firms. For example, the former Skoda plant in the Czech Republic has given VW 90 percent of its normal productivity, with labour costs a mere 25 percent of those in the West. Outsourced non-core activities such as payroll, cleaning, security and catering are similarly cheaper. There have already been problems, however, over trade barriers between the EU and former Communist states in sensitive areas such as textiles and clothing, agriculture, iron and steel.

Economic performance within the CEE has been uneven, with Slovenia, the Czech Republic, Hungary, Estonia and Poland in the lead. EBRD figures show that foreign direct investment (FDI) into CEE countries has followed a similar pattern. Favoured project finance sectors were in precious metals, oil and gas and power utilities.

It is highly likely that the EU will acquire five new members from the CEE region, with talks beginning with the Czech Republic, Estonia, Hungary, Poland and Slovenia. The first of these may join within five years. Romania, the Slovak Republic, Latvia, Lithuania and Bulgaria remain further behind in the EU queue with membership not likely within the next 10 years.

Countries of the former Commonwealth of Independent States (CIS) are less economically stable and appear to be facing greater political obstacles to reform. They are likely, at least initially, to grow more slowly, and will have a less immediate impact in most industries. Exceptions are to be found in the commodity markets. The former Soviet Union was the biggest producer of oil in the world, controlling 19 percent of world oil production in 1987, and Russia remains one of the world's key suppliers of oil. Its dominance was equally noteworthy in other commodity markets, including grain (especially Ukraine with its good soil and good rainfall). The effect of these commodities entering world markets has already put pressure on prices and margins, pressure that is likely to grow as productivity in the sectors concerned rises towards West European levels. The EU will feel the impact on agricultural products, and ultimately on the Common Agricultural Policy (CAP), which cannot survive long-term in its present form.

The strongest CEE economies can be expected to continue to grow and develop, providing a stimulus to European growth, but also introducing further turmoil in the sectors in which they are strongest by attracting investment and jobs which until now have been located in the West. By the end of the decade, some are likely to represent competitive threats from inside the European Union. Weaker economies and the CIS, in particular Russia, will have strong impacts too, especially in the commodity markets.

To guard against unfair competition within the Single Market, the EU reinforces the Social Chapter to protect employment standards.

Welfare benefits and social protection for both the employed and unemployed are strong in Europe and consume large amounts of public (and private) resources. Employment protection laws and customs ensure that decisions to employ new staff or release existing staff are not taken lightly or quickly. The UK has been alone in adopting a policy of reducing benefits and employment protection.

All the member states have now signed the EU's 'Social Chapter' and are bound by its terms. Any non-compliance falls within the jurisdiction of the European Court of Justice. Although the extra business costs resulting from the Social Chapter are small, they could increase if and when enhancements are agreed. Laws, regulations and conventions vary across the EU, and with the Social Chapter often affecting areas not covered by previous national laws, qualified majority voting could see Member States agreeing deals for mutual voting support. A considerable body of legislation could emerge as each country tries to ensure that its own legislation is reflected in EU law.

Countervailing pressures arise from the more open global trading environment and from local culture and politics. Indirect labour costs and job protection provisions may encourage employers (especially multinationals) to make more use of cheaper labour in parts of the UK, South East Asia and Central and Eastern Europe. This could result in work being outsourced or headquarters, offices and factories being moved to the less regulated countries. Countries that lose out may respond by freeing up their own labour markets. Alternatively, it is argued that the emergence of the single currency will force member countries to remove restrictions on labour market flexibility, and that new working patterns will reflect employers' needs for flexibility and changes in the composition of the workforce (increasingly female and part-time). In the UK 1992-96 recovery, only 31 percent of jobs created were full-time. Based on this kind of trend, the Henley Centre for Forecasting projects that workers in full-time jobs will be in a minority by the end of the next decade.

On the other hand, the European electorate may reject the likely reduction in social standards and job security, and seek to share employment and rewards for economic

expansion more equitably; recent French moves to limit working hours are an example of this. The EU could legislate to prevent 'social dumping' from countries such as the UK and non-members. The Social Chapter could be used as a base for a progressive raising of minimum EU standards towards those prevailing across much of Northern Europe. The US and the EU may eventually agree to throw their weight behind a social clause in the GATT which would allow contracting parties to refuse imports where labour conditions do not meet required standards. This proposal is strongly opposed by the UK and developing countries within the WTO, but the EU and US may succeed in securing it as the essential price of their continuing commitment to multi-lateralism.

Despite greater openness in financial reporting, corporate governance in continental Europe remains more planned and less entrepreneurial than the US and UK systems. Mechanisms of corporate control and governance vary across the EU. Anglo-American models for corporate control, in which the threat of hostile takeovers plays a key role in motivating managers, are rare in continental Europe. Ownership of enterprises in continental Europe is largely dominated by 'insiders' such as major banks – which control relatively large, illiquid stakes or operate via dual-class shares, some of which may have reduced or no voting rights. Such systems promote long-term relationships with employees, customers and suppliers, and can make it easier to take a planned long-term approach to investment research and development, for instance.

The exception within the EU is the UK which generally operates on an 'outsider' model, in which control rests with investors who often hold relatively small stakes that are readily traded on the stock market. This system allows investors to contain their exposure to company-specific risk, but it also reduces their incentive to monitor the management of the firm closely. In the UK (as in the US), the 'outsider' system of corporate governance has allowed the pension funds to assume an increasingly dominant role.

However, the role of pension funds and other major investors such as insurance companies in corporate control and governance has changed in the last few years. Many large funds have adopted policies of always using their votes at the relevant Annual General Meetings. Others intervene selectively where poor performance becomes evident. But shareholder activism may be reduced by innovations such as the growth of index funds.

The provision of equity and debt to large firms has become more international. Companies like Daimler Benz are listed on the New York Stock Exchange as well as in Frankfurt and London. Such actions can help to underline the differences in business culture and accounting standards that exist across industrialised countries and within the EU. EU enterprises, for instance, need to change their accounting systems when they decide to list in the US, where detailed quarterly financial information is required and can have a major effect on stock prices. Continental European senior managers may be relatively unfamiliar with operating in an environment where short-term movements in share prices often become the dominant factor in managing the business.

Reforms to social security systems across the EU could lead to major increases in private saving for retirement. The growth of pension funds could reduce and ultimately undermine 'insider' systems of corporate governance if these funds follow UK-style investment strategies and minimise company-specific risk. Alternatively, pension fund managers may become important 'insiders' with individual funds holding significant stakes in relatively few firms. Such a movement could increase the differences between Anglo-American-style shareholder companies and continental-style stakeholder companies – or push the UK closer to the continental system.

The evolutionary paths of Anglo-American and Continental systems of corporate control are asymmetrical. Co-ordination between firms and owners in 'insider systems' can break down under pressure from 'outsiders'. Conversely, firms in Anglo-American environments cannot individually move the system from one in which implicit contracts cannot be enforced to one in which they can.

Governments will find it hard to achieve movements from share-holding to stake-holding. It is much more probable that movement will be from stake-holding to share-holding and that any movement in this direction will not be reversed over time, even if there consensus that this would be a good idea.

To defend living standards, the EU drives up public and private investment in learning and skills.

The personnel requirements of businesses have been transformed by technology, with skilled workers increasingly in demand across the industrialised world. Increasingly, the level of education and training has come to affect the probability of being employed or unemployed.

These changes in skill requirements have led to an increasing emphasis on the ability to acquire new knowledge and new skills throughout one's working life. States can therefore be expected to move to secure lifetime learning opportunities for their employees. Since this means an increase in overall cost of education and training, some states (such as the UK) are expecting their citizens to make a greater financial contribution.

Similarly, as rationalisation, consolidation and restructuring become a fact of life and as new technologies radically transform the skills required in the labour market, firms and businesses too can be expected to endorse the 'cradle to grave' principle for education and training and learn to reflect it in their working methods and career planning. They may wish to finance more for their own employees. Apple Computer and IBM Europe are already running virtual campuses where their multinational employees can be constantly updated with new company information and training materials. These organisations allow their employees to seek advice and share business wisdom with co-workers around the world. McDonald's is responding in a more traditional way with its Hamburger University.

As costs decrease and pupils in primary and secondary schools become more skilled with IT, distance learning should become more viable. Undergraduates will have alternative learning sources to the under-funded and ill-equipped traditional universities or colleges. Many more businesses will also find it appropriate to use virtual education for in-house training.

People

The population of Europe is rapidly ageing. There are fewer active participants in the labour market supporting more pensioners. Family patterns are changing as more women enter the labour market while long-term unemployment becomes a reality alongside a growth in part-time employment.

Implications

- Ageing populations and high unemployment lead to a transformation of Europe's welfare states.
- Increasing female employment, associated with a shift from manufacturing to services, puts pressure on social and family structures.
- Skilled and non-skilled workers migrate.

Ageing populations and high unemployment lead to a transformation of Europe's welfare states.

The EU's population of 374 million is growing slowly – at about 0.3 percent p.a. The other countries of the European Economic Area add only a further five million, but the countries most likely to join the EU soon would add more than 60 million. Changes in the age structure are set to have a substantial impact. For more than 30 years the birth rate has plummeted in the EU: in 1965 the average number of children born in a woman's lifetime, was 2.7; by 1975 it had slipped to 2.0, and has since fallen to 1.4 in 1996. Meanwhile, the number of pensioners has soared as life expectancy has increased by two years or so each decade; a further increase in life expectancy of one year is expected within 10 years. The increase in longevity means that the number of pensioners is increasing at more than twice the rate of increase in the population as a whole, whereas the number of workers per pensioner is dropping sharply.

All this has implications for social and welfare policy. Nearly 16 percent of all EU inhabitants are over 65. In 10 years, it will be 17 percent. In some EU countries, Greece, Italy, Spain and Finland, the number of pensioners has been growing very much faster. In those countries they have seen an increase over the last generation of nearly half as many again, and in the EU as a whole the increase is by a quarter. In all countries there are likely to be serious welfare problems caused by a static or decreasing number of contributing workers and in Belgium, the Netherlands and Italy these problems are already evident.

At the same time, healthcare costs for the elderly are much higher – for example, government-funded healthcare in the UK costs about 10 times more for a person over 75 than for those of working age. How much that contributed to the increase of 72 percent in real terms of the cost of healthcare in Britain since 1979 is difficult to tell, as there has also been a substantial change in people's healthcare expectations.

The fall in the birth-rate over the last 30 years is starting to affect the number of young people entering the workforce. Increasing longevity means more pensioners to support. The picture is clouded by current high levels of unemployment across most of Europe adding to the welfare burden and decreasing the number of workers contributing to the support of the elderly. Early retirement has also increased the number of pensioners, although not all, by any means, will be entitled to state welfare benefits.

There is no consistent pattern of unemployment across the EU. It varies widely from below 7 percent for the UK, Austria, Luxembourg and the Netherlands, through the EU average of 10.7 percent to 20.8 percent in Spain. Long-term unemployment is a problem for much of Europe. Nearly half the unemployed have been unemployed for a year or more; in Belgium and Italy the figure is just over 60 percent. And these figures have remained stubbornly static over the past 10 years.

Europe's demographic developments contrast with those in Africa, Asia and Latin America, where fertility rates are high and the population is young and expanding rapidly. Europe's share of world population will continue to slip, and this will, to some extent, result in a decrease in Europe's relative impact in the world.

Demographic changes are essentially long-term, but some aspects of their effects can lead to quite abrupt changes in government thinking and policy on immigration. For instance, if the economy across Europe improves it may well lead to the kind of optimism which encourages an increase in the birth rate, but it is unlikely to be early enough to provide the skilled workers the improved economy needs. Increased immigration from Central and Eastern Europe – or, elsewhere – is clearly one practical possibility, but public acceptance may not be forthcoming. A reversal of the trend towards early retirement would not encounter the same political problems, but might not represent a full practical solution.

The rise in female employment, associated with a shift from manufacturing to the service sector, puts further pressure on social and family structures.

The status and role of women in European society is changing. The common factor across Europe is that better education, employment and social status have resulted in changes to family models. Single-parent families, divorces and births outside marriage are now very significant factors.

The number of women in secondary and tertiary education has been rising. Between 1985 and 1994 the ratio of females to males in secondary education rose from 98:100 to 101:100. During the same period the rise in the ratio in higher education was even more marked, from 85:100 to 99:100, and by 1996 women constituted the majority of higher education students across the EU. In France, Portugal and Sweden there were at least 20 percent more women than men in tertiary education. Only in Germany, the Benelux countries and Greece were there fewer women students than men.

Recent reports show that higher education is a particularly important factor for women in being employed, more so than for men. Women with a higher degree have a 36 percent greater chance of securing a job than those without, while the corresponding figure for men is 19 percent. Women aged 25-59 with higher education qualifications have an 85 percent activity rate, only 10 points below their male counterparts, compared with those with minimum education where the gap is 34 points (men 86 percent, women 52 percent). In most member states, however, the gap between men and women with the same education is wider for those over 40.

The number of women in the labour force has also been increasing steadily. Between 1984 and 1994 their share climbed 7 percent: from 52 percent to 59 percent. Higher education and equal opportunities have undoubtedly contributed and in Sweden, Denmark and Finland, the figures are well above the EU average.

Part of the trend results from the shift from manufacturing to service industries. Many jobs in manufacturing have been lost to automation or, in some industries, to countries outside Europe. Most of those were in traditionally male-dominated

occupations. But many of the jobs in service industries are in occupations which have traditionally been dominated by women. By 1996 only 30 percent of EU civilian employment was in manufacturing; 65 percent was in service jobs, with agriculture, forestry and fishing accounting for the remainder. And while male unemployment has been high, and, if anything, increasing, female unemployment has been much lower, and has fallen over the last decade.

The trend towards service jobs looks set to continue. But there may not be as many such jobs as expected, as a result of de-skilling followed by automation of routine, low-level clerical, sales, telemarketing and similar jobs. With the increasing use of expert systems and hi-tech customer services, more functions will become automated.

There is also a significant increase in part-time employment. In a decade (1985 to 1995) the EU average of part-time employment as a percentage of total employment increased from about 21 percent to 24 percent, with particularly large rises in Ireland, the Netherlands and France. Again this is dominated by women – about three-quarters of European women workers work part-time, while only 10-20 percent of European men do.

Increasing female employment is clearly linked with changes in family structure. Older first marriages, lower birth rates, an increase in the number of people who never marry, and a rise in cohabitation, separation, and divorce have all contributed to the changing European labour force. Women are entering the workplace with academic qualifications similar to, if not higher than, men.

Marriage trends vary markedly across Europe. Thus, although there has been a general trend towards more births being extramarital, the figure for Sweden – with 54 percent of births being extramarital, is very different from that in Greece – 3 percent; the EU average in 1996 was 23 percent. Similarly, while on average around 30 percent of young couples under 30 living together are unmarried, this varies from 70 percent in Denmark to less than 10 percent in Greece and Portugal.

With the social structure continuing to change, the number of women entering the labour force is expected to continue to rise. Some will be women entering the professions but many will be women who want part-time rather than full-time work. This will reinforce a trend, away from set patterns of full-time work. Whilst these arrangements could be flexible and efficient at first, many will just perceive the complexities, such as whether or at what point a part-time employee becomes entitled to full benefits for sickness and pension etc. There are also likely to be increasing demands at national and EU level and upon employers, for provision of child-care, special leave systems for both parents and vocational retraining courses for those returning after a career break. There will be costs for such benefits, but there should also be advantages in terms of employee satisfaction and loyalty.

There is also growing concern about the implications of the changing family structures. It is an open question whether this will discourage female employment, but it might lead to more tele-working and other arrangements which help parents to reconcile work with family roles.

It is also possible that the part-time employment market, which has tended to be one of low wages and limited prospects for careers, may not remain so. For example, there is a reaction against excessive time demands and work pressure. Quite large numbers of income-rich, time-constrained people may reduce their working hours to devote more time to the care of their children, homes and elderly relatives, leading a trend away from conventional full-time working. It might also lower the demand for public and private services.

The trend, however, is for a continued rise in the divorce rate and the number of extramarital births, with corresponding pressure on many women, as heads of single-parent households, to work. Those who do not succeed will place further pressure on state benefits.

In countries where women's employment continues to increase, the need for formal care will create new market opportunities (homes for the elderly and infirm, day care for children, care for sick children, before- and after-school care). This is less likely to be true in southern Europe, where the divorce rate remains lower and fewer women find work outside the family business.

With continuing high unemployment across much of the EU, trade unions and other opinion-formers may seek more job-sharing and reductions in working hours. The counter attack from those concerned about inflation and loss of productivity will be powerful.

If social policies were to make it easier for women to combine work and family, this could raise the birth rate. Initially, this would increase dependency, but in the longer-term, it should lower dependency and boost economic growth. On the other hand, there is also a possibility of a shift in public opinion towards more traditional family patterns, as a reaction to the increasing numbers of single-parent families reliant on state benefits. Although this is unlikely to reverse trends in divorce and individualism, it may give some impetus to a swing back in values towards the family unit and the community, with divorce and especially extramarital child-bearing being frowned upon and even penalised by public policy. The result could be a polarisation between those highly-educated women who decide to forego motherhood in favour of well-paid and fulfilling careers, and a majority accepting reduced job prospects and spending long periods caring full-time for their families. There are other possibilities, such as an increase in the number of fathers staying home as carers.

Skilled and unskilled workers migrate.

There was substantial net migration into the EU from Central and Eastern Europe, North Africa and Turkey in the 1980s. Asylum applications were also significant, but have since dropped back. Over the last five years, net migration seems to have dropped from some 1.3 million to a fairly level 0.8 million. Even at that lower level, net immigration amounted to 75 percent of EU population growth in 1995.

Future trends are unclear. Many think that the disintegration of the former Communist bloc and the conflict in the former Yugoslavia produced an exceptional influx. And immigration from North Africa reduced, as family reunion became less of a factor. We may not see a repeat of the number of asylum seekers, nearly 0.7 million in 1992, as EU countries have taken measures against abuse. There is still the possibility of pressure for general immigration, especially if there are major political disturbances. In Central and Eastern Europe there is a pool of trained workers who may look towards the EU for their future if their own economies do not move forward rapidly.

In 1993, the largest populations of legal (non-EU) immigrants lived in Germany (6.5 million), France (3.6 million), the UK (2.2 million), and Italy (0.9 million). In the same year, the highest shares of legal immigrant populations existed in Luxembourg (30 percent), Belgium (9 percent), Germany (8 percent) and Austria (6.6 percent). Most EU countries have responded to increased immigration by strengthening border controls, visa regimes and documentation checks. However, these measures have not been as effective in controlling immigration as hoped.

While the restrictions on legal migration have got tighter, illegal immigration has increased. Western Europe's illegal immigrant population is estimated to be 2.6 million, with one million or more concentrated in southern Europe, particularly Italy and Spain; nearly 0.8 million are estimated to have entered the EU in 1996 alone. Albania appears to be a major source; perhaps 0.3 million Albanians have entered through Sicily in five years. Illegal immigrants take low-paying jobs in sectors such as catering, hotels and textiles.

Pressures for immigration into the EU will continue as a result of the growing need for highly-skilled labour, the continuing need for low-paid workers in labour-intensive industries and the demand for family reunification resulting from the migration of single males in the 1960s and 1970s. It is therefore unlikely that EU nations will stop immigration entirely. France, Germany, the UK and other northern European countries can be expected to continue tight curbs, but Spain, Portugal and Greece will continue to receive immigrants.

Over the next decade, as immigration rises, Europe will have to cope with growing tensions, especially where racial divides co-exist with economic inequality. Continuous flows of immigrants may force the EU to provide further aid for the economies of North Africa and to discourage emigration. But the immigrants will still come in, and that flow will place additional burdens on southern European countries already short of jobs. As a result southern Europeans may move to northern European states to look for higher-paid jobs – putting pressure on the job market of the northern economies. Official labour migration within and into Europe of highly qualified manpower will probably increase as the Single Market becomes fully effective.

Immigration will have to increase to more than one million per year to prevent population decline. In the short-term, some immigrant populations may make significant demands on public funds but in the medium-to-long term, this may be outweighed by immigrants' tax contributions.

The development of a harmonised, cohesive EU immigration policy may stumble or fail; witness the refusals in early 1997 by France, Germany and the Netherlands to approve Italy's full accession to the Schengen Agreement because its position as 'gatekeeper of the south' with a virtually unpatrollable Sicilian coastline has made Italy a prime entry-point for illegal immigrants.

Pressure to impose sanctions and fines on those who employ and traffic in illegal immigrants will grow. A European Identity Card has been discussed as a necessary corollary of such sanctions. In Britain, however, such measures can excite accusations of racial discrimination, making them difficult to implement.

The large numbers of immigrants into southern Europe who are prepared to work for low wages could exacerbate the wage gap between the north and south. This may lead to greater migration of low-cost, low-wage industries from north to south.

The European Union

Political trends in the EU will be of major significance to business, and business's response will in turn affect the governance of the EU. Key factors are the planned enlargement of the EU, the consequent strain on budgets, the potential for a multi-speed Europe, development of a Common Security Policy, and the rise in the importance of the regions.

Implications

- New, poorer members join the EU, their progress dependent upon the willingness of existing members to fund them.
- Authority is increasingly exercised through central EU institutions.
- Tensions on Europe's borders increase the need for common defence and security.
- The regions grow in importance.

New, poorer, members join the EU, their progress dependent upon the willingness of existing members to fund them.

The European Union is set to expand further. From the 12 (France, Germany, Italy, Belgium, Luxembourg, the Netherlands, Denmark, the United Kingdom, Ireland, Greece, Spain, and Portugal), it expanded in 1995 with the addition of Austria, Sweden and Finland. Norway, Iceland and Switzerland have decided not to be members, but Norway and Iceland remain members of the wider free trade area, the European Economic Area. Several other European states have, however either applied to join the EU, or intend to do so. It is now highly likely that the Czech Republic, Hungary, Poland, Slovenia, Estonia and Cyprus will be EU members within the early years of the next century, possibly leapfrogging others like Turkey, which applied long before the new applicants from Central Europe, and Malta, whose incoming government shelved its application.

Two clear points arise over all the likely new members. Firstly, their GDP is well below the EU average and their economic structure is not well matched with those of current Member States. Secondly, any expansion beyond the current 15 raises difficult questions over the future governance of the EU.

The European Union has been widening its scope as well as its membership. The Maastricht Treaty, which came into force in 1993, added the Common Foreign and Security Policy and Justice and Home Affairs to the European Community. Economic and Monetary Union will encourage further integration.

Certain poorer countries have received substantial financial help from fellow EU members. Structural funds accounted for more than 33 percent of the EU budget of ECU 90 billion in 1996, when more than 50 percent of the population in the EU received some kind of aid. Between 1994 and 1999, a total of ECU 153 billion has been allocated for structural funds.

'Cohesion funds' were created in 1993 to help Greece, Ireland, Portugal and Spain improve their transport and environment protection infrastructures, and provide some ECU 1.5 billion in 1993 to ECU 2.6 billion in 1999 (all at 1992 prices). Spain gets 52-58 percent of this; Greece and Portugal 16-20 percent each; and Ireland 7-10 percent. There is already evidence that these funds have helped these four countries increase their national GDP. Ireland has experienced the largest

increase, up from 65.5 percent of the EU average in 1983 to 98.2 percent in 1995. Although these funds seem to have reduced disparities between EU countries, they have not necessarily reduced disparities within countries. In Spain, for example the most dynamic development has occurred in its more prosperous areas – Catalonia, Madrid and the islands.

The European Commission insists that regional aid has been an efficient means of narrowing the gap between rich and poor countries, and that the net contributors of structural funds such as Germany were benefiting through obtaining extra public works contracts and business in the poorer countries. Others, however, have pointed out that the gap between rich and poor regions is widening, notably in the UK and Spain. And by mid-1996, the EU was massively under-spending on its poor regions as the national governments of the recipient countries held back on matching funds in an effort to meet the Maastricht criteria. The amount of untapped credit rose from ECU 15 billion in 1993 to ECU 20 billion in 1996. Belgium, France and Germany were particularly slow to take up EU aid money. There have also been fraud problems with structural funds.

Cohesion funds are next due for EU budget negotiations in 1999, when Germany, still bearing the costs of reunification, the UK and the Netherlands are expected to press for a freeze in real terms. Spain's centre-right government, however, will lay claim to a sustained flow of EU aid. The level of cohesion funds going to Greece, Spain and especially Ireland may be reduced on the grounds that their living standards are rising satisfactorily and that the costs of future accession of some countries with farm-intensive economies need to be anticipated.

The accession of selected CEE countries will increase pressures on cohesion funds since they will account for a substantial proportion of the regions where GDP is less than 75 percent of the EU average. Based on continuation of current policies, the net cost of EU enlargement will be close to 70 percent of the 1999 EU budget. Paying out money from the structural funds on the present basis will cost ECU 14 billion, and richer nations facing other budget pressures may be unwilling to share their wealth. But there is no doubt about the need for transfers on this scale if accession is to proceed smoothly.

Since accession-seeking countries generally lack sufficient public finances to provide matching funds, the structural funds programme will need to be revised, perhaps by loosening the eligibility rules. Alternatively, countries could be admitted to EU membership but excluded from receiving structural funds. So, while the CEE nations may see joining the EU as a remedy for their generally lower living standards, it may prove difficult for the EU to meet the expectations of these new members. The EU will only allow those countries to join which are already meeting growth rate targets and showing a clear path to convergence of living standards with existing Member States.

If major contributors to the EU budget refused to contribute to the cohesion funds after 1999, the EU would be unable to prepare for the accession of CEE countries. Membership for these countries might then be postponed indefinitely.

As the EU has widened its membership and scope, the concept of a 'multi-speed' Europe has also developed. In this, different countries participate in some optional arrangements. On immigration, for example, several EU Member States have removed internal borders for immigration purposes. This approach will probably continue, for two reasons: firstly, there will be areas in which some Member States will want to harmonise with each other, for mutual benefit; secondly, there will probably be areas in which it will not be possible to get all Member States to harmonise simultaneously.

A 'multi-speed' Europe of this kind makes it possible that some features of membership will be optional, and there will be distinctions between major players.

Authority is increasingly exercised through central EU institutions.

The main players in the governance of the EU are the Council of Ministers and the European Commission. The European Parliament and European Court of Justice also have important roles. The Council of Ministers is the gathering of Ministers of the governments of the Member States, and is the major decision-making body for both EU legislation and policy. The Presidency rotates at six-monthly intervals. Decision-making was originally by unanimous vote only, but progressively more issues have been made subject to Qualified Majority Voting (QMV). There is pressure for more QMV, and as more countries join, the pressure is likely to increase further. The European Commission has Commissioners nominated by Member States, supported by a staff of European public servants. It is the EU's executive arm. There are now 20 Commissioners, an unwieldy arrangement, making it difficult to give appropriate portfolios. That would get worse with widening membership.

The Intergovernmental Conference (IGC), with representatives from Member States, the European Commission and the European Parliament, has been working on possible future governance arrangements; it is the focus of pressure towards QMV etc. as well as looking at enlargement and institutional reform more widely.

Changes in the internal workings of the EU are inevitable with further enlargement. Some think that an increase in EU membership to 25 or more could so affect the EU's ability to enact uniform policies that individual national governments might only be willing to participate in the EU on an 'à la carte' basis. To avoid this, established EU policies would have to be revised. Even then, the workings of some common policies will become increasingly difficult, notably the Common Agricultural Policy (CAP). Indeed, there are some indications that the prospect of accession of Central European countries with major agricultural sectors will act as a spur to much-needed reform of the CAP or perhaps slow down the accession process if progress on CAP reform is too slow.

Given that all the likely new members have a lower GDP per head than the EU average, accession of new members will impose additional costs on the EU budget unless regional development incentives are swept away, or not applied to new members.

There is a simultaneous trend towards devolution to the regions. At present the governments of nation-states have the power, and the Committee of the Regions is informal. National governments can be expected to resist vigorously any devolution of EU power to regional bodies. Much, therefore, will depend on how the power of the regions develops.

An enlarged 'multi-speed' Europe could therefore lead to a firm inner core of Germany, France and a number of other countries, all in EMU and sharing other arrangements, with other Member States becoming increasingly outsiders with less and less real decision-making power.

Tensions on Europe's borders increase the need for a common defence and security policy.

The threats to security in Europe which had characterised East-West politics since the 1940s diminished with the ending of the Cold War. But, soon, other tensions were unleashed, with armed conflicts in Central and Eastern Europe and the Balkans. The countries which are seen as the best prospects for joining the EU soon are among the most stable, but there is potential for further ethnic conflict in the former Yugoslavia and in some parts of the former Soviet Union.

In some of these countries, especially Russia, there is also the possibility of disruption through lawlessness. In particular, organised crime can be heavily involved in the corruption of the market economy. At the same time, central authority tends to be weak, with the police and other authorities discredited, and a thin legislative base when it comes to relations between traders, consumer rights or safeguards or sanctions against fraud. Corruption and organised crime may therefore become a destabilising influence, possibly spilling over the borders, with governments powerless to check it. Civil disturbances or economic chaos can also give rise to massive movements of refugees, as with Albania in 1996.

Conflicts like that between Muslim fundamentalists and government in Algeria may have knock-on effects in the EU, particularly if they, too, give rise to a large increase in asylum-seekers. Similar conflict in Egypt and elsewhere may also have an impact.

Europe is moving towards a collective security policy, albeit only slowly. The Common Foreign and Security Policy (CFSP) was initiated under the Maastricht Treaty, but only the first and easiest level – the world view – has yet been achieved. Under this there is a common view taken from the standpoint of liberal democratic countries with market economies, supportive of the UN's peacekeeping role and the rule of international law. Progress on the two further stages of CFSP – common positions and common action – has been more limited.

Nato remains the dominant security force in Europe, even though much of its reason for existence has gone with the demise of the Warsaw Pact. Nato provides collective defence for its members, and a number of Central European countries and the Baltic states are keen to join.

Nato members continue to co-operate on joint procurement of equipment. That is expected to continue, not least because defence budgets across Europe have been reduced since the fall of the Berlin Wall. There have, however, been continuing problems of cost over-runs and slippage of joint projects. There has been a trend towards more co-operation between defence industry companies, but this has not been as extensive as, for example, the mergers in the US – a consolidation which has put them in a good position to challenge the European defence industry even in its own markets. The European Commission has been trying to encourage co-operation and joint procurement by Member States and a buy-Europe policy.

With armed conflicts between EU Member States effectively discounted, and Nato's original role so changed, the kind of approach pursued under the CFSP is likely to be developed further to prepare for the kinds of conflicts threatened in the East. There may also be further initiatives to counter threats from cross-border crime, terrorism and drug trafficking. This could put strains on the Schengen Agreement.

Co-operation between European police forces, particularly on drug smuggling and organised crime, will tend to strengthen Europol. EU countries may explore ways of sharing costs of military expenditure.

The regions grow in importance.

Most Europeans feel very attached to their country, and even more to their region. Fifty million (one in seven) speak a minority language. The trend in the EU is towards preserving, and in some cases, reasserting autonomy for, unique regional and ethnic identities. This has occurred in such regions as Flanders, Andalusia, Catalonia, Galicia, the Basque country and Alto-Adige, as well as in countries like Germany where the federal Länder are already strong. In the UK, there are substantial moves towards devolution in Scotland and Wales and greater powers for England's regions.

As memories of the Cold War fade, and as the need for national defence and security against the threat of communism wanes, people will prefer smaller group loyalties and identities to those based on strong national allegiances. Fragmentation in Eastern Europe – in the CIS, the former Czechoslovakia and Yugoslavia – finds its echo in Western Europe as Catalonia and the Basque country reject Spanish rule and the Bretons and the Corsicans seek autonomy from the rest of France. In Italy, the Lega Nord grows in strength as a political party and asserts its separatist platform with increasing aggression and success. In the UK, successful devolution referendums are leading to the establishment of a Welsh Assembly and a Scottish Parliament, the latter with tax-raising powers.

In the face of these strong trends towards regionalism, national governments become more involved in orchestrating regional and sub-national development programmes than in their actual implementation. But it may prove difficult to ensure that local, municipal and regional entities have the capacity, funding and administrative expertise to operate effectively.

EU institutions may show the same pattern as that of national governments, though if there is a strong regional policy with substantial funding – still a possible outcome as the EU expands – there is the possibility of a stronger bond being established between strong EU institutions and regional authorities. To ensure that the EU does not become more remote from its citizens, the Commission can be expected to support relevant regional movements, in both cultural and economic development. It is also likely to favour participation on a genuinely regional basis in the European Parliament and other aspects of governance.

It is not clear how far sub-national and cultural separatism could go. If EU nation states gave up large amounts of power to their constituent parts, the EU could cease to be a political entity. The representation of national governments at EU level through the Council of Ministers would be replaced by a new system representing regions and provinces. The European Parliament would become more powerful as a consequence. Faced with this, national governments might retaliate by trying to clamp down on sub-national trends and movements. Alternatively, the Länder, provinces, regions and local assemblies could oppose their national governments, making it impossible for them to take initiatives in the EU, and stopping them from agreeing to anything but the most consensual policies at EU level. Measures such as harmonisation of taxes and social security could then be off the agenda for good.

Technology

Technology has had a profound impact on European economies and lifestyles over the past 50 years. New industries like petrochemicals, medicines, biotechnology, and information technology have established themselves across the EU and revolutionised the economics of production, distribution and exchange. The pace of change has accelerated rapidly, as wealth creation is increasingly driven by knowledge, creativity and the harnessing of technology. But Europe still lags behind the US and Asia in reaping the rewards.

Implications

- The performance of European knowledge-based firms and the development of new technologies continues to be influenced, and in some cases held back, by national cultures and by an underdeveloped financial infrastructure.
- Virtual communication networks enable business to compete and transform demand.
- The growing number of cash-rich super consumers creates new markets for high-technology, customised goods and services.

The performance of European knowledge-based firms and the development of new technologies continues to be influenced, and in some cases held back, by national cultures and by an underdeveloped financial infrastructure.

European companies have rarely dominated recent developments in high-technology. Although Europe traditionally has a strong science base in its universities and research institutions, ground has typically been lost to the US and Japan.

As the table below illustrates, the EU still depends on low-technology industry for much of its export revenues, and if anything the trend over the past 20 years has been away from high-technology industries rather than towards them.

Export specialisation by type of industry

	United States			Japan			EU-12		
	1970	1980	1992	1970	1980	1992	1970	1980	1992
High-Tech Industry	159	153	150	124	141	144	84	83	80
Medium-Tech Industry	110	106	90	78	106	114	100	99	100
Low-Tech Industry	64	67	74	114	76	46	107	109	114
High-Wage	136	119	118	64	92	108	97	100	95
Medium Wage	95	94	95	122	127	121	99	96	97
Low-Wage	64	83	82	102	66	55	107	106	111

Note: A value of 100 indicates the same export specialisation as the OECD average. The index compares the importance of each industry's exports within each country to the OECD average. EU-12 includes intra-EC trade.

Source: OECD, Industry and Technology, 1995 Scoreboard of Indicators.

Patents provide another indicator of technological performance. In 1989 the Asia-Pacific zone overtook Europe for the first time in the number of US patents granted. Europe's relative advantage is strongest in chemical sectors (e.g. fertilisers, pesticides, organic chemistry and pharmaceuticals), industrial machinery and railroad equipment. Europe has fallen behind Japan and the US in the production of IT hardware and software. Only in smart cards does

Western Europe lead (accounting for 73 percent of the \$756 million smartcard market), and that is primarily due to the strong support of one national government (France). Lower levels of production and the use of technological tools and information could prove a critical competitive disadvantage to Europe in the future.

Most of the reasons for this are to be found at national level. An economy's capacity to innovate depends not only on how specific institutions such as firms and universities perform, but on how they interact with each other as elements of a broader system of political and social institutions and values. The values and expectations of customers and suppliers are also relevant. Legal, cultural and institutional arrangements vary strongly across Europe, so that although there is some evidence that national boundaries are becoming less significant (e.g. somewhat greater R&D activity by multinationals outside their home country) the issues here may be primarily national in nature.

Regulation is a key area. Here the issue may be to prevent over-regulation of new technologies such as biotechnology (which could fall prey to religious and ethical objections) and the information superhighway/internet (censorship, cryptography and local content).

Much, if not most, regulation is driven by voter concern. So it is encouraging that most European consumers anticipate benefits from technological progress. They are more ambivalent about biotechnology and genetic engineering than other technologies.

A recent Eurobarometer study showed that in all the Member States, the two most useful applications of modern biotechnology were thought to be the production of pharmaceuticals and the development of genetic tests with a view to detecting certain illnesses. In contrast, the two developments generally considered least useful were the use of modern biotechnology in food production and the introduction of human genes into animals to produce organs for transplantation into humans. A majority of those questioned had moral objections to genetic manipulations with a view to producing organs for transplantation into man and the development of genetically modified animals for health-related research. Further regulation in these areas is entirely possible, creating the risk of a flight of research and innovation to regions which are more laissez-faire.

If Europe's environment for innovation is constrained, the revolutionary breakthroughs in medicine will come from outside Europe, especially in the US. This could lead to US biotech companies dominating the global market and market share in Europe. Within a decade, the only European companies that survive could turn out to be those that enter into strategic alliances with overseas companies.

New technology typically requires a lot of long-term capital to finance the necessary investments. Within the EU, there have traditionally been several sources of funding – venture capital groups, private placements, public equity and corporate partners – but investment has been much lower than in the US. Europe's investment community remains far more cautious than its counterpart in the US. Until recently, European early-stage investors had no exit route for their investments: they either had to sell companies via trade sales, which depressed investment returns, or float the companies on the North American Security Dealers Automated Quotation (NASDAQ) market in the US. This resulted in many of the EU's most dynamic young companies becoming US-owned.

The creation by NASDAQ of the European Association of Security Dealers Automated Quotation (EASDAQ) market in the EU, on which the first companies floated in November 1996, has provided a European equivalent for NASDAQ. It has had some success, with market capitalisation of more than \$12.3 billion in

June 1998, representing 32 companies. Meanwhile, EuroNM, a grouping of the growth-company stockmarkets of Germany, France, Belgium and the Netherlands has 101 listings and a market capitalisation of \$20 billion. These remain small in comparison to NASDAQ, which has over 5,000 companies together worth over two trillion dollars.

Government technology policies are also starting to concentrate more on the finance of innovation and less on the development of specific technologies. The EU's 1996 Green Paper on Innovation is evidence that the Commission is prepared to act on finance for innovative small- and medium-sized enterprises.

Much may depend on the investment climate within the wider EU, which in turn will depend on European growth rates. A burgeoning and growing single market and a successful single currency could provide a large stable domestic market for technology, whilst increased competition on the financial markets following the creation of the single currency could help resolve the financing gap. Provided governments and European institutions offer plenty of work, and provided national regulations are not allowed to get in the way, prospects for European technology could improve.

Nonetheless, it remains possible that the EU will continue to lag behind US performance because the latter's more entrepreneurial culture and favourable venture capital markets simply cannot be replicated in Europe. Even if US- or Asian-owned subsidiaries dominate the emerging sectors and own most of the relevant patents, technology-led changes in the economy will not be any fewer – global organisations will introduce technology wherever there is advantage to be gained. But the changes will be less beneficial to local economies, which will miss out on returns on intellectual property and possibly on production as well. Highly qualified EU nationals who wish to work in technology-based firms may continue to emigrate to the US.

Virtual communication networks enable business to compete and transform demand.

Over the past 20 years, the costs of enabling technology have decreased whilst its speed has increased exponentially. There is no sign of an end to this process, and over the next decade, technological advances in areas such as memory chips, computing power, storage capacity, software and communication capabilities will have a profound impact on business and competitiveness. Computing power will become ever cheaper and smaller, and can be more and more interwoven into our lives.

There are already six billion embedded microprocessors in cars, toasters and thousands of other devices. As embedded microprocessors and sensors become increasingly ubiquitous, they will become integrated into our clothing, homes, physical offices, and neighbourhoods. Intelligent systems will extend our reach physically and mentally. Technologies that respond to our needs regardless of time and location will make our lives easier.

Within a decade, broader-band networks, including satellites, fibre-optic cable and other newer technologies, will vastly increase communication speeds. Universal connectivity will ultimately include personal networks, which will take over and extend the functions currently performed by diaries and personal organisers. Many could be permanently on-line.

Major international Internet service providers report that the amount of data flowing through their networks is doubling every four months. Much of this new information takes the form of new object types that go beyond text and data into graphics, sound, and video. The use of speech, natural language, and

handwriting-recognition technologies will make electronic interaction as natural as saying hello. Intelligent agents and more efficient knowledge management tools will help navigation through large amounts of information.

Instant access to multimedia information and communication will enable ubiquitous networks and networked devices to deliver services and information in real time to the point of need. Business will come to the customer.

The widespread adoption of information technologies has driven much recent change in European markets. By now, all except the smallest businesses maintain computerised records and support systems. Data warehousing, data mining and groupware have made it possible to track, analyse and support customers and customer behaviour better than ever before. Operational performance data can be measured, monitored and acted upon. Information can be swapped more speedily and effectively.

As commerce becomes electronic, it becomes even more unmistakably about understanding the customer. Almost every industry uses eCommerce to explore new ways to service customers and extend customer relationships. Hence the development of buyer-centric markets, reverse markets, and markets-of-one. Companies in some industries – clothing, for example – can already provide customer-tailored products and services rapidly. Increasingly individualistic consumers can be expected to take up these opportunities. In turn, rewards will go to those organisations who can be most flexible and respond to customer demands most quickly – heightening the importance of IT links and physical logistics.

In business markets, value chains have been changing to take advantage of advances in technology. Electronic data interchange (EDI) is common in the engineering industry, allowing producers to transmit design information between themselves. As networks become increasingly interconnected and access devices increasingly widespread, this trend can be expected to continue. Some American IT companies already use Internet technology extensively in their dealings with suppliers and customers. Pioneers such as General Electric, the world's largest diversified manufacturer, have already developed considerable expertise in business-to-business eCommerce. Faster and more effective communications between businesses have allowed the widespread introduction of 'just-in-time systems' with consequent reductions in the costs and levels of stock held.

Technological development is leading to further mechanisation of tasks (or parts of tasks) which humans once undertook exclusively. Internet sites, public multimedia kiosks and advanced telephony/computer telephone integration are being used to assist in customer service and marketing in a range of industries, including financial services, utilities and government. A freer flow of communication allows for faster response times, reduced time to market, better white collar effectiveness and productivity and better co-operation and co-ordination. About 30 percent of large organisations now have intranets, whilst the vast majority of small- and medium-sized firms are developing them; and 40 percent of the Fortune 1000 executives are budgeting more than \$2 million for intranet projects. A recent survey of the top 250 companies in the UK found that more than 70 percent had an intranet, and 94 percent of those who did expected to expand their use. Technology infrastructure developed for one purpose is being used for several more, providing a platform to break down barriers between industries as, for example, those between supermarkets and banks.

Products and services have changed too. Microphones, cameras, motion and biometric sensors are beginning to record data on many facets of life. Such devices are already enabling cars (some of which now have more computers on board than

early moonshots) to recognise their own theft, notify relevant authorities and allow themselves to be tracked. Soon vehicles should be able to identify their owners via biometrics, and to predict their own breakdown and arrange emergency repairs with motoring organisations en route before notifying the driver of the problem. Increasingly, florists are able to remind customers of important dates, bookstores can notify customers of new books they will like, and news services can provide individually tailored headlines.

The combination of all these various technologies to support electronic commerce will have a far reaching impact. Projections for global eCommerce revenues vary widely, but figures of \$300 billion to \$400 billion by 2001 are not atypical. These changes are already evident in the US where the Internet bookstore Amazon.com increased net sales for fiscal 1997 to \$147.8 million, an 838 percent increase over net sales of \$15.7 million reported for fiscal 1996.

In both consumer and business markets, industries will use eCommerce to co-ordinate and communicate with partners, bypassing cost-laden middlemen, brokers, and agents. Intra-industry collaboration will sharpen supply-and-demand chains (such as chemicals, natural resources, and retail). In the electronics industry, members of the value-chain use eCommerce to share forecasts and demands, synchronise order fulfilment, and perform joint capacity planning. Many companies are linking to bring new core competencies to eCommerce market opportunities. For example, MSNBC (the Microsoft and NBC partnership) successfully pairs content-creation with technology competencies.

Amid the growing complexity of the electronic marketplace, brand awareness becomes essential. Besides building existing franchises, companies are creating new brands for the electronic marketplace, and using established brands to combat new entrants (such as Barnes & Noble's attack on new entrant Amazon.com). Interactive electronic media provide companies with the opportunity to extend their brand in new ways, such as using communities or affinity groups (Procter & Gamble's Pampers website focuses on 'Parenting') and highly targeted advertising (on-line searches, related business sites, and aggregated ad forums). The full impact of eBrands is only beginning to be understood.

eCommerce is encouraging the convergence of industries such as financial services (across retail banking, insurance, and financial markets) and electronics/hi-tech (computing, communications, and consumer electronics). It is also reducing dependence on location-based commerce and tightening cross-industry relationships. Examples of this convergence can be seen in vehicle purchase and ownership (travel, automotive and financial services industries) and providing health outcomes analysis (pharmaceuticals and healthcare industries). The table opposite gives an indication of what this might mean for just a few industries.

Of course the precise pace of this change is uncertain. Much depends on the response of European businesses, consumers and governments to the opportunities and challenges presented by electronic commerce. However, over a ten-year timescale, significant change is inevitable in all European industries, and for many it will be transformational. The open question is how far European companies drive the change and so benefit from it, versus how far it is driven from the US and elsewhere.

The potential impact of technology:

Industry	Potential Impact
Telecommunications	Transmission becomes a commodity. Competition will be based on new value-added services, enhanced services and applications
Publishing	More newspapers, magazines and information services will be delivered electronically. Potential to customise, providing customers with information they can select
Retailing	Less physical marketing and merchandising. Growth of electronic commerce
Financial Services	Home and telephone services accelerate the decline in the bank branch network and the insurance distribution system
Healthcare	Virtualisation of many activities (e.g. consultation, home healthcare operations)
Utilities	Emergence of the virtual utility offering 'one-stop-shop' energy or general utility services
Postal Services	Growth of electronic relationships with customers reduces volumes of physical mail (e.g. utilities bills, bank statements)
Travel Agents	View sample videos and book on-line; decline in importance of high street outlets

The growing number of cash-rich super consumers creates new markets for high-technology, customised goods and services.

No one knows to what extent consumers will wish to buy electronic services, rather than rely on more traditional mechanisms. Mass-market reaction to multimedia and to remote/home shopping for services remains largely untested. Datamonitor has projected that electronically enabled banking (ATMs, phone and PC banking) will constitute more than 50 percent of banking transactions by 2000, with phone and PC banking (which have largely developed over the last decade) taking about a quarter. This represents a massive change in consumer behaviour, but still leaves 44 percent of transactions being processed through branches. Whereas older consumers may be slow to adapt, 15-29 year olds are much more comfortable with technology and will surely embrace the changes.

Markets may increasingly segment, creating further polarisation between the information-rich and the information-poor – with the technology-literate population coming to enjoy a higher standard of living. A two-tier service delivery system could develop in every market, one for those willing to use technology and the traditional system for those who have failed to embrace it. Businesses that fail to provide and cater for this technology-literate market may find themselves losing many of their best customers – with severe implications for profitability. Specialist markets may develop to service these customers, offering carefully tailored products and services.

Values

Individualism and the demands of consumers are on the rise. There is a new kind of polarisation between rich and poor, both in terms of money and information – which is the new currency of business. At the same time, there is growing concern for the environment, as people aspire to truly sustainable lifestyles in which community values endure. These prevailing values and attitudes affect consumer behaviour just as much as geographical location, social status or education.

Implications

- Europe is increasingly a 'post-traditionalist' society, in which personal autonomy is highly sought, and values and lifestyles are seen as matters of individual choice.
- In the quest for non-material values, environmentally aware consumers make growing demands of businesses and politicians.
- A new cosmopolitan class emerges – well-educated, well-off and well-networked – and increasingly polarised from the have-nots (lacking money or information or both).
- The European Union lacks a strong European identity in the face of increasingly powerful national and regional attachments.
- Racism and xenophobia have a growing appeal to the minority who want to defend what they have against 'outsiders'.

Europe is increasingly a 'post-traditionalist' society, in which personal autonomy is highly sought, and values and lifestyles are seen as matters of individual choice.

For the past 50 years, a system of values has emerged in Europe which places the highest priority on participation and freedom of expression, accompanied by an assumption of basic material well-being and aspirations for something more.

In the 1950s-1960s, the model was the traditional nuclear family with the husband as breadwinner. Most of the population was unable to afford much more than the basic material things they needed. Nor was much more expected. The market was concerned with meeting progressively increasing demand; compared with today, there was negligible competition.

Since the 1970s, people have increasingly shunned marriage, and those who have married have done so later. With more children born outside wedlock and more divorces, the average size of households has decreased while their number has increased. OECD economies have expanded beyond the point at which the basic material needs of the overwhelming majority are covered. In this sense, we have a 'post-materialist' society, characterised by an increase in the market for services in contrast to goods.

Over the next ten years the 'baby-boomer' generation will start to retire. The more affluent part of the market (see below), will be dominated by a younger generation that never experienced a time when people were content simply to meet their basic material needs. Europe's new generation will be unfamiliar with the notion of having to wait for what they want, or wait to get the financing for it. For many of them the crucial question is simply whether they are credit-worthy enough to get what they want, when they want it.

At the same time, newer generations are realising that a 'job for life' is a thing of the past. As a result, their attitudes towards employers are changing rapidly. Government is no longer seen as a major provider of future security. The more

sophisticated Generation-X'ers treat employers more like clients than conventional provider/protectors. Many of them value private pensions and insurance more highly than company or Government ones. They are prepared to look at the balance between work and leisure quite differently from earlier generations which tended to adhere to a conventional 9-to-5 or 40-hour week schedule. Some may opt for individual arrangements, working from home, by telephone, or on flexi-time. Working mothers, whether part-time or full-time, need this kind of flexibility. Companies able to be flexible in response may have a substantial advantage in motivating and retaining staff.

While different cultural backgrounds bring variations across Europe, the trend has been in the same direction for all EU Member States. In the past 15 years, the average number of occupants per household in Italy fell from 3.3 to 2.9; in France and the UK there was a corresponding reduction from 2.9 to 2.4.

The total number of households, meanwhile, has risen by nearly 20 percent, from 111 million to 131 million, during the 1980s. This resulted from a combination of later marriages, lower marriage rates, higher divorce rates and an increase in the number of widows and widowers – trends which are expected to continue. Ten years hence, the number of households in Europe is expected to reach 150 million. This trend will have various effects. In Britain there is growing resistance in rural areas against the inevitable house-building this will entail in the countryside (as well as in recycled urban areas).

How will attitudes develop? Probably continuing along the path towards greater individuality. Consumers will increasingly demand products and services which closely match their own particular needs. Different consumers will have different priorities – quality, convenience or competitive price – but they will all expect the market to cater for them. Gone will be the days when consumers were prepared to be patient and accept what the market produced. In post-materialist Europe, customers will want uniqueness, and will be prepared to pay a premium for it. This may go beyond choosing from a limited list of pre-determined options, like the fitted kitchen, to more extensive customising and design. This trend may, however, be slow to develop, or only apply to products deemed particularly personal and vital to their owners – like cars, clothes and hi-fis which are an outward expression of persona. Cash-rich, time-poor consumers may increasingly demand arrangements with, for example, supermarkets and banks which get mundane chores done without wasting time at the point of sale. These consumers will increasingly make purchasing decisions on the basis of service and convenience.

Another emerging trend is the consumer's desire to be constantly entertained. Combined with the trend towards individualism, this will create opportunities for the travel and leisure industries, to provide new kinds of excitement, holidays and days or evenings out.

The new consumerism is not without its anxieties, however. Changing patterns of working and the end of jobs for life have brought increasing job insecurity, so that people sometimes worry about maintaining sufficient income to keep up the payments on ever-increasing credit balances. These worries are a spur to activity and achievement, particularly while the economy is expanding, but if recession threatens, they may cause an abrupt change in consumer behaviour. If insecurity does increase, it will tend to reduce individualism, possibly halt the trend towards decreasing household size, and increase the market for price-sensitive economy products and basic services. Values could shift towards more communal lifestyles, or new forms of family arrangements. Companies may have to decide which market segment to serve. Since large income differences might be expected to generate higher levels of crime, security features are also likely to continue to be built into a wide variety of products and services.

In the quest for non-materialist values, environmentally aware consumers make growing demands on businesses and politicians.

Post-materialist values are less concerned with economic and physical security and more concerned with freedom, self-expression and the quality of life. The last, in particular, is driving concern about the environment – pollution generally, global warming, the destruction of the ozone layer, the depletion of natural resources and other aspects of human impact on the planet. Public pressure for strict environmental and pollution control standards is likely to continue or increase. EU-wide environmental policy, implicit in the Treaty of Rome, has become progressively more explicit. Environmental issues are now integrated into a wide range of EU policies. Since 1995, ‘sustainable environment’ development policies have been integrated into the EU’s structural funds programmes. In 1996, 69 percent of Europeans saw protection of the environment as an issue best handled by joint EU decision-making, an increase of 3 percent over the year before, and one of few issues on a rising trend.

Concern over the environment is not evenly spread across Europe and is more marked in Germany and Belgium than elsewhere. But it is high enough among younger people in all European countries for it to be a major factor for governments and companies. Germany, Denmark and the Netherlands have powerful environment ministries, some of which have deliberately distanced themselves from industry. More recently, the focus has been towards an environmentally sustainable economy, and towards a more co-operative approach with industry. The table below shows a large percentage of 18-29 year olds ‘very concerned about the environment’.

Concern for the environment among 18-29 year olds (percent)

	Very concerned	Somewhat concerned	Not very concerned
Belgium	48	38	14
France	37	47	13
Germany	69	27	3
Italy	54	37	8
Netherlands	49	44	7
Spain	65	29	5
Sweden	49	48	4
UK	38	49	13

Source: Eurobarometer 43, Autumn 1995

Single-issue interest groups have, over the past decade, changed the policies of supermarkets and building societies, persuaded businesses to move and to alter their products. The high-profile example was Greenpeace’s success in persuading Shell to rethink its disposal of the Brent Spar oil rig. This episode showed how such an organisation can rouse passions and mobilise widespread action, like a Europe-wide boycott of petrol stations. This is likely to present a serious challenge for some major companies.

As politicians increasingly acknowledge the importance of environmental issues, they will adopt a number of policy instruments. New regulations, laws and taxes will impose burdens on certain sectors in the European industry and will cause a degree of industry restructuring. Firms may be required by law to undertake environmental audits.

EU-wide environmental regulations may force firms to co-operate in order to reduce the costs of transition. This has already occurred in the auto industry where

Germany’s 1990 take-back law required auto manufacturers to take responsibility for their vehicles at the end of their useful lives. Renault, Fiat and BMW signed an agreement to recycle each other’s cars as part of a planned European network; they also set up networks to train and equip dealers in recycling techniques. Fiat is participating in a take-back and recycling scheme with Peugeot, Volvo and Citroën.

Greater public desire for a more sustainable global environment should also lead to huge revenue growth in categories of products, services and technologies that barely exist today, especially those designed to assist in pollution control. In turn, in order to attract market share, businesses will need to think ahead in devising new ‘green’ production processes and products.

Environmental regulation will come through international conventions (like the Montreal protocol on CFCs) as well as through the EU, and Europeans will be anxious to ensure that the rest of the world keeps pace with their standards. Since the Uruguay Round of the WTO agreement, the EU knows that it cannot restrict imports on environmental grounds without cutting across the WTO provisions on technical barriers to trade.

The environment is therefore set to remain on the political agenda. EU regulation, on air pollution and similar issues of broad concern, may occasionally be resented and resisted by some member states or individual companies. But the alternative may well be further direct action by activists, who have the power to undermine companies as surely as any government.

Other ‘post-materialist’ issues will surface – like child labour in factories in developing countries. European companies will have to be equally aware of public disquiet on this kind of issue.

A new cosmopolitan class emerges – well-educated, well-off and well-networked – and increasingly polarised from the have-nots (lacking money or information or both).

While the more affluent have been increasingly concerned about non-materialist issues, there has been a growing polarisation of the market, with the poorest getting a smaller proportion of total European income than before. For example, while the bottom 20 percent in Germany shared 10 percent of national income in 1984, by 1991 their share had fallen to 7 percent, as shown in the table below. This trend has continued across Europe.

Proportion (percent) of income accounted for by top 20 percent and lowest 20 percent of households

Country	Lowest 20 percent		Highest 20 percent	
	1984	1991	1984	1991
UK	7.5	4.6	38.0	44.3
West Germany	10.0	7.0	35.0	40.0
France	8.0	6.0	38.0	42.0

Some have argued that this underclass is not only growing, but is actually poorer than before in absolute terms. In relation to the generally increasing standard of living in Europe, the poorest are certainly living quite close to a basic material existence. A few do so from choice, but mostly it is the result of a shortage of jobs in several European countries, or increasing numbers of non-earning, single-parent families, and of pensioners. A distinct market division has developed between these consumers and the more affluent average.

The European Union lacks a strong European identity in the face of increasingly powerful national and regional attachments.

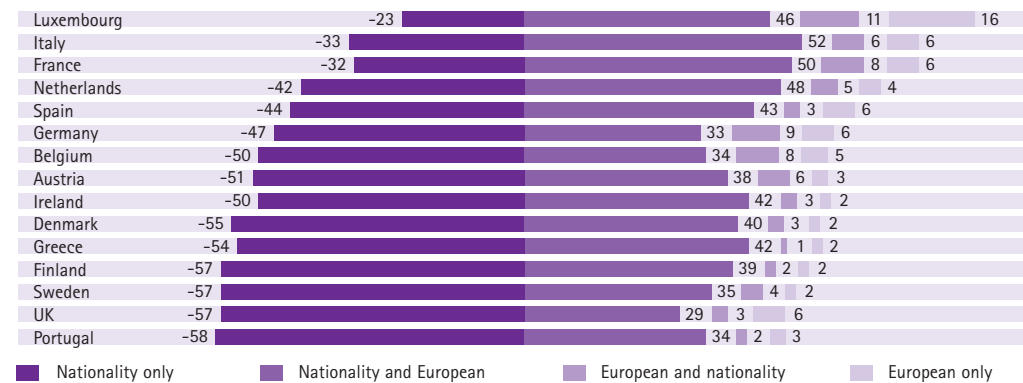
The people of Europe have historically tended to associate themselves with their nation-state rather than think of themselves as Europeans. Today, despite freer trade between European countries, fewer border restrictions, the privatisation of state industries, global communications systems and a growth in pan-national decision-making, there appears to be no trend away from the nation-state towards a common 'European' identity. On the contrary, national and regional allegiances seem stronger than ever. As the table below shows, the number of people in Europe perceiving themselves as 'nationality only' rose 12 percent between 1994 and 1997, while those seeing themselves as partly or wholly European fell by the same amount.

European and National Identity

	Autumn 1994	Autumn 1995	Spring 1996	Spring 1997
Nationality only	33	40	46	45
Nationality and European	46	46	40	40
European and Nationality	10	6	6	6
European only	7	5	5	5

Source: Eurobarometer 47, 1997

When these figures are broken down by country, there is a clear spread of views – but with all countries retaining a significant percentage of people who never view themselves as Europeans.



Source: Eurobarometer 47, 1997

Across the EU as a whole, people's local and regional loyalties are at least as strong as those towards their own nation-state. These seem to have been reinforced by measures aimed at preserving unique regional and ethnic identities. Thus, 90 percent feel 'attached' or 'very attached' to their region, 89 percent to their country and 87 percent to their town or village while 54 percent feel 'very attached' to their town or village. The degree and intensity of attachment to country, region or local community increases with age and varies slightly with gender. 62 percent of people over 55 feel attached to their town or village while only 48 percent of 15-24 year olds feel the same way. Men are slightly more likely to feel like EU citizens than women, who are more attached to local geographic entities (country, region, town or village). Local and regional attachment is also more pronounced in the poorer EU countries – Greece (97 percent), Portugal (94 percent), Spain (93 percent) and Ireland (92 percent). In addition to geographic attachment, one-third of Europeans are very attached to their language, culture and sub-national identity.

The trend towards preserving unique regional and ethnic identities is shown by developments in places like Flanders, Bavaria, Provence, Andalucia, Catalonia, Scotland and Wales. Some regions, such as the Basque country, have benefited from a devolution of central power, and have simultaneously reasserted ancient customs and traditions. In Belgium, the Walloons have demanded more power. These various expressions of regionalism are gaining recognition through the EU's Committee of the Regions. The EU has bolstered local, regional and cultural ties by encouraging minority languages as precious expressions of cultural diversity. Decisions by the EU and the Council of Europe have established respect for linguistic diversity as a fundamental human right. About 50 million (one in seven) people in the EU speak a minority language within their respective nation-state. There are wide disparities between GDP in the different regions, but few people think that reducing income disparities should be the EU's highest priority. Indeed, with such a focus on regional and national identities, it is not surprising that there is indifference about what 'Europe' should do. For many, peace-keeping and common defence emerge as the main issues on which there should be collective decisions or common policies.

As memories of the Cold War continue to fade, and as the perceived need for security against external aggression wanes, people will tend to concentrate further on local identities and smaller groups, based on ethnicity, race, religion or social class. The more global the EU economy becomes, the more people will want to retain their cultural heritage by emphasising their regional differences such as language, history, ethnic background and religious beliefs. There is already a trend for national governments to devolve powers to local centres where citizens will be more able to exercise direct control over issues that concern their daily lives. This trend is likely to continue.

How far will regionalism go? At the extreme, sub-national, ethnic and religious separatism could change the very nature of the EU itself. If the EU's nation states lost much of their power to their constituent parts, the EU might cease to be a political entity dominated by national governments. Could the representation of national governments at the EU level through the Council of Ministers, backed by the representation of nation states in the European Parliament, give way to regional representation on the Council of Ministers, back by a much stronger European Parliament, elected by all EU citizens on a common system? If so, there might be a temptation for national governments, anxious at threats to their power from 'identity politics', to try to clamp down on regional, cultural and ethnic trends and movements within their sphere of influence. The picture is further complicated by the possibility that any tendency towards European fragmentation might result in a transfer of power and influence back to nation states or to regional entities. The next big power struggle, in other words, could be between national governments and leaders of the regions.

Well-educated people tend to have a more cosmopolitan and European approach. Young people, those still studying, especially those studying away from home, and those holding management positions, are more likely to feel comfortable with other Europeans. It is an open question whether this, taken together with the large increase in the number of people with higher education qualifications (see table below), will make for a trend towards 'citizens of Europe' at the expense of national or regional loyalties. There are signs that a more cosmopolitan workforce, perhaps reinforced by mutual recognition of qualifications, will help to make people more comfortable working together in Europe. But this may not translate into a wish for policies to be furthered at a European level.

Generally, the trend towards higher education, and other forms of post-secondary education and (re)training is set to continue as more people recognise the need to

be prepared for life-long learning. There may, however, be setbacks as governments adjust the funding of higher education, forcing students to bear more of the cost, through fees and loans. This may increase the proportion of students living at home while in tertiary education – thereby reducing the cosmopolitan impact of large numbers of young people leaving home to study.

At the other end of the scale are groups which may feel more and more excluded from the mainstream. Some will feel that there should be more recognition of what they feel they contribute to society – whether by bringing up children on their own, making music, or engaging in other activities that don't necessarily make money. Such resentment on the part of socially excluded groups could lead to the formation of more aggressive single-interest factions and new grass-roots movements for social justice. At the same time, crime, including organised crime, is liable to increase. Thus an inability to improve the living standards of the bottom 20 percent of the population and failure to stem the rise in long-term unemployment could lead to civil unrest, perhaps exacerbated if the structure of local economies were to be adversely affected by EMU and other macroeconomic policies. Dissatisfaction could easily take on a regional character which the EU, as well as national governments, would need to address.

Racism and xenophobia have a growing appeal to the significant minority who want to defend what they have against 'outsiders'.

Racism and xenophobia spring from the individual's fear and insecurity about the future. They are nurtured by unemployment and poverty. If the European economy performs well, these malignant forces should be kept in check. But if the economy falters, the tendency towards regionalism will help prepare the ground for increased xenophobia. Although the anti-racist principle is strong throughout Europe, there is a risk that extremist political parties will gain ground with policies that amount to thinly-veiled racism. Recent Eurobarometer surveys have shown that while over 80 percent of Europeans do not find the presence of people of another nationality or race in their country disturbing, this leaves a significant minority of people who still do. Ethnic minorities across Europe tend to suffer much higher unemployment than the native population. Despite this, they are still successfully used by extremist parties as scapegoats if times are bad. Right-wing, racist parties have already had significant success in some areas of France, at the ballot-box as well as in grass-roots support, and there is a worrying amount of support from some young Germans for neo-Nazi organisations.

Extremist parties may pick up more support as the general trend in favour of single-issue parties develops. But just how significant this will be will depend on how the economy fares. In the longer-term the trend may be more helpful towards the immigrants, as the native population becomes accustomed to having the immigrants around. From the immigrants' point of view, the better their children are integrated into the education system, the more easily they will settle into society. The cause of tolerance can easily be set back by highly-publicised asylum-seeking, or attempts at illegal immigration, such as by Albanians and Kurds into Sicily. Such episodes may also set back attempts to remove borders within the EU under the Schengen agreement.

Although much racism across Europe is aimed at immigrants, xenophobia of a more general kind can be directed against foreigners taking control of national companies. If this were to turn EU countries against each other, it could threaten the principles holding the EU Single Market together – but this hardly seems likely in the foreseeable future.

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