Foreword

Europe is becoming increasingly similar to the late Habsburg Empire, a powerful example of fragmentation and tendencies towards disintegration arising in multinational, multi-linguistic, and multi-ethnic integrated economic entities. To understand why and what the consequences may be, this year's report by the European Economic Advisory Group (EEAG) at CESifo looks inside EU member states, where much besides European integration has been happening, and outside Europe, where powerful economic and geopolitical challenges have shaken many European countries and sectors.

Technological and trade developments play an important role in shaping country-specific performances. **Chapter 2** reviews how, in specific cases, policy reactions and reform initiatives have – or have not – dealt adequately with the resulting challenges. Special emphasis is devoted to the Italian experience, which has been a laggard since the early 1990s, and the positive developments in Denmark, the Netherlands, Sweden, and other countries which all managed to break out of relative decline in the past. The chapter illustrates based on these country examples that the wealth of nations depends partly on circumstances beyond each countries' control, but carefully designed reforms do make a difference.

The European Union in its current incarnation incorporates only a fraction of important automatic stabilization mechanisms of well-functioning currency unions and federal states. This creates serious limitations on the ability to respond to severe asymmetric shocks. In **Chapter 3** we consider various ways of dealing with the constraints imposed by the incomplete currency union, both in a cooperative and non-cooperative spirit. Examples of the latter include proposals to introduce parallel currencies or fiscal monies and the use of cryptocurrencies. As the chapter shows, there is no compelling reason to believe that this would provide a viable solution for a country that is facing a protracted economic downturn.

The shocks that shape country experiences often originate from outside the European Union and in particular from the EU's integration with the rest of the world. Relations with the United States are increasingly dominated by conflicts over defence and trade, and the rise of China as a leading power in science and technology may threaten the competitiveness of European companies. Some Chinese foreign direct investments (FDI) was in the form of mergers and acquisitions of European companies and those involving high technology companies and sensitive public infrastructure have attracted public attention. In **Chapter 4** we show that these developments challenge the European Union to respond appropriately, but also offer ample opportunities for progress at both the member country and the EU level. For example, an enhanced mechanism for screening inward investments at the member state and at the EU level would be a good response to these dangers, alongside stronger spending on R&D in all member states. Moreover, the EU needs to strengthen strategic policies towards science and technology, balancing coordination from centralised investments in some areas with experimentation from individual member states' uncoordinated efforts in others.

As always, **Chapter 1** of the report contains an in-depth analysis of the economic situation of the European Union and other countries around the world, together with a forecast for the year ahead. After the unusually long expansion phase that followed the recent economic and financial crisis, the global economic momentum slowed noticeably last year. At present it is still unclear whether the global economy will experience a significant downturn or rather a gradual deceleration in 2019.

The European Economic Advisory Group at CESifo, which is collectively responsible for all parts of the report, consists of seven economists from six countries. This year the Group is chaired by Giuseppe Bertola (University of Turin). The other members are Torben M. Andersen (Aarhus University), John Driffill (Yale-NUS College), Harold James (Princeton University), Jan-Egbert Sturm (KOF Swiss Economic Institute, ETH Zurich), Branko Urošević (University of Belgrade) and myself (ifo Institute and University of Munich).

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