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General Secretariat

# ART

Analysis and Research Team

# Forward Look 2023

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## EXECUTIVE SUMMARY

Events over the past year – first and foremost the Russian invasion of Ukraine, with its immediate and long-term consequences – have both **confirmed and accelerated the long-term global trends** which were highlighted in last year's Forward Look. These trends included global fragmentation, the polarisation of society, evolving economic models, and pressing environmental challenges. Their development during 2022 suggests that we are witnessing the beginning of **a new era of both challenges and opportunities** which may call for a far-reaching reassessment of the European model. Russia's war against Ukraine is the most visible and far-reaching of these developments, but it is not the only one.

As these trends continue to play out in 2023, we expect the EU's agenda to be dominated next year by **four main challenges**:

- 1) material scarcity
- 2) societal pressures
- 3) the weaponization of interdependencies
- 4) the need to preserve the EU's international influence

These will result in **tensions which the European Council and the Council of the EU** will need to address. They include tensions between **austerity and cohesion**, and between **values and interests**.

The Russia's war against Ukraine, migratory pressures, energy, the economy, and the EU's strategic position globally will all figure prominently on the political agenda. The need to manage ongoing crises, together with the approach of the end of the EU political cycle, will combine to put additional pressure on EU leaders and ministers. In this political context, it will be increasingly important to **reconcile the longer-term perspective with short-term objectives**, and not to lose sight of the former in pursuit of the latter.



# INTRODUCTION

The year that has just ended showed once again that it is often the most unexpected events that have the most immediate and far-reaching impact. The restrictions imposed in response to the COVID pandemic were still in place only twelve months ago yet feel like something from the distant past.

At the beginning of 2022, the EU appeared to be emerging gradually from crisis mode and on the road to recovery. But this apparent return to normality was upended by the unexpected **invasion of Ukraine by Russia** which is leading to a fundamental change in the geopolitical landscape and is disrupting the lives of all Europeans. Its **effects are set to be far reaching** and are likely to **transform the international order**.

Very few in the EU foresaw such an overt act of aggression, and even fewer expected the Ukrainian army to have the capacity to resist and fight back. Similarly, nobody can predict with any certainty how long the war will last or how it will unfold. But it is clear that **its impact and consequences will continue to drive and shape the agenda** of the European Council and the Council of the EU in 2023.

Decisions of leaders and ministers will inevitably focus on issues that require an urgent response. But crisis management should not simply be about the short term. Decisions need to consider the wider European and global context, as well as Europe's key long-term objectives.

Against this background, **the aim of the Forward Look is to offer a basis for reflection** on the main issues our institutions are likely to face in the short, medium, and long term. The **first part will analyse how the seven global trends** that were highlighted in last year's exercise prior to the war.<sup>1</sup> have evolved, and in some cases accelerated, during 2022.

The **second part will focus on** what can be expected in 2023. Taking the global trends as a basis, the paper analyses how they impact on each other, and identifies **four main challenges** that the **EU** is likely to face in the coming year: scarcity, societal pressures, weaponization, and how to maintain influence.

The **final part** will look at how these challenges lead to **tensions between four different policy objectives** - austerity and cohesion, values and interests - and how these tensions will **impact on the work of the European Council and the Council of the EU**. The aim is to offer some food for thought to help the two institutions to be better prepared and able to respond coherently to the developments the EU will face over the coming months and years.

## HOW THE SEVEN TRENDS EVOLVED IN 2022

The events of the last twelve months have both confirmed and accelerated the global trends described in last year's Forward Look: global fragmentation, changing politics, digitalisation, evolving economic models, polarisation, demographic imbalances, climate and environmental challenges. The Russian invasion of Ukraine has of course been the most far-reaching event of 2022 and has had a major impact on all seven trends.

**Global fragmentation** and the **competition between different political models** have been accelerated by the war. The EU and the West have responded to the Russian invasion with an impressive degree of unity. At the same time, Russia's decline has been accelerated, nudging Moscow even closer into Beijing's orbit<sup>2</sup>, whilst a number of countries across the globe which are less directly affected have tried to use non-alignment as a bargaining chip<sup>3</sup>. The different reactions to the war and the COVID pandemic have together increased the already-widening gap between democracies and autocratic powers. And the effect of the squeeze on energy and food, particularly on the global South<sup>4</sup>, has put greater distance between the world's richest and poorest countries. **Digitalisation** and the tech race are playing an increasingly important role in the competition between global powers. The Biden administration's restrictive measures on the export of semiconductor technology to China are seen as a declaration of economic war<sup>5</sup>, and are widening the global technology gap. The implementation of Europe's digital decade is under pressure from supply chain disruption and growing pressure over access to critical raw materials.

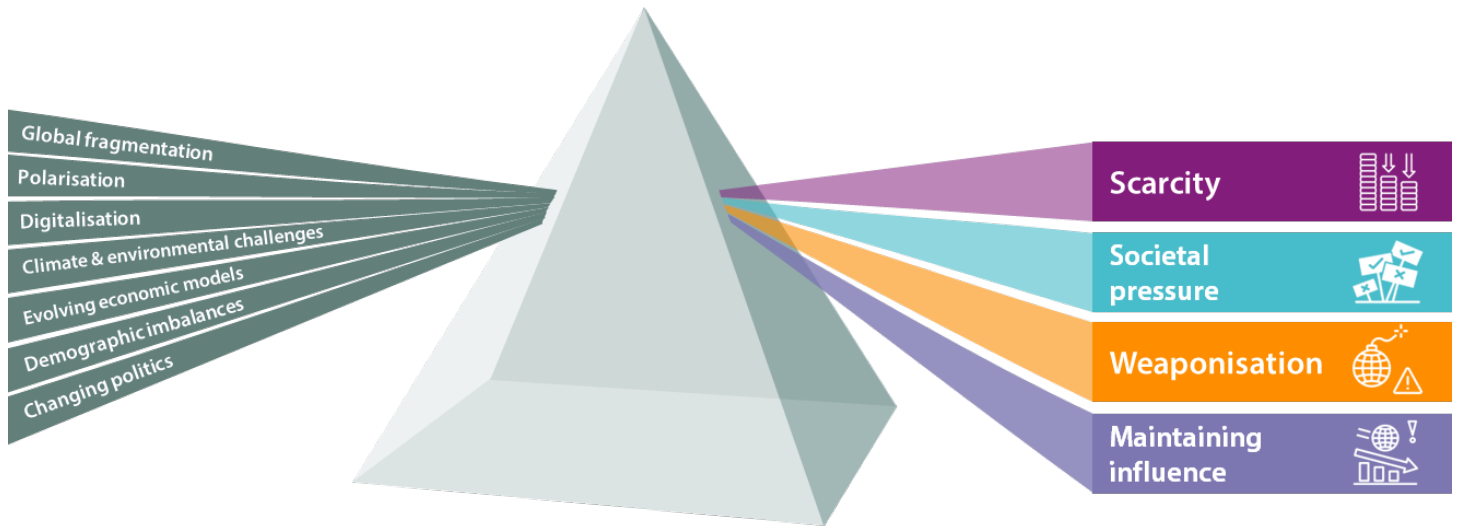
The war in Ukraine has also intensified the **competition between different economic models**, leaving the EU with little option but to move away from a strategy based on continuing cheap energy from Russia. The war has dealt a major blow to global growth, but the EU is one of the biggest losers, with a further decline in its share of global GDP<sup>6</sup>. Inflation, driven largely by

the increasing price of energy and food, has reached levels not seen for decades, and is eroding the purchasing power of households. Most EU citizens claim that they have difficulties in making ends meet<sup>7</sup>. Economic disparities are in turn leading to increased societal **polarisation**. Having retreated in 2020 and 2021, populist movements have once again gained ground across Europe - a clear sign of underlying social tensions and unhappiness with conventional political parties<sup>8</sup>. Whilst public support for Ukraine remains relatively strong, the economic and other costs of the war, which are unevenly spread, are beginning to take a toll. The economic fallout of the war, coming on top of the pandemic, has had a particularly significant impact on the younger generation, highlighting the importance of deeper structural measures to address the effects of **demographic imbalances** and the ageing population.

With so much else going on, it has been a challenge for the EU to maintain its focus on addressing **climate change**. The intensity and frequency of extreme weather events not only brought their own challenges, but also served as a stark reminder of the urgency of the issue. The summer heatwaves in Europe had a severe impact on agriculture, food supplies and energy, which were already under pressure because of the war in Ukraine. Meanwhile, the IPCC's Sixth Assessment Report<sup>9</sup> warned that the world is likely to miss the target of limiting global warming to 1,5°C. This sombre assessment underlined the urgent need for global mitigation efforts, although this was barely reflected in the relatively modest outcome of COP27 in November 2022.

The events of 2022 have confirmed the continuing relevance of the **seven trends** and have underlined their interconnectedness. These **interconnections are in themselves generating four significant challenges**, illustrated below, that the EU is already facing or is likely to face soon.

**Figure 1: The seven global trends lead to four significant challenges for the EU**



### Scarcity

The impact of shortages of food, energy and other essential products combined with economic and budgetary pressure on governments and populations



### Societal pressure

The increasing difficulty of the existing political systems to meet the expectations of the population for long-term prosperity, security and stability



### Weaponisation

The hostile use by competing powers of the instruments and consequences of interdependency to apply pressure in the pursuit of political goals



### Maintaining influence

The need for the EU to maintain its political, economic, and diplomatic agency in the world through adapting to a changing global landscape

Source: GSC-ART

# MAIN CHALLENGES IN 2023 AND BEYOND

## SCARCITY

A combination of factors exacerbated by the war in Ukraine, the supply chain disruptions due to the pandemic and an increase in extreme weather events point to the **end of an era of relative plenty** for Europe. This era was based on cheap gas from Russia, inexpensive imports from China, easy availability of natural resources and little or no direct cost of the impact of climate change. For the first time since World War II, the context in which our societies and our industry operate is one of **scarcity**, which means that societies need to change the way they live and work. This brings new challenges to social cohesion and to Europe's industrial model, with increased political and financial pressure on the EU and the Member States.

While renewable energies are expected to free Europe from its dependence on Russian gas, building the necessary infrastructure will take time and risks bringing new dependencies, notably on China.

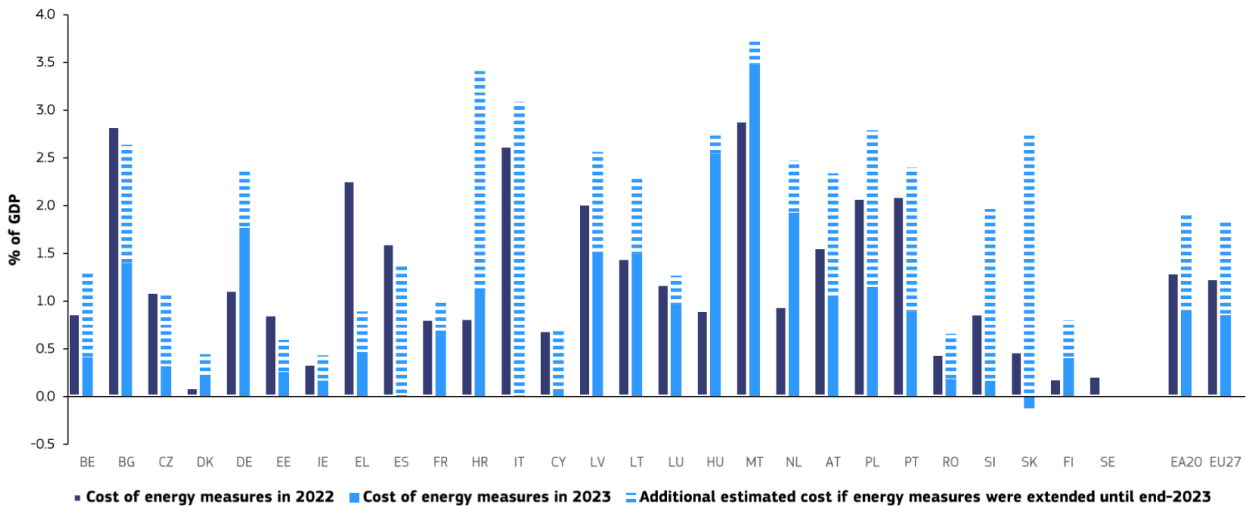
The **main factors behind scarcity date from well before the invasion of Ukraine** and will not disappear quickly. Energy and food prices are expected to continue to increase throughout 2023 at least. Refilling energy storage capacity for the 2023-2024 winter will be a challenge in the light of the expected increase in Chinese demand for LNG.<sup>10</sup> and tight global markets.

**Figure 2: EU Natural Gas projected trade values until 2023 according to analysts' expectations. The possible price range is reflected in the light blue band**



Source: Trading Economics.<sup>11</sup>

**Figure 3: Estimated budgetary cost of energy measures and potential additional costs in 2023**



Source: European Commission.<sup>12</sup> Note: Budgetary cost of energy measures as included in the Autumn Forecast.

International food commodity prices are expected to be 24% above the baseline assumptions in the first quarter of 2023 and 33% higher in 2024.<sup>13</sup> High inflation and interest rates will lead to **reduced access to funds and investment**. Although the Commission's 2022 autumn economic forecast expects EU inflation to decline from an average of 9.3% in 2022 to 7.0% in 2023, this is still high, and presents risks in the volatile context resulting from uncertainty over gas prices.

Europe's **industrial model** will need to adapt to the new realities of scarcity and find ways of absorbing sustained higher input costs which are making European goods less competitive than their North American or Asian equivalents. At the same time EU industry is likely to continue to face damaging measures from the US such as the Inflation Reduction Act. The combination of US protectionism and high energy prices in Europe risks leading to a shift in EU manufacturing to the US at the expense of transatlantic trade and the EU's domestic industrial capacity. Unemployment rates in the EU are forecast to be 6.5% in 2023, and 6.4% in 2024.<sup>14</sup>, with the impact of the energy crisis being particularly severe for small and medium-sized companies. This context presents a challenge to the European **social contract**, as scarcity will lead to increased difficulties for people in accessing basic services, e.g.: affordable housing (borrowing capacity), education (lack of teachers) and health (drug shortage, affordable medicines, lack of medical personal).

The twin transition brings long-term opportunities but will also add short-term stress to the system, as far-reaching changes to Europe's way of life and production models will be needed. Whilst the current situation points to the need to accelerate the transition, there is a risk that **short term needs take priority over longer-term objectives**. In 2023, Member States are likely to request further exemptions and greater solidarity, which could lead to calls for a reassessment of budget priorities and the green objectives. To turn these challenges into opportunities, the EU will need to strengthen its **vision of a positive transformation** that is centred on green and environmental objectives, and which replaces the model of unchecked consumerism, unlimited waste, and excessive resource extraction.

**Less money for investment combined with increased demands on social services** means that leaders will have to take tough decisions in the context of the end of the EU political cycle. The EU and its Member States will have to do **less with less**. The asymmetric impact on Member States will represent **a significant test for European solidarity and cohesion**, as increased budgetary pressure will most affect those countries with lower fiscal margins. The resulting pressures on societies (which will be described in more detail in the next section) could trigger protests and social unrest if not accompanied by supporting measures and a commitment to burden sharing both within and between Member States.

## SOCIETAL PRESSURES

The pressures on the cost of living brought about by the war in Ukraine come on top of the disruptive effects of two years of pandemic. They are challenging the ability of existing political systems to meet the expectations of the population for long-term prosperity, security, and stability. In 2023 **there is likely to be increasing pressure on political leaders** to come up with rapid responses on how to mitigate the domestic impact of the war. Populists could exploit these pressures, which may be further exacerbated by an increase in migratory flows.

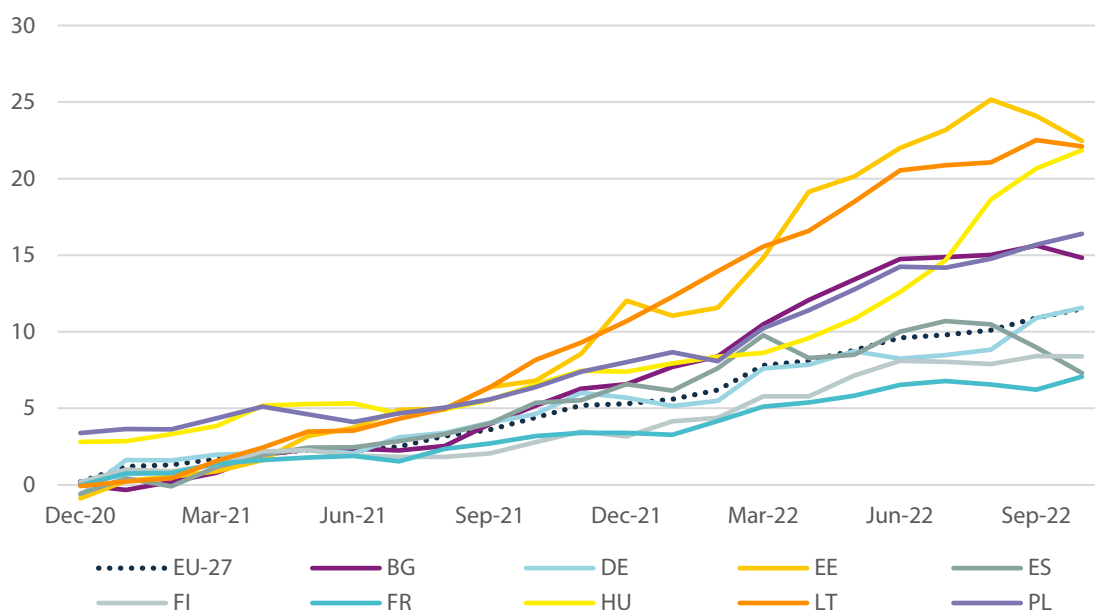
Throughout the EU, societies that have barely recovered from the impact of COVID are now facing further pressures because of increasing food and energy prices. These are set to continue throughout 2023. The impact is however uneven, with some parts of society much more vulnerable than others. Within Member States, the **lower and middle classes will be the most affected**<sup>15</sup>. Poverty could rise further, and social inequality is likely to increase.

The **intergenerational aspects** should not be underestimated. After more than two years of disruption due to COVID, the interests of young

people, especially those in education and at the beginning of their careers, risk being overlooked<sup>16</sup>. The increased cost of borrowing will lead to reduced access to mortgage finance, which will in turn mean that young people end up postponing significant decisions. This could affect their long-term economic stability<sup>17</sup>. Together with simmering discontent over what they see as an insufficient response to tackling climate change, anger among young people could spill over into more protest movements<sup>18</sup>.

The impact of the crisis will vary between Member States, with some better able than others to respond. Central and Eastern European countries will be particularly vulnerable<sup>19</sup>. Businesses, already weakened by the pandemic, will face increasing energy costs, leading to a risk of layoffs especially in those Member States with energy-intensive economies and fewer financial resources<sup>20</sup>. Finding a common macroeconomic policy stance will pose challenges for national governments and for the European Central Bank. As a result, **rising inequality** between Member States' populations **could undermine cohesion within the EU**.

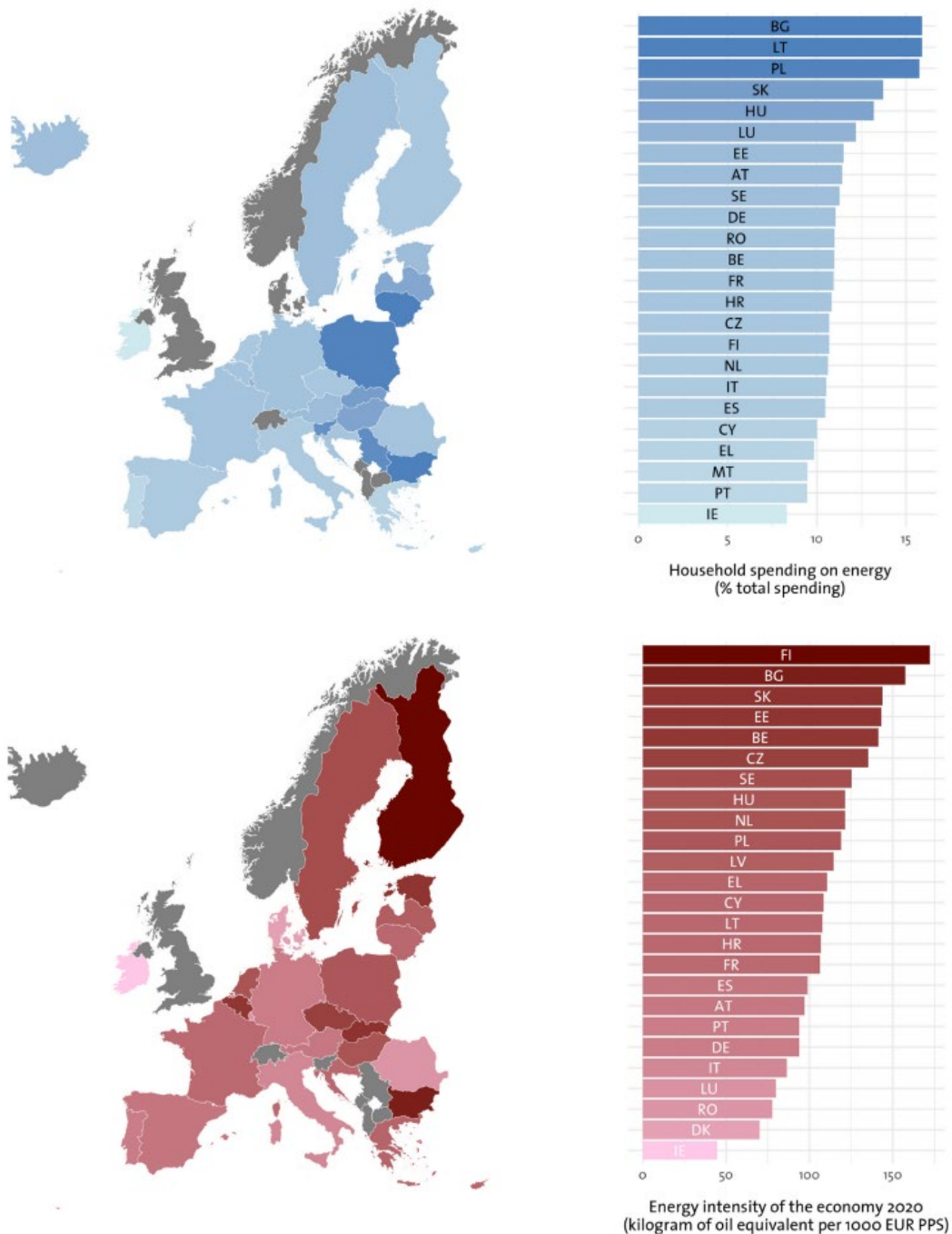
**Figure 4: Inflation rates in selected EU Member States**



Source: GSC-ART, based on Bruegel and Eurostat.<sup>21</sup>



**Figure 5: Household spending on energy (electricity, heating and transport) and energy intensity of the economy in 2020**



Source: Jacques Delors Centre.<sup>22</sup>

Other challenges are on the horizon: the pressures linked to **food security** and **climate change** could increase migration flows into the EU.<sup>23</sup> As in previous years, extreme weather events will occur more frequently but with different impacts on Member States, and a greater effect on those in society with fewer resources.<sup>24</sup>

The continuing high cost of energy will affect the replenishment of Europe’s gas storage facilities ahead of next winter. This could lead to **further economic pressure** towards the end of 2023 and in early 2024.

With the risk of these developments leading to public discontent and even protest, the political system will be under significant pressure to deliver.

Institutions will need to be agile and respond quickly and creatively if the public is not to be attracted by the simplistic solutions offered by populist movements.<sup>25</sup> Despite the welcome given to **Ukrainian refugees** since the Russian invasion, populists could be tempted to use the presence of so many refugees, many of whom are unlikely to return in the medium term, to provoke and exploit **compassion fatigue**, especially in countries with a large share of refugees and marked economic downturns.<sup>26</sup>

The fallout from the unfolding corruption scandals hitting the European Parliament also provide populist movements with an easy target, leading to the risk of a significant loss of public confidence and trust in the EU as a whole.

Growing **societal fragmentation will also test the ability of coalition governments** to agree national positions, leading to a further weakening of their capacity to negotiate. The differing impact of the Ukrainian war on Member States, coupled with the risk of some governments creating political links between unrelated dossiers could complicate EU decision-making and lead to a further erosion of trust within the system.

The ability of leaders to deliver a set of policies which meet the public's expectations in 2023 will be an important test for the legitimacy of both the European and national political systems.

## WEAPONIZATION

Weaponization of interdependence is **one of the key drivers of global fragmentation**, as it pushes countries to reduce their reliance on external partners and prioritise security over the efficiency gains of globalisation and openness. While by no means a new phenomenon, there are several reasons to think that weaponization is set to become even more prominent in the immediate future. Firstly, 2023 is expected to be a year of **heightened geopolitical tensions**, in particular along two main axes: Russia vs. the West, and US vs. China. Weaponization of interdependence among these actors in 2023 would be a continuation of existing trends. Secondly, **societal pressures** (resulting from increased polarisation, migration, recession etc.) create levers which can be exploited and weaponized by hostile actors. And finally, the **pursuit of increased autonomy and resilience** by each of the major powers generates pressure on others, which can be perceived as protectionist or even hostile, and lead to further disruption.

From a European perspective, the threat of weaponization can be expected in the context of Russia's war against Ukraine, where there is no obvious end in sight. But **2023 is going to be a critical year for Russia**, with increasing domestic dissatisfaction over the economic and human

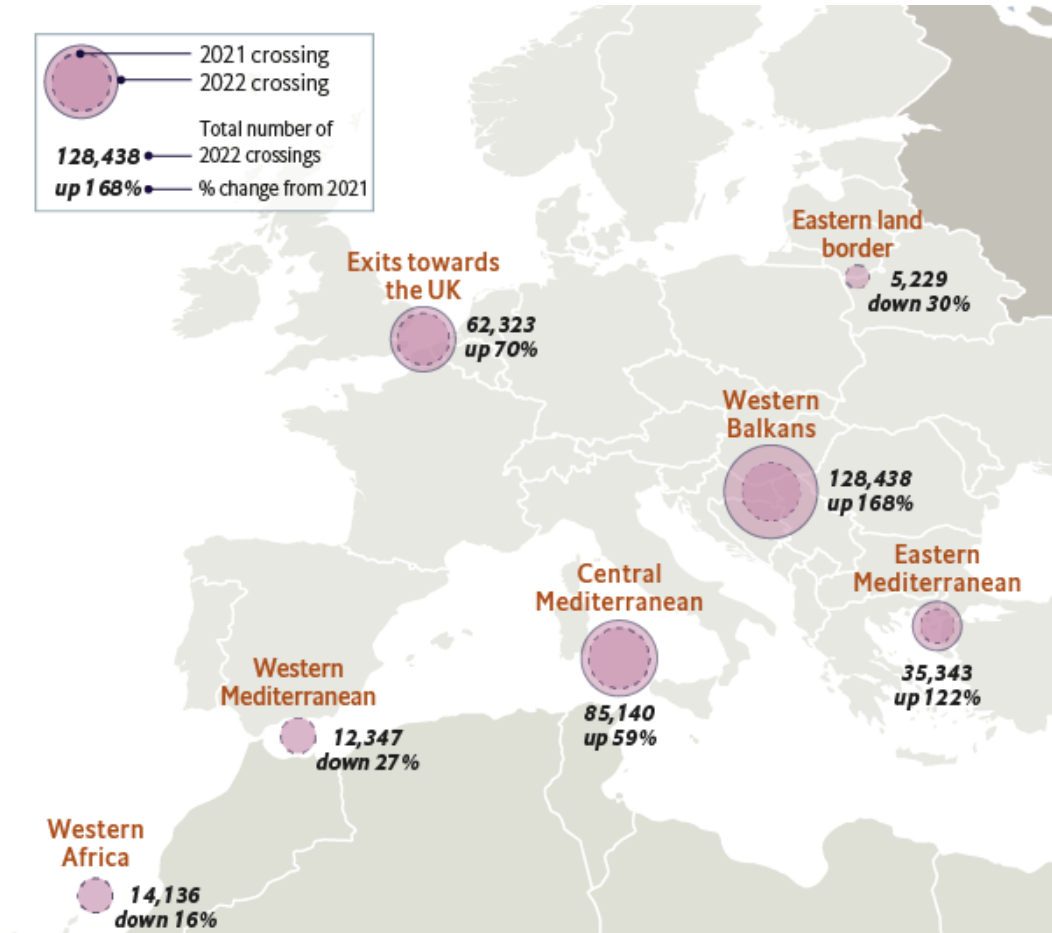
costs of a war in prolonged deadlock. Mounting pressure from embargoes and oil price caps, together with the prospect of presidential elections in early 2024, could lead the Kremlin to take even further hostile action against the West. These are likely to target **energy supplies** (possibly using intermittent disruptions in an attempt to divide Member States and protect revenues), coupled with further **disinformation and propaganda** campaigns to maximise discontent and polarisation among Europe's public – especially in the context of elections in several Member States in 2023.

In a domestic context dominated by economic pressure, polarisation and disinformation, the EU will be vulnerable to **attempts to weaponize migration**. In addition to refugees from Ukraine, traditional migration routes such as the Western Balkans and the Mediterranean have all seen an increase during 2022, and the number of crossings is expected to increase further from around February or March of next year after a winter slowdown.<sup>27</sup> Russia may take advantage of rising tensions within the EU over migration to threaten measures which could aggravate the situation through the deliberate disruption of global **food supplies**.

Other regional actors could also resort to weaponizing migration (as Belarus, Libya and Turkey have done in the past). **Turkey**, where general elections are planned on 18 June 2023,

may also continue to take advantage of the role it has adopted as a mediator between Russia and Ukraine to shield itself from Western criticism of its policies.

**Figure 6: Migration movements in 2022 compared to 2021**



Source: The Economist.<sup>28</sup>

In the context of **US-China rivalry**, the world is likely to see a continuation of the current trends in economic statecraft, especially in the form of US restrictions on Chinese **access to sensitive technologies**, with economic repercussions for both Western and Asian exporters in countries allied to the US. On the other hand, some analysts see a positive sign in the conciliatory approach taken by Xi Jinping at the G20 summit in November this year.<sup>29</sup>, which could be interpreted as a shift to **a less combative foreign policy** in the face of domestic challenges – perhaps as part of a ‘charm offensive’ to undermine US-led containment efforts. There will be several opportunities in 2023 to assess whether and to what extent Beijing is indeed shifting to a more cooperative foreign

policy. These include China’s stance towards Taiwanese elections in January 2024; its role in mediating potential nuclear tensions in the Korean peninsula; and the possible lifting of punitive tariffs against Australia. There could, on the other hand, be opportunities for China to weaponize its position in the international system. Recent episodes such as joint Chinese-Russian military exercises in South Korea’s air defence zone.<sup>30</sup> do not augur well

2023 will be **a crucial year for the European Union to shore up its resilience** to external shocks and supply chain disruptions, whether malicious or not. This could become even more of a priority if the rise in the number of COVID cases in China following the relaxation of the

lock-down rules further hits Chinese exports. Debates about protecting sensitive economic sectors such as semiconductors and critical raw materials are closely linked to those on the green transition and the energy crisis, with the potential for them to either unite or divide.

At the same time, as Russia's war against Ukraine progresses and the scope for further sanctions is reduced, the EU (and the West, more broadly) may want to consider how to further exploit interdependence for its own interest and at what

cost, bearing in mind the capacity of third countries to retaliate and adapt. For example, 2023 might see the roll-out nationally of China's digital currency (currently being piloted at regional level), a tool which could be used to circumvent future Western sanctions. Similarly, analysts have warned of the possibility of non-Western powers taking measures (such as tankers and insurance) to enable them to bypass Western chokepoints on the energy market as a result of sanctions on Russian oil.<sup>31</sup>

**Figure 7: Overview of current and potential geopolitical hotspots**



Source: GSC-ART

## MAINTAINING INFLUENCE

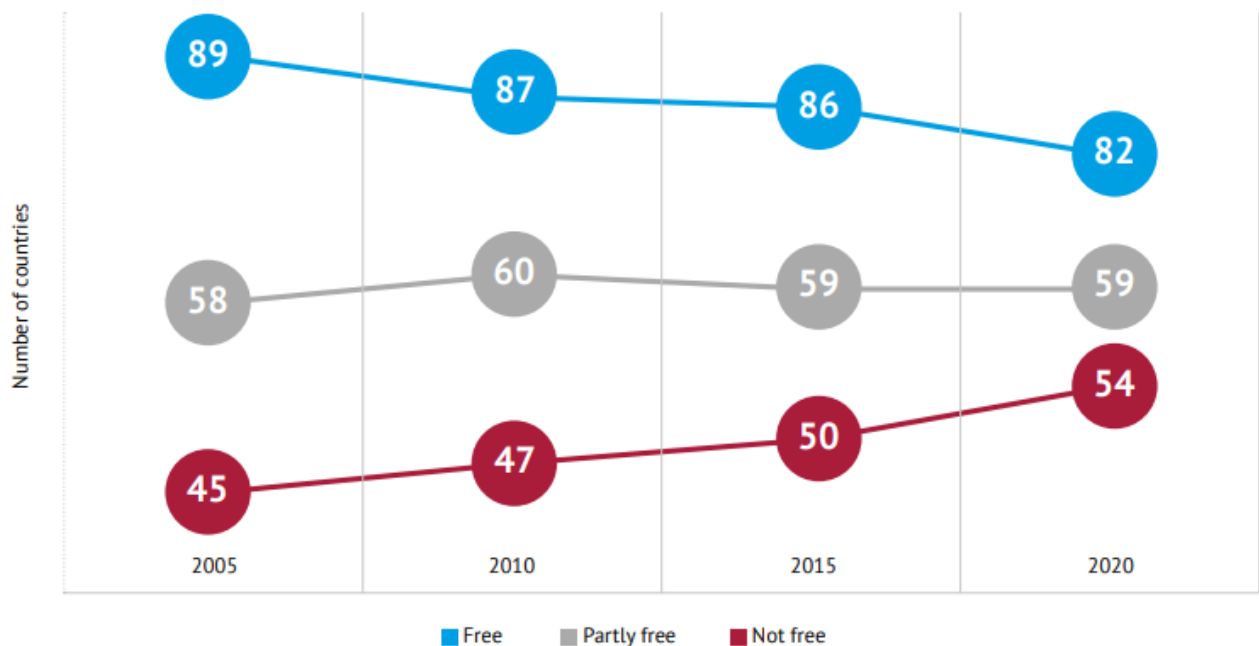
The continuing attractiveness and influence of Europe is based on a wide range of factors such as its democratic and rules-based system, the powerful pull of its consumer and economic base, and its ability to project itself as an attractive model and to articulate a narrative for a better world. On inclusion, Europe leads on most dimensions, including equality, social progress, and life satisfaction. But **long-term structural factors**, which have been accelerated by the impact of the war in Ukraine, **are challenging Europe's ability to defend and promote its interests** and are therefore also having a direct impact on Europe's influence in the world.

**Demography and economics both undermine Europe's global influence.** The world has twice as many inhabitants as in 1975 and seven of these eight billion live in the countries of the South, more than half in Asia alone. Europe's share of the global population is shrinking, and it is ageing. Europe's share in the global economy is also declining. In 2018 it accounted for over 18% of global GDP, but this has since shrunk by nearly a quarter.

The departure of the UK from the EU has also reduced the influence of the internal market. Overall, 90% of global growth takes place outside the EU. All these longer-term trends have been exacerbated by the impact of the COVID pandemic and the war in Ukraine. The result is even lower growth and higher inflation.<sup>32</sup>

Whilst the EU remains in many ways a destination of choice and continues to exert a pull on both refugees and economic migrants, **the notion of a world governed by universal values as defined by the West is increasingly contested** at a time of stronger identity narratives,<sup>33</sup> including its religious dimension. Since the highpoint of democracy in the 2010s when 50% of the world's population lived within democratic systems, autocracies have now rebounded and now account for 70% of the world population. This includes economically powerful countries which are intent on promoting an alternative world order.

Figure 8: A shifting international balance of freedom



Source: EPC.<sup>34</sup>

**The geopolitics of (inter) dependence**, whether it be energy or raw materials, **are shifting the global landscape**, driven by a range of factors, not least the rivalry between the US and China. In 2023, this will impact on economic links, but will also generate further political tensions. If it is to maintain its influence, the EU will have to find a way to grapple with international sanctions, foreign interference, the principle of state sovereignty and an increase in protectionist measures, including from like-minded partners.

Maintaining influence will not only require the EU to manage better its dependencies, but also adopt measures to encourage inward investment, reindustrialize and implement the green and digital revolutions. In 2023, these **longer-term ambitions will have to face the short-term reality** of the need for an immediate response to the pressures on the business sector and the cost of living. There will be pressure to develop a more robust industrial policy to meet both internal and external challenges. But this

will need to be consistent with the principles underpinning the Single Market which in 2023 celebrates its 30<sup>th</sup> anniversary.

For the business sector, choices and priorities risk becoming a bone of contention between Member States, not least as **Europe's long-standing disadvantage in the tech sector and its weaker industrial basis become ever clearer**.<sup>35</sup> This trend will contribute to affect the EU's traditionally strong role of standard setter which is beginning to be challenged.

Overall, in 2023, the impact of the energy crisis, interdependence and weaponization have become more important sources of political influence than social, environmental or governance issues. These challenges, in addition to the ongoing tensions between Member States over European values, will test **European unity and leadership**, which **are essential if Europe is to continue to maintain global agency and influence**.

**Figure 9: Out of ten transversal technologies, such as AI, quantum computing and cloud, Europe leads on two**

**Relative European position vs leading or second-best region on a range of metrics, multiple<sup>1</sup>**

Europe trailing ● <0.8 ● 0.8–1.2 ● >1.2 Europe leading

Transversal technology	Innovation <sup>2</sup>	Production <sup>3</sup>	Adoption <sup>4</sup>	Average
<b>Next-level automation</b> Industrial, collaborative, and professional robots; additive manufacturing; virtualization	<span style="color: #ADD8E6;">●</span> 0.6	<span style="color: #00B0F0;">●</span> 1.0	<span style="color: #ADD8E6;">●</span> 0.7	0.8
<b>Future of connectivity</b> 5G, Internet of Things	<span style="color: #ADD8E6;">●</span> 0.7	<span style="color: #ADD8E6;">●</span> 0.7	<span style="color: #ADD8E6;">●</span> 0.3	0.6
<b>Distributed infrastructure</b> Cloud, edge computing	<span style="color: #ADD8E6;">●</span> 0.2	<span style="color: #ADD8E6;">●</span> 0.1	<span style="color: #ADD8E6;">●</span> 0.7	0.3
<b>Next-generation computing</b> Quantum computing, neuromorphic software	<span style="color: #ADD8E6;">●</span> 0.5	n/a	n/a	0.5
<b>Applied AI</b> Robotic process automations, optimized decision making, natural language processing, computer vision, speech technology	<span style="color: #ADD8E6;">●</span> 0.5	<span style="color: #ADD8E6;">●</span> <0.1	<span style="color: #00B0F0;">●</span> 0.8	0.4
<b>Future of programming</b> Software 2.0, no-code and low-code programming	<span style="color: #ADD8E6;">●</span> 0.3	<span style="color: #ADD8E6;">●</span> <0.1	n/a	0.2
<b>Trust architecture</b> Blockchain, Zero Trust security/ cybersecurity	<span style="color: #ADD8E6;">●</span> 0.3	<span style="color: #ADD8E6;">●</span> 0.3	<span style="color: #ADD8E6;">●</span> 0.6	0.4
<b>Bio Revolution</b> Biomolecules, biosystems, bio-machine interface, biocomputing	<span style="color: #00B0F0;">●</span> 0.8	<span style="color: #ADD8E6;">●</span> 0.4	<span style="color: #ADD8E6;">●</span> 0.5	0.6
<b>Next-gen materials</b> Nanomaterials, composite materials, semiconductors	<span style="color: #ADD8E6;">●</span> 0.7	<span style="color: #000000;">●</span> 2.0	<span style="color: #00B0F0;">●</span> 1.2	1.3
<b>Future of cleantech</b> Solar power, wind energy, hydropower, nuclear, electric vehicles, hydrogen	<span style="color: #000000;">●</span> 1.3	<span style="color: #ADD8E6;">●</span> 0.4	<span style="color: #00B0F0;">●</span> 1.2	1.0
<b>Average</b>	<b>0.6</b>	<b>0.6</b>	<b>0.7</b>	

<sup>1</sup> For instance, if Europe issues 200,000 patents per year related to process automation vs 400,000 a year in the United States, the multiple is 0.5.

<sup>2</sup> Average number of the ratios based on number of publications, number of patents, and venture capital funding (\$ billion).

<sup>3</sup> Average number of the ratios for top ten companies on market share (%), market capitalization (\$ billion), and corporate or private equity funding (\$ billion).

<sup>4</sup> Average number of the ratios based on public investment (\$ billion), penetration (count per capita), and end-market share (%).

Source: McKinsey.<sup>36</sup>

# THE EUROPEAN COUNCIL AND THE COUNCIL OF THE EU IN 2023

The European Council and the Council of the EU will operate in 2023 in a context of multiple crises that constitute the most complex and cross-cutting set of challenges of the last few decades. The resulting **tensions between different policy objectives** will have a direct impact on the work of our institutions, creating both risks and opportunities for the EU.



## Tensions between austerity and cohesion

- In the context of increased **competition for resources**, the Council will face difficulties in reaching compromises across a range of issues. These risk giving rise to **more divisive discussions**. The ability of coalition governments to agree on national positions will also be tested. Issues related to rule-of-law conditionality are likely to continue to be problematic. This combination of factors could **slow down the work of the Council** and will put pressure on Member States to look for creative solutions.
- **But political systems will be under significant pressure** to deliver, not least given the risk of citizens being tempted by the attraction of simplistic solutions on offer from populist parties. The fall-out from the corruption scandal in the EP risks sapping public confidence in the EU and is already being exploited by some in support of their own interests. On the other hand, a coordinated and effective European response to rising economic and social inequality would help shore up public trust in the EU.
- The **debate on the future of fiscal rules** will take place in early 2023 **against a background of economic recession** that will affect Member States in an asymmetric way. Pressure on national budgets is likely to increase, with more calls for exemptions to the rules. In the meantime, the **ECB will be confronted with a difficult balancing** act between dampening inflation and sustaining growth.
- Given reduced fiscal margins, **reaching decisions on EU priorities will be a challenge**. Conflicting pressures on budgets will continue as resources are required both to meet the objectives of the twin transition as well as fund measures to address the consequences of the war in Ukraine. Rising public dissatisfaction risks triggering **social unrest**. But the EU also has an opportunity to strengthen its vision of positive transformation replacing the model of unchecked consumerism, unlimited waste, and excessive resource extraction.
- As the economic costs of the war become clearer in the course of 2023, there is a risk of differences emerging between Member States over ongoing **support for Ukraine**. This could have spill-over effects on the Council's work and might undermine the strong show of unity to date in the face of Russian aggression.
- **Migration** will remain an extremely divisive issue, despite the pressing need to alleviate labour shortages. Faced with increased migratory pressures, discussions in 2023 are likely to focus on how to strengthen external borders, whilst progress generally on the **Pact on Migration and Asylum** risks remaining slow.
- **Extreme weather events** are set to hit Europe more frequently, bringing additional costs and putting solidarity to the test. But these could also provide further incentives to promote the green agenda and to continue to play a leadership role, including at COP 28 in Dubai.



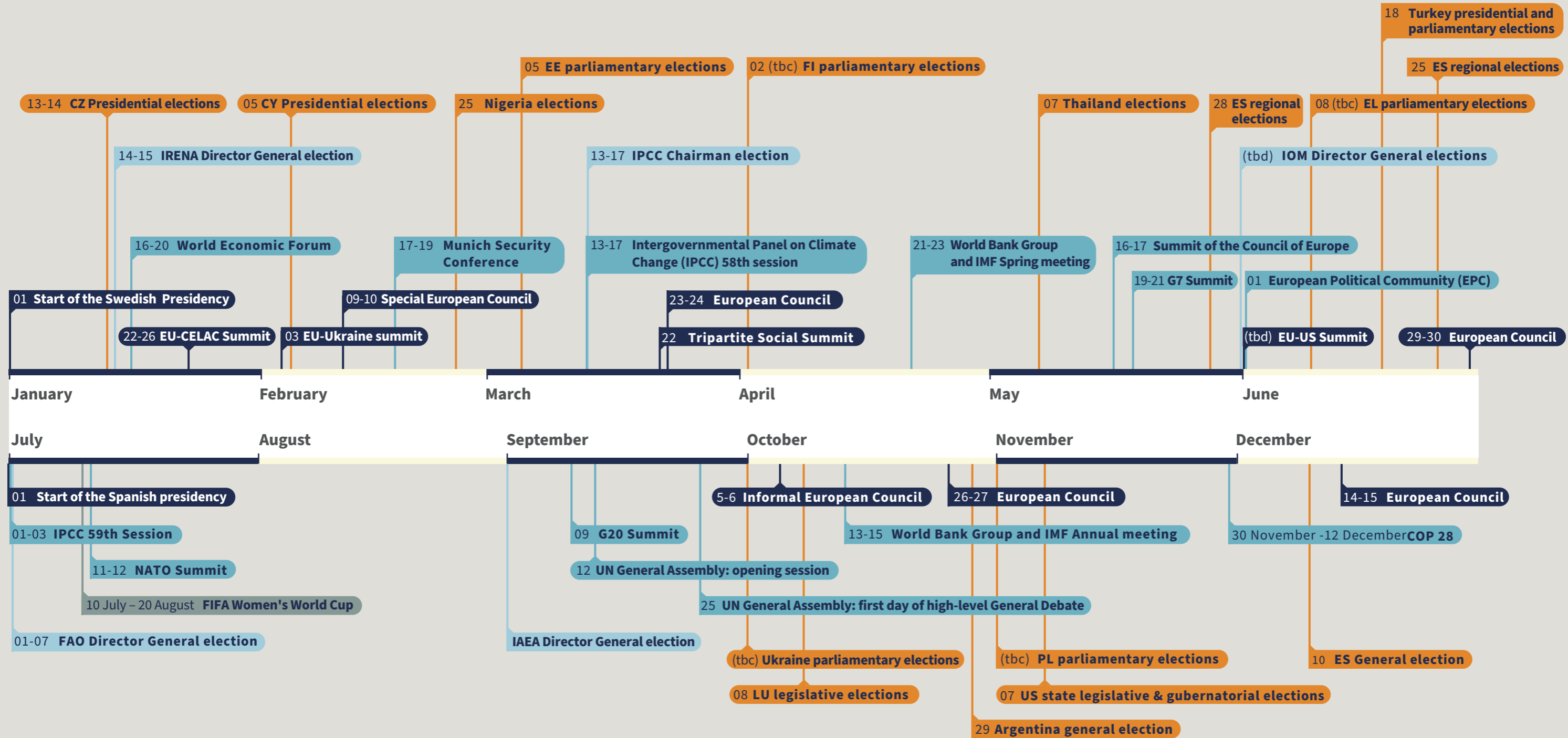
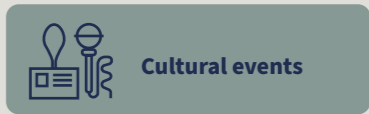


## Tensions between values and interests

- The **war in Ukraine** and related developments will continue to dominate the agenda of the Council. Increasing domestic dissatisfaction and growing economic pressure **could lead Russia to take even further hostile action** against the West. These actions could target energy supplies, refugee flows, computer systems (cyberattacks) or disinformation. Russia's key aim will be to generate divisions between Member States.
- The war has highlighted the vulnerability of Europe's **energy dependence** on Russia. 2023 will be a critical year for **managing the energy transition** and **establishing the EU's autonomy**, through diversification and the intelligent management of dependencies through a proper assessment of costs and benefits. Early planning will be needed to develop an effective strategy to **prepare for a more difficult winter in 2023/2024**.
- The EU has demonstrated that it too can **weaponize interdependencies**, as in the case of sanctions against Russia. But a more generalised recourse to weaponization risks leading to global fragmentation, and the EU will need to assess the extent and long-term impact of the **leverage it wishes to use** in support of its interests.
- Rapid changes in trade patterns are likely to require further reassessment of EU trade policy and a reflection on **how to manage trade in the long-term**. As the world's largest trading bloc, it is in the interest of the EU to maintain trade both as a deliverer of prosperity but also as a tool of influence. Addressing topical issues such as supply chain disruptions and access to raw materials will be of major importance (particularly if rising COVID infections in China start to impact on its export capacity).
- The international stance towards the war in Ukraine offers the opportunity to **reassess the EU's strategic position towards key countries**, regions, and continents such as China (EU-China summit in Beijing), India (EU-India summit, the Indian presidency of G20), Turkey (general elections in June), Mercosur (trade deal) and Africa.
- The EU remains largely dependent on the US in key areas such as defence, technology, and trade, but interests between the two sides of the Atlantic are increasingly divergent. The US trend towards a more protectionist trade policy risks undermining EU interests and will require a response. In general, the prospect of elections in the US in 2024 might suggest value in a more strategic EU review of the **transatlantic relationship**.
- The war in Ukraine provides an opportunity to **enhance EU security and defence policy**. The ongoing reflection on how Europe can become autonomous **with and beyond NATO** to defend its security interests is vital. This should include the EU's preparedness and resilience for security challenges such as sabotages and cyberattacks.

In 2023, leaders and ministers will be called upon to take tough decisions against a background of domestic and global tensions. In the run-up to the end of the EU political cycle, the **coordinating role of the European Council will be central**. Inevitably, discussions will tend to focus on issues that require immediate solutions. But in addressing the multiple crises, it will be important not to lose sight of the long-term consequences of more pressing decisions. It is only by **bringing together both the short and the long term** that the European Union can be better prepared not only to weather a fundamentally more challenging international context, but also help shape it in line with its own long-term interests.

# EVENTS TO WATCH 2023



**Not yet available:**

- EU-China Summit
- next TTC meeting
- EU-Western Balkan Summit
- EU-African Union Summit
- EU-Southern Neighborhood Summit

**No fixed date:**

- possibly Feb/March WFP Executive Director
- possibly before 30 Sept NATO Secretary General

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