

CAN EUROPE RESPOND TO ITS CHALLENGES?

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IESE, Madrid, July 8th 2004



Contents

- **European integration and the process of globalisation**
- **EU's Economic Performance: The European Model**
- **Challenges**
- **What should economic policy do?**
- **Conclusions**



European integration and the process of globalisation

- **Europe is favourably contributing to globalisation (One Market, One Money)**
- **Considerable institutional success**

Past:

- Enlargements 1986 (Sp, Port) and 1995 (Sw, Aus, Fin)
- Single Internal Market 1993
- Monetary Union 1999

Present:

- Central-Eastern European enlargement May 2004
- European Constitution

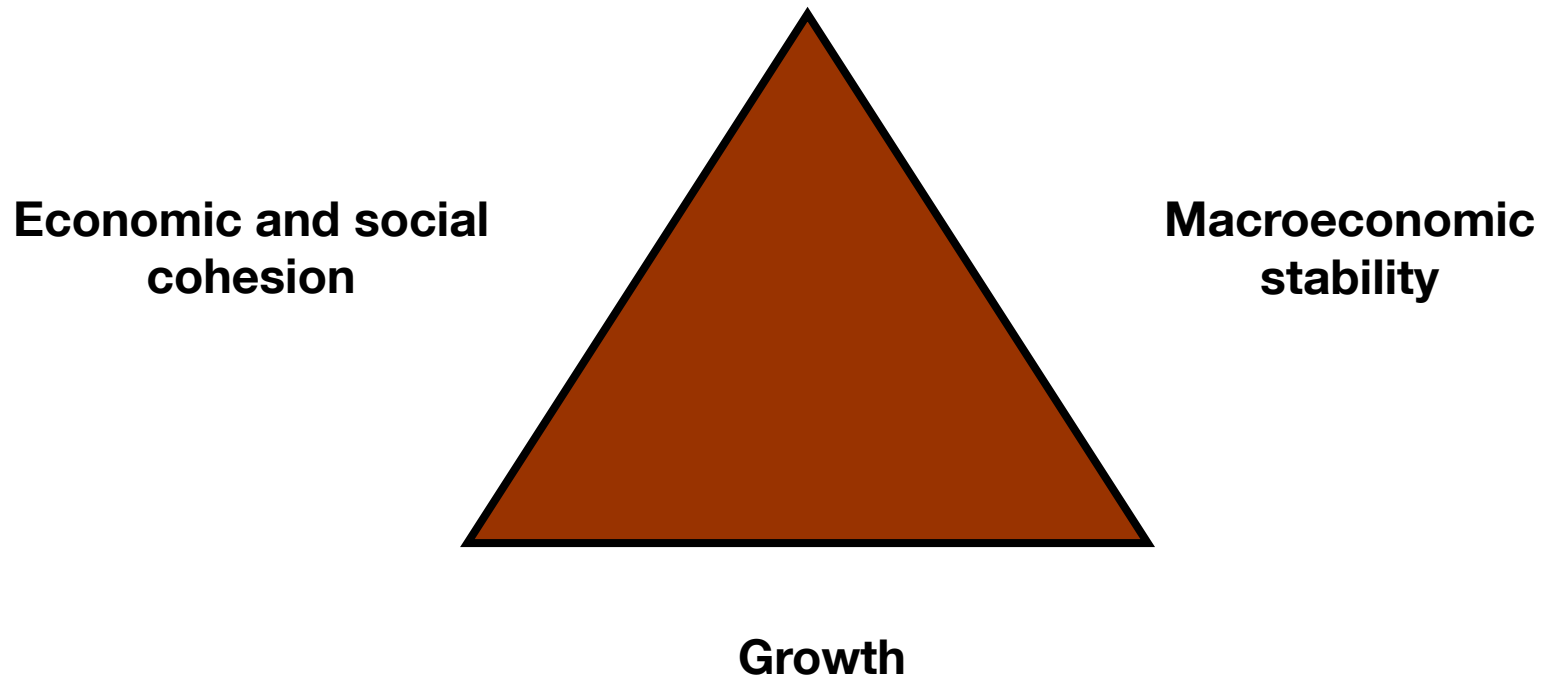


How is the EU economy performing?

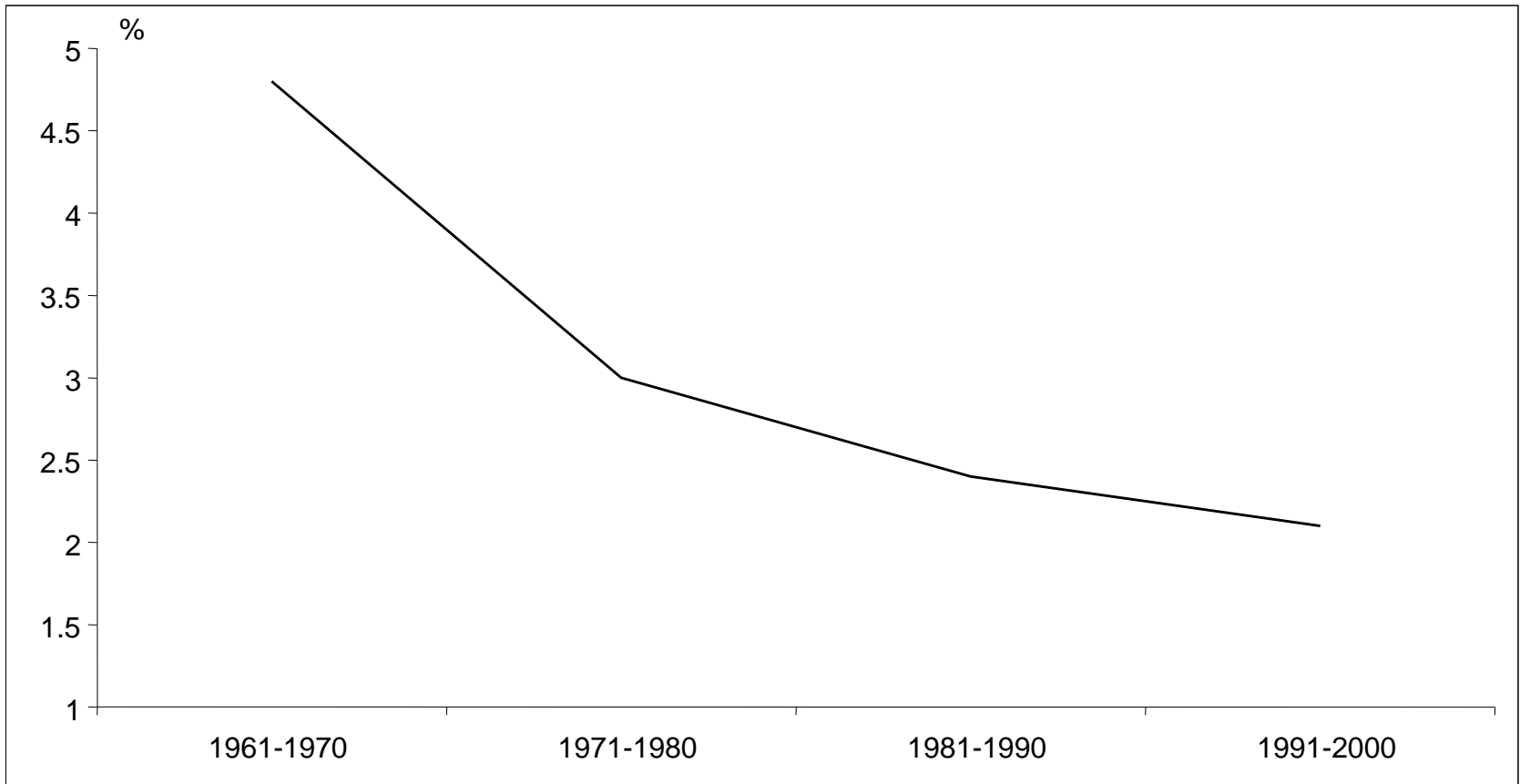
- **Long-term evolution is most useful also to understand present European problems and future prospects**
- **The European economic and social model**



The European economic and social model



Economic growth EU 15 (1960-2000)



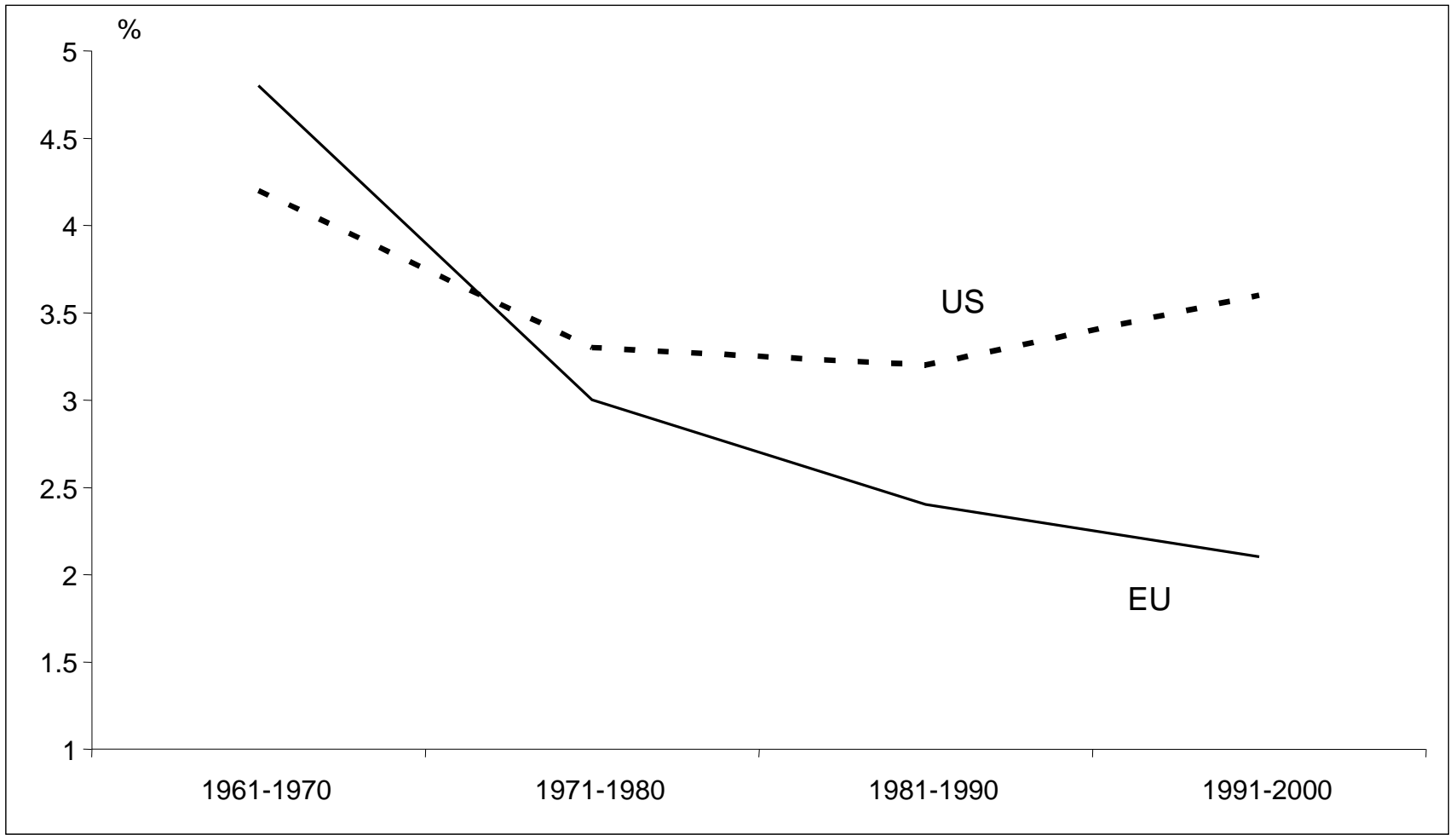


Growth malaise most worrying

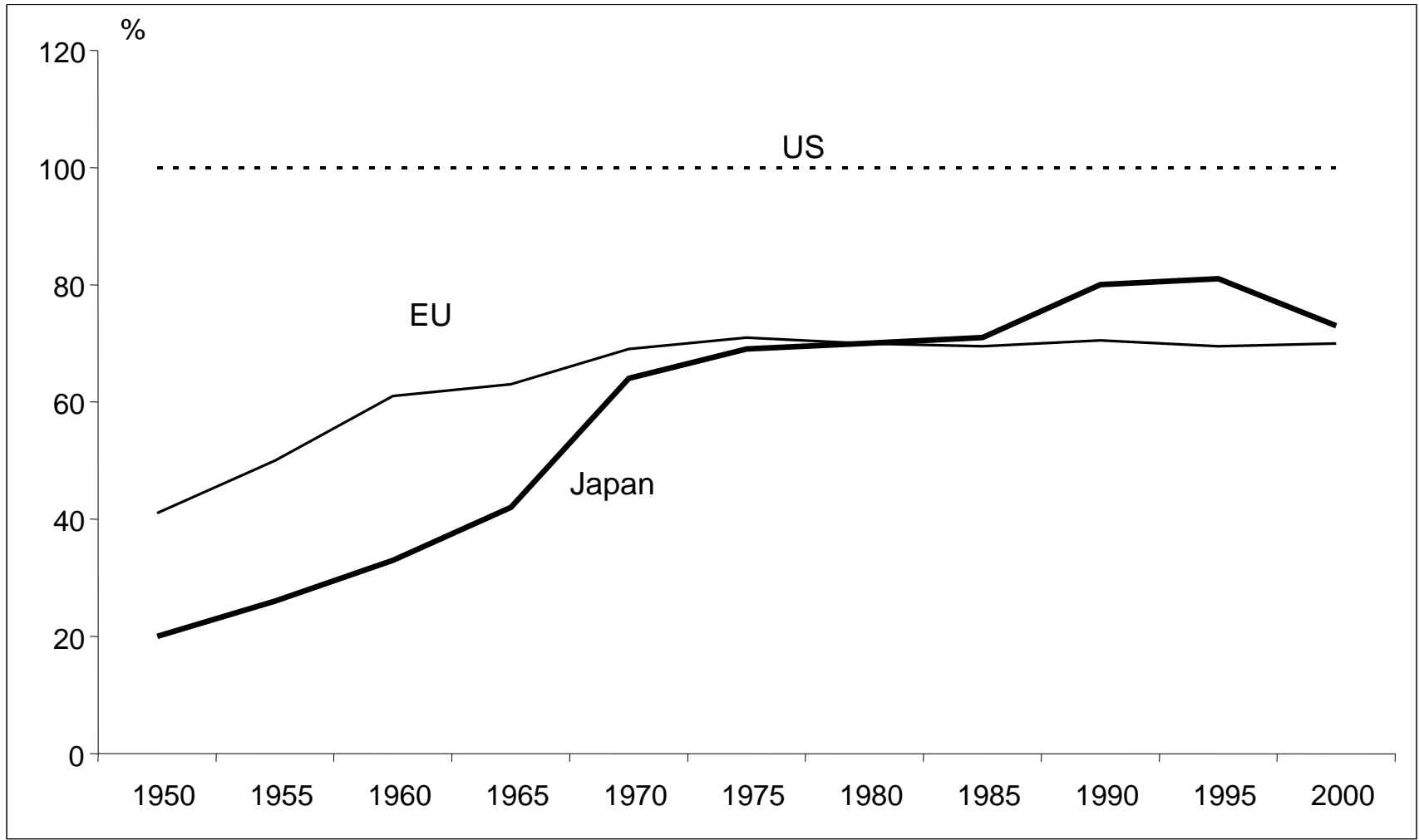
- **In spite of institutional progress**
- **Frustrating relative to the past**
- **Frustrating relative to expectations**
- **Frustrating relative to the US**



Economic growth: EU vs US

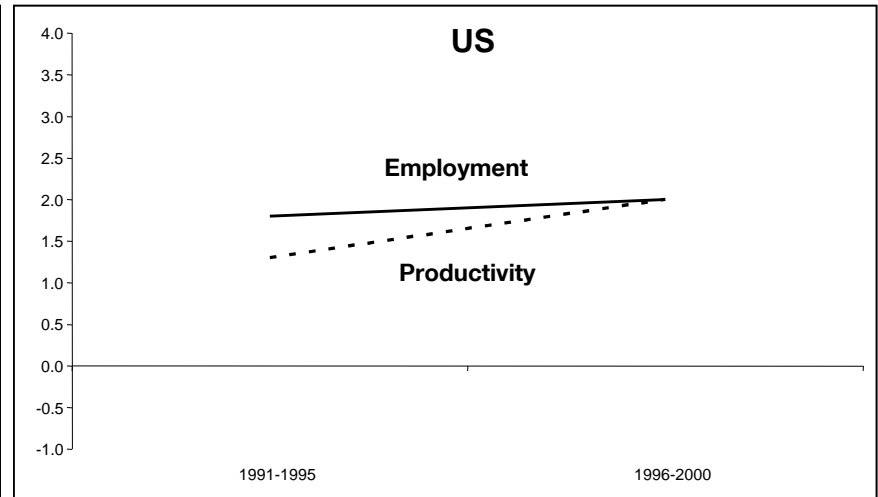
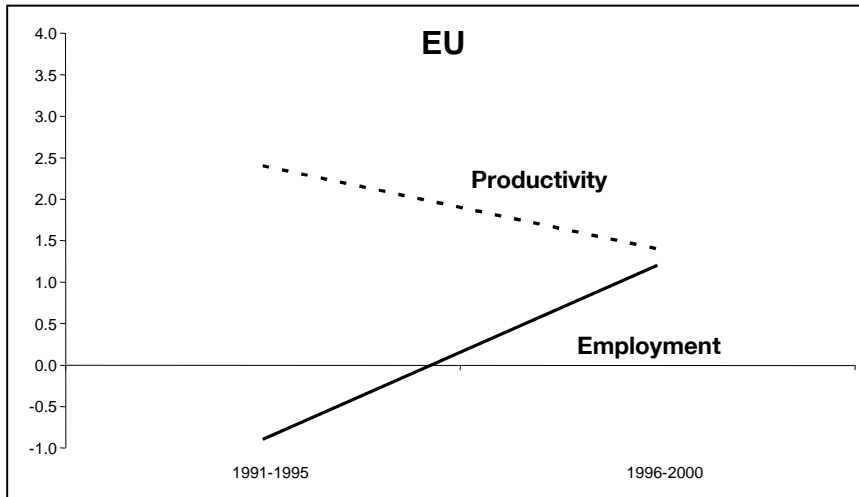
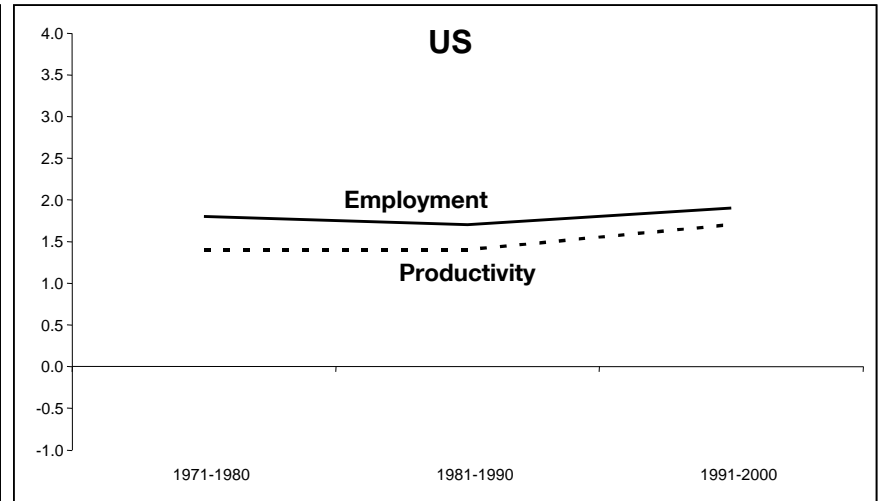
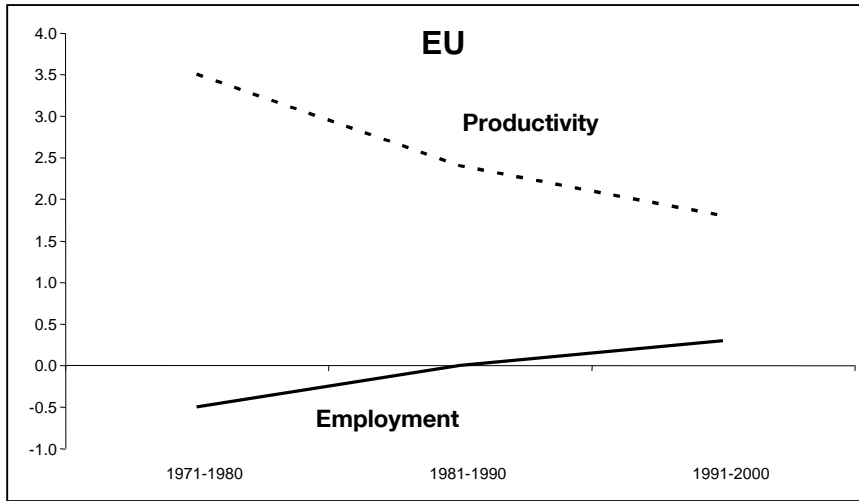


Per capita GDP (US = 100)





Productivity and employment growth: EU vs US

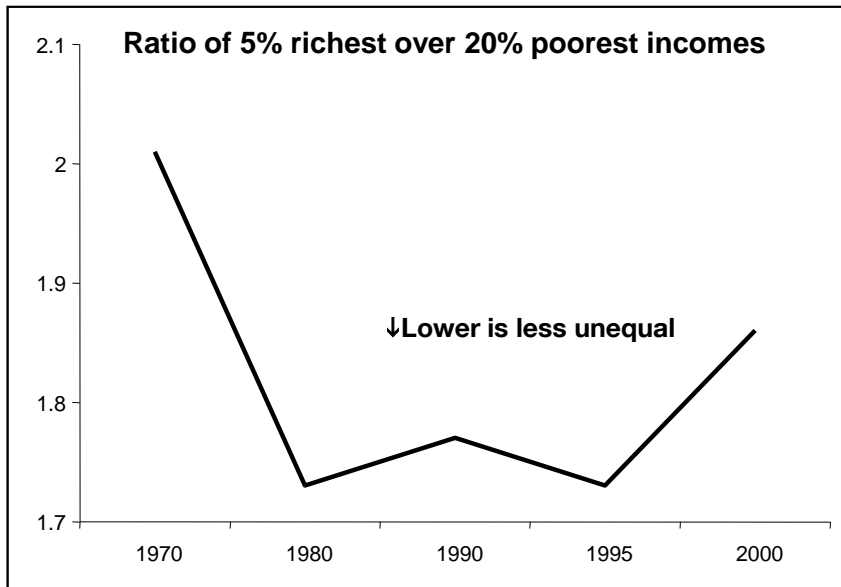




Macroeconomic stability: EU vs US

	1961-1970	1971-1980	1981-1990	1991-2000
EU				
Inflation	3.9	10.8	6.7	2.7
Cyclical instability	0.9	1.7	1.2	1.0
US				
Inflation	2.8	7.9	4.7	2.8
Cyclical instability	1.8	2.0	2.4	1.5
EU - US				
Inflation	1.1	2.9	2.0	-0.1
Cyclical instability	-0.9	-0.3	-1.2	-0.5

Income inequality in EU





European long-term economic performance: where do we stand?

- **Mixed performance of the European model**
 - Lights-macro stability and cohesion
 - Shadows-growth
 - Other factors?



What can explain such low growth?

- **Demography?**
- **Preference for leisure?**
- **Stability-oriented macropolicies?**
- **Other factors?**

Other factors

- **EU is not a country**
- **Growth has not been a priority**
- **Unfavourable European economic environment**
 - Supply-side problems
 - Innovation and competitiveness failures
 - *Little R+D+i*
 - *Insufficient tertiary education of quality*
 - *Uncompetitive product-markets*
 - Socio-economic cohesion systems very inefficient at both EU and national levels
 - *Inflexible labour markets*
 - *Inadequate tax systems*
 - Single market incomplete and not dynamic
 - *Financial system*



R + D expenditure (% GDP)

	<u>EU</u>	<u>US</u>
Total	1.9	2.6
Private	1.2	1.8
Public	0.7	0.8



Expenditure in tertiary education (% GDP)

	<u>EU</u>	<u>US</u>
Total	1.4	3.0
Private	0.3	1.6
Public	1.1	1.4



Europe recognises its problems

- **Lisbon Agenda (2000)**

- Ambitious goal: to become the most dynamic economic area by 2010 ...
- ... but inadequate means: voluntarism, no teeth.



Challenges

- **Achieve higher sustained growth while**
 - Consolidating macroeconomic stability
 - Maintaining an adequate degree of cohesion

- **Challenging environment**
 - Recent EU enlargement
 - Adverse demographics
 - Technological change
 - Globalisation



What is at stake?

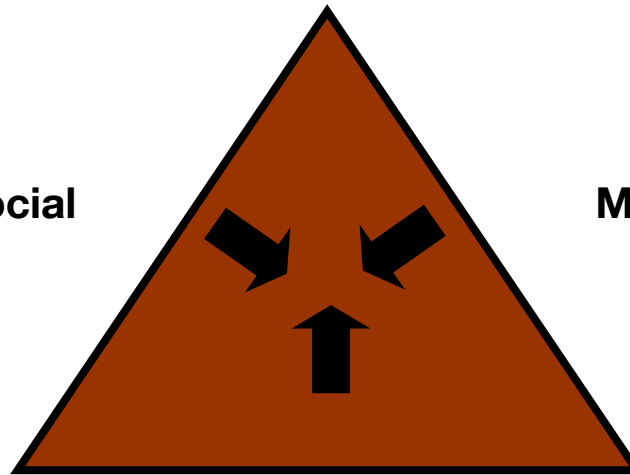
- **Success of enlargement**
- **Future standards of living of European citizens**
- **Sustainability of the European model**
- **Process of European integration**
- **Role of Europe in the world**

The European model under strain



Economic and social cohesion

Macroeconomic stability



Growth



Cornerstone

▪ **Low growth** →

- Threat to macro stability (budget deficits, inflation)
- Cohesion can no longer be financed

→ **even lower growth**

• **High growth needs** →

- Stable macro policies
- Modernised cohesion (incentive-compatible)



What should be done?

- **Growth must become the top priority for policy**
 - European
 - National
- **But fostering growth requires massive reforms**
 - Of economic policies at European and national levels
 - Of European economic governance (EU as a catalyst-facilitator)
- **Absolute need for a minimum degree of political consensus**
 - So far, very difficult to achieve (Germany, France, Italy)



To do list: National level

- Essential
- Germany is key to unblock reforms
- Which reforms?
 - *Goods and (particularly) services markets*
 - *Labour markets and cohesion policies*
 - *R+D+i+e*



To do list: European level

1. Complete Single Market and make it more dynamic
2. Boost investment in knowledge (R+D+i+e)
3. Redesign-modernise cohesion policies
4. Improve macroeconomic policy framework (more symmetry in fiscal and monetary policies)
5. Improve methods of economic governance
6. Refocus the EU budget

Conclusions

- Europe is nowadays at a cross-roads
- Economic problems are deep and structural
- Unless decisive change of course to place growth as the top priority
 - Standards of living of European citizens will stagnate or fall
 - The European model will not survive
 - The very process of European integration will be at risk
 - The role of Europe in the world will shrink further
- Diagnosis of problems and solutions is clear: fundamental growth problems requires focus on growth
 - Will there be the political will to act?
 - So far, no but some hope
 - *European Constitution is a positive step*
 - *Best way to ensure a reaction is to identify the very painful consequences of failing to react*



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1. Complete and make more dynamic the Single Market

- Financial services and integrated capital markets
- Regulatory & competition policies for new entry
- Policies to facilitate intra-EU labour mobility
- “Green cards” for 3rd country nationals
- Infrastructure for connecting up markets



2. More investment in knowledge

- Higher spending in R+D+i [1.9%=>3%] & higher education [1.4%=>3%]
- Better spending [several centres of excellence]
- Independent European Agency for Science and Research
- Tax credits for small start-ups



3. Redesign cohesion policy

- Fundamental change needed
- Cohesion and convergence
 - The best cohesion is to achieve real convergence
 - Goal: nations and not regions
 - Funding criteria: efficiency in generating value-added
- Restructuring
 - Deeply affects the Common Agricultural Policy
 - Eligibility criteria: restructuring need and a good proposal (value added rather than rents maintenance)
 - Comprises affected individuals in all Member States



4. More symmetric macro policy

- More effective & flexible implementation of SGP
 - Reinforce the role of the Commission
 - Create independent national Fiscal Auditing Boards
 - Foster higher surpluses-lower deficits in good times

- Better policy coordination
 - A consistent fiscal stance for the euro area
 - Reinforced dialogue euro area Council/ECB/Commission



5. Better economic governance

- Simpler and more effective decision-making needed in large, heterogeneous Europe
- Stronger EU enforcement of the Single Market (independent EU bodies, like Competition Agency)
- Better decentralisation of regulatory functions
- Incentives for implementing the Lisbon Agenda (role of the EU budget)
- Qualified majority voting

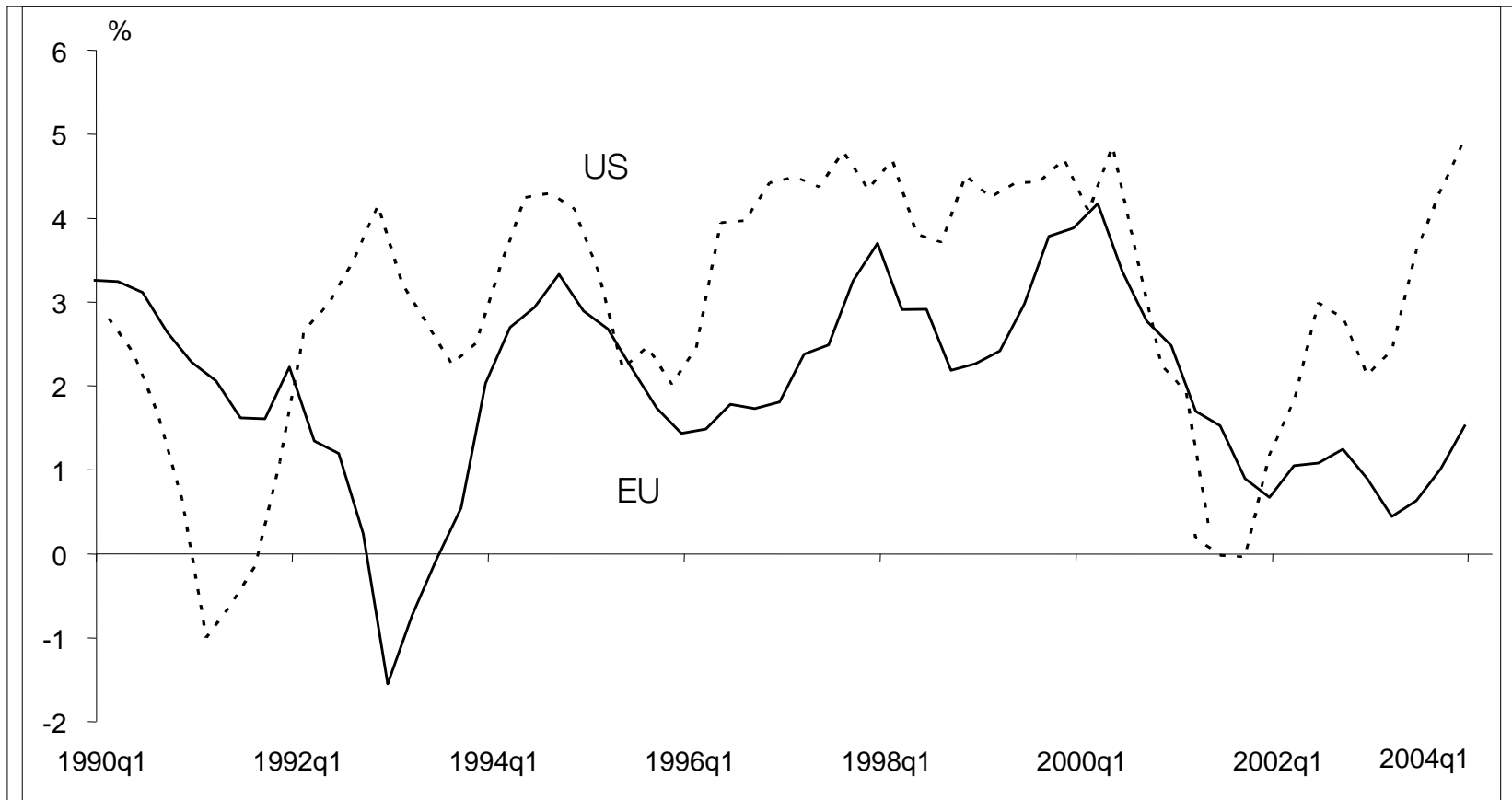


6. Refocus the EU budget

- Cohesion should be consistent with growth, not an impediment to it
- Reorganise radically economic expenditures, focussing on limited areas:
 - Growth fund (for the EU)
 - Convergence fund (for low-income countries)
 - Restructuring fund (for affected individuals)
- Revenues: target tax bases with EU dimension



Cyclical evolution EU vs US (1990-2004)





Países candidatos: indicadores básicos (a)

	PIB (% PIB UE)	PIB per cápita (b) (% media UE)	Población (millones)	Tasa de paro (% pobl. activa)
Chipre	0.11	74	0.6	3.9
Eslovaquia	0.25	47	5.4	19.4
Eslovenia	0.23	70	2.0	5.7
Estonia	0.07	40	1.4	12.4
Hungría	0.65	53	10.0	5.7
Letonia	0.15	33	2.4	13.1
Lituania	0.09	38	3.7	16.5
Malta	0.04	58	0.4	6.5
Polonia	2.23	40	38.6	18.4
República Checa	0.71	59	10.3	8.0
Países en adhesión	4.57	47	74.8	14.5
Bulgaria	0.17	24	8.5	19.7
Rumanía	0.50	24	22.4	6.6
Países candidatos	5.25	45	105.6	13.1
UE	100	100	377.5	7.2

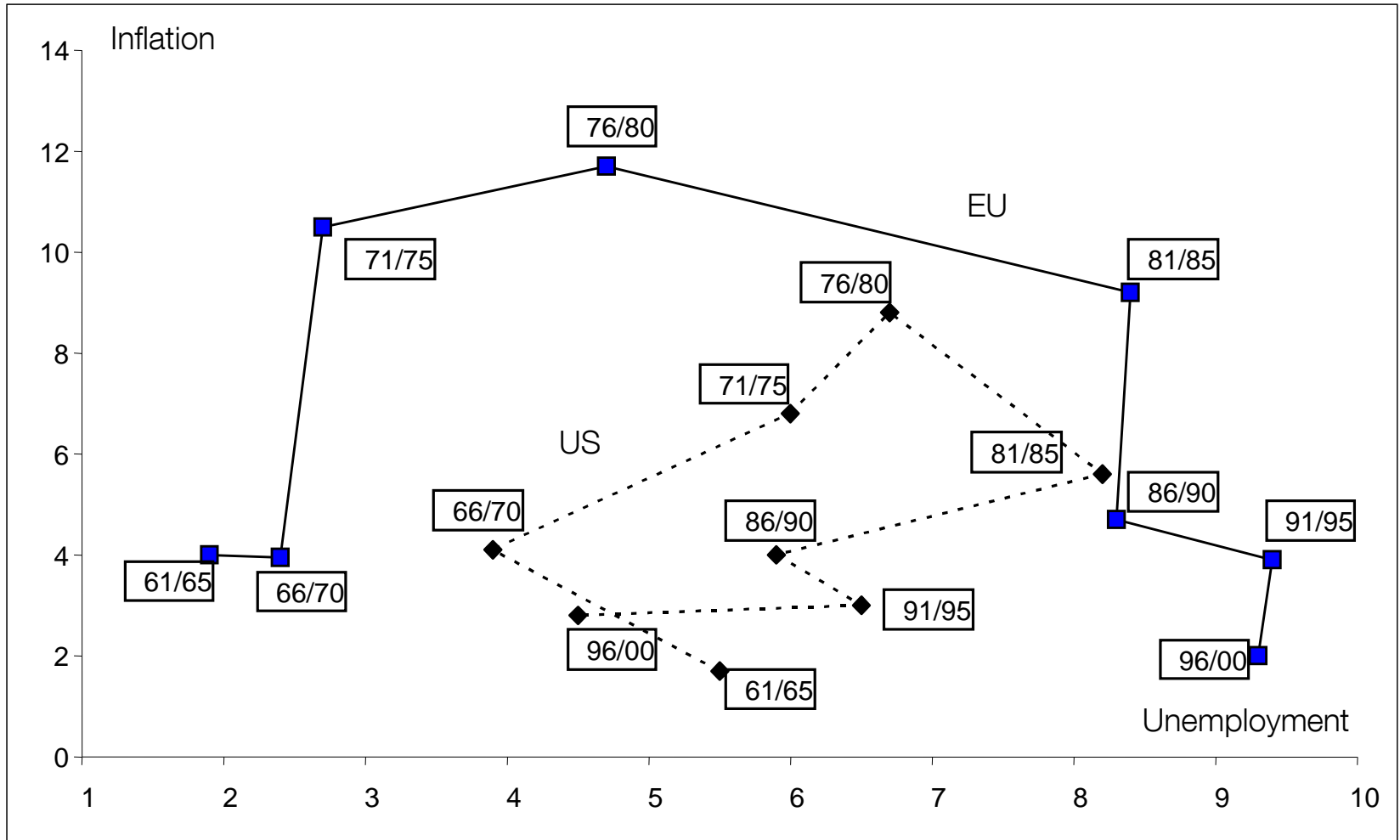
Fuente: Eurostat y Banco de España.

(a) Datos correspondientes a 2001.

(b) Medida en paridad del poder de compra.

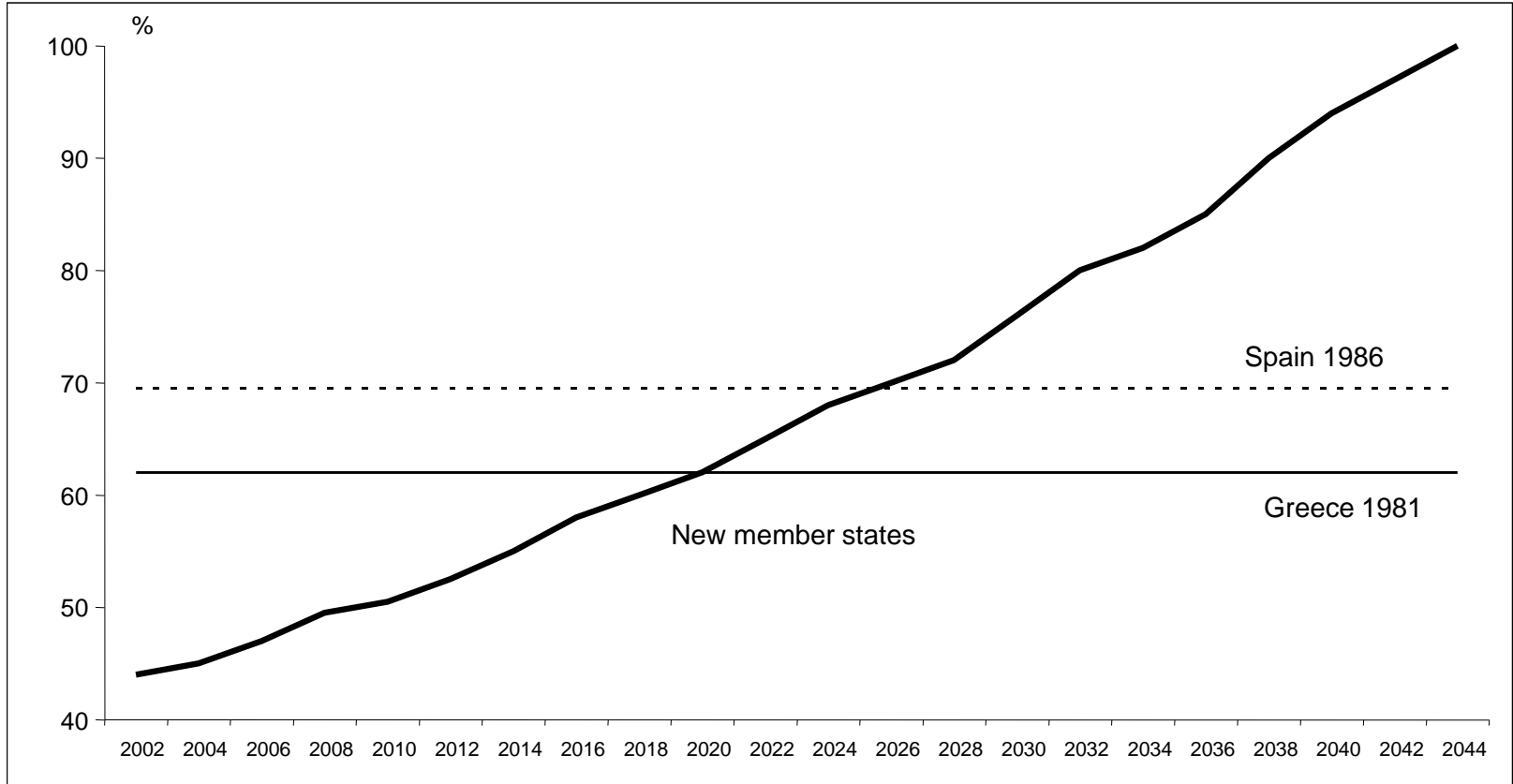


US vs UE: Philips Curves





Per capita GDP (% EU average)





Income inequality “within” and “between” countries in EU before and after Enlargement

	<u>“Within”</u>	<u>“Between”</u>	<u>Total</u>
UE - 15	0,152	0,008	0,160
UE - 27	0,149	0,064	0,213
