An Agenda for a Growing Europe

Report to European Commission president Romano Prodi of an Independent High-Level Study Group

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PLAN

1. Mission & caveats
2. Assessment: The EU performance
3. Assessment: The underlying factors
4. Challenges
5. Recommendations
Mission

• Analyse the consequences of two strategic goals for the current decade:
  – Making a success of the Lisbon Agenda
  – Making a success of enlargement

• Review entire system of EU economic policies

• Propose a coherent strategy for faster growth with stability and cohesion in the enlarged EU
Caveats

• Focus on the medium term (2010), rather than on short term considerations
• Economic approach
• Focus on EU and shared policies, rather than on purely national policies
• Take current budget ceiling (with ~1% for internal economic activities) as given
2. ASSESSMENT: THE EU PERFORMANCE
The EU performance in a nutshell

High institutional achievement
• Single Market
• Monetary Union

But mixed economic performance
• Progress on stability
• Better regional cohesion
• *Low growth*
• *Poor performance on major trade-offs*
Progress towards fiscal consolidation was made in the 1990s....
Catching-up is taking place...

- GDP per head in the major backward regions (Greece, Spain, Ireland, Portugal, East Germany and the Mezzogiorno) is converging towards EU level
But GDP per capita remains at 70% of US level

Per capita GDP at PPP
Trade-offs 1: Growth - stability

- In the 1960s, the EU had both more growth and more stability than the US
- The US has been able to improve on stability without reducing growth
- Europe has seen a reduction in growth without progress on stability
Trade-offs 2: Inflation – unemployment

Phillips

Inflation rate vs. Unemployment rate

- US
- EU15
Trade-offs 3: Productivity – employment

$R^2 = 0.7461$
3. ASSESSMENT: THE UNDERLYING FACTORS
The underlying factors

- **Micro** failures: outdated institutions
  - Institutions that were conducive to growth in the 1960s can be dysfunctional in the 2000s

- **Macro** failures: policy errors
  - Reforms of the policy regime have not delivered enough on cyclical behaviour / reactions to shocks

- **Governance** of the EU system: weaknesses
  - EU system of governance is increasingly complex, tension between responsibilities and instruments
Micro factors

- Failure to adapt the economic system based on
  - Assimilation of existing technologies
  - Mass production
  - Large firms with stable markets & labour relations

- Failure to become an innovation-based economy
  - Not enough emphasis on entry
  - Low labour mobility within & across firms
  - Not enough retraining
  - Low investment in R&D and higher education (1.4% of GDP against 3% in the US !)
Illustration: Much less growth of new firms in Europe than in the US
Macro factors

• Significant macroeconomic policy errors in the past decades
  – Reaction to oil shocks
  – German unification

• Progress with EMU but problems remain
  – Overall policy stance
    • MP: right ‘sign’, questions on predictability and speed
    • FP: wrong ‘sign’ in 2000
  – National fiscal policies: procyclical bias in 2003
  – Difficulty in designing one-size-fits-all monetary policy
Illustration: Procyclical features of the Euro-area policy mix
The EU system of governance

- Genuine type of federalism
- EU governance based on a variety of methods
  - Delegation (of specific responsibility) to a EU institution
  - Commitment by MS to abide by EU rules (hard coordination, with sanctions)
  - Coordination of MS policies towards common goals (soft coordination)
  - Autonomy of MS
- Move towards a « shared competence » model but lack of instruments to make coordination effective
  - Voluntary coordination lacks teeth
  - Sanction approach lacks positive incentives
## Illustration: EU governance methods

<table>
<thead>
<tr>
<th></th>
<th>Micro</th>
<th>Macro</th>
</tr>
</thead>
<tbody>
<tr>
<td>Delegation</td>
<td>Trade, CAP</td>
<td>Monetary policy</td>
</tr>
<tr>
<td>Commitment</td>
<td>State aids</td>
<td>Fiscal policy (Art. 104)</td>
</tr>
<tr>
<td>Coordination</td>
<td>Labour markets</td>
<td>Fiscal policy (Art. 99)</td>
</tr>
<tr>
<td>Autonomy</td>
<td>Direct taxation</td>
<td>Level of spending</td>
</tr>
</tbody>
</table>
4. CHALLENGES
Set the priorities

• The #1 priority for the EU must be growth
• Growth is the *sine qua non* condition for
  – the sustainability of the social model
  – the success of enlargement
  – the sustainability of the European ‘contract’

Otherwise, risk for process of European integration

• Increasing growth requires:
  – To give priority to growth-enhancing policies
  – To reform economic policies and their delivery modes (EU governance and budget)

• (To govern is to choose, in Europe too)
Address the challenges

• Respond to exogenous shocks: demography, technology, globalisation

• Respond to domestic transformations:
  – Higher ambition: Lisbon
  – More diverse Europe: Enlargement
  – More complex system: EMU / two-speed Europe

• Enlargement is an opportunity and a challenge for implementing reforms
Make the EU system deliver

• Post-Lisbon EU:
  – High ambitions, weak instruments
  – Either give up on objectives or adapt instruments

• Keys to change
  – Act both at EU and national levels
  – Avoid targeting several goals with one instrument
  – Give the EU the role of a « facilitator » (less sticks, more carrots)
  – Use the leverage of the budget to improve governance
4. RECOMMENDATIONS
A six-point agenda

• Policies for promoting growth
  1. Make the Single Market more dynamic
  2. Boost investment in knowledge
  3. Improve the macro policy framework
  4. Redesign policies for convergence & restructuring

• Modes of delivery
  1. Achieve effective economic governance
  2. Refocus the EU budget
Four sets of policies
1. A dynamic Single Market

Complete the Single Market
- remains the #1 economic pillar
- (including financial services)
- enforce existing regulations

• Focus more on **new entry**
  - regulatory & competition policies

• Facilitate intra-EU **labour mobility**
  - Support mobility of EU residents
  - “Green cards” for 3rd country nationals

• **Infrastructure investment** for connecting up markets
2. Invest more and better in knowledge

More
- Higher spending for
  - research [1.9% => ~3%]
  - higher education [1.4% => ~3%]
- Start spending already in the coming years (address compatibility with SGP)

Better
- Scientific excellence rather than juste retour
- Independent European Agency for Science and Research [for academic research, like NSF in US]
- Tax credits for research by small start-ups
The EASR proposal

• Independent agency
• No ex ante allocation per country
• Bottom-up approach
• Peer review
• Accountable but autonomous in its operation
3. A more symmetric macro policy

- **Better budgetary surveillance**
  - Reinforce role / responsibility of the Commission
  - Create independent national Fiscal Auditing Boards (without policymaking responsibility)

- **More effective & flexible implementation of SGP**
  - Higher degree of country differentiation based on debt
  - “Exceptional conditions” for deficit > 3%: growth < 0 rather than <-2%
  - Voluntary rainy-day funds

- **Better policy coordination**
  - Eurozone council responsibility for Eurozone decisions
  - A European stability programme
  - Reinforced dialogue euro area Council/ECB/Commission
4. Convergence & restructuring

• Convergence policy
  • Target: low-income countries rather than regions
  • Implementation: also through regions
  • Eligibility criteria: income & performance conditionality
  • Priority action: administrative capacity (earmarking)
  • Other actions: human & physical investment (free allocation)

• Restructuring policy
  • Target: affected individuals in all Member States
  • Implementation: through Member States
  • Eligibility criterion: restructuring need
  • Actions: re-training; re-location; new ventures
  • Some sectoral earmarking (agriculture)
Two modes of delivery
1. Better economic governance

- A leaner Commission (15)
- A clearer system of multi-level governance:
  - Procedures rather than catalogue for competence assignment
  - Devolution of some funding & regulatory functions to independent EU bodies
    - academic science & research,
    - anti-trust & mergers
  - Structured decentralisation of regulatory functions
- More effective mechanisms:
  - more QMV
  - Incentives for implementing shared priorities
2. Restructure the EU budget

Aims
– A more flexible budget to target EU priorities
– A focus on common goals, getting rid of *juste retour*

Means
• **Reorganise economic expenditures:**
  • Growth fund (for the EU)
  • Convergence fund (for low-income countries)
  • Restructuring fund (for affected individuals and sectors)
• **Reform revenues:** target tax bases with EU dimension
• **New procedures**
  • QMV for financial perspectives
Illustration of a possible EU budget
(re-allocating current ~1% of EU GDP for
internal economic activities)

- **Growth** 0.45
  - (R&D) (0.25)
  - (Education & Training) (0.075)
  - (Infrastructure) (0.125)

- **Convergence** 0.35
  - (For new Member States) (0.20)
  - (For old Member States) (0.10)
  - (Phasing out for macro-regions) (0.05)

- **Restructuring** 0.20
  - (For displaced workers) (0.05)
  - (For agriculture) (0.05)
  - (Phasing out of agricultural expenditure) (0.10)

- **Total** 1.00
Consequences for CAP & SF

- **CAP**
  - Decentralise to MS spending on rural development
  - Keep funds for agricultural restructuring (+ phasing out)

- **SF**
  - Earmark *convergence* funds for [poor] countries, not regions (except phasing out)
  - Allocate *growth* funds irrespective of country / territorial criteria
  - No EU responsibility for interregional redistribution, but:
    - Regional programmes still have a role under growth / convergence / restructuring funds
    - Regions can still be partners in definition / implementation / monitoring