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The Case Against Europe's 2020 Agenda

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SUMMARY

The European Union has set out a new strategy for growth and competitiveness. A successor to the Lisbon agenda, the 2020 strategy aims to usher Europe into an era of smart, sustainable and inclusive growth. It is of tremendous importance that Europe speeds up growth. Fiscal stabilization can never be achieved without growth, and many countries in Europe are facing great future challenges to its fiscal policy.

However, the 2020 strategy is not going to deliver neither growth nor pro-growth reforms. Like its predecessor, it is a confused strategy with conflicting ambitions. Core areas for policy reforms at the European level are missing in the strategy. In its current form, it will soon be forgotten, if not gone.

At the heart of the strategy is a erroneous notion that Europe is such a unified

economy that a central strategy works for all countries. Furthermore, it lives and breathes the sort of pop internationalism that presents economic success in other parts of the world as a threat.

The current 2020 strategy should be put in the bin. There is no point toying with marginal changes. It is the fundamentals that must change.

THE CAMPAIGN FOR a “growth and competitiveness agenda” for the European Union is once again revving up. This time it is called the EU 2020 strategy and aims, modestly, to shepherd Europe into a new era of reforms to advance “smart, sustainable and inclusive growth”.

The timing of this initiative could hardly be better. In the whirlwind of the new European debt crisis, EU countries need to advance an agenda of pro-growth economic reforms to make any promise of fiscal stabilization credible. There is a limit to fiscal stabilization through cuts in expenditures and tax increases;

without higher economic growth it will be tremendously difficult to balance budgets and substantially bring down debt levels in Europe. The European Commission has estimated EU public debt to rise to 120 percent of GDP over the next decade, and behind this rise hides many other factors than current cyclical deficits.² Hence, getting EU countries on a new growth trajectory is almost an existential matter.

Furthermore, Europe needs a pro-growth agenda to harness its policy now when the Lisbon agenda has expired. The Lisbon agenda certainly had its weak-

TABLE 1. DECOMPOSING EU GROWTH: AVERAGE GDP GROWTH PER CAPITA 1998-2007

| <2% | | 2-3% | | 3-4% | | 4-5% | | >5 % | |
|----------|-----|-------------|-----|------------|-----|-----------|-----|-----------|-----|
| Italy | 1 | Netherlands | 2,1 | Finland | 3,3 | Slovenia | 4,2 | Ireland | 5 |
| Germany | 1,5 | Austria | 2,2 | Czech Rep | 3,5 | Hungary | 4,3 | Bulgaria | 5,9 |
| Portugal | 1,5 | UK | 2,4 | Greece | 3,7 | Poland | 4,3 | Lithuania | 7,2 |
| Denmark | 1,6 | Cyprus | 2,4 | Luxembourg | 3,9 | Romania | 4,4 | Estonia | 7,8 |
| France | 1,7 | Spain | 2,5 | | | Slovak ep | 4,9 | Latvia | 8,7 |
| Belgium | 1,8 | Sweden | 2,9 | | | | | | |
| Malta | 1,8 | | | | | | | | |

Source: World Bank

nesses. It also failed to deliver on its promise: to make Europe the most competitive economy by 2010. What European leaders agreed in the Portuguese capital a little more than ten years ago turned out to a confused strategy with conflicting ambitions. Absent reform delivery by the member states, the agenda lost traction after a few years. And the closer the agenda got to its end, the more anemic it became. All countries chairing Europe's rotating presidency in the past three years have allegedly "prioritized" the Lisbon agenda, but every member state has only considered it in a perfunctory way. It was forgotten, but not gone. The 2020 strategy, however, could redress the imbalance between high ambitions and low reform activity by a new smart strategy that puts greater pressure on member states to deliver.

Now, this may sound like a good pitch for the 2020 agenda; the only problem with it is that it is true only in theory. The proposed 2020 agenda is far away from being a policy strategy that could deliver growth. It is rich on rhetoric but poor on actual policy reforms. Many of the suggested reforms have – kindly put – very little to do with economic growth; some of them can hamper rather than help growth. Finally, there is nothing in the strategy now that suggests member states to become more incentivized – by carrots or sticks – to reform their economies by this agenda than the last time around. If the EU wants a growth strategy true to its ambition, there is no alternative than to put the 2020 agenda in the bin and start anew.

LIMITS TO GOVERNMENT-INDUCED GROWTH

The 2020 strategy has fired up the chattering classes in Brussels. But it is a sign of the ambitions and the profile

of the strategy that it panders mainly to those who believe governments can steer economies to growth and that the solution to every economic problem in Europe is stronger policy harmonization. Such views are not only mistaken intellectually. They also contradict key pillars of the European growth experience – recent as well as past.

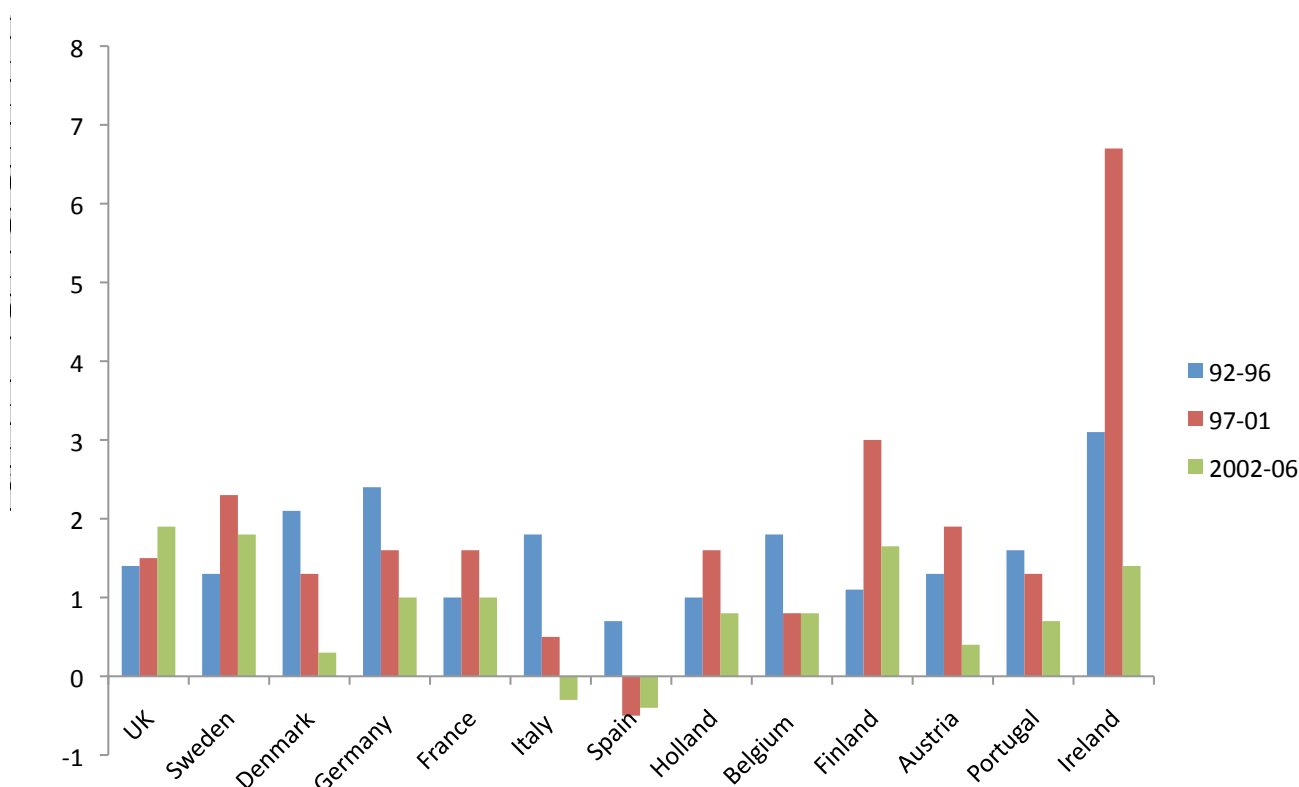
First, economic performance in Europe has always been diverse (see Table 1). Before the onset of the crisis Europe had some high-growth countries and some laggards. The oft-expressed view of Europe as a region of sclerotic growth, a general lack of dynamism, and on the inevitable decline in the new world of globalization and rising economic powers in the Far East, is certainly true for some countries. But as a review of all countries of Europe, it is certainly false. Some countries in Europe, also among "older" Europe, have rather performed well over the past decade. The growth laggards – some of whom picked up growth rates in the years immediately before the crisis – are the usual suspects. It might come as a surprise to some that Germany and Denmark belong to the group with the poorest rate of growth. It should not. Germany had many difficult years in the 1990s and early 2000s; GDP per capita growth was negative in 2002 and 2003. Denmark had three years of almost zero per-capita growth in the early 2000s. The Baltic countries, on the other hand, experienced very rapid growth.

Secondly, a managerial, visible-hand approach to European growth policy neglects the important growth-enhancing role played by institutional competition between European countries over the past 50 years.³ Most forcefully, institutional competition has been pushed by the reduction of barriers to trade within Europe. Such reforms,

TABLE 2. AVERAGE LABOUR PRODUCTIVITY GROWTH

| Period | Belgium | Denmark | Finland | France | Germany | Italy | Holland | Austria | Sweden | Spain | UK | US | EMU |
|-----------|---------|---------|---------|--------|---------|-------|---------|---------|--------|-------|-----|-----|-----|
| 72-76 | 4,7 | 4,2 | 1,5 | 3,7 | 4,3 | 4,1 | 5,4 | 4,8 | 2,5 | 4,9 | 2,3 | 1,3 | 4,2 |
| 77-81 | 2,9 | 1 | 3 | 3,6 | 2,4 | 2,7 | 1,7 | 3,3 | 1,7 | 4,4 | 1,9 | 1,1 | 3 |
| 82-86 | 2,2 | 1,6 | 3,1 | 3,1 | 2,1 | 2,6 | 2,7 | 2,7 | 1,3 | 4,1 | 2,9 | 1,5 | 2,6 |
| 87-91 | 2,4 | 2,3 | 2,8 | 2,6 | 3,1 | 2,4 | 1,9 | 3,1 | 0,9 | 1,4 | 1,3 | 1,3 | 2,5 |
| 92-96 | 2,4 | 2,6 | 3,1 | 1,7 | 2,4 | 2,6 | 1,4 | 1,7 | 2,1 | 1,7 | 2,6 | 1,5 | 2,2 |
| 97-01 | 1,3 | 0,8 | 2,5 | 2 | 1,9 | 1,1 | 1,5 | 2 | 2,2 | -0,2 | 2,2 | 2 | 1,5 |
| 2002-2006 | 1,6 | 1,4 | 2,8 | 1,7 | 1,4 | 0,2 | 1,3 | 1,4 | 2,6 | 0,2 | 2,1 | 2 | 1,1 |

Source: European Commission (2008), *The Impact of EMU on Growth and Employment*. Economic Papers 318, April 2008.

FIGURE 1. AVERAGE TOTAL FACTOR PRODUCTIVITY GROWTH

Source: European Commission (2008), *The Impact of EMU on Growth and Employment*. Economic Papers 318, April 2008.

accomplished by policy harmonization, have exposed domestic institutional structures for greater competition. They have been guided by *proscriptive* rules of harmonization, a view that emphasizes a “negative” agenda: simple and transparent rules of conduct for what governments cannot do. They are in opposition to *prescriptive* rules of policy, instructing actors what to do and how to behave. It is policy harmonization based on the latter view that

lately has come to guide much of the integrationist agenda in Europe and, by accident or design, diluted the forces of institutional competition.

Thirdly, the belief that one central strategy can fit the entire European Union – 27 economies with different reform needs and priorities – borders on a central-planning mentality that can only do damage to economic growth.

Too often, European policymakers fall victim to their own rhetoric and view Europe as a uniform economy. Such a view has political appeal. It also panders to those countries that are poorer, less productive and have an overall less advanced industry or services sector. Nevertheless, it is an uninformed view. There are significant differences – even if all the new member states (who are at a different development level) are excluded from the analysis. Labour productivity and total productivity growth differ quite substantially between EU countries and over time (see Table 2 and Figure 1). The balance between export and consumption as source for growth also differs significantly (see Table 3).

TABLE 3. AVERAGE EXPORT AND FINAL CONSUMPTION GROWTH, 2002-2007

| | Average Export Growth Rate (%) | Average Final Consumption Expenditure Growth Rate (%) |
|----------|--------------------------------|---|
| Germany | 7,66% | 1,47% |
| Ireland | 4,70% | 8,63% |
| Greece | 6,82% | 7,32% |
| Spain | 6,53% | 7,44% |
| France | 3,07% | 4,21% |
| Italy | 4,92% | 3,70% |
| Hungary | 11,68% | 9,52% |
| Poland | 14,29% | 5,97% |
| Portugal | 6,44% | 4,45% |
| Slovakia | 18,78% | 13,89% |

Source: Eurostat

While Germany has grown in the past years through an expansion of industrial value-added (up by 5 percent in the five years prior to the crisis) the United Kingdom shrunk industrial production and expanded value-added in services (industrial value-added fell by 15 percent in the five years prior to the crisis). The ratio of services-to-industrial export fell in Germany and Sweden while it increased rapidly in Spain and the United Kingdom. The profile of services export in Spain and the United Kingdom, however, differs fundamentally and the differences have nothing but increased over the past decade. Overall, EU countries have their comparative advantage in different service sectors (see Table 4). This is good news: increasing specialization in trade reflects increasing specialization of production. The greater the divergences are

within Europe, the more Europe stands to benefit from borderless trade. However, for those charged with forging an agenda for growth, such differences present political and administrative difficulties.

THE FEAR OF NEW ECONOMIC POWERS

THE LISBON AGENDA had some good targets that, if met, would have benefited all economies. It called for a borderless market for services and shepherded in some deregulation in sectors such as telecommunications. But if that agenda put too little emphasis on freeing up Europe for commerce, there is hardly anything of that caliber in the 2020 strategy. Once the 2020 strategy enters into to concrete policy reforms, it is striking how woolly the language gets. And when it does say something, it is notable how it contradicts many of the central elements of the commercial policy reforms in the Lisbon strategy. There has clearly been a shift from soft market liberalization to soft industrial policy activism.

It is important to correct a misunderstanding or misconception that is at the heart of the conceptual thinking behind the strategy. The same misconception was on display in the Lisbon agenda and the grand trade strategy – Global Europe – that was “annexed” to the previous growth agenda. Worryingly, this misconception has lately also been growing in Europe (and other parts of the world). And the misconception is that competitiveness and increasing competitiveness equal global commercial dominance in *all* sectors.

This is a perception that feasts on fear—a fear similar to the trans-Atlantic doomsday notion in the 1980s that Japan would out-compete Europe and the United States. It may be seen as a silly notion today that America and Europe in the 1980s seriously feared a Japanese onslaught on their welfare. But back in the 1980s the perception of Japanese commercial dominance caused widespread anxiety and guided Europe and the United States in a soft protectionist direction.

Voluntary Export Restraints (VERs), Orderly Market Arrangements (OMAs) and other mostly nontariff barriers was part of the response against the alleged Japanese commercial onslaught. In the 1980s, American car manufacturers were protected by VERs that restricted the number

TABLE 4: REVEALED COMPARATIVE ADVANTAGE FOR EU COUNTRIES IN SERVICES TRADE

| | Transport | Travel | Communication | Construction | Insurance | Financial | Computer/ Information | Royalties | Other business | Personal |
|----|-----------|--------|---------------|--------------|-----------|-----------|--------------------------|-----------|-------------------|----------|
| BE | | | | X | X | | | | | |
| BG | | X | | X | | | | | | |
| CZ | | | | X | | | | | X | |
| DK | X | | | | | X | | | | |
| DE | X | | | | | | | | X | |
| EE | | | X | X | | | | | | |
| IE | | | | | X | | X | | | |
| EL | X | X | | | | | | | | |
| ES | | X | | X | | | | | | |
| FR | | | | | | | | | X, X | |
| IT | | X | | | | | | | | |
| CY | | X | | | | | | | | X |
| LV | | | | X | | | | | | X |
| LT | X | | | X | | | | | | |
| LU | | | | | | X | X | | | |
| HU | X | X | | | | | | | | |
| MT | | | | | | | | | X | X |
| NL | | | X | | | | | X | | |
| AT | X | | | | | | | | X | |
| PL | | | | X | | | | | X | |
| PT | | X | | X | | | | | | |
| RO | | X | | X | | | | | | |
| SI | X | X | | | | | | | | |
| SK | X | | | | | | | | X | |
| FI | | | X | | | | X | | | |
| SE | | | X | | | | X | | | |
| UK | | | | | | X | | | X | |

Source: Eurostat; own calculations

of Japanese cars exported to the United States. The European Community negotiated a similar agreement with Japan in 1983. To further restrict Japanese exports, some European governments imposed “local-content requirements” on the cars produced in Europe by companies such as Nissan and Toyota.⁴ Many other sectors, e.g. semi-conductors and videocassette recorders (VCRs), were also protected by VERs or similar measures.⁵

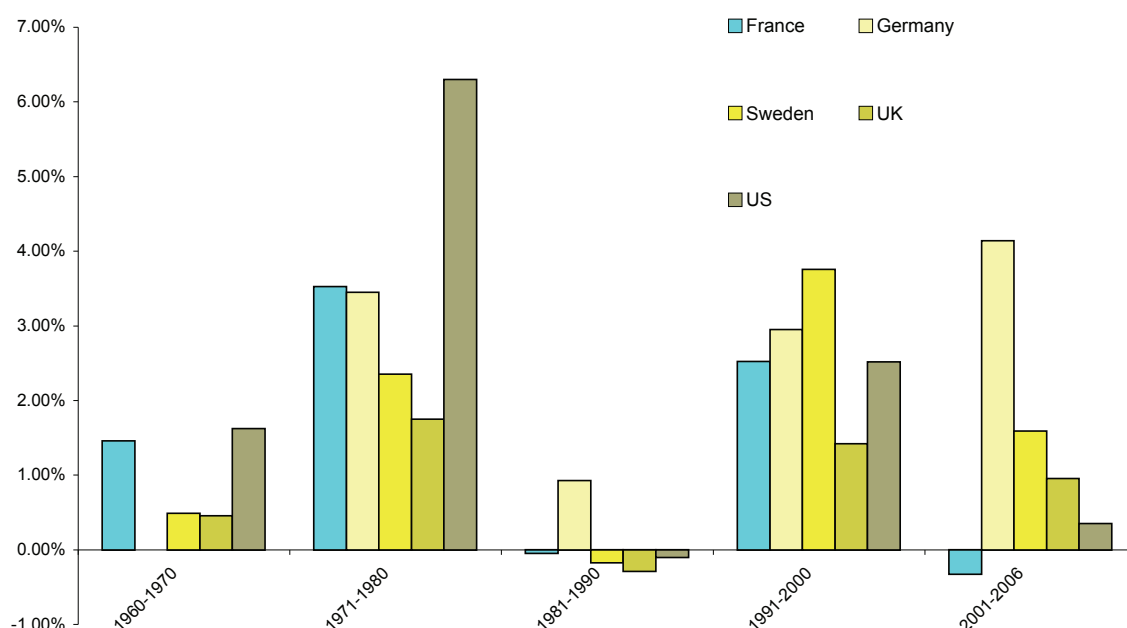
The European steel sector was awash in subsidies. British Steel, owned by the British government, received subsidies through the 1970s and early 1980s that averaged 40 per cent of the export price. The United States defended its steel producers with higher tariffs against steel from emerging Asia and Brazil. The French government even demanded that Japanese VCR imports enter France via Poitiers, a town hundreds of miles from the nearest port. The use of antidumping measures in the United States

and the EU also accelerated sharply in the 1980s and in the wake of the 1970s’ crises. All these measures had a contracting effect on global trade in the 1980s. The 1980s became the “lost decade” for trade in many European countries (see Figure 2). The trade-to-GDP ratio shrunk in major Western economies and contributed to overall slow GDP growth in that decade.

The school of “New Protectionism” came to dominate the trade debate and scholars who favoured “managed trade” rose to prominence.⁶ Inspired by what was believed to be a miraculously efficient trade policy in the Far East – protecting and supporting domestic industries while aggressively pursuing export promotion – industrial policy of an activist stripe grew in practically all developed countries.

This time the fear is about China and other fast growers.

FIGURE 2. ANNUAL AVERAGE GROWTH RATE FOR TRADE AS PART OF GDP



Source: World Trade Organisation, International Trade Organisation

Their economic successes can only mean problems for business and labour in Europe, according to the mercantilist view that lies behind the conceptual thinking about competitiveness. Competitiveness – as perceived in the Lisbon accord and the 2020 strategy – is largely a zero-sum philosophy. It is seen as a problem that other countries increase their share of the world economy while Europe's share is decreasing. Similarly, it is seen as a threat to the EU economy that other countries invest more in research and development than the European average. These notions are silly. Rather than lamenting them, they should be applauded. Expanding economies in other parts of the world gives new opportunities for EU firms to increase sales. That underdeveloped regions increase their market shares is good news: they are becoming richer. High R&D investments in other parts of the world mean that EU consumers and producers can get access to new knowledge and innovations without having to pay for the entire bill.

It is this sort of thinking that economist Paul Krugman ridiculed in his book *Pop Internationalism* from the early 1990s with the same name.⁷ The notion that countries compete neck-to-neck with each other is a dangerous obsession that too often misguides policy. It is a view

that may help policymakers to sell political reforms at home; the commercial prowess of other countries can be a source of reform motivation. Hence, it is a perception that may leverage good economic reforms. However, these are theoretical propositions; it is in fact more likely that pop internationalist notions will push irrational economic policies and provoke an overall defensive posture to economic reforms and the global market.⁸

Yet this zero-sum economic mindset informs much of the thinking in the elements of the 2020 strategy that deals with commercial policy. As it has been set out, so far, it is a program that aims at beefing up the competitiveness of the agricultural, industrial (heavy, light and advanced) and services sectors—that is, of all sectors and production in Europe. In the EU's 2020 paradigm that also involves a return to industrial policy activism, the idea that governments can “pick winners” by writing checks to favoured sectors. The profile and extent of the new industrial policy that Europe envisions remain to be seen. The approach, however, is for an industrial policy that is activist and micro-managing, harking back to the disastrous industrial policies of a bygone era

This is a dangerous turn of policy. Any growth agenda true to its ambition would cherish the economic success of other countries. Rising affluence abroad means more and richer consumers for your own firms. More often than not, the economic successes of other countries are driven by foreign investments and foreign firms, and such foreign establishment is most often done in a way that enriches all parties and countries involved. The better countries like China fare at industrial production, the bigger the opportunities are for Europe to shift to more high-yielding and high-paying production. The rise of China, for example, has been of tremendous importance for structural change in European economies. In that spirit, rather than asking themselves how policy can boost competitiveness of agriculture, light and advanced industry, or other sectors in Europe, European leaders should ask: What domestic production would benefit us if it withered away in Europe?

Political suicide, many would call such a strategy. That may be true. Comparative advantage, is what David Ricardo once called it. Any failure on the part of Europe to act on the basis of comparative advantage in its design of the 2020 strategy means it will dilute the growth-enhancing potential of its strategy.

LEARNING FROM PAST MISTAKES: THE LISBON AGENDA

THE 2020 STRATEGY fails to take account of lessons from the Lisbon agenda. There are several reasons why the Lisbon agenda failed to deliver on its ambition to usher Europe into a new age of economic reforms. Too many elements of the Lisbon agenda had little or no direct link to growth or pro-growth reforms. These items clouded the purpose of the agenda and the political abilities to deliver reforms. Another problem was that the Lisbon agenda did not make proper use of the vehicle for market integration in Europe – the vehicle that in Europe’s past has delivered progressive integration as well as increased productivity and economic growth.

Most of the core Lisbon targets concerned areas where the EU did not have any jurisdictional competence. The main mission for the EU institutions, especially the European Commission, was to bring a more significant EU dimension to the national policy arenas by monitoring

and evaluating member countries. The underlying role of the EU was to be a “midwife of good policies” and smooth reform processes by providing benchmarks and experiences from one member state to another.

The EU could at times also put pressure on member states, but this was done to a very little degree and in a perfunctory way. Hence, the EU did not have the teeth to really push or punish countries that did not deliver. This, however, does not necessarily translate into an ineffective role for the European institutions. An innovative and dedicated Commission with a clear mandate can leverage reforms if it is sufficiently sensible and knows when and where to push for them. The history of the EU provides many examples of critical moments when EU institutions have helped to dissolve nationally based anti-reform coalitions by concerted reform packages in several or all member states. True, this sort of political management is more difficult today than in the past as the EU has expanded in membership and issue focus. Yet the Commission was given backseat role in the Lisbon process reform methodology. A few years into the agenda, the outside world and too many member states had lost interest in it and efforts by the Commission to advance the agenda often passed unnoticed by the member states.

Viewed in a historical perspective, the Lisbon agenda could arguably be seen as a policy innovation. It was not the first attempt at beefing up competitiveness and growth. But in the institutional structure of European cooperation, the Lisbon agenda was the first time that member states agreed to set up an extensive growth agenda in areas largely outside the scope of centralized EU policy. The traditional model of EU growth promotion – or, if you wish, the political economy of European cooperation – has been increased competition by market expansion and economic integration. The basic idea of the European community (along with many other international institutions) was to tie European countries closer together through increased economic integration. That is the genesis of the EU. Many other policy areas have progressively been integrated in the European policy structure, particularly after the Maastricht Treaty, but economic integration remains the backbone. One can therefore argue that EU growth promotion strategy has largely been confined to market

integration and the reduction of barriers to integration, with the Single Market as the crown jewel.

The Lisbon strategy had reform components of that ilk, especially the program to liberalise energy, financial, telecom and transport sectors. The market liberalisation element of the Lisbon agenda was, however, limited, and the reforms that were launched did not result in far-reaching de facto reforms. The Lisbon agenda rather tried to venture into a different area of growth policy.

First, there was a change of *economic mode*. Instead of pursuing the traditional agenda of market liberalization and integration, the agenda directed attention to the contributions to growth from research, technological change and innovation.

Second, there was a change in *policy methodology*. Rather than reducing barriers and establishing rules for what countries cannot do, the agenda aimed at instructing member states what to do (e.g. targets on R&D spending).

Third, there was a shift in *governance structure*. The Commission never was the vehicle of reform or in charge of the policy process; it was up to the member states to set out reform agendas and deliver upon them.

Analytically, there are good reasons speaking in favour of a Schumpeterian growth component in economic policy. The type of Schumpeterian growth the Lisbon agenda aimed to push is central to long-run growth, but has not contributed as much to growth in Europe as it has in the United States. As a centralized EU agenda for policy reform, however, this strategy was flawed. It was doomed to run into difficulties as European institutions have little leverage on such national policies. Astonishingly, the 2020 strategy will repeat this mistake as the Council, and not the Commission, will be the central actor in this reform strategy.

The 2020 strategy is weak on methodology to facilitate and incentivize reforms by member states. The strategy sets out reporting models, but they are perfunctory and do not put the Commission in command of the reporting process. More worryingly is that the strategy takes for granted that harmonization of goals, targets and pol-

icy is a good strategy to achieve the larger aim of economic growth. This may be true for some areas, but far from all. Goals need to differ from country to country. Harmonization of policy or of the policy process can in many instances become a hinder to national reform processes as it takes away an element of institutional competition. The idea that countries should move jointly and at the same speed, which is reflected in some of the thinking in the 2020 strategy, is more likely to slow down aggregate reforms. The strategy should rather aim at designing the mechanisms that will increase competition between European governments over reform delivery. That requires a different approach to benchmarking and to the overall strategy of transmitting news to some countries that they are underperforming.

Furthermore, the 2020 strategy is set to repeat the Lisbon agenda mistake to downplay, or neglect, policy areas where the EU already have strong jurisdictional competence and can act. The EU budget, the Common Agricultural Policy and the cohesion programme are barely dealt with in the 2020 strategy. Reforms in these areas might not give as much contribution to growth as labour-market reforms or deregulations of the telecom market, but they would enhance structural change and drive economic growth. Proposals on trade policy and the Single Market are also remarkably weak – if at all existing.

In fact, the 2020 strategy does not have a trade component. It says that such a strategy will be presented later. The Single Market is mentioned only insofar as it suggests a Digital Single Market. That is a good initiative, but Single Market reforms cannot be confined only to the digital area. There are lots of unfinished businesses with the Single Market for goods, and the attempt at setting up a Single Market for services only marginally improved policy. Rules on state aid and government procurement have been under attack for quite some time, but the 2020 strategy is silent on those issues. Other important issues for growth, like non-EU labour migration, is absent from the strategy. Overall, commercial policy is very weak in the 2020 strategy. Improvements might come later, but it does not look good. The strategy is low on ambitions to that end and does not give a general approach that future commercial policy reforms easily could fit into.

For the 2020 strategy to be respected and successful, these flaws need to be remedied. Neglecting the central commercial policy areas where Brussels has strong power is to repeat the mistakes of the Lisbon agenda.

A NEW TAKE ON ECONOMIC REFORM

The current 2020 strategy should be put in the bin. There is no point changing it at the margins. It is the fundamentals that must change.

A new common strategy for growth in Europe should depart from two propositions.

First, the basis for a growth strategy should be reforms of policies that Brussels control and that fits into the already existing structure of jurisdictional competence. In these areas, the Commission can drive reforms without peddling with sensitive policies trespassing on national sovereignties. Furthermore, the Commission can approach policy in a uniform matter (member states have already transferred power to Brussels and the EU already runs a uniform policy) in areas where it makes sense to have one rather than 27 sets of policies.

Second, if a new agenda should include components that fall outside the structure of jurisdictional competence in Europe – and there are many such areas of importance to growth (e.g. tax and labour market restrictions) – the Commission must have the courage and be granted the tools (benchmarking, empowering institutional competition, “naming and shaming”, fines, etc) that could incentivize delivery of reforms by national governments.

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