

EU 2020 Strategy: Raising the Game!

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The State of the Union

When they met for the first time under the Presidency of President Van Rompuy in the elegant surroundings of the Bibliothèque Solvay in Brussels on February 11th last the heads of state and government of the EU 27 were presented with a sobering account of the economic 'State of the Union'. The presentation was made by President Barroso on behalf of the European Commission.

GDP growth declined by -4% in 2009, the worst since the 1930s.

Industrial production fell by -20% to levels last experienced in the 1990s.

23 million are unemployed, with a rise of 7 million in twenty months. This is expected to reach 10.3% in 2010, again back to levels last seen in the 1990s. Within this total, youth unemployment is over 21%.

The economic crisis has halved the EU's long term growth potential on a no policy change basis.

Public Finances are constrained

With deficits in public finance averaging 7% of GDP and debt levels of over 80% of GDP predicted for 2011 the last two years have wiped out twenty years of fiscal consolidation.

In 2010 all 16 member states of the Eurozone will have deficits over 3% of GDP.

The Union is more diverse

The crisis is deeper in several Central and Eastern European states. Hungary, Latvia and Romania are receiving EU balance of payments support and IMF assistance, the first such assistance in three decades for any EU member state.

Unemployment in Latvia is running at just under 23%, with youth unemployment reportedly at a shocking 43.6%

The income gap per capita between the richest and poorest EU regions stretches from less than a quarter to more than 300% of the EU average income per capita.

The banking system still needs to be fixed

Our democracies have put 25-30% of GDP at taxpayer risk to sustain the financial sector. Several member states have guaranteed 100% of bank deposits, at a theoretical risk of several multiples of their national incomes.

In the EU there is still a significant adjustment to come in this sector with possible damaging effects on a recovery. Through pressure on their balance sheets, banks have a diminished capacity to increase their lending. Confidence is weakened and credit is scarce. Firms and households face difficulties to borrow and invest.

Our financial system still needs to be fixed. Zombie banks risk spreading their contamination through reduced bank lending to zombie companies. In their turn, these risk producing a zombie economy.

Familiar structural challenges remain

Our working age population will be reduced by about 2 million by 2020, and the number of over 60s is increasing twice as fast as before 2007.

Only 46% of our older workers (55-64) are employed compared to over 62% in the USA and Japan.

Together with the re-emergence of mass unemployment and constrained public finances the European social model is under duress.

Productivity levels are lagging behind our competitors. Two-thirds of our income gap with the USA is due to lower productivity, more or less what it was in 2000 when the Lisbon Agenda was adopted inter alia to help close this gap.

Our research effort, public and private, as measured by gross expenditure on R&D as a percentage of GDP continues to trail our developed economy peers almost by as much as it did a decade ago.

Total spending on tertiary education in the EU (as a % of GDP) is less than half the US level. This is mainly due to lower private spending in Europe. However the USA also outspends the EU in public spending on universities.

More than 50% of all broadband connections in Japan and 40% in Korea are fibre optic delivering high-capacity connectivity. This figure is only 1% in Europe.

Risk of fragmentation

Achievements such as the single market and the single currency are under stress from fragmented member state responses to the crisis. For example the automobile industry has been especially hard hit with output declines of up to 30% triggering multiple separate national responses with spillover effects to what is a shared EU sectoral crisis.

The Eurozone is challenged by imbalances

The sharp focus on Greece's combined double deficits in public finance and balance of payments has raised fears of sovereign debt default and the risk of contagion spreading to other vulnerable Eurozone economies. This poses a systemic challenge to the coherence of Eurozone policy making capacity.

Greece has to repair its reputation and its public finances.

But the Eurozone also is challenged to repair its imbalances between surplus and deficit states, to address the gaps in internal competitiveness between states because of diverging domestic costs and, in terms of managing sovereign risk, to establish its collective capacity to act.

For the moment bond vigilantes have replaced the EU as the chief enforcers of fiscal discipline through bond spreads that are truly penal for those states deemed at risk of sovereign default. The recent informal European Council 'expressed a strong political commitment to take determined and coordinated action if necessary' in a political act of verbal reassurance that has temporarily contained an issue that has yet to run its course.

The economic recovery remains fragile

The European Economic Recovery Plan so far has helped to prevent the downturn triggered by the great recession from becoming a great depression.

However, the recovery, such as it is, remains patchy, fragile and vulnerable. Exit strategies will demand a more determined co-ordination of fiscal policy to strike the right balance between the short term danger of excessive tightness and the longer term consequences of excessive looseness. Decisions taken in one Member State, especially the larger states, impact the others with significant spillover effects. The Commission in particular has a duty of care to emphasise and deliver these balances.

The changing global context

A new dynamic in the equation, tens years on from the launch of the Lisbon Agenda, is the ferocity and scale of global competition. The EU share of global exports is declining relative to China and India.

Our ambitions are high

The 20-20-20 climate change package aimed at emissions reductions, renewables and increased energy efficiency calls for nothing short of revolutionary low carbon changes to EU patterns of production and consumption. It offers both focus and traction for new policy initiatives since emission reductions will need to double in the next decade compared to the last if the targets are to be achieved.

Never waste a good crisis

Emmanuel Rohm, the Chief of staff of the Obama White House will, if for nothing else, be remembered for his injunction to ‘never waste a good crisis’. As a thought it commends itself to the new European Commission perhaps with an added caveat ‘or it will waste you’ by reinforcing the drift to intergovernmentalism in EU affairs.

The fierce urgency of now

In summary – in terms of employment the economic crisis, through job losses, has driven us back two decades to the early 1990s. This is in a

context of constraints on public finances unmatched since that time. One must add to this mix the sclerotic and dysfunctional state of the banking and financial sector and the consequential limited access to vital credit, especially for SMEs.

The strength of a medium term perspective such as Europe 2020 is that it offers a road map for coherent policy making over time faced with challenges such as the ferocity of global competition and Europe's ageing demographics.

However, this cannot and must not take away from the fierce urgency of now.

Europe needs to raise its game -

The Financial Perspective

The debate on the next Financial Perspective is scheduled to begin in the early part of 2011. In the ordinary course of events, after due political consideration, this should be completed by 2012 or at the limit early in 2013 for commencement in 2014.

Reflecting agreed political priorities in a budget that starts only months before the current Commission finishes is a date with destiny that misses the fierce urgency of now.

In adopting the current Financial Perspective 2007-2013 it was agreed to conduct a mid term review scheduled for 2008. This was postponed pending ratification of the Lisbon Treaty.

The Treaty is now law. The review should now happen.

Politically it may be more limited in scope than a full re-opening of the budgetary perspective but the times demand bold initiatives.

Sovereign EU debt

There have been numerous proposals for the **common issuance of euro-denominated sovereign bonds** in the name of the European Union, starting in 1993 with a proposal from Jacques Delors.

Some have suggested issuing bonds for the orderly rescue of collapsed banks. Others have proposed the creation of a European Monetary Fund to deal with sovereign risk inside the Eurozone.

The Delors style proposal has been taken up by many as a means to enhance investment in infrastructure or to stimulate new sources of innovation and growth, exactly the things that the Europe 2020 strategy proposes to do.

There has been a deeply embedded resistance by some member states to the notion of EU indebtedness. This has severely limited collective EU flexibility in deploying adequate economic policy tools in an efficient and coherent way. **If ever there was a time to consider new financial models to pool resources it is now.**

In reviewing the current Financial Perspective consideration should be given to the creation of sovereign EU debt through issuing debt securities as part of the normal budgetary requirements of the EU.

This could help to accelerate an economic recovery, to promote growth and innovation and to restore the EU's capacity to achieve its potential growth rate over the coming decade.

In return for their agreement member states could be offered a proportionate reduction in their budgetary contributions which could be used to bring them closer to their compliance requirements under the Stability and Growth Pact.

A ceiling on EU indebtedness could be set at a multiple of its annual budgetary spend subject to repayment, review and roll over as part of the ordinary budget making cycle.

Left as it is, the existing budgetary model is inadequate to the scale of the current crisis or the ambitions of the Europe 2020 strategy.

Mobilising multi level governance

Coherent multi level governance frameworks for programme management at European, national, regional and municipal levels need to be animated by incentives and energised by access to resources.

There are more than 90,000 local authorities and 300 regional authorities in the EU today, many with transfrontier policy perspectives. They

account for one third of public expenditure and two thirds of public capital expenditure. Together their spending amounts to 16% of EU GDP.

Their mobilisation as part of the Europe 2020 growth and innovation strategy is an indispensable platform for its prospects of success. Money, even if only on a limited co-financing basis, will talk louder than words in attracting their attention.

Multiplication through public procurement

Eurostat reveals for 2007, the latest year available, that public procurement openly advertised within the EU 27 amounted to just over 3% of EU GDP.

This is three times the size of the annual EU budget.

Again it offers a multiplier platform for growth and innovation if imaginatively incentivised.

Leveraging other actors

Combined with the work of the **EIB** and the **EBRD** a revitalised EU budgetary and governance perspective could offer genuine prospects for hope and recovery.

Multi tiered co-financing of agreed priorities could also leverage **public private partnerships** to add to the multiplier effect.

Conclusion

There is no magic bullet or overnight solution to the state we find ourselves in. Prior to the crisis 80 million Europeans were deemed to be at risk of poverty, among them 19 million children. Those figures surely have been accentuated by the crisis.

What they and the 400 million other European citizens do not need is a poverty of imagination and leadership on the part of their political elites.

President Barroso remarked to the heads of government and state two weeks ago that the time for bold initiatives is now.

He was right.

Carpe diem

