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Conference report

Economic recovery and Europe 2020: towards smart, sustainable and inclusive growth

Wednesday 24 – Friday 26 October 2012 | WP1207

In association with:

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Representation in the UK

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Key points

- Europe 2020 is a strategy for long-term growth, as opposed to a rapid response to the economic crisis. Its goals (competitive economy, smart, sustainable and inclusive growth) date back to the Lisbon Treaty agreed by member states in 2007 which came into force in 2009.
- The delivery mechanism is new however. It includes specific recommendations for each country and a yearly cycle of economic policy coordination called the European Semester whereby the European Commission undertakes a detailed analysis of EU member states' programmes of economic and structural reforms and provides them with recommendations for the next 12-18 months.
- The strategy puts competitiveness and growth at the top of the agenda and addresses structural weaknesses, for example deficiencies in labour markets and the need to complete the single market.
- A drawback, however, is that it can be seen as 'a single prescription' for very different patients with very different diseases.
- And the country specific recommendations are neither sufficiently individualised to address this issue nor binding. This means that they can be ignored as were past recommendations urging countries to carry out economic reforms. Treaty change would be necessary to make them binding, and this would be resisted by governments.
- Accumulation of know-how in the EU is very uneven as evidenced by the huge difference in member states' applications to the EU Patent Office. These differences have a significant impact on Europe's ability to compete in a global economy.
- Germany's approach to these issues of competitiveness reflects lessons learnt from German re-unification when considerable resources were devoted to developing existing industries in the East with limited success. In a similar way, the economies of certain EU countries' can be seen to lack the essential core structures for growth.
- Structural reforms need to reflect the particular conditions of each member state with specific solutions for each one.
- There is a real problem in identifying sources of investment to stimulate growth. The role of the European Investment Bank is crucial as is pressing ahead to create a genuine single market in areas that are key for development. Greece will struggle to attract investment until it is perceived to have solved its institutional and structural problems.
- Despite a trend towards convergence of European economies over the past 50 years, the economic crisis is widening the wealth gap between countries.

Austerity measures have led to drops in wages of up to 30% in some countries. It can be argued that the single market is making the strong stronger and the weak weaker.

- There are some encouraging signs however. Ireland is seen as a periphery country which is succeeding in implementing structural reforms to redress economic imbalance of the past. Austerity measures have been introduced without the violent response triggered in other countries such as Greece and Spain.

- Spain may have a very high unemployment rate but it also is a world leader in some sectors such as fashion retail.

- Working on the premise of never wasting a good crisis, the current situation provides an opportunity to question economic development models based on constant GDP growth as the overriding measure of success. The rise of indices to measure "happiness", such as the OECD's better life index, and the interest shown in these by political leaders, suggest that a more holistic view needs to be taken of the factors that contribute to well-being in societies.

- And more should be done to promote the exchange of best practices between member states with regard to issues such as improving banking systems and creating other conditions necessary for sustainable growth. Germany's system of vocational education, which links skill to employers' needs and of labour market organisation where there is a genuine 'on-going conversation' between worker representatives on boards and management is attracting great interest from other countries.

Europe in the world economy

1. For many years, the European Union has fostered economic integration among member states and been a successful 'convergence machine'. But the economic crisis has shown up the real disparities between economies. Many enterprises in Southern Europe are small-scale and not suited to operating in the global economy. Much needed structural reforms have been delayed widening a gap between northern and southern Europe; the core and the periphery.

2. The need for these long-advocated structural reforms has now been widely accepted, particularly in Southern Europe with politicians showing greater willingness to push them through and create a climate that is more business and investment-friendly.

3. Short to medium term priorities include reforming the labour market; corporate and regulatory structures of retail and professional services. Longer term reforms include the need to restructure institutions and contractual systems; effective development of human capital; updating infrastructure and increasing investment in R&D.

4. Six important factors underpin growth; political conditions, macroeconomic stability, macroeconomic conditions, human capital, technological capabilities and microeconomic environment.

5. The periphery countries score badly on these factors as compared to the rest of Europe creating a 'tale of two Europes'.

6. Europe spends more than the United States, and the rest of the developed world, on 'social protection', defined as benefits relating to sickness, disability, old age, family and children and unemployment and housing.

7. Education and health spending are not included in this definition. While some EU countries manage to afford such 'large government' by running it very efficiently, for example Sweden, others, such as Greece, cannot.

8. Europeans are now retiring earlier and living longer hence the increasing amount spent

on pensions. In other developed countries, by contrast, the retirement age is later.

9. Europe requires greater fiscal discipline and a reduction in public spending. The financial sector needs to operate in such a way that it fosters production over consumption. There is also an argument for streamlined financial regulation at the European level.

10. Europe is very heterogeneous both between states and within them and that poses real difficulties for economic recovery. The differences need to be recognised and addressed and a viable road map developed that can lead to a genuine economic and monetary union for those who wish to form part of it.

11. Real wages in Germany are now growing, after a decade post re-unification when they did not. This was necessary for Germany to regain its competitiveness. The South is now experiencing a period of adjustment, and real wages will not grow until productivity does.

12. The rise of China is a key factor in the development of the global economy. China is very competitive in sectors that were once a domain of Southern European countries such as textiles. Northern European countries, with a wider knowledge base and greater technological advance, are in a stronger position to withstand competition from China.

13. But the Chinese economy is evolving towards prioritising quality over quantity improving the 'made in China' brand to satisfy internal private consumers and thus becoming less dependent on manufacturing for export. There may, therefore, be a gradual convergence as China develops a more expensive labour market and European countries lower their labour costs.

Focus on education and poverty reduction

14. Successful education policy is the key to an innovative and enterprising society with co-ordination between education, training and workplace essential.

15. It is important to achieve a balance between the basic skill set - the three 'rs'; reading, writing and arithmetic and those which foster creativity and innovation.

16. Among the most successful of Europe's education systems are those which encourage clear goal-setting and provide personalised attention from teachers to students.

17. The consequences of educational inequality, due to factors such as socio-economic background of students, have increased dramatically. High drop-out rates are due to education appearing irrelevant as viewed from the labour market. As one participant remarked, 'if 30% of those coming into a supermarket looked around and left without buying anything, changes would be made'.

18. Japan, Singapore and Finland have been successful in breaking down artificial boundaries between subjects that are taught in schools.

19. High performing countries prioritise quality of teachers. In Finland, every teacher does a research masters' thesis in education. So the knowledge base is built by the profession instead of being dictated by a ministry.

20. Providing the right skill set can begin at the initial level to develop personality traits such as how to work collaboratively. The UK is good at early years' education, and comes out very well at primary school level, but results fall back at secondary level.

21. In Finland, children start school at 7, and have limited hours at school and yet come out top of OECD rankings (with some Asian countries). In France, children start at 3, spend a lot of time at school and yet the country is ranked only average (15 among OECD countries).

22. The link between education and business needs varies a great deal. Education in the

Far East has excelled at focusing on business requirements. In Austria, Germany and Switzerland employers play a role in devising education policy. Their capacity to anticipate immediate skills needs means there is almost no youth unemployment in those countries. But in the UK there is little connection between school leavers' capacity and the skills needed, as repeatedly noted by the Confederation of British Industry (CBI).

23. South Africa is an example of a middle income country where teaching takes precedence over research which has led to a brain drain. However the emphasis in South Africa is on creating a skilled labour force and hence there are much bigger class sizes than before.

24. The University of Cape Town is South African's only university in the THES top 200. Is it necessary for each European country to have a university in the top 100, or could Europe be seen as a whole? In a sense Europe does have a higher education policy - the Erasmus programme and the Bologna process that launched the European Higher Education Area in 2010, in which students can choose from a wide and transparent range of high quality courses and benefit from smooth recognition procedures.

25. The Bologna Declaration of 1999 put in motion a series of reforms needed to make European Higher Education more compatible and comparable, more competitive and more attractive for Europeans and for students and scholars from other continents. But reform is still needed if Europe is to match the best performing systems in the world.

26. Education may lead to poverty reduction but not necessarily to a fall in inequality. On the contrary, when human capital is raised, via education, it also increases at the middle and at the top, and this is reflected in the incomes of those groups. However, addressing literacy has huge economic returns for the individual.

27. There is concern that, in comparison to the past, too few students have adequate levels of maths and science - and this applies even to those entering top universities. Some education systems take great efforts to preserve self-esteem, and to 'encourage', which can hinder sheer application. Whereas in the Asian learning model, there is a very strong link between hard work and success.

28. In Japan, a new teacher spends 6 months in a school before they are alone with pupils. They also have a system where there are 6 -8 scientific advisors put in the class with the teacher. The teacher decides what they want to achieve, and receives guidance on how to do it. The advisers return at six-month intervals.

29. In the UK, students who go to the top universities are ‘buying a brand’, which buys them a job. They are recognised as being adaptable but below that level, what is taught at universities is not necessarily appropriate for the labour market. And the growth of internships has further increased inequality as many are poorly paid (or not paid at all) so only graduates from better off families can afford to do them.

30. It can be argued that universities are better when they are not free, and that students work harder when there is some ‘pain’ associated with their education. In the UK, it appears that student opinion has accepted the change to a fee-paying structure but the impact with regard to career choices has yet to be seen.

31. It is a laudable aim to increase the number of students in higher education but the priority should be to ensure development of the workforce of the future: matching training and skills to employer needs.

Focus on promoting innovation, investment and job creation

32. The attitude to innovation in the USA is different from that in Europe. Europe creates ‘security addicts’, and scientists gravitate towards the civil service, protected by a social security system. Europe is less good at transforming knowledge into innovation.

33. On the other hand, universities should not be forced to do applied science. They can

play an important role in training young people for jobs in industry where they can innovate and develop their own ideas.

34. The European Research Council (ERC) has been very successful in creating a super-link of scientists. It has generated competition between universities, awarded 3,100 grants and 15,000 PhDs and post-doctorates and can even claim credit for a Nobel prize in physics. It has encouraged networks (at and between existing universities) as a means of fostering excellence.

35. The ERC encourages research from the 'bottom up'   Again, the USA combines these elements successfully - it has one programme which states 'we need transformative research aiming at the next ‘S curve’ technology life cycle.’

36. Radical innovation can be contrasted to incremental innovation. Germany is good at the latter, and at linking it to commercial products. Both types are extremely important.

37. The role of government in research and development is difficult to get right. In the UK, considerable amounts of money have been directed towards business support with variable results. In 2005, no government money was going into innovation, but in 2007 the Technology Strategy Board was re-launched as a public body operating at arm's length from the government, and reporting to the Department for Business, Innovation and Skills, to work with business encouraging innovation. It has a budget of £200 million and a recent track record of successful grant giving to companies such as Rolls Royce.

38. The expected 2% growth in Europe this year is low and will clearly have an impact on innovation, investment and jobs. Greece became uncompetitive, because instead of investing during the boom times it went on a consumer spree. And, without investment and lending, innovation and jobs decrease. In the UK employment may have risen, but the rise is mainly in short term jobs.

39. There is a very real problem that austerity programmes to cut public spending have also led to a reduction in the private sector. The IMF now recognises that when governments cut back on capital spending the private sector does too. Therefore a 1% cut in public spending can reduce GDP by 1.7%. Thus more innovative solutions are needed. Greece and Portugal's debts may need to be written off, before there can be growth. Investment in skills is crucial in the long term. A further problem is the (lack of) mobility of labour.

40. Five years after the crisis started there is disagreement about the way forward and a risk of mistakes leading to repeated recessions.

41. The attractive feature of 'Brand Europe' has been the combination of social and economic progress, fairness and efficiency. However Europe appears to be losing its confidence in this model. It is wrong though to consider that Europe needs to become more unequal to succeed. Research does not show either equality or inequality necessarily promotes growth, although some studies have shown a negative relationship between inequality and growth.

42. There are different routes to job creation. Some argue that mass labour deregulation is not necessarily the answer although some changes are needed. The OECD has investigated the idea that employment protection legislation should be designed by workers, such that they could accept lower wages if they also get longer term jobs and more training. In the UK, leading economists predicted that introducing the minimum wage in 1999 would cost 1,000,000 jobs. This did not occur, due to the rate at which it was set. Had it been set at £10 per hour, it would have had a detrimental effect on jobs.

43. It is also not the case that welfare benefits in the UK need to be cut. It does not disincentive employment; on the contrary studies show that unemployed people value work and do not set themselves a 'reservation wage'. There is a problem in the UK with productivity. The very high levels of self-employment are not due to a rise in entrepreneurship, which would stimulate demand. On the contrary it is those made

redundant, on discovering the very low level of jobseeker's allowance, who then offer services such as those of a handyman or 'man with a van'.

44. However, it is the case that strong trade unions, whilst helping decrease inequality and poverty, can also reduce the differentials between working hard and not working hard. So there is a need to maximise their advantages and minimize their disadvantages, for example by encouraging mature trade unions, building partnerships and trust and investigating flexi-security.

45. Country specific recommendations emanating from Brussels are barely discussed in the UK. The UK persistently ignores very useful European policy on, for example, youth unemployment, 'NEETS' (a young person who is not in education, employment or training); the problem of too many low-skilled workers, the housing crises and finance conditions.

46. An agenda for job-creating growth should focus on green growth, cities, a new industrial strategy, reform of banking and revitalising social partnership. An underperforming city is a serious problem for a country. Dublin, for example, has now been transformed, and attracts young people from all over the world. Cities are also where green growth will be generated. Ireland has experience of using social partnerships, whilst being under a Troika programme. The disadvantage is that decisions cannot be made quickly, as the various partners have to be consulted. However it is noteworthy that the cuts in Ireland have been achieved without any violence on the streets.

47. It is unclear as to whether government spending hurts growth. It may be the case in Southern Europe, but is probably not the case in the UK.

Focus on energy use, climate change and green growth

48. The demand in world energy is going up, and is forecast to increase between 30-40% by 2030. This growth is from the non-OECD countries, mainly from China and India. OECD countries have already passed peak consumption. And although China and India are the big polluters now, they are less energy intensive than the 'west' was, when industrialising, or even 20 years ago.

49. Comparing the sources of fuel – renewables, nuclear, hydroelectric, coal, natural gas and oil – renewables are the fastest growing sector (from a percentage share of the whole of 0.4 in 1990 to 6.3 in 2030) but they are starting from a very low base. These figures include biofuel in the definition of ‘renewables’. Europe’s target for renewables is 20% by 2030.

50. Shale gas is becoming increasingly important in the USA. Gas generally is the best option for the future, and it is to be hoped that China switches from coal. The unknown is the future use of nuclear power as currently governments are not discussing it. As a result of Fukushima, Germany is withdrawing from nuclear and building coal fired power stations.

51. The major issue for Europe is its dependency on pipeline gas. Currently 1/3 of it comes from Russia, and it has long been recognized that it is important to diversify. So a southern corridor from the Caspian area through Turkey is being developed, plus liquefying natural gas from North Africa and the Caribbean and continuing to invest in the North Sea. And it is far preferable that EU should negotiate as a whole with Russia rather than Russia picking off 'sweetheart deals' with individual countries and attempting to divide and rule.

52. There are differences (mineral rights law and existing equipment) between USA and Europe which account for why shale gas is unlikely to be as dominant in Europe. Those involved in shale gas argue that, if the extraction is done correctly, there is very little risk, and no more than exists with any industry. There has already been a breakthrough

in technology with shale gas and there will be more.

53. Most energies tend to move easily across borders, even when they are from troubled areas of the world. As they are a major source of income for those countries, they tend to find their way to markets.

54. It is the case that global CO2 emissions are increasing. The Internal Energy Agency (IEA) ‘450 scenario’ whereby they start to decrease and continue to do so to almost 2000 levels by 2030 looks unlikely. Far more likely is that they will continue to rise, and that we have to assume that they do lead to climate change and a rise in temperatures.

55. Europe is currently only responsible for 11% of global emissions and it is predicted the figure could be down to 4% in 2030. Thus clearly Europe is not the solution on its own. It also could be argued that Europe has switched its emissions to abroad (e.g. China) so this percentage figure is not an entirely honest way of looking at it.

56. There is a view from within the industry that the idea that oil and gas will run out is premature and instead believe that demand will run out before supply (due to improved technologies). They also argue that more investment should go to energy efficiency measures instead of to renewables, some of which have proved inefficient and are heavily reliant on subsidies, which of course governments can withdraw. It was for this reason that BP withdrew from the solar business in Germany – not the natural place for solar panels. Off-shore wind is also too reliant on subsidies. Even Spain, which has done particularly well with wind, is now concerned about whether it can afford the subsidies. And when subsidies are reduced, foreign investors withdraw.

57. Investing in energy efficiency as a top priority should be uncontroversial. However it does not raise taxes or win votes, and so attracts insufficient interest. It is the neglected part of the climate change story.

58. A key question is whether decarbonisation leads to negative growth. Even if it might, and there are lots of variables, there is a compelling 'insurance case' that action is needed on climate change. The extent to which decarbonisation might actually stimulate growth is also uncertain. A comparison can be drawn with military spending, where much of it, on best case scenario, goes to pay for equipment that will not be needed, but it can be argued that it stimulates growth. However there is little empirical evidence of this, even after decades of military spending, and economists should be cautious regarding the potential of green growth.

59. Thus although more green innovation is needed, its impact on GDP is unclear. There is a 'complex menu of drivers' . It is arguable that good 'green' policies should replace less good existing policies even if they only 'might' be growth enhancing. However it should be noted that innovation tends to be driven by entrepreneurs not policy makers.

60. It is important to start green innovation now, so that it is well developed when oil runs out, and there is clearly an important role for public policy on this. And it is essential that the EU strengthens the single market with regard to energy. There is a lot here to be pessimistic about; Germany phasing out nuclear and polluting other countries, France favouring French electricity companies and even the Nordic countries are not building transmission lines. There is no coordination.

Conclusion

61. The top priority for the Irish Presidency of the Council of the European Union, which runs until July, is to strengthen the single market.

62. Solving the euro crisis is key to preserving and developing the single market. The disintegration of the euro would have a very negative effect on innovation, investment and on the single market, leading to an increase in protectionism. The Irish presidency focuses on job creation and on increasing Europe's competitiveness.

63. Solving the banking crisis is a necessary pre-requisite for the success of policies to

stimulate growth. Political factors will impact on this, in particular uncertainty over the outcome of the German election in September 2013 even though it is likely that Angela Merkel will be re-elected.

64. A clear strategy, well communicated and coordinated, is needed. Innovation and expertise in the public sector must be fostered. Many public sectors in the EU need to be modernised and adopt a multi-disciplinary approach involving greater use of social partners and networks.

65. The EU's achievements to date, as an international actor and force for good, were recognized in the award of last year's Nobel prize. But the present crisis has highlighted the need for a fresh narrative and pressing requirement for solutions to Europe's economic problems which are prompting significant changes in attitudes to the EU and moves towards a redesigned model based on "variable geometry"- differing degrees of engagement by member countries.

66. In Ireland, the crisis is not being wasted, as painful but necessary structural reforms are being carried out. The austerity programme amounts to 20% of the GDP, and thus is very serious - like re-wiring a house with the lights on. But after an earthquake, it is not possible to build on the same foundations. Competitiveness is now improving. Social partnerships have been very important, if cumbersome; public sector salaries were reduced by 20% but an agreement was also made with the unions that there would be no further salary cuts until 2014. However, taking a wider perspective, over recent decades the Irish GDP has increased significantly as compared to the EU average, which may explain the acceptance of austerity measures.

67. The public needs to understand that the EU can be part of the solution. There is also a crisis of trust among politicians - this has to be overcome if politicians are to enhance growth. EU policy makers and civil servants, as public servants, need to regain the trust of the people they are meant to be serving if the principles of solidarity are to survive the current crisis.

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