

Growth in Europe beyond the crisis

André Sapir

**Professor of Economics, Université Libre de Bruxelles
Senior Fellow, Bruegel**

**Productivity and Long-Term Growth Potential in Europe
The 2011 EIB Annual Conference in Economics and Finance
Luxembourg, 27 October 2011**

Before the crisis: challenges were mainly M/L term

- Technological change and globalization
 - Demographic change: ageing of population
 - Climate change and energy security
- 
- Issue of sustainability of Europe's economic and social model
- Need to transform Europe's economic and social model towards an innovation-based society
 - Europe's response: The Lisbon Agenda (2000-2010)
 - Achievement: modest at best

With the crisis: challenges became mainly short term

- Saving the financial system
- Saving the euro: a matter of survival for the EU
- But medium/long -term challenges did not go away
- On the contrary the crisis made these challenges even more acute AND revealed new problems
 - » Inadequate financial regulation and supervision
 - » Inadequate economic governance
 - » Unsustainable growth model in parts of the EU: core vs. periphery
- Europe's response: Europe 2020, up to the job this time?

Beyond the crisis

- Medium/long term: What sources and level of growth?

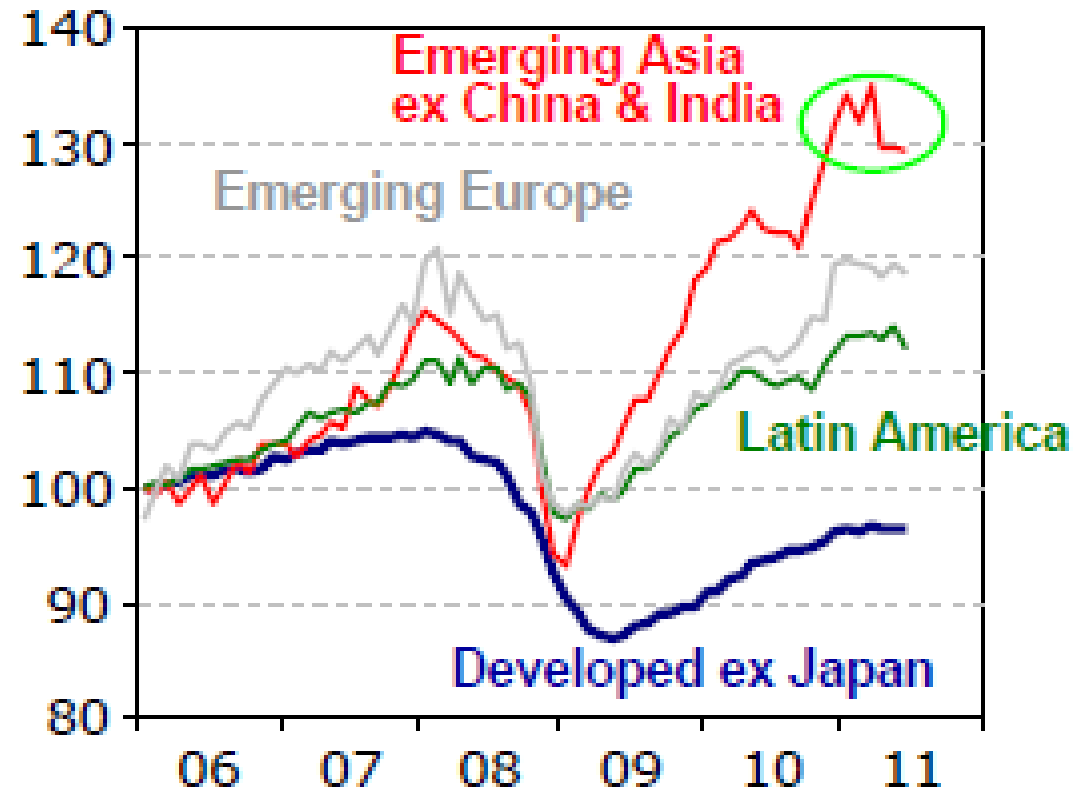
- How much more acute will the challenges existing before the crisis become
 - » For structural adjustment, due to globalization and other changes such as climate?
 - » For the sustainability of public finances and the social models, due to ageing?

The crisis: an accelerator of trends

- Globalization
 - » Acceleration of industrial restructuring
 - » Acceleration of the catching-up by emerging countries

- The sustainability of public finances and of European social models
 - » Demography: Ageing
 - » The effects of the crisis

Industrial production: Mature vs. emerging countries



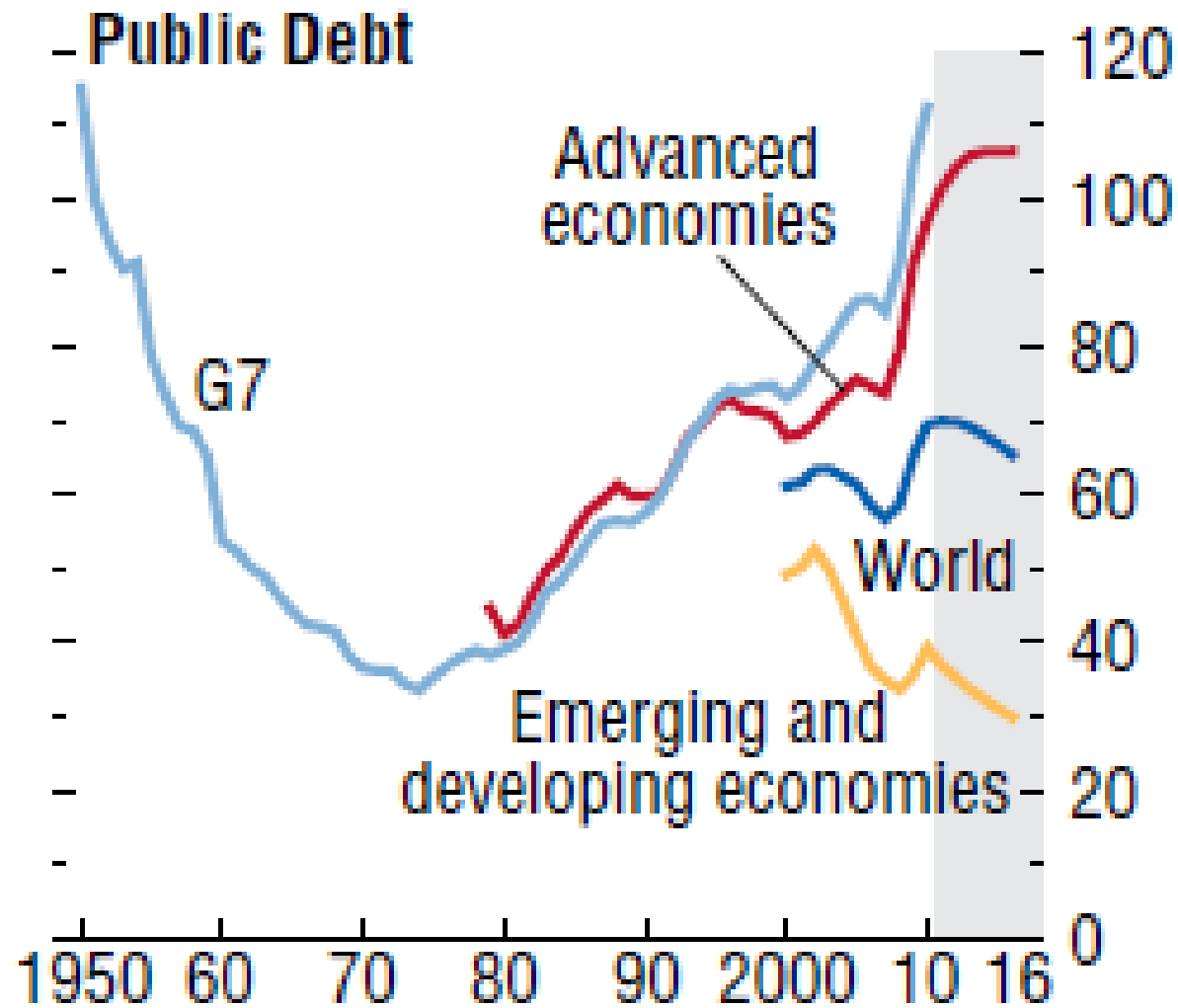
(January 2006 = 100)

The crisis: an accelerator of trends

- Globalization
 - » Acceleration of industrial restructuring
 - » Acceleration of the catching-up by emerging countries

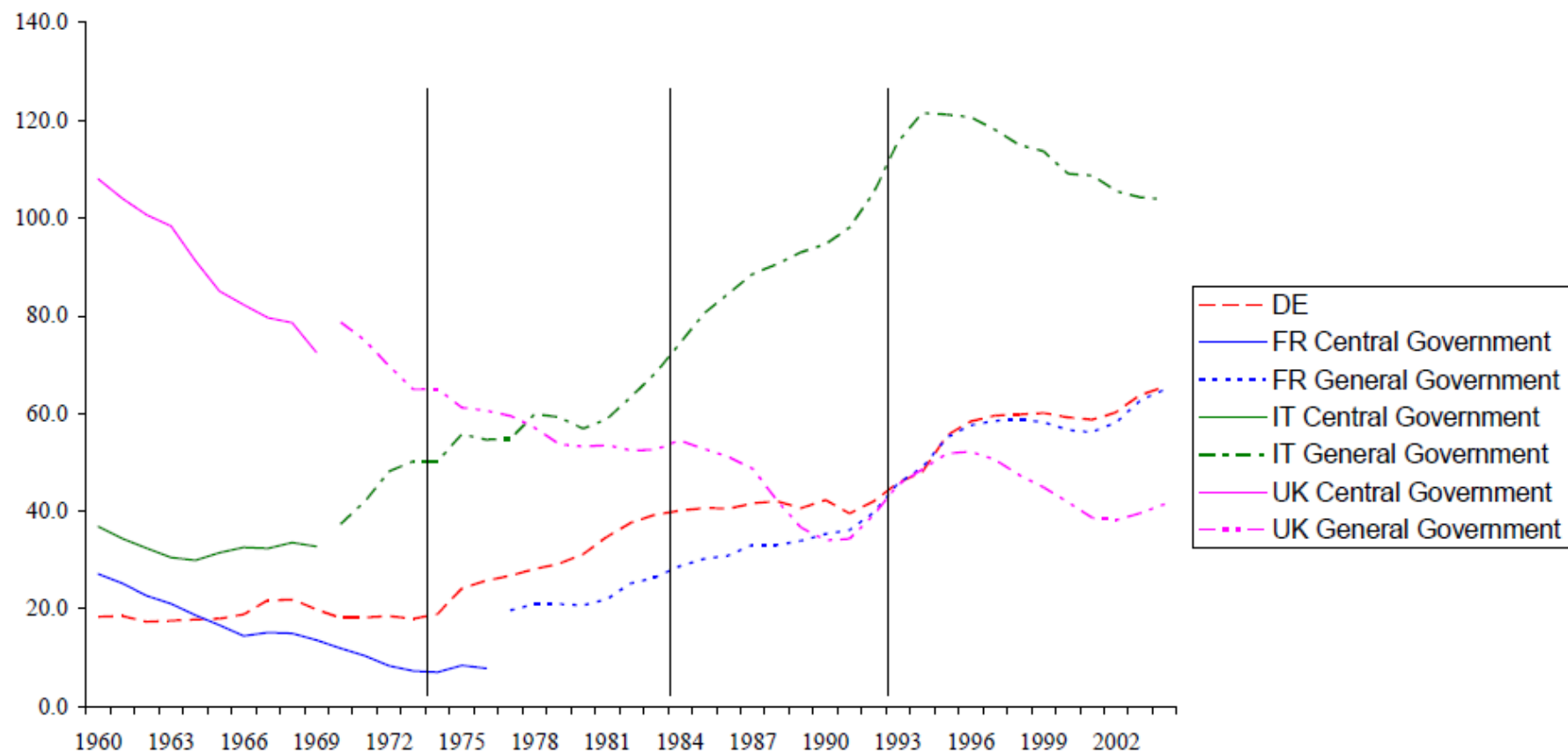
- The sustainability of public finances and of European social models
 - » Demography: Ageing
 - » The effects of the crisis

Advanced vs. emerging countries: debt-to-GDP ratios



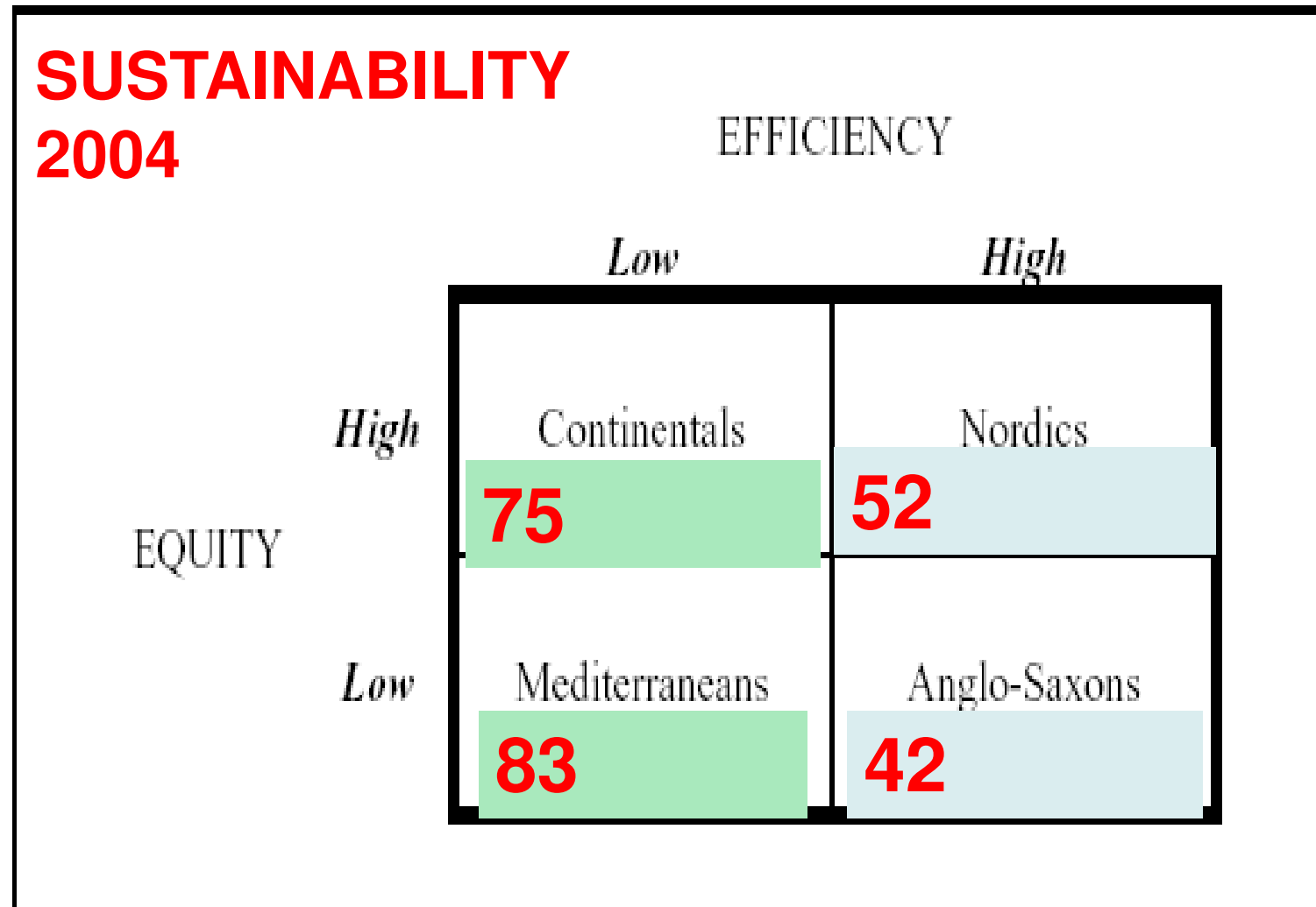
Source: IMF, WEO, September 2011

EU-4: debt-to-GDP ratios before the crisis



Source: Buti and Sapir (2006)

Good and bad European social models before the crisis



The bad ones got worse

SUSTAINABILITY

2004 => 2010

EFFICIENCY

		<i>Low</i>	<i>High</i>
EQUITY	<i>High</i>	Continental 75 => 89	Nordics 52
	<i>Low</i>	Mediterraneans 83 => 95	Anglo-Saxons 42

The A-S model was in fact fragile

SUSTAINABILITY

2004 => 2010

EFFICIENCY

		<i>Low</i>	<i>High</i>
EQUITY	<i>High</i>	Continental 75 => 89	Nordics 52
	<i>Low</i>	Mediterraneans 83 => 95	Anglo-Saxons 42 => 81

Only the Nordic model still looks sustainable today

		EFFICIENCY	
		<i>Low</i>	<i>High</i>
EQUITY	<i>High</i>	Continental 75 => 89	Nordics 52 => 53
	<i>Low</i>	Mediterraneans 83 => 95	Anglo-Saxons 42 => 81

The danger: a vicious circle

- Crisis
 - » Lowering of potential growth
 - » Debt increase
- Ageing
 - » Lowering of potential growth
 - » Debt increase
- Lowering of growth => debt increase
- Debt increase => lowering of growth
- How to avoid this danger?
 - » Sustainability vs. austerity
 - » Increase growth
 - ✓ Increasing productivity: Europe 2020
 - ✓ Reforming European social models, and public expenditure (health and pension)
- The problem is particularly severe in some parts of Europe

A tale of two or three Europes

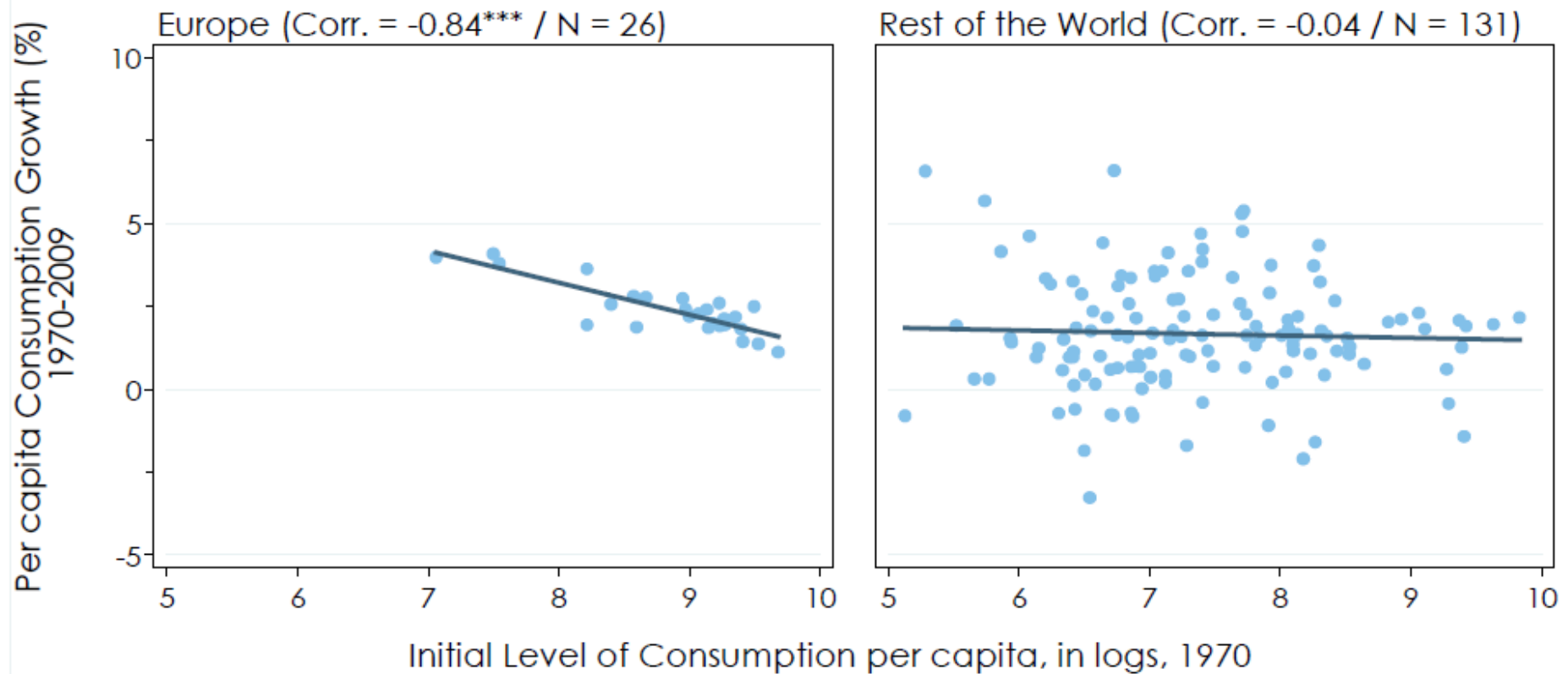
- Convergence = Europe's success story: core vs. periphery (South/East)
 - » Trade
 - » Capital flows
 - » EU transfers (?)

- The crisis has hit hard the peripheral countries

- The crisis hit Central and Eastern periphery first
 - » Sudden stop
 - » But generally healthy fundamentals => Speedy adjustment and recovery

- The crisis hit Southern periphery second
 - » Their growth model was flawed => Slow adjustment and recovery

Convergence: A European success story (1970-2009)



Source: World Bank (2011)

A tale of three Europes with one core and 2 peripheries

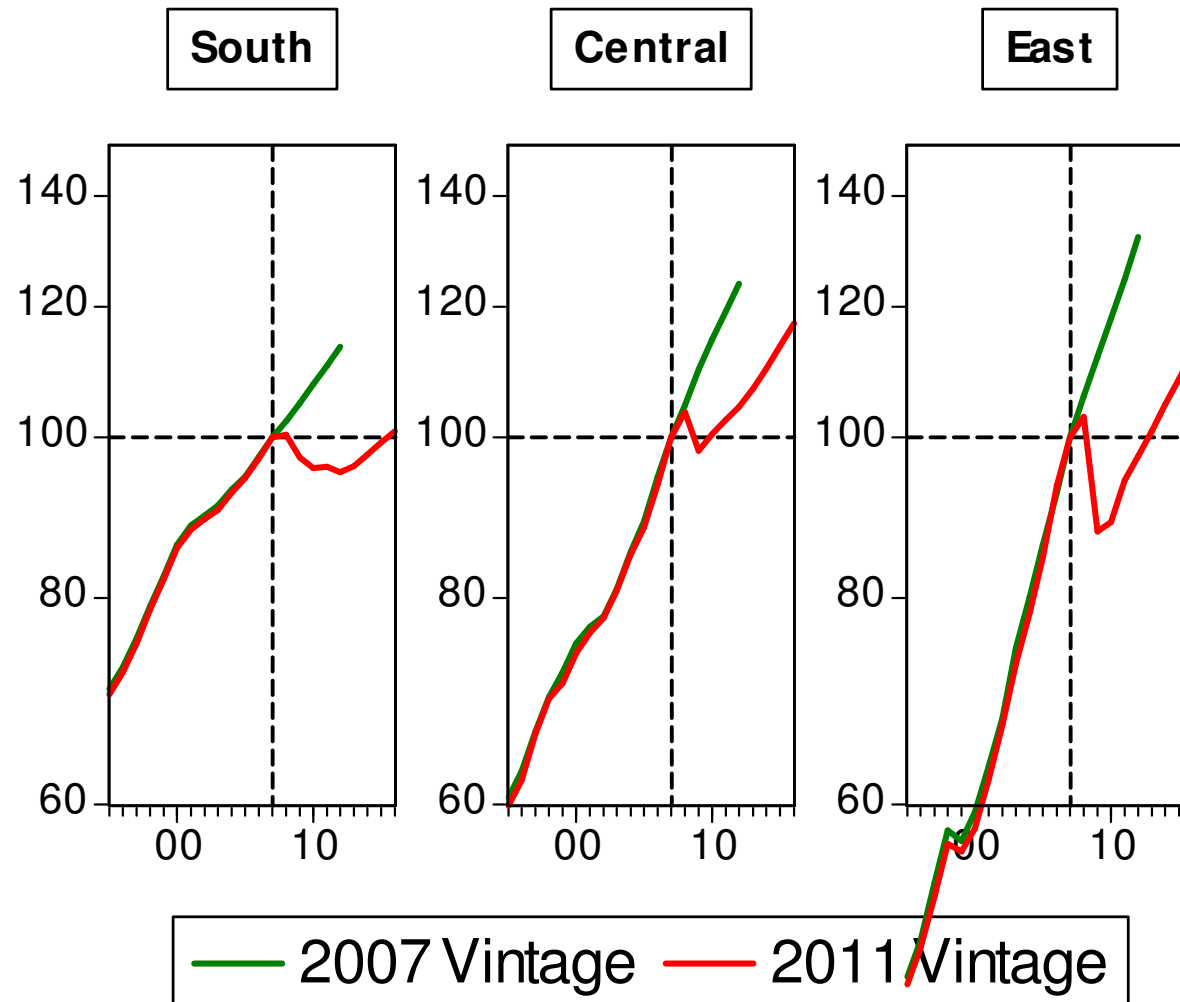
- Convergence = Europe's success story: core vs. periphery
 - » Trade
 - » Capital flows
 - » EU transfers (?)

- The crisis hit hard particularly some of the peripheral countries

- The crisis first hit the Eastern periphery
 - » Sudden stop in capital inflows
 - » But generally healthy fundamentals => Speedy adjustment and recovery

- The crisis then hit the Southern periphery
 - » Their growth model was flawed => Slow adjustment and recovery

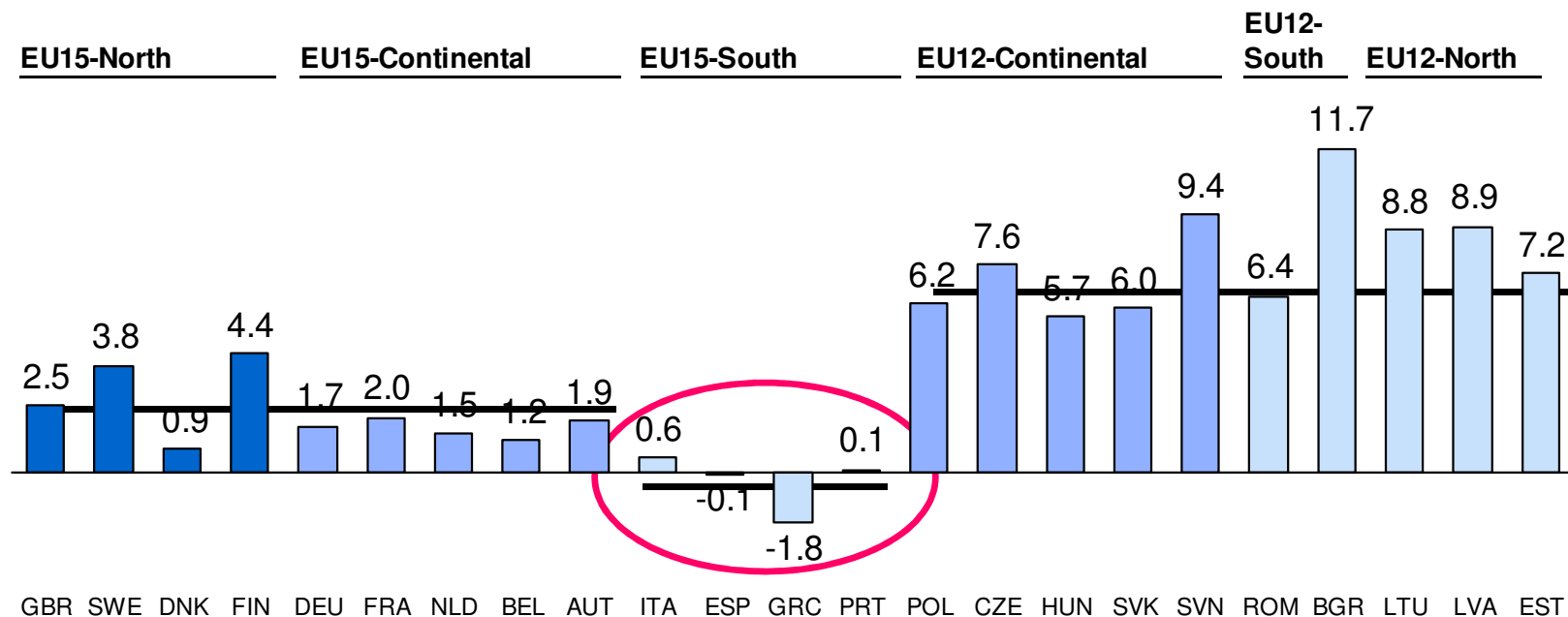
Growth since the crisis: South vs. Central & East EU



Source: Darvas (2011)

The South vs. other EU countries : Productivity

The east has been catching up, the south has been falling behind
Average productivity growth in EU27, annual rates, 2002-2007

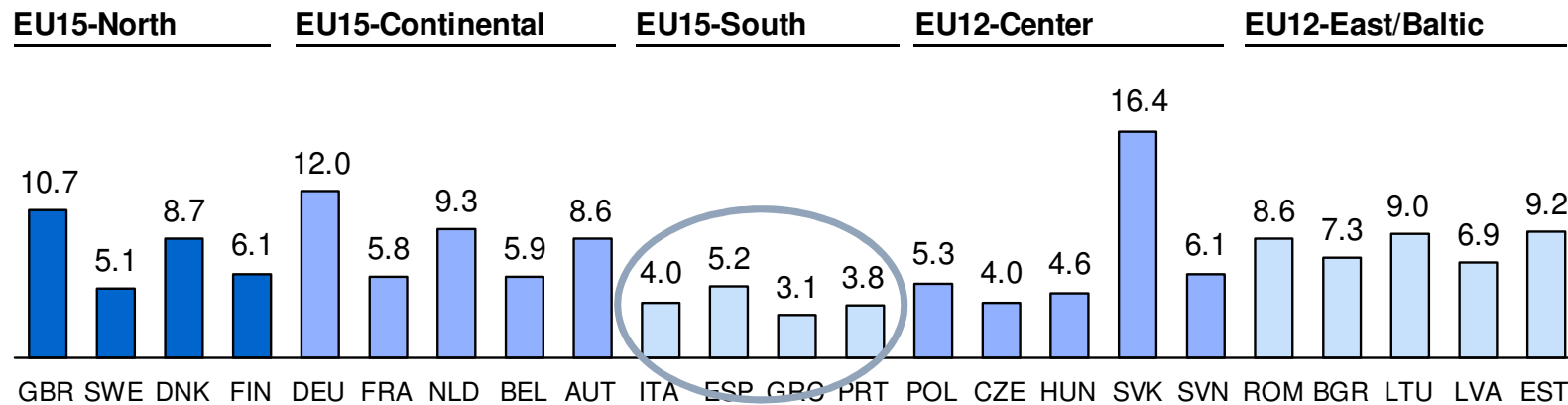


Source: World Bank (2011)

The South vs. other EU countries: Firm size

Firms in EU-15 South are consistently smaller than in the rest of the EU

Average enterprise size, number of employees 2003



Share of employment in firms with less than 10 employees (% , mid 2002-07)

22

23

44

35

25

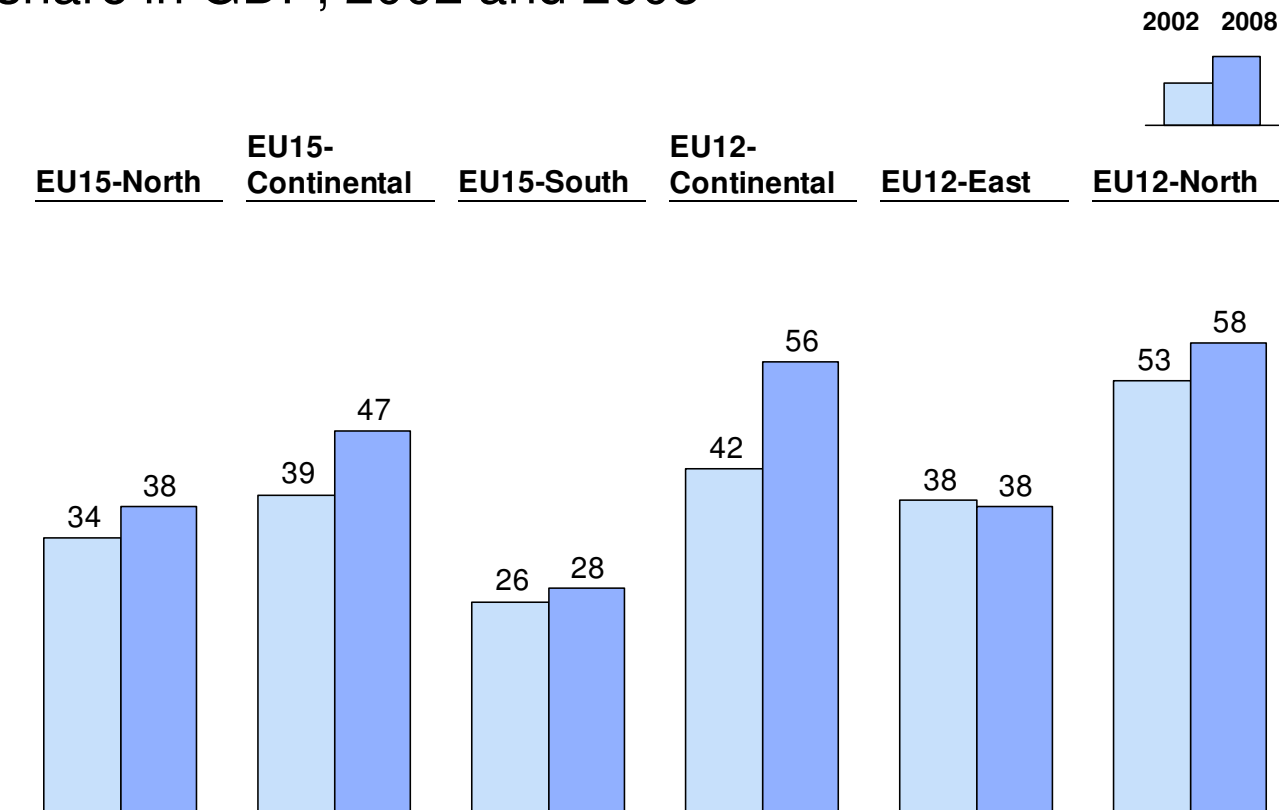
Source: World Bank (2011)

GRC 58

The South vs. other EU countries : Trade openness

Southern Europe is the least open

Export share in GDP, 2002 and 2008



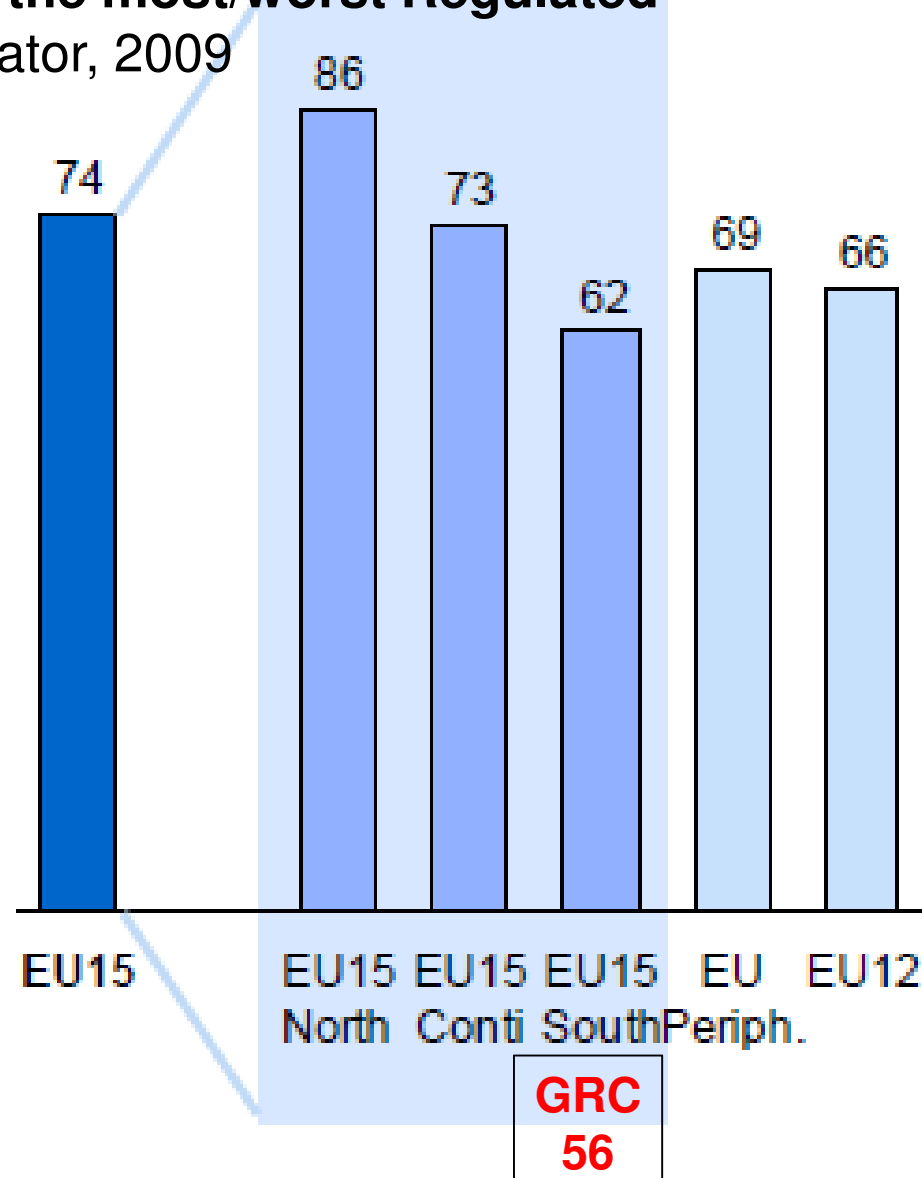
Source: World Bank (2011)

GRC 20

The South vs. other EU countries : Business regulation

Southern Europe is the most/worst Regulated

Doing Business indicator, 2009



Source: World Bank (2011)

The Southern countries have a big problem

- Their growth model, which is based on
 - » Small firms that don't invest enough in human capital and R&D
 - » Low trade openness
 - » Low manufacturing and generally tradable activity
 - » Inefficient and inequitable social systems,
- was already flawed 10-15 years ago due to
 - » Increased global competition from emerging countries
 - » Increased competition within Europe from the NMS.
- But they managed to avoid the necessary adjustment thanks to their adoption of the euro which permitted large net external debt positions, whereas the euro should have been an impetus for reform.
- Now these countries have both
 - » A competitiveness problem, mainly in my view vis-à-vis the NMS
 - » An external debt problem

What can Europe do to help?

- Improve the regulatory environment
 - » Single Market
 - » Competition policy, financial regulation, etc.

- Use better EU financial resources

Conclusions

- Lots has happened since the Lisbon Agenda was launched in 2000
 - » Globalization and global competition have increased at rapid pace
 - » The crisis has made this and the challenge of ageing more acute
 - » And it has added new challenges

- Serious danger of a vicious circle: low growth, high debt, low growth. But the solution cannot be to lower debt alone with austerity measures, also need to raise growth.

- The danger is different in different parts of Europe: core vs. South and East

- The main problem is in the South which took advantage of the euro to escape changing a growth model that was getting exhausted already 10-15 years ago

- Growth needs to be sustainable