



**The 2011 Euro Summit
Lisbon Council
Europe beyond the Crisis:
Charting a Successful Path towards Prosperity**

Tuesday, 15 November 2011

High-Level Panel Discussion

MARTIN LARCH
Head of Unit, ECFIN, European Commission



List of issues

- Sustainable prosperity at risk?
- Growth and prosperity: Long standing issue, new urgency?
- What are the main obstacles to growth?
- Crisis has already triggered wave of reforms! Not enough?



Current crisis is unprecedented in post WWII history

Key questions for medium to long run:

- Will recovery „simply“ last a bit longer? Business as usual once shock is over?

- Are we at a cross roads in economic development?
 - Crisis drastic signal that previous model was not sustainable? Harbinger of dismal prospects ahead?

 - Crisis as catharsis? Constructive destruction?



Growth and prosperity: Long standing issue, new urgency? (1)

The ,eternal' quest for prosperity

“In the long term, only increasing total factor productivity can lead to sustained economic growth.” Paul Krugman

Anaemic growth performance was already an issue well before the post-2007 global economic and financial crisis started. Debate on relative growth performance vis-à-vis the US heated up more than 10 years ago and peaked in pre-crisis years.

“While Europe’s level of productivity has almost converged, its income per person has levelled off at about three-quarters of America’s. How could Europe be so productive yet so poor?” Robert Gordon (2004)

Additional concerns as crisis drags on

Twin-challenge during the crisis: restore sustainability of public finances (and/or of balance sheets of non-government sectors) while protecting or possibly fostering growth.

Adjustment versus growth issue omnipresent in European policy debate. Also in recent programmatic documents of the Commission (e.g. 2011 AGS, The Single Market Act, A Roadmap to Stability and Growth, etc).



Growth and prosperity: Long standing issue, new urgency? (2)

Why has European growth lagged behind (the US)?

- Bottlenecks vs preferences?
- By sector: Retail revolution (Walmart model not so sexy to start with) and financial industry (no longer that sexy).

Can we simply grow out of the crisis (US and EU)?

- What about underlying problems?
- What type of growth? Pre-crisis tigers in EU turned into 'sinkers'.

“I will not let anyone tell me we must spend more money. This crisis did not come about because we issued too little money but because we created economic growth with too much money and it was not sustainable growth.” Angela Merkel



What are the main obstacles to growth and prosperity?

What are the options to boost growth? The new tripple challenge:

- Fiscal and monetary firepower largely exhausted. On the contrary, need to consolidated and regain control of public debt overwhelming in most MS. Little choice on that front.
- Structural reforms take time to be implemented and to produce results. How to overcome resistance?
- Pre-crisis economic paradigm no longer valid. Do we already have a new one? Do we know how to tame macro economic imbalances other than inflation and public debt?



What are the main obstacles to growth and prosperity?

Badly needed reforms not forthcoming (until recently)

“There is nothing more difficult to take in hand, more perilous to conduct, or more uncertain in its success, than to take the lead in the introduction of a new order of things.” *Niccolo Macchiavelli*

Prediction of dynamic OCA theory proved wrong. EMU did not trigger reform process to overcome heterogeneity/divergence.

- Integration of capital markets without integration of macro prudential supervision and regulation became short-term substitute for structural reforms.
- Entrenched political economy of structural reforms at national level.
- Economic Governance at EU level not effective enough.



What are the main obstacles to growth and prosperity?

Making reforms palatable

"We all know what to do, but we don't know how to get re-elected once we have done it." Jean-Claude Juncker

Reforms produce losers and winners? How to compensate for losses?

Past example at EU level: regional policy as price for single market.

Do we need new compensation mechanisms at the EU and national level?

Do we need to rethink national social systems?



What are the main obstacles to growth and prosperity?

Enhancing EU economic governance

Enforcement

MS did not adhere to SGP. Various EU reform agendas have been only partial success. However, tension between EU rules and national sovereignty persist. Further integration and stronger enforcement necessary but appetite for further centralisation limited !? Gradual progress only in the face of crisis (e.g. 6 pack, additional initiatives on enhanced surveillance)

New areas of coordination

Macro economic imbalances (EIP), macro prudential supervision (ESRB), financial regulation (three new EU authorities).

Creation of crisis resolution mechanism

Crisis resolution outside logic of previous EU governance model. Intellectual improvidence that produced large costs when the unthinkable arrived. New instruments (EFSM, EFSF, ESM)



Crisis has already triggered wave of reforms! Not enough?

Old wisdom vindicated: The crisis as catalyst

Economic progress, in capitalist society, means turmoil. Joseph A. Schumpeter

Few years of crisis more effective than decades of flowery reform agendas?

Combination of global financial and economic and sovereign debt crisis has produced unprecedented reform momentum.

Countries with financing gaps and/or clear reform backlogs have no choice but to implement comprehensive and ambitious reform programmes.

Once out of the woods, many EU Member States likely to be in much better shape.