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Foreign Policy Centre Briefing: The struggle to solve Europe's economic woes: Are Europe's leaders up to the challenge?

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What has now been dubbed the "Great Recession" has left Europe's economies in a conundrum on their future. How can Member states fight mass unemployment and recover economically while digging themselves out of large crisis-related deficits? Will Europe lose further economic ground to Asia and the US? And of more ominous urgency, will the euro survive it all?

The latest massive sell-off of Greek government bonds, taking the euro to another low point, laid bare the failings of the latest round of EU economic decisions at the European summit in March. The summit was a first attempt to agree on a new Europe 2020 economic strategy and a loan mechanism for Greece and other eurozone economies unable to refinance their debts on the markets. But a lack of clarity in both decisions left many unimpressed, as dramatically demonstrated on the Athens stock exchange and the need for a further statement by Eurozone finance ministers last Sunday.

Europe 2020

The decision to boost Europe's economic weight was taken no less than a decade ago. EU leaders created the so-called Lisbon Strategy in March 2000 to transform Europe into 'the most dynamic and competitive knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion, and respect for the environment' by 2010. The rationale for a common strategy lies in the high level of economic interdependence between Member states, making success or failure in one country crucial to others. If Britain, Germany, France and other European economies wanted to move their societies forward while not being left behind by other world economies, they were impelled to work together.

The original strategy involved forty-four indicators to achieve the headline goal – including specific targets like raising growth to 3% GDP per annum, increasing investment in R&D to 3% GDP and taking employment to 70% of the working population. Despite its laudable ambitions, by 2005 it had become obvious that Europe was not on course to becoming the world's leading economy. Growth remained sluggish, unemployment had lowered but not substantially, and continuing underinvestment in R & D and education dogged innovation and labour productivity growth. An official report by a high level group, chaired by former Dutch Prime Minister Wim Kok, was damning: "disappointing delivery is due to an overloaded agenda, poor coordination and conflicting priorities. Still, a key issue has been the lack of determined political action."[1] Without drastic action,

[1] "Facing the Challenge: The Lisbon Strategy for Growth and Employment", Report of the High Level Group chaired by Wim Kok, November 2004.

Europe’s growth potential would be halved to around 1% GDP per year, with serious consequences for living standards into the future. So a revamped strategy was launched, streamlining objectives – focusing efforts on structural economic and labour market reforms, while downgrading social cohesion and the environment.

The onset of the global financial crisis in 2008 finally put paid to hopes of achieving the Lisbon strategy by 2010. But it also raised the bar for the European Union, calling for more European cooperation than ever before to prevent the banking meltdown, fight the recession and bring about new growth and jobs. As Dominique Strauss-Kahn, IMF Managing Director, recently noted: “In the post-crisis era, international policy cooperation will be even more important to secure stable, strong, and balanced economic growth. […] in the context of Europe, […] a broader framework of policy cooperation—encompassing monetary, fiscal, financial, and structural issues—is needed to bolster economic growth.” So last month, the European Commission proposed a new strategy, Europe 2020, intended not only to tackle the previous Lisbon strategy’s failings, but also define the new economic paradigm that should emerge post-crisis.

The Commission’s proposal for “smart, sustainable and inclusive growth” sets five headline targets for the year 2020: 75 % of the population aged 20-64 should be employed; 3% of the EU's GDP should be invested in R&D; the “20/20/20" climate and energy targets for greenhouse gas emissions reduction, energy efficiency and renewables should be reached; the share of early school leavers should be under 10% and at least 40% of the younger generation should have a tertiary degree; and 20 million less people should be at risk of poverty. Member states would establish national reform programmes, as in the previous strategy, and policy warnings would be issued to countries failing to meet the targets. Implementation would also be improved by synchronising the coordination mechanisms of Europe 2020 with the Stability and Growth Pact so as to make deficit reduction compatible with investments.

In addition, the Commission has proposed seven flagship initiatives to achieve the targets through EU and national level actions: an "Innovation Union" to improve framework conditions and access to finance for research and innovation; "Youth on the move" to improve education and mobility for better youth employment; "A digital agenda for Europe" to speed up the roll-out of high-speed internet; "Resource efficient Europe" for environmentally friendly growth; "An industrial policy for the globalisation era" to improve the business environment and promote globally competitive industries; "An agenda for new skills and jobs" to modernise labour markets promote lifelong learning; and a "European platform against poverty".

However, the Commission’s Europe 2020 proposal came in for major criticism on a number of fronts. The choice of targets appears arbitrary and leaves question marks as to how these translate into a transformed

European model for sustainable development, particularly as they are no mid-term targets to deal with the ongoing economic crisis. Europe's Employment Ministers have called for the addition of stronger measures to tackle rising mass unemployment of over 23 million Europeans. The upcoming chairperson of the Employment Council, Belgian Minister Joelle Milquet, suggested that specific policies, such as direct job creation tools, should have been included.

Major political and non-governmental stakeholders are also unhappy. The Party of European Socialists – Europe's federation of government and opposition labour parties – has similarly criticized the failure to prioritise the fight against unemployment and has called for a coordinated investment strategy "underpinned by new fiscal resources", including Eurobonds. Labour party leaders warned that premature withdrawal of stimulus measures would kill new growth potential and also criticized the "lack of concrete objectives, targets and measures on strengthening social protection, overcoming social inequalities and exclusion and improving the quality of work and life", calling for legislation to guarantee public services and minimum income schemes.[2]

The European trade union confederation, European environmental bureau, Social Platform and Concord, criticized the lack of policy tools and have written to European leaders asking them to "develop within a year specific targets on improving public services, social protection and quality of jobs […] new ways of raising public funds, such as using Financial Transaction Taxes and Eurobonds, harmonise capital gains taxation, and shift at least 10% of the revenue or tax-base away from labour to environmental pressures, resource use and capital."[3] While Europe's main business lobby, BusinessEurope, criticise the lack of urgency and focus in the strategy, calling for a "Go for Growth" target of 2% GDP by 2014, accompanied by a variety of measures to foster business and job creation.[4]

Furthermore, commentators and campaigners have also noted the absence of any significant shift in economic paradigm. A key issue is the use of GDP as the main measure for economic development. In view of the widespread rise in social inequalities and climate change, President Sarkozy established an International Commission on the Measurement of Economic Performance and Social Progress, chaired by Nobel Prize winner Joseph Stiglitz last year, which made recommendations on defining measures beyond GDP for long-term sustainable development. Stiglitz highlighted the importance of the issue for Europe in these terms: "In the years preceding the crisis, many in Europe, focusing on America's higher rates of GDP growth, were drawn to the US model. [..] A good set of metrics captures the notion of economic as well as environmental sustainability. And there have been long-standing concerns about the use

[2] "A clear choice for Europe: Solidarity or Self-interest, Recovery or Austerity", declaration adopted by PES Prime Ministers and Leaders' conference, 25th March 2010.
[3] "Civil society network calls on EU leaders for bold EU 2020 strategy, 23rd February 2010, www.etuc.org/a/7078
[4] "EU strategy should be more focused on the short term", interview with BusinessEurope President Jürgen Thumann, Euractiv, 24th March 2010.

of market prices, especially for evaluating long-run sustainability. These proved warranted: the seemingly strong performance of some countries (as indicated by GDP) was not sustainable and was based on "bubble" prices that exaggerated profits and output."[5]

The European Commission issued a report "Beyond GDP and Beyond" in August 2009, promising to complement GDP with social and environmental indicators. But since then the issue appears to have been swept under the carpet, leaving the traditional economic growth orthodoxy unchallenged. Claude Turmes and Phillippe Lamberts of the European Greens complained last month that "rigid attachment to GDP growth as the driving target for economic development is a recipe for repeated failure. […] New indicators are needed."[6]

Troubles at the summit

The March European summit confirmed that the Europe 2020 proposal did not gather consensus amongst European leaders either. Several decisions were postponed on its precise targets and design until June. The education targets have disappeared for the time being as Chancellor Merkel claimed that these would infringe on Germany's federal competences (despite the fact that Europe already boasts more than one education target). The poverty reduction target was also deleted for further consideration, following reservations expressed by EU Finance Ministers. Following the summit, the Spanish Prime Minister José Luís Rodríguez Zapatero announced that he now wanted to add gender equality as a major theme of the strategy - including the reduction of the gender pay gap and raising female employment to 70% by 2020 – further confirming the summit's failure to reach a decision on core priorities.

Moreover, one of the major flaws of the Lisbon strategy - coordination – remains unresolved. Although there is greater clarity in what Member States and the European Union should respectively do at their levels, there is no answer on how to reconcile the huge investment needs for sustainable growth and employment with the demands for reducing crisis-related public deficits. On this point, Chancellor Merkel stood in the way of attempts at greater policy coherence by torpedoing the idea of coupling the policy coordination mechanisms of Europe 2020 with that of the Stability and Growth Pact. Merkel claimed that this would have "politicized" the Stability Pact, thereby endangering enforcement of the 3% GDP deficit limit.

Indeed differences on how to improve European economic governance could deal a fatal blow to the chances of the Europe 2020 strategy. Chancellor Merkel and President Sarkozy had announced back in February at a Franco-German summit that they would be making a joint proposal on economic governance. But their show of unity soon unraveled as French Finance Minister Christine Lagarde publicly criticized Germany's export-orientated growth model – which has relied on strong wage

5 "Towards a better measure of well-being", Joseph Stiglitz, Financial Times, 13th September 2009.
6 "EU 2020 Strategy: Commission presents myopic attempt at 2020 vision", Greens press release, 3rd March 2010.

moderation and low internal demand – for causing macroeconomic imbalances that were unsustainable for other countries in the eurozone.[7] Berlin rebuffed the criticism and, within two days, German finance minister Wolfgang Schäuble presented a tough German "exit strategy" from economic stimulus measures, thereby suppressing any hopes that Germany might be the motor of European recovery.

The Franco-German dispute revealed wildly different interpretations of European economic governance: Germany sees it as a means to impose more budgetary rigour, while France wants to use it for more balanced and coordinated pro-growth policies. The European Commission has now been charged with making recommendations on economic governance to the next European summit in June, but the question remains how an agreement can be reached in view of this fundamental divergence.

The future of the euro: the Greek test case

At the same time, divisions on how to handle the single currency area have further compounded Europe's economic woes in recent weeks. Last week's sell-off of Greek bonds confirmed that the markets had been left unconvinced by the European summit deal on a loan support mechanism, notably because it seemed to offer the loans on market rates, which would defeat the purpose of a bailout. The interest rate reached a high of 7.45% on two-year Greek bonds last week, which is regarded as unsustainable for Greece.

A breakthrough was achieved in an urgent conference call on 11th April amongst eurozone finance ministers where they finally agreed the details of a three-year loan package. If activated on the basis of a Greek request for help, the package would amount to EUR 30bn in eurozone contributions with an additional IMF contribution of up to EUR15bn for the first year, at significantly below market interest rates of around 5%. Greece is now hoping that this offer will reassure the markets, thereby lowering the prohibitively high market interest rate. The first market reactions on 13th April suggest that this is working. Greece wants to avoid a bailout involving the IMF where the latter would seek to impose tough conditionality, including dismissals in the public sector, which could cause further unrest. For Chancellor Merkel, IMF involvement was a pre-condition for the deal and something of a political face-saver, given her staunch resistance to a eurozone support mechanism that would be largely funded by Germany.

The loan mechanism is a step forward for the management of the single currency – and details of the plan have resulted in the euro making its best single-day gain since August 2009. Indeed the Greek crisis has brought a broader debate on how to improve governance. Germany has insisted on a new commitment to stricter economic and budgetary surveillance as well as stronger enforcement mechanisms against

[7] Interview, Financial Times, 14th March 2010

profligate Member States. A new crisis resolution framework will also be put in place. To work out all the details of this tougher stance on fiscal discipline and crisis management, a taskforce will now be set up by European Council President Van Rompuy and the Commission, composed of Member State representatives, the rotating Presidency, and the European Central Bank. The taskforce is due to report their recommendations by the end of this year. One threat already issued by the German Chancellor – which has sent shivers down the spines of many pro-Europeans - has been the possibility of changing the EU treaty to allow the expulsion of a Member State from the eurozone. The euro may no longer hang in the balance in the short term, but its future is far from certain.

Next steps

Europe's internal divergences will also have repercussions for its influence in shaping the global economy at the upcoming G20 summit. Currently there is no European consensus on a number of key issues. Germany is siding with China in attempting to minimise discussion on macroeconomic imbalances in the face of other European countries like France and the UK that wish to promote a more sustainable and balanced global growth strategy. There is also no European agreement on the appropriate form and timing of the exit from economic stimulus policies, which leaves the Canadian hosts with a freer hand to push their own agenda for an exit strategy in the summit conclusions, as the Canadian Prime Minister recently indicated as a priority.[8] Pascal Lamy, Director-General of the World Trade Organisation and a former European Commissioner, has gone so far as to remind the Europeans that their failure to coordinate could entail their irrelevance at the G20: "If one European expresses himself, then another…nobody listens".[9]

Leaders now have until their next summit of 17-18 June, just a week before the G20 meeting in Canada, to agree on the fundamentals of governance and strategy for the sake of Europe's economic future as well as Europe's ability to lead the shaping of the future world economy.

[8] Speech from the Throne, Canadian Parliament, 3rd March 2010.
[9] "The WTO advises Europeans to speak with one voice", Le Monde, 28th March 2010.