



Driving Sustainable Recovery in Europe:

Time to rethink structural reforms

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Document based on the discussion organized in collaboration with FAES in Madrid (25 March 2010) of papers presented by prof. Luis Graciano, professor of Economics and Strategy (London School of Economics) and Dr. Diego Valiante, of the European Capital Market Institute.

In the framework of the EU 2020 Strategy proposed by the Commission, and partially endorsed by the late European Council, member states are required to devise their **national 2020 action plans**. Some, as Belgium, have started the process already.

This is an excellent opportunity to restart some mid-term thinking about structural reforms.

At national level, one has to **analyze complementarities between the return to budgetary discipline and the necessary reforms on the supply side**.

Opposing budgetary and fiscal consolidation to growth policies is a non-sense. Both have to go together and in carefully planned and coordinated sequence.

If one has clearly to understand the mid-term evolution of the demand side within the European Single Market (as the recent Cohen report to French Prime Minister tries to do), artificially engineered demand will lead nowhere but to further decline in competitiveness and increased imbalances between countries and regions in the Union.

A CLEARLY TARGETTED FAST TRACK APPROACH IS NEEDED

- Structural Reforms are in disarray throughout Europe after eighteen months of crisis management. One desperately needs an overall framework for action. The crisis has severely reduced the margin of manoeuvre of member states: time and resources are even more constrained than before. **Therefore gradualism is not an option anymore.** The requirement today is for every member state to establish a comprehensive plan, maximizing complementarities between the different structural reforms, as, for instance, those between labour market reform and pension reform. Time is running short
- One has also to refocus on **productivity growth**. Without productivity growth no real wage growth will be attained and in many member states the welfare state will become unsustainable on the long run. Imbalances in productivity gains will put national budgets and the long term stability of the Euro at risk. The loss of structural competitiveness (prices and salary grown too fast in comparison with productivity gains) severely affect many members of the Eurozone. There is no easy solution to that key challenge.

FURTHER INVESTMENTS IN HUMAN AND LEGAL INFRASTRUCTURES ARE REQUIRED

- Innovation is not enough to lay down the basis for growth by itself: innovation should be completed by **investments in human, physical and legal infrastructure and the shaping of more competitive markets**. The expected return on such investments is to be measured and accounted for more carefully than in the past.
 1. **Investment in human infrastructure** involves the reengineering in the primary education first, because this is the sector in which lasting imbalances are started. This is the task of member states and regions. One also needs a new approach to health issues (including prevention): the present growth of health related costs is not sustainable. This is also a domain for national action. Only people in good health will be able to remain active participants in the job market after 65. A creative approach to investments in health is needed.
 2. **The improvement of physical infrastructures** is a necessary step to increase energetic resilience and competition in network industries within the Union. Smart grids are part of the picture. The improvement of physical infrastructures is greatly needed in the field of energy in order to increase market efficiency and security of supply. Some argue that such a move cannot happen unless the Union has increased competences in the field of energy.
 3. **Further steps forward in the Union legal environment** are needed now so as to reduce the present risks of corruption and to strengthen the implementation of the existing legislation. Temporary measures and exemptions that were needed to smooth the management of the financial crisis by member states should be abolished as soon as possible. The return to the common principles of the Single Market and the return to a normal functioning of control and sanctions mechanisms managed by the Commission should be considered a priority by all European Institutions.

4. The completion of the Single Market for products is not enough: **labour, housing and financial markets** are still far from being harmonized, competitive and transparent enough both at national level and at European level. National action is required together with further regulation at the European level.
- Misconception seems to prevail as far as "innovation" is concerned: investment in university R&D is far from being the core requirement of an innovation policy: private R&D and early transfer of knowledge are the core of such a policy. Companies, small but also larger companies, have to be recognized as the key actors of innovation. One has to be careful to keep research careers as attractive in Europe as in other knowledge based economies. The human infrastructure of innovation, including up-to-date curricula in the school system, is an important element of long-term competitiveness. An effective European patent system is an important element for any European integrated innovation policy. The impact of the Union research spending on overall innovation should be evaluated more carefully.
 - **Structural reform of financial markets at national levels and at European level is an important step in sustainable recovery:** investor confidence has been decreased and access to credit by companies reduced. That situation has to be reversed by better service, transparency and information for the investors.
 1. Investors need protection, better transparency, market integrity and efficiency, besides adequate supervision and competitiveness
 2. to prevent misselling practices in financial services (unbalanced and upfront fees, hidden costs), promoting MIFI Directive business conduct standards will not be enough, harmonization of investor protection rules should be made legal across all distribution channels, and private enforcement as collective redress schemes made possible for all investors ;
 3. to ensure transparency regulation is necessary to ensure that price sensitive information is continuously and timely disclosed by sellers to minimize information leakage and impaired price formation ; suspension should be considered an option if market actors fail to provide such information ;
 4. A new EU supervisory structure should function under majority vote, with binding standards and emergency procedures.

ACCOUNTABILITY AND SUBSIDIARITY

- Evaluation of structural progress made at national level requires **a common metric** to hold governments accountable and to communicate to the public. Preliminary impact assessment is needed but also regular ex-post evaluation
- Duties should be carried out at home first as every country is a specific case for structural reforms - hence the importance of 2020 national action plans.

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