

## **Facing up to Europe's growth deficit**

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As always it's a pleasure to be in Paris, and of course it's an honour to speak here at Sciences-Po. During my four years as EU Trade Commissioner I came here to Paris often, but I have to say that a trip to Paris often meant I had irritated someone important. So it's rather nice to be here and *not* feel like I'm in trouble somehow!

And I have to say that those four years only reinforced my respect for France's commitment to a strong and resilient EU. The French Presidency in 2008 was a high point for Europe's projection in the world. This augurs well for 2011 when France chairs the G8 and the G20.

In every respect, I wanted, and want, the same strength and resilience for Europe. And in that sense the arguments about globalization, or trade liberalization were, and are, eminently worth having.

I am often caricatured as a bit of an Anglo Saxon liberal in France. As a typical free market, free trade Brit. And I am a liberal at heart, with all the necessary caveats. But ironically, *really* ideological liberals in Britain and America regard me as *dangerously French*. So you can't believe everything you read...

Today I want to make three arguments, and I will try to be a bit provocative about this so as to keep things interesting.

The first is that we are in economic trouble in Europe. Europe's long term economic strength is more vulnerable now after the banking crisis and the recession than it has been at any point for a generation. This threatens not just our prosperity and our solidarity, but weakens our ability to project Europe's influence more widely in the world.

The second is that the EU is key to responding to this, but that we need to rethink some of the basic ways in which we use EU policy as a way of driving European economic growth. We are in the process of updating the Lisbon Agenda for another decade. Professor Mario Monti is working on recommendations to the Commission.

This is a moment to challenge some parts of the status quo. In particular, we need to refocus EU policy and EU budgets more on innovation, low carbon and high technology research and development. We need to focus on the

commercialization of science and technology because this a route to more jobs and growth.

My third argument is that a genuinely transformative agenda for the European economy has to be owned by the European Member States themselves.

This week the European Commission will set out its “Europe 2020” proposals for economic reforms. It is important that the Commission is doing this and we should support it. But the challenge of difficult reform cannot simply belong in Brussels. We cannot subcontract it.

### **Prosperity at risk**

Over the last twelve months a huge chunk of the growth and employment generated by the European economy over the last decade has simply been wiped away.

The banking crisis and the collapse in public revenues following the recession have undone twenty years of public financial consolidation in Europe. Not least in Britain – and I am quick to acknowledge that.

So we face this huge challenge of reconstruction, renewal, rebalancing. We need to upgrade Europe’s economic model. The broader pressures on us as an economy and a society have not changed. In fact they have been compounded by the challenges of economic recovery.

Like Japan, we are ageing while most of our major economic competitors remain demographically skewed towards relative youth.

After the relative luxury of playing catch-up with America over the last decades of the 20th century, now the emerging economies, especially, but not only in Asia, are playing catch-up with us. Indeed, in many respects they are already breathing down our necks.

Pressure on many traditional sectors means that European businesses and entrepreneurs will need to create millions – probably tens of millions – of new jobs over the next decade. And we will have to do this while progressively raising the cost of carbon to reach our climate change targets and operating in public spending constraints.

In this light it is alarming that the 1.5% growth rates projected by the European Commission for the EU after 2010 describe an economy limping into the future.

And there is no escaping the fact that this is a collective European problem. The largest 'external' market by far for every European Member State is the rest of the EU. So there will be no sustained national recoveries without a European recovery.

Sharing a single market, a single banking system and, in part, a single currency is a source of great potential strength for Europe. But it is also a declaration of inter-dependence that we have to make work.

The credit crunch has provided a necessary wake up call with respect to the inter-dependence of our financial markets. That is why we took the *de Larosiere* route to toughened and harmonized financial market regulation in Europe and globally. A route which needs to remain as now agreed, and on which the UK is as determined as anyone.

The debate over the response to Greece's budget deficit and the need to rebalance demand across the EU is an extreme reminder that the divergences between us in our national competitiveness and fiscal management can turn out to be everybody's problem. The credibility of big projects like the euro depend on our willingness to defend them when the going gets tough.

So the bottom line is that Europe has a growth deficit which is putting our future at risk. We are rightly proud of our social models, and I believe that they are an important part of our response to a world of very rapid economic change. But they are not cheap. The only way to ensure that they remain affordable is to put the European economy on a stronger path to growth.

### **The policy response**

So how do we do that? Well, we start by recognizing what we have got right over the last two decades. We have got right our commitment to open competition and better regulation as the basic dynamic for improving productivity.

We have got our response right in the Lisbon Agenda's basic commitment to labour and product market reform and flexibility. One of the big goals for the new Commission needs to be the deepening of the Single Market in services, which remains unrealized.

There have been plenty of people who have argued that the banking crisis has put these things in question, but they are wrong. The answer to Europe's problems is not to reverse the openness of the single market or to cut it off from competition or trade or to make it harder for people to move from job to job.

But we do need a stronger strategic approach at the European level. Not the *dirigisme* of the 70s and 80s that tried to direct industry or counter the basic logic of comparative advantage or commercial viability, but a much better sense of how we are going to focus on and drive a deepening of our longterm economic and industrial strengths.

We need a more strategic approach that invests heavily in the things from which viability and comparative advantage emerge. Infrastructure, skills, innovation, our science and research base and the effectiveness of our capital markets. This is the best way to make the most of the opportunities offered by globalisation.

Europe has spent a decade focusing on freeing up the supply side of its economy. Now we also need to think how we *equip* the supply side better for global competition through a combination of sharper business models and government covering more of what markets are failing to provide.

As one example, EU markets currently fall far behind the US in making available venture capital for small firms. The EU venture capital market is about a quarter of the size of that in the US. If we were to give the European Investment Fund the freedom to draw in an additional €billion from private capital markets to invest in venture and growth capital funds we could close that gap. The benefits for small firms with high potential would be substantial.

The UK also supports adapting EU State Aid rules to raise the cap on the maximum size of publicly-backed risk capital investments to €million per company per year.

We would also like to see the creation of an EU-wide Small Business Research Initiative similar to that used in the UK. This is a programme that provides public contracts to SMEs to enable them to research and develop new solutions to public procurement challenges – setting them the problem and commissioning an innovative solution that saves money for taxpayers. We would like to see a similar programme established at the European level.

There are a range of basic targets that EU states should commit to meeting. The Commission has set a target of 5 million high quality apprenticeships in the EU by the end of this year. All homes and businesses in the EU should have access to broadband at 2Mbit per second at least by the end of 2013 and at least 50Mbit by 2017 – creating the digital infrastructure that the modern European economy will depend on. Patent Offices in Europe should create a fast track patent for low carbon innovations.

These goals are simple, but they are concrete and real, and relatively easy to achieve with the necessary coordination and political will. They represent measurable improvements in the way the EU supports the young, the innovative, the entrepreneurial.

They are part of a new ‘EU Compact for Jobs and Growth’ that Britain has proposed for adoption by EU leaders, and which we hope will be widely taken up in the European Commission’s new research and innovation plan, which Britain strongly supports.

But I would argue that we need to go further than this and rethink the whole orientation of the EU budget. The way the EU spends money is too strategically passive. Only 5% of its budgets are spent on low carbon. There is not enough focus, for example, on EU digital communications and low carbon transport infrastructure. Only a quarter of structural funds support research and development.

Measured against the challenges we face, this suggests we need to think afresh about our priorities. In this respect, I very strongly welcome the fact that the new Commission has created portfolios for innovation and the digital economy.

## **Leadership**

And that brings us to the question of European political leadership. Politically the EU is an unusual animal. We are deeply interdependent, but we are also sovereign states.

Part of our solution to this has been to create strong and effective institutions in Brussels to protect and advocate the European collective interest. The European Commission may be unloved by some – institutions are not loveable things - but it has been the glue that has held the expanding European Union together and this must remain the case.

But the Commission’s leadership is, of course, only as good as its members. It is only indirectly accountable to Europeans. While being string in its advocacy, it cannot wholly implement reforms. That is why its authority must always be exercised with the tacit approval of the European Council. Being EU Trade Commissioner left me in no doubt about that.

But the Commission’s great strength lies in its ability to take the long view, and sometimes the politically difficult view, and the wise rather than the populist view. European governments can have short memories and short attention spans, and the institutions are there to hold them to the promises they make.

So although I have always argued, and I argue strongly now, that we do need greater political leadership from Europe's states, this cannot come at the expense of strong institutions.

What we need is both. We need a strong Commission to drive the agenda. But the Commission needs to be anchored in the strongest possible consensus from Member States in favour of ambitious change. Both sides need to remember their part of the bargain.

Europe's greatest achievements have been driven by strong Commissions acting with the clear backing of visionary political leadership from the Council. The creation of the Single Market, the creation of the euro and the enlargement of 2004 all combined disciplined Commission leadership with clear political patronage from Member States.

This is the kind of dynamic that we want to create with the EU Compact for Jobs and Growth. It would act as a political agreement between the European Member States, the new President of the Council and the Commission.

It would establish annual economic summits of EU leaders that would set the direction of travel for EU and national economic policies, identifying the key barriers to faster growth and more jobs. They would bring together and assess EU reporting on public finances, economic reform and financial markets.

European governments would establish national targets in key agreed indicators like employment rates, productivity and capital investment. These targets would not be imposed top down as they have been in the past, but built bottom up.

And although Member States would have different starting points and aspirations, they must be challenged to be ambitious. They would be monitored by the Commission and held accountable for progress. This would be done openly and publicly, so that progress could be compared across Europe.

### **Conclusion: instruments and intentions**

It might seem an obvious point, but my time in Brussels convinced me that this goes to the heart of how the EU succeeds and fails. Almost everything about Europe depends on national political ownership of the idea that Europe and its agenda matters.

We should not make the mistake of confusing instruments with intentions. The Stability and Growth pact, the European Financial Stability Board, the Lisbon Agenda, even the Lisbon Treaty itself: these are all hugely valuable instruments.

But they have to be embedded in and advanced by, political leadership and the will to make them work.

The challenges of economic reform in Europe are not resolvable by simply passing more powers – or passing the buck - to the centre. That is just not politically possible, nor necessarily desirable, given national obligations to national taxpayers. It also ignores the need for national political ownership of difficult change.

But the corollary of this has to be an attitude of mind in governments that recognizes the critical European dimension of our national economic and political lives. This is true whether we are talking about changes to financial markets, tackling climate change or the defining of a more coherent European foreign policy.

And Europe certainly needs a more coherent voice in the high politics of foreign affairs and global governance. This is what the Lisbon Treaty aimed to deliver. The EU needs to build a deeper strategic relationship with states like China, India and Russia. Periodic summits and occasional visits do not add up to a substantial relationship.

But it also needs the less glamorous kind of political leadership that owns the hard day to day grappling with national economic reform targets and delivers them on time.

Many European national politicians still regard European policy as a distraction rather than a core part of their democratic mandate. When the time comes to spend political capital, the temptation, inevitably and understandably, is to spend it at home. But I do not believe that Europe can genuinely set a transformative agenda for its future until this starts to change. As future French leaders, this is part of your challenge.

So to sum up: we as Europeans face a growth deficit that threatens our prosperity, our solidarity and our capacity to project our influence outside of Europe. This is the moment to question some of the basic ways we think about the EU's strategic role in driving growth and innovation. This debate has started in Brussels. But this agenda, however much it is shaped and driven by the Commission, needs to be *owned* by national capitals. It needs to be *driven* by national politicians. It is, after all, our names that are at the bottom of the Lisbon Treaty.

I believe that despite the sometimes exaggerated rhetoric, France and Britain are much closer on these issues than the caricatures suggest. Over the next few months we should be at the forefront of defining this agenda. Britain and France

both believe that Europe matters. Right now, in the face of a very uncertain future, Europe matters more than ever.

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