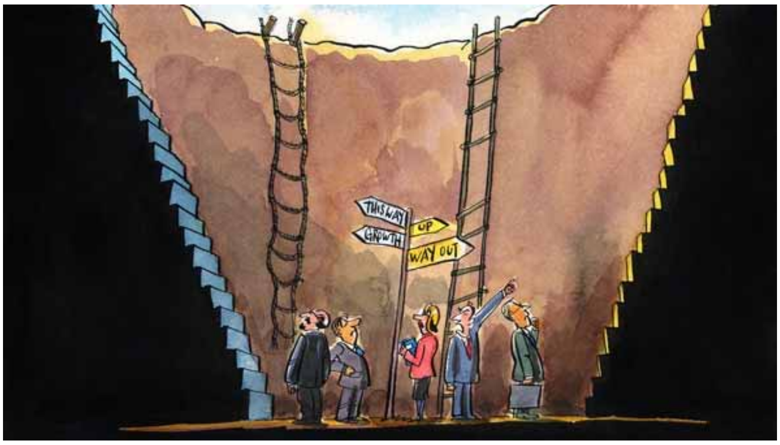
The Economist

Charlemagne

Hopeful or hopeless?

Europe struggles to find a strategy to grow out of its debt crisis

Jan 28th 2012 | from the print edition



THE buzzword in Brussels these days is "growth". Perhaps the looming recession across much of Europe is concentrating minds. Or leaders may realise that the prospect of years of austerity is stirring bad blood. Unless the debt crisis was resolved and growth recovered, said Christine Lagarde, the IMF's head, Europe and the world risked reverting to the 1930s. At their next summit on January 30th, European Union leaders will solemnly talk of boosting output, tackling youth unemployment, supporting small firms and much else. They might even commit money to job creation, for example by recycling unspent EU funds through the European Investment Bank.

Do not be fooled by such pieties. Everybody has different ideas about growth and they often reflect longstanding prejudices. For Germany, fostering growth is not about spending more money, but about fiscal discipline and structural reforms in weaker countries. For France, the priority is to curb "disloyal" competition, by harmonising taxes to stop low-tax states (eg, Ireland) taking business away from high-tax ones (eg, France), or stopping Britain from imposing tougher rules on its banks that might make them seem safer than French ones. For the British, Dutch, Swedes and other north Europeans, growth should come from the boost to competition from deepening the single market and pursuing free-trade agreements. For ex-communist countries in the east, the secret is the vital role of EU transfers.

Beyond papering over such disagreements with official verbiage, the main business of the summit will be to push ahead with the "fiscal compact". This requires the signatories to adopt balanced-budget rules. "They are going to sign a treaty that makes Keynesianism illegal," comments one diplomat. Mrs Lagarde, for her part, seems to lean the opposite way. Her recommendations for growth include easing monetary policy; relaxing deficit-cutting in surplus countries, such as Germany, that can afford to boost demand; and ensuring that banks keep lending. She is also urging the euro zone to increase the size of its rescue fund. And she makes the case for a Europe-wide system to support banks and for the mutualisation of some sovereign debt.

Mrs Lagarde's words will fall on deaf ears in the country that most needs to hear them, Germany. So is Europe doomed to paralysis? A World Bank report on Europe, launched this week, tries to sound optimistic. As the report's main author, Indermit Gill, puts it, "America has taken in poor immigrants and turned them into high-income individuals. The European Union has taken in poor countries and turned them into high-income countries." Its economic model is valid, even if it needs reform.

Two problems stand out. One is the scale of European public spending. If America is a defence superpower, spending almost as much on defence as the rest of the world combined, Europe is a "lifestyle superpower", spending more than the rest of the world put together on social protection. Big governments tend to slow growth, says the World Bank, unless they are as effective as Sweden's. Ageing will add to the burden. For Mr Gill, Europeans can still choose to work shorter days and take longer holidays than Americans, but they can no longer afford to retire early.

It would help if Europe were more productive. But this is the second area of concern. Having almost closed the productivity gap with America in the mid-1990s, Europe is again being left behind. This trend is most alarming in southern Europe, where productivity has actually dropped. A simple explanation is that Mediterranean countries enjoyed easy "catch-up" growth by importing technology. New growth needs the harder graft of innovation and enterprise. Southern economies with cumbersome regulation, poor administration, overreliance on tiny family businesses and an over-protected labour force are bad at this. Fixing that will be the work of a generation, not a summit.

Even without its Mediterranean headache, Europe produces too few high-tech start-ups in areas such as IT and biotech. The causes are varied. One is poor synergy between industry and universities. Another is the fragmentation of the single market, making it harder for new firms to expand. Even the internet is filled with frontiers, as anyone who tries to shop across EU borders online can attest.

Patently absurd

One emblematic problem is the decades-old quest for a common EU patent. Europeans can pay five times more than Americans to protect their ideas, because they need to lodge separate patents and translate documents in each country. The cost of litigation is similarly multiplied. A simple one-stop shop would encourage innovation and cut costs. Yet the common patent was long blocked by linguistic chauvinism. English, German and French are the obvious choices. But Spain and Italy wanted their languages recognised too, or to have an English-only patent system (the cheapest option). The logjam seemed to be broken last year, when 25 countries agreed to push ahead without Italy and Spain under "enhanced co-operation". Despite lawsuits, a deal was within reach last month.

But this is now being blocked by a fresh dispute, over whether the main patent court should be in London, Paris or Munich. Some money is at stake (a court creates a market in legal services), but the row is mostly about prestige. As Europe's biggest issuer of patents and host to the registration office, Germany thinks it should also have the court. Britain and France are in no mood to yield to each other after December's bust-up over the planned new treaty. But if the big countries cannot agree on a small but obvious step to enhance growth, what are the chances of the EU opening up the entire market in services? No wonder the rest of the world and the markets are losing faith in Europe.

Economist.com/blogs/charlemagne (http://www.economist.com/blogs/charlemagne)

from the print edition | Europe