in brief...

What's wrong with Europe's economy?

The argument that Europe needs deep structural reform is often overstated – but not in relation to pensions

There is a conventional wisdom that Europe's poor economic performance is a sign of deep structural problems, which must be addressed by product market liberalisation, labour market reform and reduction of uncompetitive tax burdens. But writing in a new CEP book, **Adair Turner** argues against that conventional wisdom. In his view:

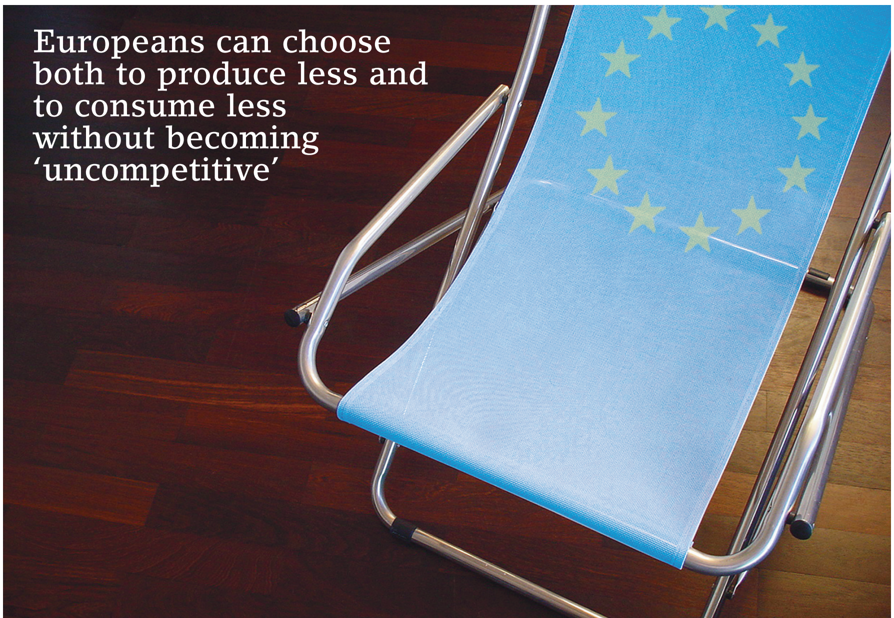
- The Eurozone's poor growth is caused by macro-policy problems and rules, which must be changed.
- Taxation burdens are not in some general and structural sense unsustainable.
- Looking at longer-term differences between European and US prosperity and productivity, we need to recognise the impact of physical environment and social choice. Within this context, while the EU's product market liberalisation agenda is positive, it is unlikely to have more than a marginal impact.
- But some EU labour markets are seriously inefficient and should be reformed.

Provided such a policy mix is pursued, there is no reason why Europe should not continue to grow GDP per capita at an attractive rate, delivering increasing prosperity and employment in an already rich continent. Absolute GDP per capita will almost certainly remain permanently below the United States, because of the social choices that Europeans make, but it will grow as far as fast.

The issue that then arises is whether these choices – to sacrifice some productivity potential in order to protect the environment and to take some of the benefits of productivity growth in increased leisure – are unsustainable? Some people believe they are, assuming that Europe cannot choose to trade off income for leisure or income for protected environment because such choices make Europe 'uncompetitive' in the global economy. But these arguments are in general quite wrong.

National economies do not compete with one another in the normal sense of the word and societies have wide degrees of freedom to make their own trade-offs. If Europeans choose both to produce less and to consume less, that has no consequences for competitive sustainability. Provided Europeans understand the consequences of their trade-offs – for instance, that shorter hours worked mean lower GDP per capita – there is nothing unsustainable about that choice.

But choices could become unsustainable if based on inconsistent assumptions: for instance, on decisions to do less work without accepting the consequences of lower income. And there is certainly one European social choice that is unsustainable: the current combination of birth rates, retirement ages and explicit or implicit pension promises. The argument that deep structural reform is required to the European model is often overstated, but not in relation to retirement ages and pension provision.



Europeans can choose both to produce less and to consume less without becoming 'uncompetitive'

This article is an extract from 'What's Wrong with Europe's Economy?' by Adair Turner, chapter 1 of *Challenges for Europe* edited by Hugh Stephenson (Palgrave, 2004), a collection of the eight public lectures delivered at LSE to celebrate CEP's award of the Queen's Anniversary Prize in 2002. **Adair Turner** is vice chairman of Merrill Lynch Europe, chair of the UK Pensions Commission and chair of CEP's Policy Committee. **Hugh Stephenson** recently retired as CEP's head of public affairs.