The Stony Path to the Strongest Economy

The “LiMa” Benchmark – Conclusions

BertelsmannStiftung

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I. What does LiMa signify?

With regard to economic policy the European Union takes its bearings from two goal systems,“Lisbon” and “Maastricht.” Lisbon stands primarily for growth and employment, and Maastricht for the monetary and fiscal regime of the single currency area defined in the Treaty of Maastricht and in the stability and growth pact.

The Bertelsmann Foundation and the Centre for European Economic Research (Zentrum für Europäische Wirtschaftsforschung ZEW) in Mannheim have developed the LiMa benchmark. “Li” stands for Lisbon, and “Ma” for Maastricht. “LiMa” is intended to show the potential performance and the future development paths of EU member states implicit in the two central goal systems of European economic and finance policy. The research concentrated on long-term development. The two goal systems were examined, as was their influence on the policymaking of the member states.

The central insights of the study and the conclusions which were reached on what needs to be done on European and nation-state levels are presented below. The results are given in full in *Bertelsmann Stiftung/Zentrum für Europäische Wirtschaftsforschung: “LiMa-Benchmark,” 2007: Eine Performance-Analyse der EU-Mitgliedstaaten im Licht der Lissabon- und Maastricht-Zielsysteme* (Bertelsmann Foundation/Centre for European Economic Research: “LiMa Benchmark,” 2007: A Performance Analysis of the EU Member States in the Light of the Lisbon and Maastricht Goal Systems.”)

There is no controversy within the EU about the goals of the Lisbon strategy and the mission assigned to all EU governments. The EU is supposed as soon as possible (2010 was the original target) to become the “most competitive knowledge-based economy in the world.” The pressure put on the member states to actually do something has increased as a result of the ever wider public debate, but there are no real sanctions.

Very much the same is true of Maastricht. The accession criteria for the single currency and the stability and growth pact demonstrate that the EU states have evolved clear-cut parameters relating to the stability of finance policy and the consolidation of the budgets. However, the long-term implications of developments in finance policy have received only limited attention.

The LiMa study examines the extent to which EU member states are doing justice to the dual goals of Lisbon and Maastricht. The EU states are not only compared with one another, but also with other selected industrialized states. Here the focus is on the growth dimension of the Lisbon target and the sustainable nature of fiscal policy. An understanding of the determinants of potential growth and a sustainable fiscal policy led to the development of quantitative indicators capable of measuring the various levels of goal attainment.

Evaluations of the performance of the EU member states currently available are marred by the imprecise character of their evaluation systems. For example, official EU monitoring evaluates the Lisbon dimension on the basis of “EU structural indicators.” However, a list of these structural indicators includes more than a hundred individual indicators, which renders it impossible to make concise statements about or indeed unambiguous evaluations of the member states. Again, the Maastricht dimension of sustainable budgetary policy has hitherto not been depicted with sufficient accuracy. In the official convergence and stability programmes the curves of the future development of the deficit on the diagrams merely have the character of political declarations of intent.

II. Results and Conclusions

Transcending economic cycles. What matters is achievement in the long term

The unanimous goal of the EU member states is to make the European Union dynamic in economic and stable in finance policy terms. For this reason indicators were selected for the two-dimensional LiMa benchmark which are of significance for the long-term growth potential (Lisbon) and fiscal sustainability (Maastricht). Thus the results of the LiMa benchmark coincide with neither the current growth predictions for the EU economies nor the attainment of the stability and growth pact criteria, but possess a medium to long-term prediction perspective.

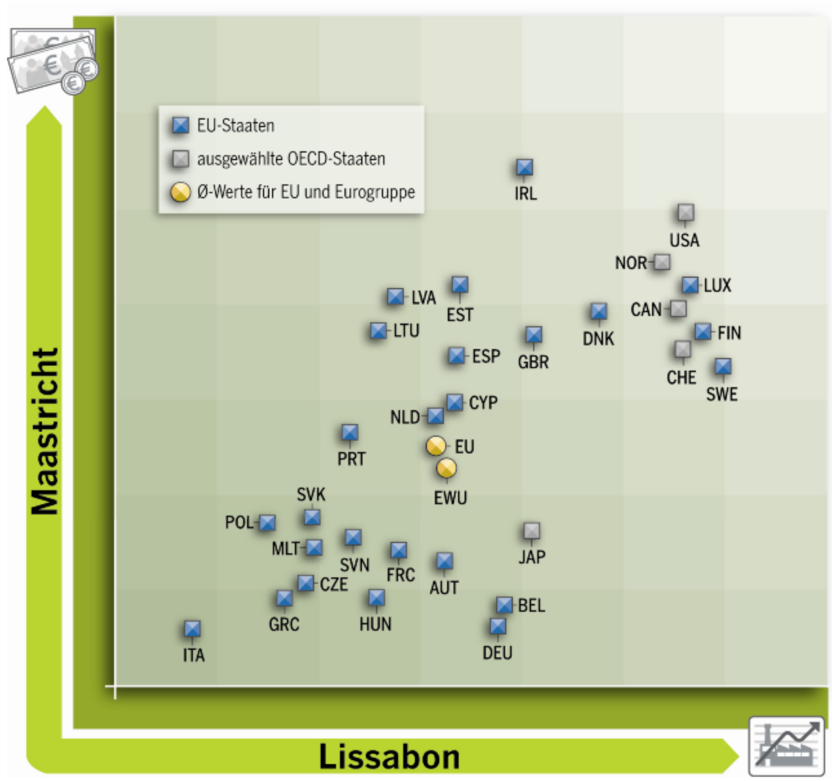


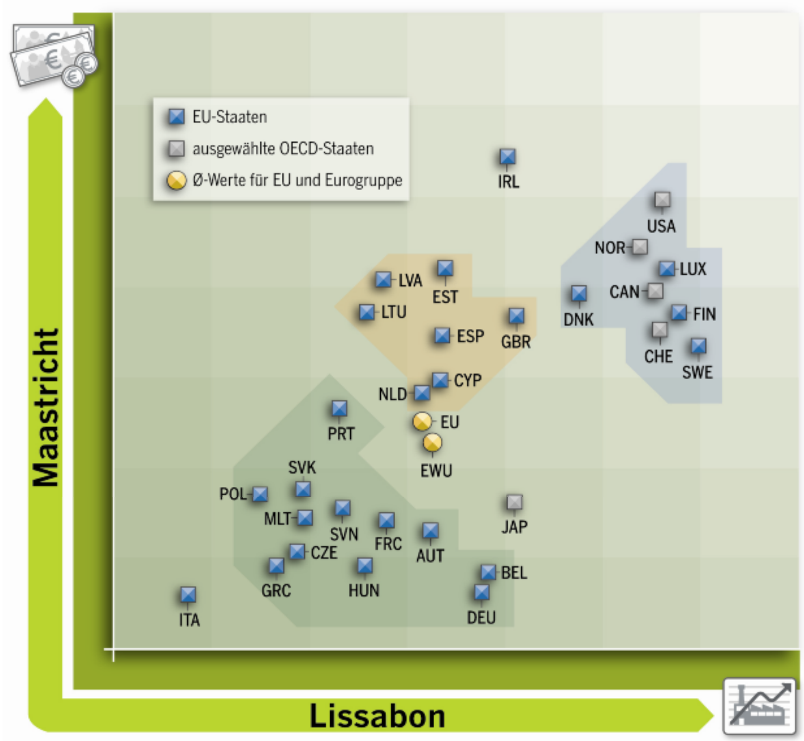
Diagram: Goal attainment in the two EU economic policy goal dimensions.

In Germany there is little reason to believe that fiscal sustainability has been reached simply because the upturn in the economy is currently leading to an improvement in the budgetary situation. Even though in many areas its consolidation policy is exemplary, Belgium will in the long term have to redouble the efforts it is currently making. Despite their current high growth rates, countries such as Poland or Slovenia must give due thought to how they can retain their chances of economic growth in ten to twenty years' time. Italy's position at the bottom of the list in both goal systems confirms that there is an urgent need for comprehensive reforms.

Many roads lead to Lisbon and Maastricht. But is this also true of the "Continental" path?

The European Union still has a long way to go before it becomes the most dynamic knowledge-based and fiscally sustainable economy. The comparison with other selected industrialized countries demonstrates that only a handful of countries, such as, for example, Luxembourg, Finland, Sweden, Denmark, and, to a certain extent, Ireland can keep up with the U.S. or Canada. Most of the successful performers are states from the north of Europe.

The overall assessment of economic performance in the two dimensions demonstrates that it is possible to identify two islands in addition to the "Nordic" one. The "Continental" island includes two large economies, Germany and France, and a number of younger member states. The group is relatively homogeneous with regard to its fiscal sustainability, but displays significant differences with regard to the prospects for growth. Thus in the long term Germany and Belgium can expect higher levels of growth than, for example, Greece and Poland.



The third island differs from the Continental one primarily on account of higher fiscal sustainability, though not so much on account of a better position with regard to Lisbon. The United Kingdom, the Baltic states, Spain, Portugal, Cyprus and the Netherlands belong to this rather diverse group.

The results tie into the current debate about a European economic and social model. In comparative welfare state analysis a distinction is made between different types. The *liberal Anglo-Saxon type* is characterized by a concentration of social policy programmes on people in need. Taxation levels are low, and the labour market is not heavily regulated. In *the central European and conservative type* (Germany, France, Belgium) social insurance dominates the welfare state. Work is weighed down with a heavy financial burden. The defining characteristic of *the Nordic and Social Democratic type* (Sweden, Denmark, Finland) is a comprehensive tax-based social security system coupled with a wide range of different kinds of work. In the rudimentary *Mediterranean type* of the welfare state, the latter is less in evidence on account of the significance of family-based structures.

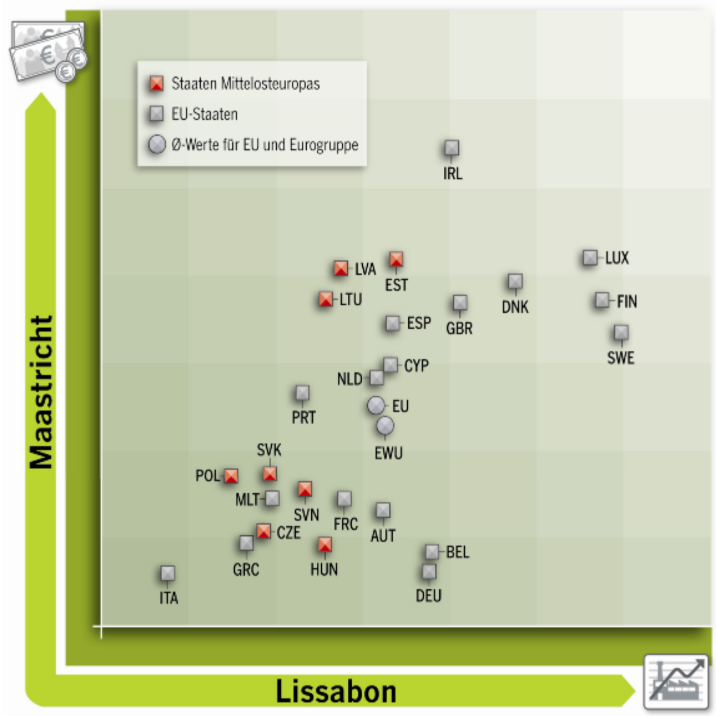
The LiMa results confirm these distinctions, for example, with regard to the Nordic and Continental "islands." However, it becomes apparent on the other hand that the typology is often no longer appropriate in terms of social reality. Portugal and Spain have long since taken leave of a Mediterranean model shared with Italy. As a result of their economic reforms, the two Iberian countries are beginning to display more and more features of the Anglo-Saxon model. With its paltry performance in both goal dimensions, Italy lags markedly behind–a glance at the detailed results shows that it is noticeably below the EU average in the area of "State and Institutions." On the other hand, in the EU the Baltic states have the greatest potential when it comes to fiscal sustainability.

Countries which can be assigned to the Nordic type in the economic model debate tend in general terms to be rather successful. Countries of the Anglo-Saxon type, which beyond the boundaries of Europe includes the U.S., can successfully "pursue the path to Lisbon and Maastricht." However, the data also show that the Continental path is currently not necessarily the best.

Each man for himself.
Central and eastern Europe is not a bloc.

There are great differences between the younger EU states from central and eastern Europe. They cannot be construed as constituting a discrete island. The Baltic countries incontrovertibly constitute the top segment among these countries, and their prospects of fiscal sustainability in particular do not lag far behind the Scandinavian countries. The data relating to the development of the growth potential of Latvia and Lithuania point steeply upwards.

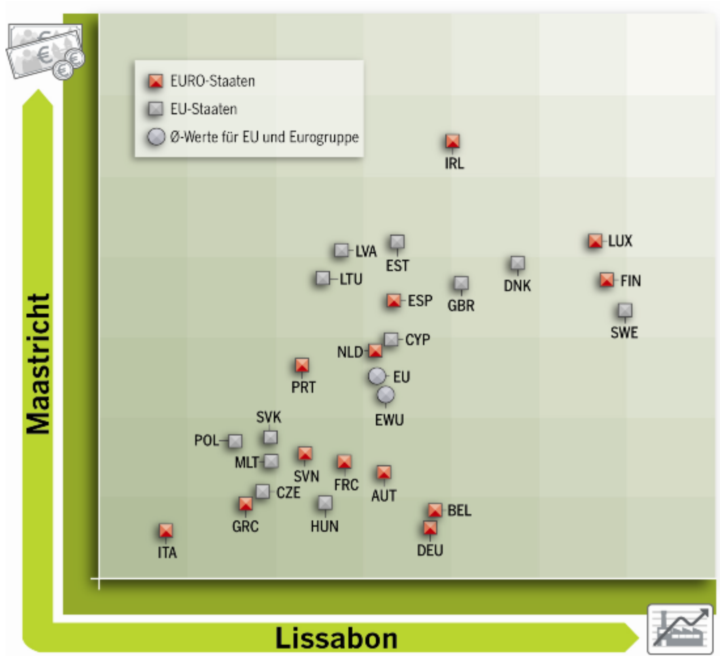
In the data relating to potential growth the Czech Republic and Slovakia, who rank in the lower half, evince a steadily ascending tendency. Of course, like Poland and Hungary, they are located on the Continental island together with Germany and France.



The formerly Communist states of Central and Eastern Europe are continually being tarred with the same brush in debates about Europe. However, the results demonstrate that the countries which joined the EU in 2004 display considerable differences which in future will tend to increase rather than to decrease. Populist governments in certain central and eastern European states make the idea of stable budgets more improbable than ever.

Leaders must be achievers. The Euro Group is not a champion

The Eurozone includes achievers such as Finland, Luxembourg and Ireland, but also Italy, which is at the bottom of the list. Neither the membership convergence criteria for the single currency nor the unitary monetary policy in the Eurozone and the stability and growth pact seem to be creating a greater degree of convergence in these economies. It is impossible to discern a more or less compact cluster consisting of the member states which have introduced the single currency.

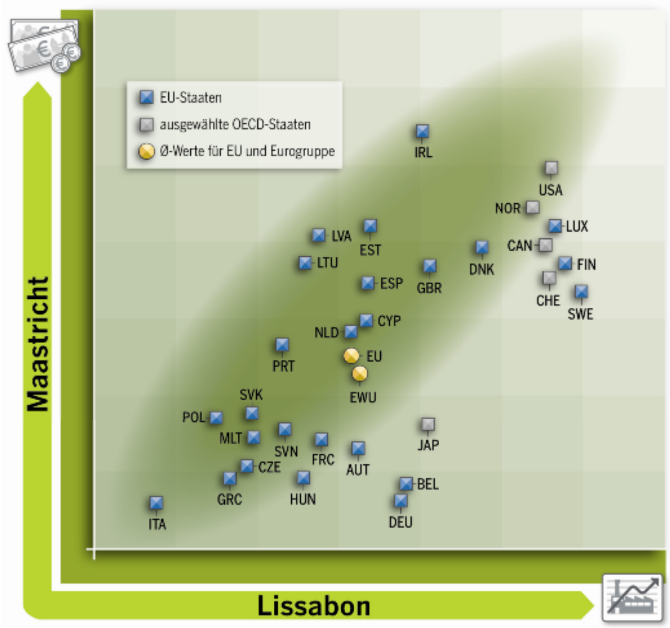


In the LiMa benchmark Lithuania, whose prospective membership of the Eurozone was torpedoed on the basis of the convergence criteria, is clearly superior with regard to its fiscal sustainability to many countries which have the euro, including Slovenia, which recently introduced it. Thus it seems that political regulations and decision-making are at odds with the reality of prospective financial developments.

In addition to the efficacy of the criteria for membership of the single currency there is the question of the effectiveness of the members of the Eurozone. It is surprising that the Euro Group, the informal avant-garde of integration, is below the EU average. The pretensions and the reality of the Euro Group are simply very far apart. It is not as yet a political body which can fashion a unified economic and finance policy. In terms of European policymaking this is a disturbing message. How can the Euro Group claim a leadership role in the areas of economic and finance policy if in fact it is holding the EU back in economic terms instead of helping it to move ahead with greater vigour?

The EU's strategic goals are apposite.
But are they of any use if there are no sanctions?

The positive correlation, which is emphasized by the ellipse in the diagram, between the performance of the countries in the Maastricht and the Lisbon goal systems suggest that, as strategic goals of European policymaking, structural reforms and sustainable fiscal policy are not at variance with one another. The Lisbon process and the criteria designed to attain stability in finance policy which are prescribed by the Treaty of Maastricht and the stability and growth pact do not contradict each other, but are in fact complementary. It seems that conflicts between the two are, at the most, of a short-term nature. The long-term character of the LiMa benchmark means that there are striking deviations in the case of only a handful of member states such as Ireland, Belgium and Germany. The EU has a long-term economic strategy that is fundamentally free of contradictions.



But what influence do the instruments have on the attainment of the stated aims? Does the economic and monetary policy of the EU have an effect on the results of the individual countries? "Lisbon" is not a regime which is able to impose sanctions. The Commission's powers of self-assertion are not enshrined in institutional terms. As the rejection of "naming" and "shaming" by the European Council demonstrates, the member states are unwilling to respect the results of the process. The stability and growth pact makes it possible to impose sanctions in the "Maastricht" context, though only for a short time. However, the EU has no influence over the long-term development of the national budgets or the rectification of structural imbalances.

III. Optimizing European Economic and Finance Policy

The EU's strategic goals are apposite. However, the interdependence of the EU member states means that there is a need for a more far-reaching coordination of structural and national policy by the European level. This is the precise reason why the alignment of "Lisbon" and "Maastricht" definitely needs to be improved.

Interdependence becomes apparent as a result of spill-over effects in the areas of research and development, where in the final analysis country-specific expenditure is of benefit to all the other European countries. Similarly, structural economic reforms in the Eurozone and their influence on the level of interest rates also affect other EU countries.

The alignment of "Lisbon" and "Maastricht" would improve if government expenditure for the implementation of the Lisbon strategy were to play a greater role in the criteria of the stability and growth pact. This would on the one hand impart additional dynamism to the more open Lisbon process.

On the other hand, the mutual dependence of the two economic policy goal systems suggests that in the long term it would also be of benefit for the whole notion of fiscal sustainability.

The role of the European Commission in both processes ("Lisbon" and "Maastricht") must continue to be strengthened. It must have the power to point out potential economic and financial imbalances of the member states at an early stage, and to impose sanctions ("naming" and "shaming"). The EU's fiscal monitoring should amount to more than a mere snapshot of deficits and debts, and it should set its sights on the long-term dimension.

The establishment, presentation, approval and evaluation of the National Reform Programmes and the associated improved comparability of the implementation of the Lisbon goals on the national level are central improvements introduced during the revision of the Lisbon strategy at the beginning of 2005. However, the programmes still lack the overall binding force in political terms and the legal status which has been accorded to the "integrated guidelines" in European economic policy.

The review of EU finances in 2008-09 should be used to make more resources available in the EU budget for the implementation of the Lisbon strategy on both national and European levels. "Maastricht," that is, the fiscal sustainability of the member states, will also benefit from this. In the final analysis, the future prospects and efficacy of the European Union–and the way its citizens see it–are dependent on a reformed economic strategy.