Introduction by

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Dear President Vike-Freiberga,
Dear Minister-President Stoiber
Excellencies, ladies and gentlemen,

On behalf of the CESifo Group it is my pleasure to welcome all of you. This fourth Munich Economic Summit provides a great opportunity to discuss the important challenges that confront us these days. Currently, everyone is concerned about Europe after the rejection of the Constitution in two founding member countries of the European Union. Obviously, the birth and progress of Europe has been a painful process, much more difficult than had been expected some years ago. The Constitution, as it is, will not come into effect as we all might have anticipated. It is impossible to offer the same document to the French and Dutch voters once again, so there will have to be major revisions.

That is good news, for the goal to create an Economic, Monetary *and* Social Union for Europe, which is implicitly drafted in the Constitution, is too demanding. Especially we in Germany know what a social union really means. We have learned under great pains that a social union with a less developed region like the eastern German states in the early 1990s is very expensive and is bound to create serious problems – particularly in those regions that one wants to help. Like a lot of Germans in the eastern and the western parts of the country, Europeans in the old member countries are disappointed about the process they are seeing. They wanted to become rich and now they are afraid to become poor because they will have to share their wages or the benefits of the welfare states with the new accession countries.

They may not completely understand the mechanisms at work, but, I am afraid, their feeling is not completely wrong. As we economists know there is a tendency towards factor price equalisation if you allow for the free mobility of capital and goods and, to some extent, also the free mobility of labour. Factor mobility, like trade, leads to factor price equalisation. This is good news for those, whose factor prices are low, but not for those whose factor prices are high. In addition, there is the issue we discussed at last year's Summit: The potential migration of people into the western welfare states might lead to an erosion of social standards. There are, of course, gains from trade that economists and the European Commission are eager to stress. But, after all, this is a very theoretical economic concept. It does not state that everybody gains but only that the winners of this process gain more than the losers lose. This is no trivial qualification as the losers might encompass a major part of the working population. If I, as an economist, tell them *"don't worry, there are winners – the capitalists – they will win even more than you lose"*, that is no help for them at all. On the contrary, I am afraid they might find this even worse than a situation where everyone loses proportionally. It is against this background that we shall discuss the theme of this years Summit **"Europe and the Lisbon goals – are we halfway there?"**.

The main message of the 2000 Lisbon Summit was that *Europe shall become the most dynamic and competitive knowledge-based economy in the world, capable of sustainable economic growth, with more and better jobs, greater social cohesion and respect for the environment.* The aim was to create a knowledge-based economy, enhance competitiveness and innovation, complete the internal market, modernise the European social model and combat social exclusion and, last but not least, apply an appropriate macro-economic policy mix. These are the basic, potentially contradictory, goals that were defined and that we identify with the so- called Lisbon Strategy.

Following the Lisbon Summit, the Commission and the Member States agreed on a large set of main goals, sub-goals and indicators to monitor progress made on the road to Lisbon. If you take a look at all the relevant documents, it is very hard to understand what all this really means. There are currently 28 main goals and 120 sub-goals, so we are talking about 148 identified goals, followed by no less than 117 indicators on which to make a judgement. It seems to me as if, through these goals, some people and groups of society had hoped to get some additional funds for particular things via the EU budget. I doubt whether these goals really help to become more competitive. On the contrary, in my view, this is a nightmare.

In addition, some of the goals violate the principle of subsidiarity. Let me give you an example: One of the goals is to achieve a female employment rate of 60 percent by 2010. Why is that a European goal? First of all, women should decide for themselves whether they want to work or not, and if there are faults in the legal and regulatory systems that artificially impede women's preferences, then each country should decide for itself whether and how to correct them. Defining a European goal on this only reveals *paternalistic or merit good* preferences, as we call them in economics. Some European body believes it knows better what is good for the European countries than the countries and their citizens themselves.

There are, of course, some sensible goals. For example, the goal to increase domestic expenditure on research and development to 3 percent of GDP, which was defined in Barcelona in 2002 as part of the Lisbon process, is in my view a good objective. It is genuinely economic, because we know that there are a lot of spill-over effects between the countries and we cannot expect that a single country has the appropriate incentives to carry out enough research. Unfortunately, only two countries in Europe – Finland and Sweden – satisfy this goal. Most of the countries are far away from it, at an EU average of 2 percent. Thus, we are missing the goal by a full percentage point. This is one of the points to discuss at this year's Summit – what can be done to get closer to such a target.

The EU Commission measures the progress of the Lisbon Strategy by many indicators: GDP per capita in purchasing power parity, labour productivity per person employed, the total employment rate, the total employment rate of older people, gross domestic expenditure on research and development, youth education attainment, comparative price levels, business investment, the poverty rate, the dispersion of regional employment rates, the total long-term unemployment rate, total greenhouse gas emissions, the energy intensity of the economy, the volume of freight traffic relative to GDP and so on. It is very difficult to see how these items can usefully be combined into one sensible indicator. It is also totally unclear how they contribute to our main goal of becoming more competitive. Again, this leads nowhere. This is by far too complicated and is too arbitrary in terms of selective criteria on which to concentrate.

Thus I am glad that the new Commission is trying to focuses on the overall economic performance as measured by jobs and growth. Let us look at these two criteria: The employment rate, which was defined in the Lisbon Council of 2000, had the target of 70 percent of people between 15 and 64. And then, while that target was defined for 2010, it was slightly reduced for 2005 at the Stockholm Summit. Figure 1 shows the reality in most of the Member States.

The EU25 is not yet there, but is close. The same holds true for the EU15: Germany is very close and some other countries like the UK, Sweden, the Netherlands and Denmark, are above the target.

Figure 1

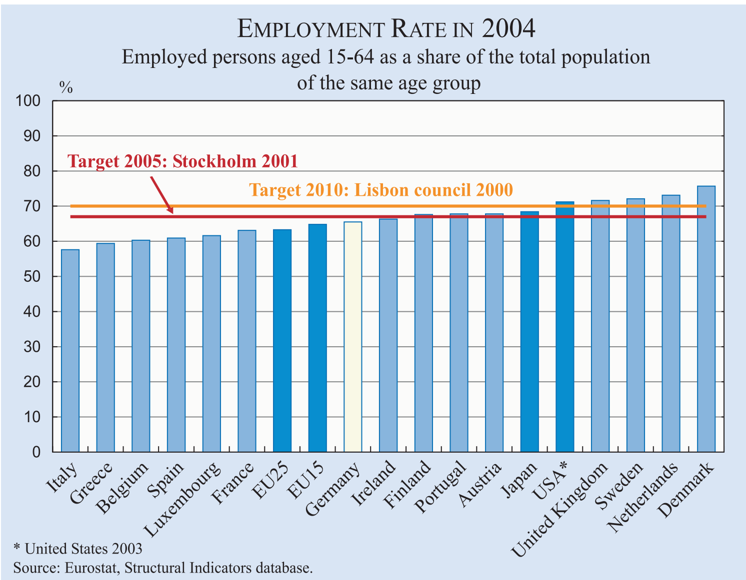
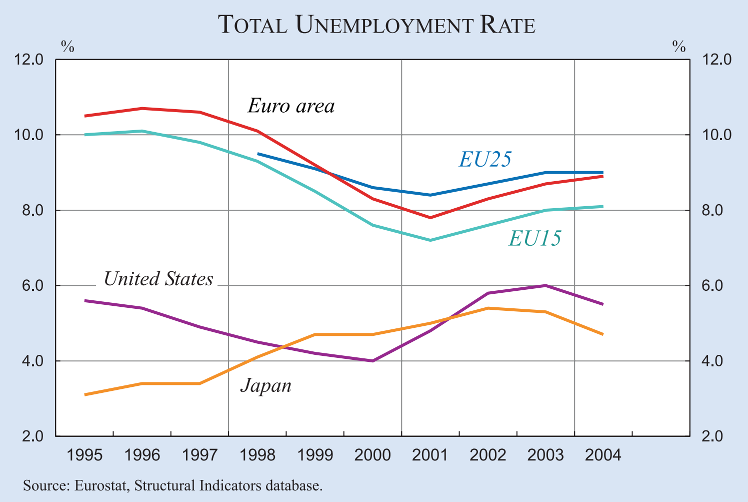


Figure 2



Source: Eurostat, Structural Indicators database.

They have somehow found ways to mobilise their population. Still, there is the persistent unemployment problem in the European Union, which is shown in Figure 2.

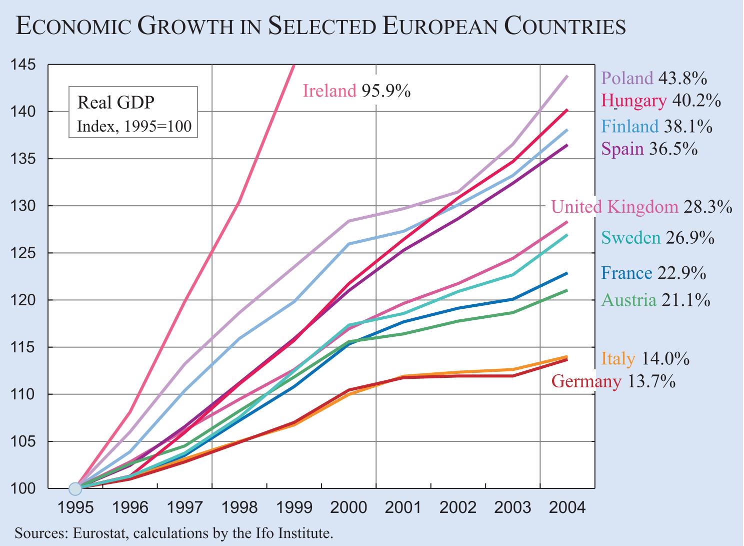
The unemployment rate is much higher in the EU15 countries and even higher in the euro-area countries than in the United States or Japan. The enlargement does not really change that picture because the average unemployment rate in Eastern Europe is about the same as in the euro-area countries. Unemployment is still one of Europe's main problems.

The second really important indicator is growth. Figure 3 shows the growth performance of the European countries from 1995 to the present. Ireland leads with 95.9 percent growth in nine years. Irish GDP nearly doubled. Poland achieved a remarkable 43.8 percent. Poland and the other new Member States should grow faster than others because they are starting from a low level. Hungary grew by 40 percent, Finland by 38 percent, which is a very good performance for a country that is already that well developed. Spain stood at 36 percent, the UK at 28 percent, Sweden at 27 percent and France at 23 percent. At the bottom you can find the back benchers: Austria grew by 21 percent, Italy and Germany only by roughly 14 percent.

Germany is the bottom country with respect to growth and Ireland the top. Is that good? Is that a healthy process? If Ireland were on a low level and Germany on a very high GDP level, this would be an encouraging development, since it would imply convergence of the EU countries. But I am afraid this is not the case. There is no convergence in Europe. Comparing the per capita incomes of Germany and Ireland, one can see that Ireland has overtaken Germany in absolute terms and is still growing rapidly. So there is more going on than mere convergence. And the same thing would be true by looking at quite a number of other countries.

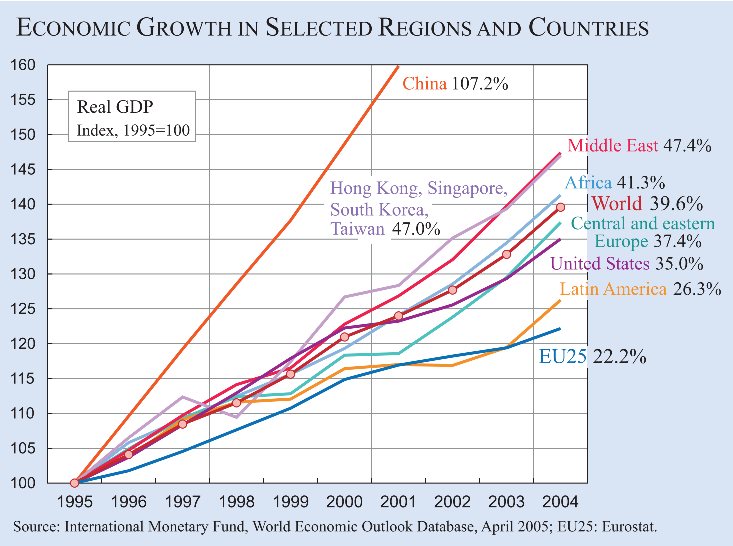
Since Europe wants to become the most competitive knowledge-based society in the world, I would also like to compare Europe with the rest of the world (Fig. 4). The entire world grew by 40 percent in real terms from 1995 to 2004. How have the non-European regions performed? China has even grown faster than Ireland. But it is a similar order of magnitude, if, of which I am not sure, one can believe Chinese statistics. The Middle East grew by 47 percent in nine years, Asia by 47 percent and Africa, surprisingly, by 41 percent, starting of course from a very, very low level. Central and Eastern Europe grew by 36 percent, the United States by 35 percent and Latin America by 26 percent. At the very bottom is the EU25 at only 22.2 percent.

Figure 3



Sources: Eurostat, calculations by the Ifo Institute.

Figure 4



The Summit's title is "Europe and the Lisbon Goals: Are we halfway there?" I do not think we are. Europe – at present and during the last ten years – has been the laggard of the world. That is the bitter truth. Obviously, the Lisbon Process is hope, not reality. To some extent this may explain the frustration of the Europeans with this enterprise.

We must face the challenge. What needs to be done to really become better? This is the core question of this fourth Munich Economic Summit.

Thank you very much for your attention.