Panel 2

# GETTING FITTER

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Over the last decade, EU16 member countries have experienced average growth of less than 1 percent per year (Eurostat, 2003-2012 real GDP growth data). Germany and Sweden have seen average annual real growth rates of 1.2 percent and 2.2 percent respectively, but economic growth in Greece and Italy has dropped to zero or even turned negative. The US economy, on the other hand, grew by an annual rate of 1.7 percent over the same period, while Turkey has enjoyed annual growth of 5 percent. It is thus not surprising that several European countries have become less competitive. According to the IMD World Competitiveness Index, only one EU country member – Sweden – was among the top 5 most competitive countries in the world in 2012. Germany made it into the top 10 at 9th place. However, Spain, Italy, Portugal and Greece fared worse, ranking respectively 39th, 40th, 41st, and 58th out of the 59 countries investigated, while France was positioned in the middle of the ranking at 29th place.

According to another IMD survey, this lack of competitiveness is coupled with a negative attitude towards globalization. The French are reported to have the worst attitude towards globalization among the 59 countries analysed, but Greece (54th), Spain (43rd), Italy (41st), Portugal (34th), and even Germany (29th) can hardly be considered as globalization-friendly societies. Moreover, those countries that need to reform the most appear to be the least willing to do so. According to the IMD, the need for economic and social reform is least understood in France (59th out of the 59 survey countries), and remains highly controversial in Spain (53rd) and Greece (44th), albeit less so in Italy (23rd).

All EU countries are facing difficult demographic, economic and social challenges. However, the drop in competitiveness experienced by several, particularly southern European, countries calls for a quick reaction. These countries urgently need to return to economic growth. In other words, they must *get fitter*. But how can this be achieved?

A crucial step towards exploiting the potential benefits of the globalization process, instead of falling victim to it, is to liberalize the product market in order to increase efficiency. The emergence of new technologies and the acceleration of the globalisation process have created the opportunity to increase productivity and prosperity. However, only those economies with lightly regulated product markets have managed to take advantage of such innovation (Nicoletti and Scarpetta 2003). This is because regulations that restrain competition slow the diffusion of innovation, by reducing investment in new technologies and lowering the amount foreign direct investment flowing into a country.

Efficiency gains may justify labour-market reforms aimed at improving the allocation of labour and increasing participation rates (Bassanini and Duval 2006). Yet equity reasons also emerge in countries with strong employment protection legislation (EPL), which experience labour-market 'dualism' between (senior) workers on permanent contracts and other workers – typically young, females, poorly educated individuals or migrants – on temporary or other non-standard contracts. These forms of temporary employment have come to represent a persistent status, as workers find it increasingly difficult to move into permanent jobs.

Given that long-term growth rests on innovation and increases in labour productivity, countries that aim to get fitter need to monitor their education system. A cross-country comparison of the mathematics performance of fifteen year-old students based on a standardized international test – the OECD Programme for International Student Assessment (PISA) test – shows that, in 2009, Britain, Ireland, Portugal, Spain and Italy were well below the OECD average, while the chart was topped by Korea, Finland and Switzerland. This early disadvantage in scientific education may lead to less innovation later on and could prove detrimental to a country's economic growth and wellbeing. Low labour productivity may also be driven by a poorly educated labour force. For instance, in 2010, the share of individuals aged 25–64 with upper secondary education attainments was 40.4 percent in Italy, in line with the figure in EU15 countries (42.2 percent), but well below that in several East European countries like the Czech Republic (75.2 percent), Slovakia (73.6 percent), Poland (65.8 percent) and Romania (60.5 percent), where many western-European firms delocalize their business.

A common challenge facing all EU countries is population ageing. The combination of falling fertility rates and a generalised increase in longevity has significantly raised the share of elderly individuals in the population. Between 1980 and 2007, the percentage of individuals aged 60 years or over increased from 13.4 to 19.9 percent in Italy, from 14 to 16.4 percent in France, from 15.5 to 19.8 percent in Germany, and from 10.9 to 16.7 percent in Spain. Public awareness of this demographic phenomenon has increased over time, especially since the actual process has far exceeded the forecast ageing trends. For instance, current OECD demographic forecasts for the expected shares of the elderly in the 2050 population differ substantially from the 1980 projections, with underestimates ranging from +1.3 percent in Denmark to +10.4 percent in Greece. This increased awareness of the actual magnitude of the ageing process, and of its impact on the financial sustainability of public pension systems, has played a key role in promoting pension reforms in many OECD countries over the last two decades. Yet many more countries will need to redesign their pension systems to cope with their ageing populations, and to reassure the financial markets of their solvency.

**Taking stock of reforms**

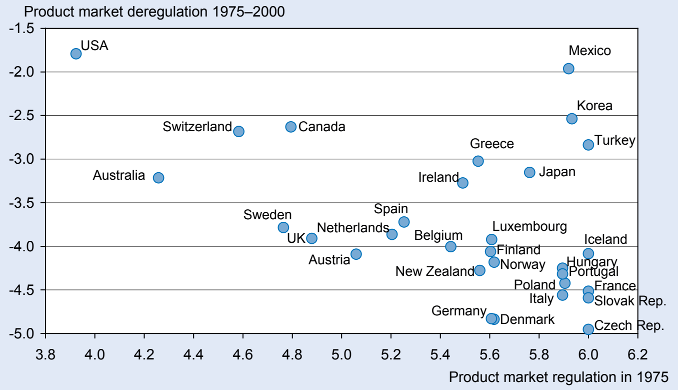
Over the past few decades many EU member countries have been involved in a process of structural reform. However, there have been significant cross-country differences in the depth, scope and pace of reform, which may explain, at least in part, the increasing divergence in the economic performance of the different EU member countries.

For the product market, indicators provided by the OECD that measure the level of anti-competitive regulation (see Conway and Nicoletti 2006) and the degree of public ownership in seven non-manufacturing industries (electricity and gas supply, road freight, air passenger transport, rail transport, post and telecommunications) show that the timing and intensity of the reforms have differed significantly from country to country. Product market liberalization[1] began in the United States in the mid-1970s. Among European countries, only Britain, Norway and, to a lesser extent, Finland and Austria followed this trend towards liberalisation in the mid-1980s. For most other countries product market liberalization came after the EU's internal market programme had been introduced and once they had gained access to the eurozone (see Høj *et al.* 2006; Alesina *et al.* 2010). In the end, as shown at Figure 1, some degree of cross-country convergence in product market regulations has indeed been achieved, since countries with strong product market regulation in 1975, like Italy, Portugal, France, Denmark and Germany, have recently been more active in deregulating their product market.

[1] Liberalizations started with road transport and spread to the air transport industry, and have also been seen in the electricity and telecommunications sectors since the mid-1990s.

**Figure 1**

**Convergence in product market regulation**

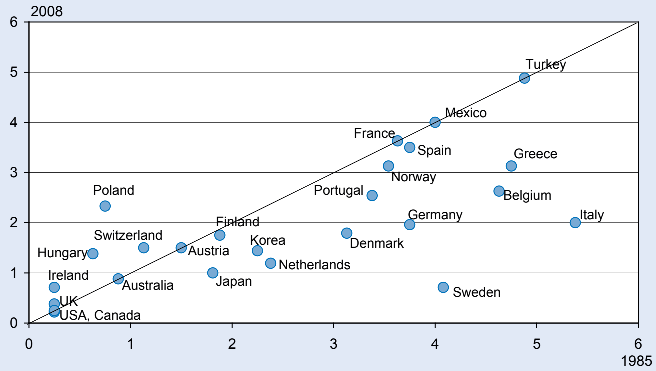



Note: OECD summary indicator of regulatory impediments to product market competition in seven non-manufacturing industries: gas, electricity, post, telecommunications, passenger air transport, railways (passenger and freight services) and road freight. For more details, see Conway and Nicoletti (2006).

Source: OECD Database.

**Figure 2**

**Changes in EPL strictness for temporary contracts**
1985 vs 2008




Note: OECD summary indicator of the stringency for Employment Protection Legislation for fixed-term contract (temporary) workers. Details in OECD (2006).

Source: OECD Employment and Labour Markets Database.

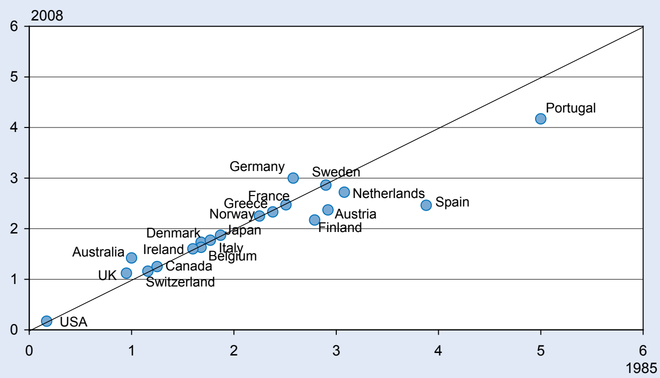
The labour market, on the other hand, has seen much less action. During the 1960s and 1970s most European countries adopted employment protection legislation (EPL), which increased labour market rigidity and hindered adjustments in job flows. Early retirement provisions were also introduced in many social security schemes, which created strong economic incentives to retire early. Since the late 1980s, however, there has been a move to make overall labour market regulation more employment friendly.[2] Labour market reforms typically featured a relaxation of EPL for temporary workers, as in Spain in 1984, in Italy in 1997 and 2003, in Sweden in 1996–1997, and in Germany in 2003. This trend is shown in Figure 2, which displays the degree of EPL for the OECD countries in 1985 and in 2008. These reform policies largely reshaped the structure of the labour market in the years that followed. In Spain, temporary contracts as a share of total employment contracts increased from 11 percent to 33 percent in about ten years; while temporary contracts represented 96 percent of the annual job-creation flow by 1997.

No labour market reform – with the exception of those in Portugal, Spain and to a lesser extent Finland – affected permanent contracts, as suggested by Figure 3. In Portugal restrictions on lay-offs were phased out between 1989 and 1991 and the use of fixed-term contracts was restrained. In Spain a new permanent employment promotion contract targeting the young (up to 30 years old) and older (above 45) unemployed individuals, as well as temporary workers, was introduced in 1997; while 'objective' reasons for layoffs were also allowed.

Perhaps the most comprehensive reforms of the last three decades were those addressing the financial sustainability of public pension systems. Among other countries, reform measures to postpone the retirement age were adopted in France (2003), Germany (1992, 1997 and 2003), Italy (1992, 1995, 2004 and 2011), and Britain (1986), either by increasing the normal and early statutory retirement age or by modifying the benefit formulae in order to reduce incentives to retire early. The striking impact of these reforms on the trend in average retirement ages in OECD countries is displayed in Figure 4, which shows how the downward trend was indeed reversed in the late 1990s. A few radical reforms modifying the architecture of the pension systems were implemented in Italy and Sweden, in the mid-1990s, and in Poland a few years later, as these countries abandoned their existing defined-benefit schemes to switch to a notional defined contribution (NDC)

**Figure 3**

**Changes in EPL strictness for permanent contracts**
1985 vs 2008



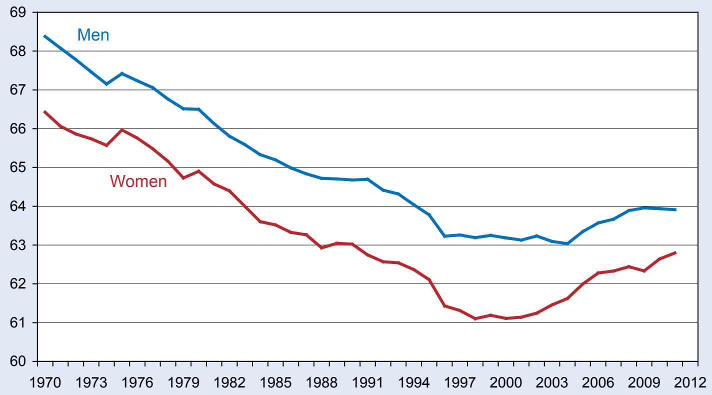

Note: OECD summary indicator of the stringency for Employment Protection Legislation for indefinite contract (regular) workers. Details in OECD (2006).

Source: OECD Employment and Labour Markets Database.

[2] For a comprehensive analysis – see OECD (2006).

Figure 4

**Effective retirement age in OECD countries 1970–2011**




Source: OECD.

scheme, which was complemented with elements of a funded system. Additional reform measures were implemented in Italy in 2011, which included the introduction of a link between retirement age and life expectancy, following the example of the United States and of the 2004 German reform, which adopted a sustainability factor to adjust pension benefits to the old age dependency ratio.

Minor modifications in the educational systems occurred in virtually all countries. Yet, quantifying the magnitude of these reforms is often difficult, as they frequently involve qualitative and/or organizational measures, and, as such, are hard to assess. Most reform measures included one or more of the following strategies: (i) decentralization, with more decisions being taken by local schools; (ii) a greater focus on underachieving students, often with targeted programs; (iii) a better mix of school types; and (iv) the recruitment of good teachers. Results from the PISA (Programme for International Student Assessment) test in mathematics for male and female fifteen year-old students from OECD countries in 2000 and 2009 make it possible to assess which country, and thus which reform measure, improved the most. As shown by Figures 5 and 6, male and female students in Germany, Poland and Italy largely improved their math scores from 2000 to 2009, although in Poland and Italy they remained below the OECD averages. In Poland and Germany, these achievements were the result of major reforms of the education system (see Tompson 2009). In Poland, the system was largely decentralized and the local hiring of teachers was allowed. In Germany, reforms focused on improving schools for weak performers, and hence their achievement levels.

**Political challenges**

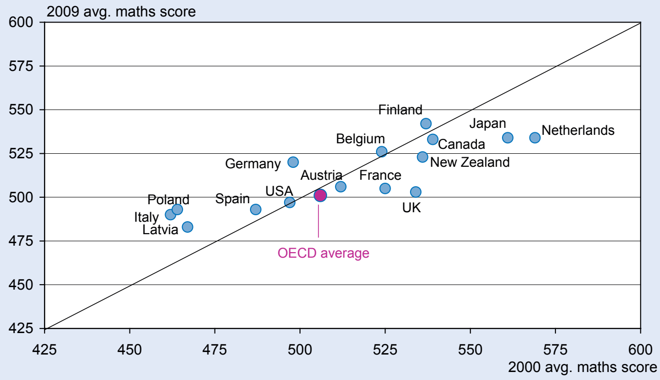
Reforming tends to be unpopular. As Jean-Claude Juncker famously stated: "We all know what to do, we just don't know how to get re-elected after we've done it".[3] In fact, the mere existence of large public programs, such as education or welfare, and of labour and product market restrictions creates a political constituency of programme beneficiaries and bureaucrats, which supports the *status quo* and opposes any reform effort. This is problematic since policy-makers, who have been portrayed as opportunistic incumbent politicians seeking re-election, aim to implement economic policies that serve their electoral interests, by targeting their core constituency of voters or the undecided (swing) voters (see Persson and Tabellini 2000). The electoral costs of reforms may be particularly large for retirement and

[3] See, however, the empirical analysis by Buti *et al.* (2008).

Figure 5

**Education performance (I)**

Boys performance in mathematics



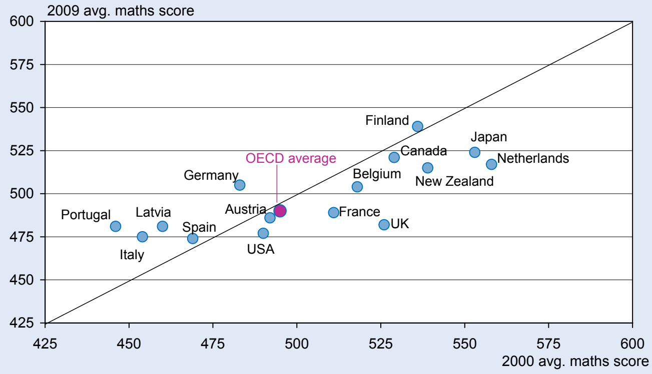

Note: Country mean values of PISA measure of 15-year-old male students' ability in mathematics. For more details, see OECD (2010).

Source: OECD PISA 2009 Database.

**Figure 6**

**Education performance (II)**

Girls performance in mathematics




Note: Country mean values of PISA measure of 15-year-old female students' ability in mathematics. For more details, see OECD (2010).

Source: OECD PISA 2009 Database.

labour market policies and measures concerning the educational system, which typically affect a wide range of individuals (Galasso 2006). Institutional features, such as electoral laws (majoritarian or proportional system) or political regimes (presidential or parliamentary democracy), that modify the rules of the electoral game, and thus the policy-makers' incentives, may therefore be important for reforming.

In policy areas in which reform benefits tend to be small and widely spread, while costs are sizable and concentrated, a 'collective action' problem emerges since the potential beneficiaries constitute a large, yet less organised electorate than the losers (Olson 1965). Product market liberalizations typically exhibit these characteristics. In such cases, resistance to reforms mostly tends to come from special interest groups composed of firms operating in protected sectors that often provide information favouring their case and/or financial contributions to policymakers (see also Grossman and Helpman 2001).

A *status quo* bias may also emerge due to uncertainty on the part of individuals about the effects of the reform on their personal situation. As most reforms have redistributive effects besides clear winners and losers, a (potentially large) group of individuals may exist who are *ex-ante* unsure about their own future prospects, and thus prefer to block a potentially beneficial reform (Fernández and Rodrik 1991).

The timing of the costs and the benefits of reform do not help to achieve political sustainability. In fact, while the costs of implementing structural reform tend to be upfront – labour market liberalizations may, for example, immediately increase unemployment risk – the benefits may take a while to materialise, as higher employment probability will increase only slowly over time (see Coe and Snower 1997). Therefore, the government's strength and time horizon may be crucial to reforms.

### The road to reforms

There is no one-size-fits-all reform strategy that can be applied in all countries and sectors. However, a few lessons for reforming can be drawn from the wide variety of successful (and failed) reform experiences in many OECD countries over the past decades.

Reforming is easier during *economic and financial crises* for two reasons: firstly, crises provide information, as they may help to unveil the cost of existing inefficient policies. This information becomes publicly available and widely spread. Secondly, crises create a sense of urgency to react, which may make it possible to overcome the usual opposition to reform and to build momentum for adopting courageous (that is, electorally costly) policy measures (Haggard and Kaufman 1992; Drazen 2000). Yet, crisis may also hinder reforms, since individuals and socioeconomic groups are likely to be even less willing to losing their rents or benefits in difficult times. Furthermore, compensatory packages for the losers of the reforms are more difficult to finance during economic crises.[4]

Past experience suggests that privatizations of state-owned enterprises, particularly in the energy and telecommunication sectors, occurred during financial crises in an attempt to fill depleted public coffers; whereas liberalizations, particularly in air transport and postal services, followed economic crises in order to enhance efficiency (Høj *et al.* 2006).

Labour market reforms, which followed large increases in long-term unemployment rates, were as-

[4] Indeed, reforming under good economic conditions would be beneficial, because the costs of reforming are lower in a growing economy, and more resources are available for compensation packages. In the absence of a crisis, however, the reform process may lack the necessary political momentum.

sociated with a reduction in regulations, but for temporary contracts only, and sometimes with more generous unemployment benefits (see IMF 2004; Duval and Elmeskov 2005; Høj *et al.* 2006). Except for in Spain, this initial reform measure did not lead to further deregulation for regular contracts, and thus produced inequitable and inefficient dual labour markets. Hence, whether these reform measures, which mostly affected temporary workers, have (at least to date) improved welfare is questionable. Indeed, even in Spain, where both temporary and regular contracts were liberalized,[5] the major differences in the protection still provided by the two contracts gave rise to one of the most extreme dual labour markets. Economic crises featuring high unemployment rates may also lead to *pension* reform measures that reduce the incentives to retire early (see Høj *et al.* 2006). This is somewhat surprising, but at the same time reassuring, given the popularity that the 'lump of labour fallacy'[6] achieved in the 1980s and 1990s. Large financial crises, as in Italy in 1992 and in 2011, have also been pivotal to the implementation of the radical reforms that curbed pension spending.

Reforming under crisis is also more likely to occur in countries, such as Italy, featuring strong initial regulations – and thus more inefficient markets. However, half-hearted attempts led either to the adoption of partial reform measures, as described in the labour market, or to long transition periods, which delayed the arrival of efficiency gains from reforming, as in the Italian pension reforms of the 1990s. The current crisis should instead be used to push forward structural labour market reforms that feature compensatory measures, like the Danish 1994-1997 labour market reforms. A feasible trade-off to exploit is to reduce the employment protection of regular workers in exchange for a package of unemployment benefits and active labour market policies (Boeri *et al.* 2012). Obviously, crises ought not to be engineered just to reform. However, once they occur, the policy implication should be clear: be ready to reform.

Another driver of reform is the release of independent, credible *information* about the cost of the *status quo* and the potential benefits of reforming.[7] This proved particularly important in the product market in terms of assessing the uncertain redistributive effects of the reform measures. Successful governments need a clear communication strategy about the benefits of their proposed reforms and must be able to enlist the support of their beneficiaries, like customers or potential new entrants (Tompson 2009). In terms of *pension* reforms, reliable projections of the future cost of the ageing process, which helped to increase public awareness about the true costs of the status quo, were crucial in facilitating the adoption of significant measures in Italy (1995), France (2003) and Poland (1997–1999), for example.

As far as educational reforms are concerned, crises and the release of information may actually coincide. A sense of urgency related to the need to improve the quality of the schooling system may come from the release of credible reports on disappointing educational outcomes. 'A Nation at Risk' published by the US National Commission on Excellence in Education in 1993, and the release of the PISA results in 2000 (OECD 2001), with disappointing, yet surprising, results for Denmark and Germany, paved the way for important reforms of the education system in both of these countries. In fact, new information may come as a shock to the players that typically oppose reforms, such as students, parents, teachers, employers and trade unions, creating enough momentum to reform the system.

*Anchoring* to external agreements, such as entering the European Single Market or adopting the euro, has proven an extremely powerful tool for driving domestic reforms. The pro-reform push of the EU Single Market Programme forced product market deregulation, particularly in air transport, road freight, telecommunications, and, to some extent, the gas sector. Moreover, this pressure also worked indirectly: faced with widened international competition in tradable goods and services, domestic producers sought lower prices for non-manufacturing intermediate inputs. The introduction of the euro also had a significant, positive effect on the speed of the adoption of structural reforms in the product

[5] More flexibility was also introduced for permanent workers in 1994, after a deep recession characterized by a drop in total employment of 4 percent and an unemployment rate of over 20 percent.

[6] According to this 'lump of labour fallacy', the total number of job in the economy is to be considered fixed, so that inducing early retirement among the elderly workers represents a policy that would increase youth employment. This argument has been proven wrong both theoretically and empirically (see Boldrin *et al.* 1999).

[7] Providing credible information is not easy. As governments have their own ideology, public opinion may attribute the information released by the government as due more to its ideological leanings than to actual economic concerns. Paradoxically, a reform can be given greater credibility by the representatives of parties that would typically be expected to oppose the reform on ideological grounds. Thus, left-wing parties may be more credible advocates of liberalisation, which is only put forward for economic reasons (Cukierman and Tommasi 1998).

market. Such deregulation was stronger in EMU countries (like France and Italy) and certain sectors (like energy and communication), which featured higher initial levels of regulation. This seems to suggest that those countries and/or sectors that were more heavily regulated and less competitive, and which suffered the most from not being able to use competitive devaluations, were forced to liberalize to some degree.

This political strategy of blame avoidance has largely been used by European countries over the last two decades to reduce the electoral costs of reforming. Yet, heavy reliance on this mechanism may have come at the long-run cost of reducing the popularity, and perhaps the credibility, of the anchoring institutions, such as the European Commission, in cases where reforms are blamed on Brussels.

*Packaging* reforms properly, on the other hand, may represent a better strategy for reform-oriented governments.

In product markets, the sequencing of reform measures, for instance choosing to corporatize monopolistic firms before liberalizing, has proved efficient in breaking down the entrenched vested interests of workers and the managers or owners of monopolistic firms.[8] Trickle-down effects may also be achieved by liberalizing product markets first, in order to reduce economic rents and thus to minimise resistance to labour-market reforms, before moving to deregulating labour markets (see Blanchard and Giavazzi 2003; Fiori *et al.* 2007; IMF 2004;, Høj *et al.* 2006). Gradualism has been successful in promoting the structural reforms of public pension schemes, for instance in Italy in 1995, when a long transition period was envisaged to reduce the cost of the reform for the elderly, and thus to minimize political opposition.

Compensatory strategies should be used in the labour market to achieve a more efficient combination of policies to protect workers against the income risk of losing their job. This is possible, since different policies or institutions, such as unemployment benefits and employment protection legislation (EPL) are indeed close substitutes (Pissarides 2001; Blanchard and Tirole 2003). Reforms aimed at more flexicurity, that is, less EPL and more unemployment benefit, may exploit this substitutability (see Boeri *et al.* 2012). Analogously, a reduction in the generosity of unemployment benefits can be offset by an expansion of active labour market policies (ALMP). This compensatory scheme was at the heart of the successful 1994–1997 labour market reforms in Denmark.

Reforms of the educational system need the support of teachers, whose lack of compliance with new measures may jeopardize them entirely. Hence, policies typically opposed by teachers, such as the introduction of performance tests, should be accompanied by measures that increase teachers' involvement in the process, as was the case with the early 2000 Danish reform.

Finally, although *political institutions* seem to have played only a minor role in the adoption of reforms, some policy implication can still be drawn. A political mandate to reform has often proved crucial to the actual implementation of policy measures. Although political parties may be reluctant to discuss detailed reform measures in their electoral programmes, the media, independent organizations, and the public at large should urge the different parties to present their reform platform. Finally, political systems giving rise to stronger government are better suited to implement reforms. Hence, constitutional reforms (or electoral laws) that facilitate the emergence of strong governments should not be overlooked.

[8] In the telecommunication sector, resistance to the privatization of the Italian Telecom was limited, since Telecom had already been corporatized, its employees had private contracts, and union density was in line other private sectors (and thus lower than in the public sector). The privatization of France Telecom, on the other hand, was largely opposed by its workers, who had the status of public employees, and were able to mobilize the unions (Boeri *et al.* 2006).

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## Panel

The second speaker, **Pier Carlo Padoan,** Deputy Secretary-General and Chief Economist at the OECD in Paris, continued with the theme of structural reform by looking at the costly adjustment process currently taking place within the eurozone, as well as the root problems of poor productivity performance and inadequate competitiveness that predate the recent crisis in many countries. Intra-euro area trade imbalances (or current account balances), possibly one of the clearest manifestations of the euro crisis, have narrowed, noted Mr Padoan. But what is driving this trend? One major and very traditional factor is that unit labour costs are adjusting, albeit not in all countries, and have fallen in the wake of the crisis. Is this trend permanent, due to the crisis or driven by cyclical factors? In Europe's periphery, where current account deficits have been narrowing, unemployment has been rising and is now the number 1 challenge facing policy makers. In Mr Padoan's view, *"A healthy and permanent adjustment process is one which tackles the roots of unfavourable or unsatisfactory productivity development".*

To some extent, he continued, it is productivity dynamics that ultimately generate strong performance. These dynamics are often measured using a composite unit called multi-factor productivity (or MFP) growth, he explained. This unit is composed of innovation, institutions and the way that production is organised, investment and labour force participation. However, Mr Padoan warned that MFP growth is an insufficient measure in many cases. Other factors may also indirectly have a major impact on productivity dynamic, he noted, citing the example of judiciary systems, which determine how effectively and quickly labour disputes are settled. Unfortunately, deeper reforms of this nature are not necessarily being addressed under the huge pressure of the crisis.

Taking a long-term perspective, productivity and growth look set to fall in both advanced and developing economies. Is this trend inevitable? In relation to this question Mr Padoan cited a paper by Robert Gordon, a leading authority on economic growth. The ultimate source of productivity growth may be innovation, notes Gordon, but the major innovations have already happened. Against that background, where will new sources of productivity come from, asked Mr Padoan? In view of the delays associated with the fruits of structural reform, *"Going towards intangible assets is one way of dealing with the Gordon problem",* he concluded.

Its loss of competitiveness is certainly the major problem facing France's beleaguered economy at the moment, according to Professor **Agnès Bénassy-Quéré** who is a director of the French government's Conseil d'Analyse Économique. France has lost a 2-percent market share in the global market over last decade due to an accelerated rise in prices, hampering its ability to sell goods abroad. Unit labour costs don't really account for the divergence in exports between France and Germany in recent decades, noted Ms Bénassy-Quéré, who focused instead on the services sector to explain France's loss of competitiveness. As prices for non-traded goods in France soared between 1999 and 2010, the labour costs were largely added to the price of services. As Ms Bénassy-Quéré, protection of the services markets also fell over this period. Emphasizing the importance of the price of services to external competitiveness, Ms Bénassy-Quéré called for greater deregulation of non-traded goods in France to lower their prices. Areas potentially ripe for deregulation in France include housing, transportation, retailing, the healthcare system and several protected professions such as chemists, for example. Ms Bénassy-Quéré also warned that the pace of national wage increases needs to be slowed. *"In France there is a lack of awareness of the need for reform and no perception of the benefits of reform"* she noted. In view of the lack of press interest in this issue, Ms Bénassy-Quéré emphasized the need to start with public opinion and create a desire for reform, which should be accompanied by fiscal space to compensate the 'losers' of reforms.

The third panel speaker **Roland Koch,** Chairman of the Executive Board, Bilfinger Berger SE, Mannheim and former Minister-President, State of Hessen, noted that politicians and business people often have to make pragmatic, but unwelcome decisions. In his view, voters in the eurozone are relatively satisfied with their basic situation and are not really prepared to endure the suffering that accompanies reforms in order to improve it. Mr Koch went on to express scepticism regarding the extent to which the 'losers' can be compensated under such circumstances. He outlined two basic alternatives for decision-makers: the first is to flood the market with money in the form of subsidies, which businesses happily accept; and the second is to give companies more room to manoeuver (greater flexibility in terms of labour, etc.). Politicians, he continued, are always asking how quickly businesses can deliver results if reforms are introduced, as they have their sights set on the next election. Their operational space is reduced by relative electoral prosperity, explained Mr Koch. He asked whether we can give politicians more space to act. Stakeholders on the business side have alternatives and will go elsewhere if regulation becomes too tight, he warned.

Addressing Ms Bénassy-Quéré, Mr Warner, ventured that the difference between Britain and France is that France is in a state of denial. He asked what can be done to shake France out of its complacency and whether France needs a Margaret Thatcher. In response Ms Bénassy-Quére noted that France's new government has delivered on its commitments in its first year and that its second year should be very different. She expects reforms of the pension system and of adult vocational training and predicted an uptick in the pace of reform. Ms Bénassy-Quéré also took pains to stress the existence of a political willingness to cut French government spending.

The first question from the floor was raised by **Peter Jungen**, Chairman of Peter Jungen Holding GmbH and of Project Syndicate. Almost everything has been tried in Europe to restore dynamism, but why is there not a greater emphasis on innovation? The start-up rate is 2.5 times higher in the United States than in Europe, reflecting its faster paced innovation, yet financing entrepreneurship is a real way to finance growth, he remarked, before throwing the question open to the panel. Mr Galasso agreed that innovation is very important and speculated that low venture capital investment in Europe may be due to poor incentives. He cited cultural differences as another key reason for reticent investment in start-ups. In the United States it is acceptable to fail, noted Mr Galasso, but in Italy failure is still seen as a stigma.

Weaker links between universities and business in Europe represent another reason constraint on innovation, added Mr Padoan. He called for the creation of a European research space that goes beyond national boundaries and promotes competition between R&D institutes. In France, noted Ms Bénassy-Quére, the situation in terms of as stimulating corporate growth is rather puzzling. While creating a firm is easy in France, hiring employees is difficult due to inflexible labour laws. Many French firms seem to struggle to grow from a small company to a medium-sized enterprise. Ms Bénassy-Quére speculated that this may partly be due to paper work, but suggested that there was also a corporate culture problem. Small French companies would do well to emulate their German counterparts in this respect, she noted.

Moving onto the issue of demographics, **Guy de Jonquières,** Senior Fellow, European Centre for International Political Economy, London, pointed out that one way of alleviating the shrinking labour force problem would be to encourage more immigration. Could this offer an answer to our problem? Mr Galasso agreed that some countries like the United States rely on an inflow of young migrants to help solve labour market shortages, but argued that this was not a long-run solution. Once they enter a country migrants immediately converge with the fertility rate of its residents, explained Mr Galasso, which is why migration can only be seen as a short-term labour market fix. Ms Bénassy-Quére criticised companies for remaining mute on the topic of immigration and called on them to be much more vocal if they do wish to employ foreign workers.

Addressing Ms Bénassy-Quéré, Hans-Werner Sinn blamed the increase in wages in the services sector for France's lack of competitiveness. Germany's wage distribution, he noted, widened in the wake of Schröder's reforms, which created jobs at the lower end of the quality scale by abolishing second tier unemployment benefit. In the absence of such reforms, Mr Sinn postulated that higher wages for lower end jobs in France may have pushed up the price of services. Rephrasing Hans-Werner Sinn's question, Mark Warner asked whether France needs to get rid of minimum wages. Ms Bénassy-Quére responded by citing studies that show that the minimum wage has little impact on unemployment, except for the young. However, this is now a taboo topic in France after the last government's disastrous attempt to introduce a minimum wage for the young. All the government can do is to cut the social contributions required for young workers at the lower end of the wage scale, she observed.

Bringing the question session to an end, Mr Koch refuted the idea that immigration may be a way to reinvigorate Europe's economy, but supported the concept of a transatlantic trade zone as one of the best ways of boosting mid-term growth. There are a large number of long-term strategies for stimulating growth that were not discussed during the panel, as Europe's problems are currently foremost in almost everybody's mind, Mr Koch concluded.