



Mannheim · May 12, 2014

Theses for the ZEW Lunch Debate:

“Elections to the European Parliament: Economic Challenges for Europe”

The 2014 elections to the European Parliament take place at a time when Europe is facing considerable economic challenges. These challenges raise complex questions, and Europe’s citizens will expect the new MEPs and the newly formed European Commission to provide answers. The recent economic and financial crisis has had a deep impact. The countries most affected by the crisis have gone through severe recessions. They have implemented drastic fiscal consolidation measures and had to adjust and redesign their economic and social policies. At the European level, various reforms have been carried out in reaction to the crisis. In particular the introduction of the European semester, the European Stability Mechanism, and the Banking Union project have substantially changed the institutional architecture of the euro area.

It is a controversial issue whether this is enough to overcome the crisis. There are encouraging signs of economic stabilisation, but the situation in many member countries is still fragile. The downturn seems to be over, but economic recovery is weak and uneven. Unemployment has stopped to grow but remains at high levels. Many young people in Europe are excluded from the labour market and are losing hope of a change for the better. A large number of households and companies are highly indebted and hesitate to consume and invest. Governments struggle to bring down their deficits and stabilise debt-to-GDP ratios. Europe urgently needs to achieve a sustainable and inclusive economic recovery.

Against this backdrop political forces seem to be gaining strength that call into question whether deeper economic and political integration is the right answer to the crisis. Those forces doubt that the European institutions are able to cope with the challenges ahead. Furthermore, in the next five years the EU’s executive authority will have to draft a new roadmap for growth and set new goals for the time after the Europe 2020 strategy. The following theses suggest what needs to be done in a number of key policy areas. There is no doubt that the EU should focus on fields where action at the European level generates added value compared to policies at the national or regional level, and should withdraw from policy areas where this is not the case. However, we argue that in many important policy areas deeper economic and political integration is required to address future challenges. Our suggestions can be summarized as follows:



- » **Making full use of growth potentials, continuing fiscal consolidation.** It is of key importance to fully exploit growth potentials in Europe, in particular through structural reforms at the national level and by deepening economic integration in the internal market. At the same time fiscal consolidation efforts should be continued. Fiscal consolidation in times of weak economic growth is difficult to achieve, but the current economic stabilisation suggests that those who expected fiscal consolidation to be self-defeating were too pessimistic.
- » **Reforming the EU budget, focusing on European added value.** The current focus of member states on 'juste retour', i.e. considering EU policies from the point of view of how they will benefit their countries, gives rise to spending on policies that are visible in individual member states. However, this approach diverts attention from spending on European public goods, where the common interests of the EU member states and their citizens are at stake.
- » **Developing a consistent institutional framework for fiscal and economic governance in the euro zone.** The euro area is in need of an institutional framework where decision-making powers and accountability for the consequences of political decisions go hand in hand, and where incentives for sound fiscal and economic policies are strengthened. A sovereign insolvency procedure should be part of this institutional framework.
- » **Continuing the set-up of a European Banking Union.** The banking union should sever the nexus between government finances and banks, remove the fragmentation of financial markets in Europe, improve the efficiency of bank resolution, and protect taxpayers in banking crises.
- » **Abandoning the Financial Transactions Tax project.** A tax on financial transactions in the euro area would be the wrong instrument. While it is correct that the taxation of the financial sector is in need of reform, introducing a financial transactions tax in the euro zone would do more harm than good. The tax will lead to economic distortions and a re-location of economic activity to other countries. It will contribute little if anything to financial-sector stability. Other instruments, e.g. levies on bank liabilities, are more effective.
- » **Focusing EU policies against youth unemployment on mobility for training and employment.** The existing EU policy initiatives to fight youth unemployment, in particular the Youth Guarantee, should be reviewed in the light of empirical evidence on the effectiveness of labour market programmes. This evidence suggests that the added value of EU policies in this area may be limited to initiatives supporting EU-wide mobility for employment and training.
- » **Developing a stringent and balanced European Energy and Climate Policy.** The targets of the European energy and climate policy, as well as the instruments employed to achieve those targets, need to be set up consistently. The European targets for the reduction of greenhouse gas emissions should be defined with a view on other important emitters like the US and China. Moreover, reducing the fragmentation of European energy markets should be another objective of the European climate and energy policy.