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ECONOMIC POLICIES FOR GROWTH AND EMPLOYMENT

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Economic Policies for Growth and Employment

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Contents

| | | |
|----------|--|-----------|
| 1 | A New Start for the Lisbon Agenda | 2 |
| 2 | The European Position | 2 |
| 3 | Framework for Growth and Employment | 5 |
| 3.1 | Productivity Growth | 5 |
| 3.2 | Labour Resource Utilisation | 7 |
| 4 | Policies for Growth and Employment | 8 |
| 4.1 | Microeconomic Reforms | 8 |
| 4.2 | Employment Guidelines | 9 |
| 4.3 | Growth and Jobs | 11 |
| 5 | Conclusion | 12 |
| | REFERENCES | 15 |

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1 A New Start for the Lisbon Agenda

In 2000, the Lisbon Agenda set out an ambitious plan to make the European Union “the most dynamic and competitive knowledge-based economy in the world”. The Agenda suggested a need for action on three broad fronts: the first explicitly macroeconomic; the second explicitly microeconomic; the third of a more institutional nature, focussed on the labour market.

First, macroeconomic policies need to create conditions for more growth and jobs in a dynamic and well-functioning Euro area. Second, microeconomic policies need to make Europe a more attractive place to invest and work, and to enhance the climate for knowledge-creation and innovation. Third, under the employment guidelines, policies need to attract and retain more people in employment and modernise social protection; to improve the adaptability of workers and enterprises and the flexibility of labour markets; and to increase investment in human capital through better education and skills. An ambitious agenda indeed, which the Commission claims might add 3 per cent to EU GDP by 2010 and add 6 million jobs.

This paper examines a number of issues. First, the current Lisbon Agenda. Second, the relative position of Western Europe with regard to growth and jobs. Third, an analytical framework linking growth and jobs. Fourth, where the current Agenda links to that analytical framework, and where it does not. Fifth, conclusions as to future directions for the Agenda.

2 The European Position

Although the current image of the Western European economy is one of ‘Eurosclerosis’, this is only a comparatively recent development. After a period of surprisingly rapid reconstruction immediately after the Second World War, the Western European economies grew at an unprecedented rate over the twenty five years that have come to be known as the ‘Golden Age of Economic Growth’. During this time, as Table 1 shows, Western European growth in output per hour of over 4 per cent a year comfortably outstripped that of the USA. This led to a considerable degree of convergence, as Western Europe adopted the best-practice production techniques and new technologies that it had failed to adopt in the Inter-War years (Temin (2002)).

It was only with the first oil shock in 1973 that cracks began to appear in the Western European edifice. Although Western Europe continued to catch up with the US in terms of output per worker hour, it did have considerable problems with inflation and unemployment. Some countries, such as Germany, dealt with these problems better than others, such as the UK and France, but by the early 1980s the level of unemployment in Western Europe had exceeded that in the United States, a worrying portent of future

Table 1: AGGREGATE ANNUAL GROWTH RATES OF REAL GDP, TOTAL HOURS AND LABOUR PRODUCTIVITY

| | REAL GDP | | | | TOTAL HOURS | | | | GDP PER HOUR | | | |
|---------|----------|---------|---------|---------|-------------|---------|---------|---------|--------------|---------|---------|---------|
| | 1980-90 | 1990-95 | 1995-00 | 2000-02 | 1980-90 | 1990-95 | 1995-00 | 2000-02 | 1980-90 | 1990-95 | 1995-00 | 2000-02 |
| France | 2.3 | 1.1 | 2.7 | 1.4 | -0.6 | -0.4 | 1.4 | -0.2 | 2.9 | 1.4 | 1.3 | 1.7 |
| Germany | 2.2 | 2.0 | 1.8 | 0.4 | -0.3 | -1.9 | -0.3 | -0.9 | 2.5 | 4.0 | 2.2 | 1.3 |
| Italy | 2.2 | 1.3 | 1.9 | 1.1 | 0.3 | -1.0 | 1.0 | 1.2 | 2.0 | 2.3 | 1.0 | -0.1 |
| UK | 2.6 | 1.8 | 2.9 | 1.7 | 0.5 | -1.2 | 1.0 | 0.7 | 2.2 | 3.0 | 1.8 | 1.1 |
| EU 15 | 2.4 | 1.6 | 2.7 | 1.3 | 0.1 | -1.0 | 1.1 | 0.4 | 2.3 | 2.6 | 1.5 | 0.8 |
| USA | 3.2 | 2.4 | 4.0 | 1.3 | 1.7 | 1.2 | 2.0 | -0.4 | 1.4 | 1.1 | 2.0 | 1.7 |
| Japan | 4.0 | 1.4 | 1.4 | -0.7 | 1.0 | -0.4 | -0.9 | -0.9 | 3.0 | 1.8 | 2.3 | 0.2 |

NOTES: Source: adapted from O'Mahony and van Ark (2003)

economic problems. This can also be taken as a sign that the institutions that served Western Europe so well in the Bretton Woods era would be less successful thereafter (see Cameron and Wallace (2002)).

Even so, despite the problems of chronic Western European unemployment, it was only in 1995 that Europe began to fall behind the USA in output per hour, as Table 2 indicates. Gordon (2004) estimates that in 1995, output per hour in Western Europe was 94 per cent of the US level, falling back to 85 per cent in 2003. This is a startling loss of one-fifth of the ground that was made up in the long half century of gains (from 44 per cent to 94 per cent).

In addition to labour productivity, there is another sense in which Western Europe has declined relative to the USA, and that is the rate of relative labour utilisation. While working hours declined in both Western Europe and the USA in the immediate post-war period, that decline stabilised in the USA in the mid 1970s, but continued in Europe. According to Gordon, in 1960, Western Europeans worked slightly longer hours than US workers (by around 2 per cent), and a higher proportion of the population was in employment (by around 16 per cent). By 2004, Western Europeans were working 15 per cent fewer hours and employment per capita was 9 per cent lower.

To put this more bluntly, based on data from the 2005 OECD Economic Survey of the Euro Area, GDP per capita in the Euro Area was 30 per cent lower than that of the USA in 2002, with just over two-thirds of that shortfall due to lower labour resource utilisation and the other one-third due to lower labour productivity.

It is worth highlighting three interesting questions that arise from the above discussion.

How high is Western European labour productivity? Among the Western European economies, the shining beacon in terms of output per worker hour is France (Eurostat data suggest that it was 8.5 per cent higher in France than in the USA in 2003). For an economy that has endured such a sluggish performance over the past decade or so, this seems remarkable. The key to understanding this phenomenon is to appreciate that the ratio of capital per worker in France is also very high. To a large extent, this is a legacy of past high investment rates, often directed into publicly-owned capital-intensive industries. But it is also the consequence of poor labour market performance that has kept low-skilled and young workers out of jobs (and hence artificially raised average labour productivity) and has also encouraged firms to substitute capital for labour (see Blanchard (2004) and van Ark, Frankema and Duteweerd (2004)).

Is low labour resource utilisation due to a high preference for leisure? This is also a sensible question to ask. Well-paid and secure workers will naturally want to take longer holidays and shorter working hours as a substitute for higher wages (Blanchard (2004)). However, Alesina, Glaeser and

Sacerdote (2005) make the point that two of the conventional explanations, namely that based on preferences for holidays, and that based on the disincentive effects of taxation (Prescott (2004)), are unsatisfactory because they fail to account for relative changes in US and Western European behaviour. For example, Freeman and Schettkat (2001) show that time-use is very different in Germany and the USA since German mothers cook at home whereas US mothers take their families to restaurants. It is tempting to see this as a fixed cultural explanation, but in fact it is only a relatively recent development - mothers in Germany and the USA would have used their time in much more similar ways in the 1950s and 1960s - so the ostensible 'cultural' change might in itself be caused by other, economic, developments. Instead Alesina *et al.* (2005) argue that short hours represent the cumulative effect of labour union policies and labour market regulation.

It is also worth pointing out that much of the problem relative to the USA is that employment per capita has shown no strong trend in Western Europe since World War Two, whereas the USA has integrated women and teenagers into its workforce much more effectively (Gordon (2004)), as well as maintaining higher participation among older and unskilled workers.

Why has the boom in Information and Communication Technologies (ICT) had less effect in Western Europe than the USA? Although Western European consumers have been quick to adopt new ICT goods, Western European industry has been less adept at exploiting the potential for new markets and new ways of organising production. Gordon (2004) suggests that the most important difference is that firms in Western Europe have failed to change the way they do business in response to the new technologies. O'Mahony and van Ark (2003) show that Western European productivity growth between 1995 and 2001 was particularly slow relative to the USA in three main IT-using service sectors: retail, distribution, and financial services. As Gust and Marquez (2004) argue, it is quite plausible that the extent of labour market regulation in Western Europe significantly slows the speed of adoption of new technologies and new ways of doing business, although of course it should be noted that regulations differ widely across countries so it is always problematic to talk of a homogenized Western Europe.

3 Framework for Growth and Employment

3.1 Productivity Growth

Economics has always considered physical investment to be an important source of growth, particularly in the short and medium run. Although it is debatable whether investment could be a source of growth in the very long run in the absence of technological change, there is the prospect of

Table 2: LABOUR PRODUCTIVITY LEVELS IN MANUFACTURING, EU COUNTRIES RELATIVE TO THE US

| | 1979–1990 | 1990–1995 | 1995–2001 |
|---------|-----------|-----------|-----------|
| Germany | 100.3 | 92.7 | 82.7 |
| France | 103.9 | 104.3 | 101.6 |
| Italy | 90.8 | 91.1 | 78.9 |
| UK | 63.3 | 81.9 | 75.3 |
| EU-14 | 84.6 | 88.0 | 80.3 |
| US | 100.0 | 100.0 | 100.0 |

NOTES: US = 100; Labour productivity is measured as value added per hour worked. Source: adapted from O'Mahony and van Ark (2003)

substantial effects on productivity that take a long time to emerge.¹ Evidence presented by Blanchard and Giavazzi (2002) suggesting that investment flows between Western European countries have increased over time, could reflect the impact of greater microeconomic integration, with beneficial effects on macroeconomic adjustment.

What other factors can help improve productivity performance? It is clear that a skilled workforce, and a capital market that can easily adjust to changes in the demand for different types of physical investment without significant distortions (due to financing constraints, for example, or regulation in the form of planning permission), will be in a better position to respond to structural changes in the economy driven by innovation or international competition. In this context, the flexibility and efficiency of the labour market will be an important determinant of an economy's ability to harness innovative activity.

In stressing the importance of explaining technological progress within the growth process, recent growth models have given prominence to factors such as innovation as an important source of growth. Capturing an abstract phenomenon such as 'innovation' in theory is difficult. However, there are a number of papers that characterise the process of innovation; for example, an early model (Arrow (1962)) examined the effect of 'learning by doing', where production experience raised productivity. Other models explicitly capture innovation via a research and development (R & D) sector,

¹As Temple (1999) observes, 'it is always worth remembering that "the long run growth rate" is a theoretical abstraction, never observable in practice. Debates about whether or not policy affects it will distract us from more questions that are ultimately of more practical importance.' (p.141).

which affects the variety of inputs used in production (Romer (1990)), or their quality (Aghion and Howitt (1992)).

Empirically, research and development has been linked to innovative activity; for example, Cameron, Proudman and Redding (2005) develop an open economy model of innovation and technology transfer, and find that for a panel of UK manufacturing industries, research and development spending affects productivity growth directly through its effects on innovation, whilst international trade facilitates technology transfer across countries.

Theoretical models and empirical evidence covering the importance of competition have spurred research into the effects of market structure on innovation and productivity growth. The picture painted in the literature, however, is more subtle than a direct causal link between increased competition and greater productivity growth. Whilst there is some evidence that competition, measured by increased number of competitors, is associated with higher TFP growth (Nickell (1996)), its impact on innovative activity and the imitation of ideas is more complex. Within a straightforward Schumpeterian view, more competition reduces the reward to (and hence the amount of) innovation. However, as Aghion, Harris, Howitt and Vickers (2001) and Aghion, Harris and Vickers (1997) demonstrate, the incentive for firms to escape competition by innovating typically outweighs this effect. Further, some imitation of ideas is productivity-enhancing, to the extent that it encourages more frequent neck-and-neck competition, but too much imitation can have adverse effects.

Other factors besides straightforward product market competition may also be important: for example, Nickell, Nicolitsas and Dryden (1997) find that financial market pressure (affecting the cost of finance) and shareholder control have significant effects on firm productivity.

3.2 Labour Resource Utilisation

Western Europe is often derided as having an extremely rigid labour market. This caricature is partially valid since the economies of the EU are extremely diverse in their labour market institutions and outcomes, with a number of relative successes, such as Denmark, Finland, Ireland, the Netherlands, Portugal, and the United Kingdom. As Professor Stephen Nickell, of Nuffield College, Oxford, has said, "Unemployment is high in the four largest economies of Continental Western Europe, namely France, Germany, Italy and Spain. Exclude these four countries and the famous European unemployment problem more or less disappears".

This clearly indicates that there is both a diversity of institutions and outcomes across the EU, with by no means every institution being associated with poor labour resource utilisation. Some institutions, however, are clearly associated with poorer outcomes - for example, high levels of ben-

efits paid indefinitely; low spending on active labour market policies; high levels of unionisation with little coordination of wage bargaining systems; and minimum wages combined with high payroll taxes along with large numbers of unskilled workers. There is also evidence that barriers to geographic mobility may also matter for labour market outcomes (Cameron and Muellbauer (1998), OECD (2005)).

When it comes to Employment Protection Legislation (EPL), however, the evidence is rather mixed. On the one hand, a case can be made that it has little effect on aggregate unemployment since it should slow the rate of firing to about the same extent as it does the rate of hiring. On the other hand, it is likely that the effect is asymmetric, especially when it comes to workers whose abilities and aptitudes are less easy for an employer to assess. For example, there is evidence that strong EPL is bad for the labour market outcomes of young workers, unskilled male workers, female workers, and older workers (OECD (2004)). Note that it is in precisely these areas that many European countries have low employment and participation rates (Gordon (2004)). In addition, it has also been argued that EPL may have a negative effect on investment and growth in situations where particular investment projects are quite uncertain, and there is empirical evidence that restrictive regulatory practices may have slowed the rate of adoption of ICT in the EU (Gust and Marquez (2004)), as mentioned earlier.

4 Policies for Growth and Employment

4.1 Microeconomic Reforms

The Lisbon Agenda aimed to raise the EU's growth potential, by increasing spending on investment and innovation. Two themes underlie the microeconomic and structural reform proposals that are designed to achieve this. First, to establish a **climate for investment**, policy guidelines are aimed at implementing the single market more effectively, broadening it out to incorporate the service sector; restructuring the regulatory environment, by assessing the cost and quality of regulation, and the legislative burden on firms; increasing competition through enforcement of anti-trust laws, and reduction of state-sponsored industry protection; expanding and improving European infrastructure; and encouraging enterprise and entrepreneurship, with a focus on start-up and medium size businesses.

Secondly, to promote **innovation**, the guidelines aim to raise expenditure on research and development, with a target of raising research investment to 3 per cent of GDP, of which two thirds should come from the private sector; facilitate the implementation of ICT, and foster partnerships between universities and enterprises; commit member states to supporting environmentally sustainable development; and establish new technologies

and markets, with the development of regional and local clusters.

Several of these elements are closely linked to economic theory. The drive to improve competition within sectors *across* the EU should improve not only product market flexibility directly, so that distortions are reduced, but should also have a beneficial impact upon research and development, thereby helping both competition and innovation. Further, a commitment to reduce direct state-led protection of industries or sectors represents an important acknowledgement of the need to minimise market-distorting state intervention, when there is no justification on the grounds of genuine market failure.

There are, however, some gaps and inconsistencies in the strategy. The basis of the investment guidelines is to create a climate in which firms are encouraged to invest; thus government policy is clearly aimed at creating an environment for firms, rather than engaging directly in investment spending. In contrast, one of the central aims of the innovation guidelines is to raise research spending to a centrally-planned target, of which a third would be directly state-financed.

There could be an economic justification for such direct public intervention, if the spillover effects of innovation were so great, and firms were unable to capture their return to research spending; in this case, in the absence of government policies, too little innovation would take place. However, it is not obvious that this applies to EU firms in general. Nor is it clear that all member states have the necessary information, expertise, or policy tools to implement research expenditure in an efficient and coherent way. Rather than aim for an arbitrary target for spending, innovation policy would benefit greatly from following the investment framework, by creating an environment which would encourage firms to engage in research and development themselves.

4.2 Employment Guidelines

The Employment Guidelines of the Lisbon Agenda have three broad goals: to attract and retain more people in employment and modernise social protection systems; to improve adaptability of workers and enterprises and the flexibility of labour markets; to increase investment in human capital through better education and skills. These are all laudable aims, although there are a number of difficulties in their implementation.

The first goal concerns the low employment and participation rates that are seen in the EU (Greece and Belgium stand out as particularly low). Here, the Agenda is right to stress that action is needed to tackle the persistently low employment rates of young people, the unskilled, women, and older people. It suggests that active labour market policies (a 'pathways to work' approach, encompassing job search assistance, guidance, and training) and the review of tax and benefit systems including management and

conditionality of benefits in order to make work pay. Such schemes have been successful in Denmark and the United Kingdom.

The second goal concerns with the adaptability of workers and firms. It aims to ensure that they can both take full advantage of new opportunities for investment. As discussed above, it seems that the EU has had particular problems with the adoption and use of ICT in its service industries and that it is possible that labour market institutions, such as employment protection, retard the ability of firms to discover new ways of doing business and perhaps also prevent the easy entry the new firms, with consequent effects on productivity and growth.

The third goal concerns investment in human capital. Inklaar, O'Mahony, Robinson and Timmer (2003) point out that EU productivity growth in high skilled industries and low-intermediate skilled industries has been poor relative to the USA since 1995. In contrast, productivity growth in high-intermediate skilled industries (such as engineering) has been relatively good. Since many industries in their high skilled and low-intermediate skilled classification are either IT-producing manufacturing or IT-using services, respectively, this again emphasizes particular areas of the EU economy that have difficulties.

However, before leaping to the conclusion that the problem is one of skills and education, it is worth remembering that, in general, the EU workforce is quite well skilled and educated, although there are big differences across the EU. This suggests that the first two goals of the employment guidelines should take priority and that the implementation of the third should be seen as supportive of the first two goals for the following reasons. First, EU efforts to raise the skill level at the bottom of the workforce will help efforts to raise employment rates among the young, the unskilled, women, and older workers. Second, EU efforts to raise the skill level among those in the middle and top of the workforce will help to make workers and firms more adaptable and to fully benefit from investment in new technologies.

It is also worth remembering two major obstacles to the success of the employment guidelines. Some EU countries have a rather inflexible view of the European Social Model, and it will be difficult to obtain the cooperation of political elites and labour unions for reforms that change the relative positions of insiders and outsiders in the labour market. In addition, there may be problems with the otherwise admirable goals of extending equal social protection to all workers (for example, giving part-time and temporary workers the same rights as full-timers) and of encouraging firms to pay the same wage rates to all workers. This is simply because it is not reasonable for the labour market to treat all workers in the same way. Consider the extension of employment rights to temporary workers, where it has been shown that high protection of temporary workers leads to low rate of transition from temporary work to permanent work (OECD (2004)). In

Table 3: CONTRIBUTIONS OF INDUSTRY GROUPS TO DIFFERENCES BETWEEN EU-15 AND US AGGREGATE ANNUAL LABOUR PRODUCTIVITY GROWTH

| | PRODUCTIVITY GROWTH DIFFERENTIAL AVERAGE ANNUAL PERCENTAGE POINTS | | |
|------------------------------------|--|-----------|-----------|
| | 1979–1990 | 1990–1995 | 1995–2001 |
| Total Economy | 0.99 | 1.19 | -0.54 |
| ICT PRODUCING INDUSTRIES | -0.13 | -0.25 | -0.45 |
| <i>ICT producing manufacturing</i> | -0.31 | -0.29 | -0.60 |
| <i>ICT producing services</i> | 0.08 | 0.04 | 0.15 |
| ICT USING INDUSTRIES | 0.38 | 0.44 | -0.61 |
| <i>ICT using manufacturing</i> | 0.19 | 0.18 | 0.14 |
| <i>ICT using services</i> | 0.19 | 0.26 | -0.75 |
| NON-ICT INDUSTRIES | 0.73 | 0.99 | 0.44 |
| <i>Non-ICT manufacturing</i> | 0.27 | 0.01 | 0.24 |
| <i>Non-ICT services</i> | 0.41 | 0.88 | 0.32 |
| <i>Non-ICT other</i> | 0.06 | 0.10 | -0.11 |

NOTES: Figures show productivity growth differential of the EU-15 countries over the US. Source: adapted from O'Mahony and van Ark (2003)

the UK, 70 per cent of those on fixed term contracts in 1998 had permanent contracts in 2000, compared with a 50 per cent European average.

4.3 Growth and Jobs

As the forgoing discussion has noted several times, the EU is a very diverse place with many different institutions, inputs and outcomes. However, it is possible to offer the following pen-portrait of EU performance.

Labour resource utilisation is low, with low hours worked and low employment and participation rates. While it would be cheering to view these as representing an EU preference for leisure time, there is little evidence to support that view, especially when it comes to the poor labour market outcomes of the young, for unskilled men, for women, and for the old.

In turn, the EU possesses a skilled, educated and innovative workforce who are able to deploy high levels of physical capital in their jobs (this is particularly true of France, Germany and the Netherlands, but capital intensity is quite low in the United Kingdom). Despite these strengths, the EU has begun to slip behind the USA in terms of output per worker hour,

even though the US economy manages to employ far more low quality workers than the EU, which must tend to bring down its average productivity level. Looking at the decline in the relative position of the EU since 1995 in Table 3, there are particular problems with ICT-producing manufacturing industries and with ICT-using service industries (Inklaar *et al.* (2003)), but no evidence that there is a problem in ICT-producing services, ICT-using manufacturing, or non-ICT industries (both manufacturing and services).

Consequently, the main areas on which the EU needs to focus are labour resource utilisation and competition and enterprise. Rather than concentrating on all areas of the economy, it should focus on the two specific sectors of ICT-producing manufacturing (that is, office machinery and electronics) and ICT-using services (that is, retail, distribution and financial services).

In contrast to the Lisbon agenda, this suggests that there is little point worrying about high technology manufacturing outside of the ICT-producing sector. Nor should it worry about the education and skill level of the workforce, except in so far as that impacts upon their employment prospects, or perhaps in peripheral countries where the level is low.

5 Conclusion

The EU has a genuine problem with growth and jobs. Employment rates are low, labour markets are rigid, and productivity growth is falling behind that of the USA. It has even been suggested that the long-run rate of growth of the EU economy may have slipped down to around 1 per cent. To meet this challenge, the Lisbon Agenda sets out a plan to make the EU a more attractive place to invest and work; to spur invention and innovation; and to create more and better jobs.

The forgoing discussion has shown that much of the Agenda sits comfortably with economic theory and evidence. However, it is possible to highlight a number of difficulties that may arise.

First, while the Agenda generally recognises that future prosperity is dependent upon the EU being an attractive place to work and invest, some of the proposals and cross-cutting initiatives by the EU tend to run against this recognition. For example, the Agenda displays an occasional obsession with *dirigiste* targets (such as spending 3 per cent of GDP on R&D, a target chosen presumably because it is just slightly higher than the US currently achieves) or fashionable shibboleths (the 'knowledge-based society'). In addition, there is a danger that other EU initiatives on the environment, equality, social inclusion, and consumer safety, will also lead to a higher regulatory burden and hence lower growth and fewer jobs. There is a clear need for much more analysis of the costs and benefits of intervention. In-

deed, there may even be times when the joint objectives of growth and jobs may conflict, given the low skills of many people who might enter or re-enter the workforce.

Second, the Agenda pays some attention to the wide disparity of economic conditions within the EU (and of course, if this is true for the EU-15, it is true, *a fortiori*, for the EU-25). This variation is apparent in all three of the important policy areas of business investment, education and training, and labour market reform: France has a great record of business investment, while the UK does not; Germany has surprisingly low participation in higher education, while Finland excels; Belgium has a low employment rate, while Denmark ranks highly. Furthermore, there are large differences in industrial structure across Europe, ranging from the oil fields of the North Sea to the olive groves of the Mediterranean. In any discussion of a group of rich countries such as the EU-15, it is going to be nearly impossible to identify any one country that does poorly on every indicator. Indeed, even the poorest EU-15 member, Portugal, has an exemplary record on labour market participation by EU standards.

Third, the Agenda also displays a willingness to be seduced by the lure of high-technology, high-skill industries. As seen above, the EU does have a productivity problem in IT-producing manufacturing, but there are potentially larger problems in the traditionally low-technology industries of retail and distribution. These are areas where US productivity has made great advances since 1995 but the EU has not. Part of the explanation lies in the slow adoption of ICT, and labour market and land-use regulations that make the attendant business change difficult (Gordon (2004)). Although sophisticated firms will always attract attention, there is plenty of scope for the EU to improve its performance by improving skills and investment among the comparatively dull firms and industries that constitute the vast majority of economic activity.

Fourth, this paper has rightly steered clear of macroeconomic policy debates. It is worth noting however, that the early macroeconomic policies of the Clinton administration put the Federal government back on the path to a balanced budget and thereby eased the way for the Federal Reserve and the bond market to ease monetary conditions. In addition to some microeconomic reforms in the labour market and the formation of NAFTA, these macroeconomic reforms did seem to lay the groundwork for the astonishing burst of productivity growth enjoyed by the US since 1995 (Katz and Krueger (1999)). Furthermore, Duval and Elmeskov (2005) have recently pointed out the difficulties of structural reform within a fixed exchange rate system where individual reforming countries lack the monetary autonomy necessary to affect the initial negative demand effects of reform.

Fifth, there will no doubt be serious political difficulties across the EU in the agreement and implementation of national action programmes. Two economic issues occur: first, that there is nothing really in the Agenda that

requires a large transfer of resources from member states to the EU except for the 3 per cent R&D target. Second, that the statement by the EU Commission that it is more ambitious than merely wanting to create McJobs in the EU displays a high degree of *sang-froid*. After all, it is precisely McJobs that many EU countries lack; jobs that offer pathways to work for the young, the unskilled, women and the old. Perhaps this rhetoric is merely used to allay fears of a wholesale dismantling of the European Social Model, but as the Financial Times recently noted “Europe has fundamentally changed since the post-war welfare systems were constructed. It would be strange indeed if they could not be made more relevant today” (15th July 2005).

Lastly, there are a number of areas for possible reform that are largely missing from the Agenda. Many economists have argued that one key element of Western Europe’s Golden Age of Economic Growth was the re-deployment of labour from agriculture into industry. Reform of the CAP, along with a better investment climate, offers the chance to repeat that experience, albeit on a smaller scale. Similarly, progress on trade reform to open EU markets also offers the chance to reallocate resources on the basis of the EU’s great strength, its skilled and competent people.

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