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Making Democracy Thrive

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Something peculiar is going on in Europe. European markets have regained some stability since 2009-2011 and, yet, **trust** in European politics continues to drop. That decreasing confidence, however, has still not triggered the electoral landslide that so many expected. Progress of extremist parties remained limited, even in the member states that were hit the hardest by the crisis, and the Eurosceptic parties failed to become the dominant force in the European Parliament. Frustration among citizens does not seem to get organized. Should we consider this to be the famous social firewall in action? Does it show that our society is resilient and tolerant enough to allow the European Union to continue to move forward incrementally, like it did after previous crises?

Unfortunately, it does not. In fact, such conclusion would be very misleading and perilous. This crisis is different. There might be some cyclical economic patterns at work, but the most important trends are structural and potentially wrecking. The habitual collective action problem between member states has become much more pressing exactly because of the degree of integration; the magnitude of the challenges and the decrease of trust in the European institutions are unprecedented. At the same time, national governments too are grappling with historically low levels of trust and the pragmatic parties that upheld the process of European integration now represent a historically small share of the electorate, a share that inches close to a minority. So, this paper argues, today's crisis is certainly different.

This poses major challenges as the paper goes on to explain. The European Union could become less able to prevent and address future economic crises, which would undermine its legitimacy even more. Populism and nationalism reduce the scope of governments to make mutual compromises, which is vital to keep the European project alive. The paper asserts that this still **does not equal a "crisis of democracy"**. It is certainly so, that the functioning of Europe's democracy can be improved and that citizens should feel more involved. Yet, a democracy crisis would imply people to stop to believe in the importance of democracy, which is not the case. Instead, **there is a crisis of political performance,** which inevitably leads to greater political distrust. The only way to solve it is to generate economic opportunities that reach the majority of the people.

Onwards, the paper evaluates the most common proposals to deliver economic progress and concludes that none of them will be sufficient to reduce social uncertainty and political distrust. Subsequently, it seeks inspiration from a small number of member states that did manage to limit political distrust and to create more economic opportunities. It is found that even if economic rebalancing remains essential, the main keys to economic success and confidence are: reforms in education, resilience through economic diversity, high quality standards and regulation, and soft assets like satisfaction, professional pride, and entrepreneurship.

This crisis is different

First of all, we are in an unprecedented legitimacy crisis of the European institutions and a persistent failure to address the main causes of the crisis. Never in forty years was the scepticism about the benefits of the European project so large.[1] The EU is more than ever under pressure to deliver prosperity and security, but the bickering between the member states has not gone away. They go on in more discrete committee rooms, where the capitals remain unable to agree on crucial policies – ranging from energy to employment.

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Trust in European institutions	50	50	50	45	48	48	47	48	42	34	32
Trust in national governments	30	34	35	30	34	34	32	29	24	25	24
Voter turnout	70	69	69	69	71	69	67	67	72	65	64

Table 1. **Trust in European Institutions (tend to trust), trust in national governments (tend to trust) and voter turnout (annual average for national parliamentary elections).** *Source:* Eurobarometer.

Second, we experience an unprecedented weakening of national mainstream parties – the Social Democrats, the Liberals and the Christian Democrats. If trust in the European government is in decline, trust in national government declined even faster.[2] Today, public confidence in national governments is actually lower than trust in European institutions (table 1).[3] Again we are at a tipping point. For the first time since WWII, mainstream parties might lose their majority. National election results show that 36 per cent of the electorate now vote pragmatic, resulting in 51 per cent of the effective votes. These pragmatic parties used to be the main facilitators of European integration.

	Social-dem.	Liberal	Others	Christ. Dem	Greens	Communists	Nationalists	Conservatives	Abstention
1990-2000	25	9	9	7	2	3	5	12	27
2000-2012	22	8	8	6	2	4	6	14	30
Change	-3	-2	-1	-1	0	1	1	2	3

Table 2. **Change in support for political groups (percent of the total electorate).** *Source:* Own calculations based on European Election Database for Austria, Belgium, Bulgaria, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Netherlands, Portugal, Romania, Spain, Sweden, and the UK.

Third, we witness unprecedented challenges to the social model that allowed governments to maintain stability and to make concessions towards one another. Unemployment continues to be at very high levels. But there is more. Since the crisis, the income after inflation dropped significantly in most countries (table 3). This trend was visible across all income groups, but it is obvious that it particularly afflicted the lower income groups. This is especially so because, income inequality had already increased significantly in the decade before the crisis.

	GDP		Earnings		Disposable income		Disposable income per income quintile (2007-2013)				
	2000	2007	2000	2007	2000	2007	I	II	III	IV	V
Belgium	6	-5	11	5	-2	-10	-11	-10	-10	-9	-10
Bulgaria	70	9	80	40	70	23	33	22	21	18	16
Czech Rep.	70	-4	74	10	14	-3	-3	-5	-6	-7	-7
Denmark	6	-6	18	6	14	-3	-18	-8	-6	-5	-1
Germany	7	2	9	6	11	2	11	1	2	3	-3
Ireland	-1	-20	6	-5	-8	-25	-25	-21	-23	-26	-27
Greece	-4	-24	35	1	-17	-29	-38	-29	-26	-28	-32
Spain	1	-16	2	1	-4	-17	-25	-19	-18	-17	-15
France	4	-5	9	2	0	-6	-12	-12	-11	-10	2
Italy	-9	-14	-2	-2	-13	-17	-21	-17	-17	-18	-17
Hungary	5	-22	20	-5	3	-24	-27	-26	-25	-24	-22
Netherlands	2	-9	11	4	-2	-12	-3	-5	-6	-7	-12
Austria	9	-2	4	0	8	-4	-12	-4	-2	-2	-4
Poland	44	2	12	0	38	2	6	4	4	4	-1
Portugal	-7	-10	7	-8	-11	-11	-8	-7	-8	-12	-17
Slovenia	-2	-14	0	3	-3	-14	-16	-15	-13	-13	-13
Finland	8	-11	25	3	8	-12	-11	-11	-12	-11	-14
Sweden	17	8	38	17	22	-1	-10	-4	_2	0	-1
UK	-21	-28	-23	-26	8	-14	-14	-12	-15	-14	-13
Average EU-27	8	-8	8	2	9	-11	-12	-10	-10	-10	-11

Table 3. **The evolution of GDP, earnings and disposable income after CPI-adjustment (%).** Selected member states and average for total EU-27. *Source:* Own calculations based on Eurostat. Disposable income is the total personal income minus personal current taxes and some insurance.

The relation between income and political attitudes is strong. A large survey shows that those who said that membership in the EU was bad for their country, 45 per cent of respondents said it was because the EU has harmed the national economy of their country.[4] The EU countries most affected by the crisis tended to register the highest disapproval rates of the EU's crisis management.

Each income quintile one goes down, political trust drops by five per cent and turnout at elections by 2.5 per cent. Strong dissatisfaction with the functioning of democracy goes up 3 per cent each quintile one descends. (Table 4) On a country-by-country basis, average incomes strongly correlate with trust in national governments. Unemployment too has a large impact. Strong dissatisfaction with the functioning of democracy is about twice as high among the unemployed. (Table 5). Polls show that economic performance is considered the most important issue on which citizens expect the EU and their country to deliver: the combating of unemployment (marked by 49%), the economic situation (33%), and inflation (20%) – followed by immigration (11%).[5] This is interesting. The migration problem is often seen as the main reason for far right's advance at the expense of the social democrats. But migration does thus not seem to be as important as a public concern as the economy.[6] Migration usually is a greater concern in countries that are economically weak. In other words, the key to understand the electoral shift might thus not be the success of far right, but the failure of the left to address the other issues. To clarify this properly, more research is certainly required.

	Q1	Q2	Q3	Q4	Q5
Strong political distrust (10-9)	39	31	27	23	20
Political distrust (10-6)	72	68	64	61	58
Vote abst.	27	23	21	18	17
Strong dissatisfaction with the funct. of democracy (10-9)	24	18	15	13	11

	Unemployed	Employed
Strong political distrust (10-9)	44	29

Table 4 and 5. **The relation between income or employment and political attitudes**. *Source:* Own calculations based on ESS. Goes for the EU-27 member states ex. Austria (no data available for 2012).

Fourth, we face unprecedented challenges to our economic power – and privileges. There is of course the demographic challenge. But Europe is also losing competitiveness and this becomes nowhere as clear as in our rapidly shrinking advantage in high-tech exports. European countries also increasingly rely on external debt. Since the Eurozone crisis broke out, about 2 per cent of our GDP was generated by selling bonds abroad – 2 per cent each year (table 7). That's a lot. Europe's next generations will thus have to service a larger external debt with a shrinking labour force and an economy that is less competitive.

	Bonds share
Luxembourg	150
Ireland	20
Sweden	6
Italy	6
France	5
Netherlands	5
Finland	5
UK	5
Denmark	4
Austria	4

Table 7. Change in gross external debt (bonds) as a share of accumulated GDP (percentages for 2000-2013). Top-10. *Source:* Own calculations based on ECB and Eurostat.

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Share high-tech	40	39	39	39	37	38	37	35	35	33	33

Table 6. **The evolution of high-skill and technology-intensive manufactures in the EU's export.** *Source:* Own calculations based on UNCTAD Stats.

So, this time is different. The four layers of identified uncertainty create a situation that is totally new and has made Europe much more fragile. It can also not be excluded that the achievements in erecting a firewall against new shocks in the Eurozone will be sufficient. Internal imbalances are still very large, powerhouses like Germany do not create enough demand for peripheral countries and new bubbles seem to be in the making.

A crisis of democracy or a performance crisis?

Is this a crisis of democracy? Citizens have become more sceptical about the current democratic procedures and its performance.[7] But have people also given up in the importance and merits of democracy? The rise of some strong leaders might indicate so. Moreover, data for 14 European member states show that respondents have fewer problems with anti-democratic parties. In 2002, still 66 per cent found that anti-democratic parties had to be banned; in 2010 this dropped to 59 per cent.[8]

Interesting is that in spite of the Eurozone crisis, countries like Spain, Cyprus, Germany, and Greece remained more outspoken against anti-democratic parties. 77 per cent of Europeans find it very important to live in a democratically governed country.[9] We cannot evaluate this over a longer span of time, but societies in economic distress do not value democracy less than others. There are indications of growing pressure on democracy, but this is insufficient to speak of an acute crisis of democracy in the member states.

In any case, there is a crisis of political trust. There remains a big gap between the large support that still exist for democracy and the dissatisfaction with national politicians. Governments are considered less able to deliver on the key tasks on which the people expect them to deliver and that understandably undermines their legitimacy. There is evidence for increasing majorities of Europeans disapproving their governments' handling of economic policy. So there is certainly a performance crisis.[10]

At the level of the European institutions, people do believe that there is not enough democracy. They demand more transparency and political accountability. On a positive note, that shows that people still expect institutions to function democratically, but it also reveals their lack of understanding, because the EU institutions do function democratically. Distrust in the EU might have increased first of all because of the economic uncertainty, the fact that the EU became more prominent in economic affairs, that the curbing of the Eurozone Crisis has not led to many tangible benefits, that Eurosceptics were successful to attribute economic problems to European integration, and that solidarity between societies might be naturally limited. But fundamentally, it is clear, though, that the EU institutions too failed to convince European citizens that they could reduce economic uncertainty through collective action.

Hence, those who assert that Europe has to learn to live with less deny the political repercussions. No government will survive if a lasting economic decline leads the poor to say that they are too poor to pay, the middle class to argue that taxation will cripple the economy even more, and the rich to threaten to leave. They might try to draw the ire to the European institutions, after states launched they attack Europe without delivering growth, what comes next? Regions attacking states? Cities attacking regions?

Standing still and loosing out is no political option. **To address the democratic deficit, we have to improve governments' performance.**

The options

Performance is about more than the economy. Yet, given the strong relation between economic variables and political trust, this paper mostly focuses on economic performance. Economic strategy has to strike a balance between the need to become more competitive and the fact that more social uncertainty will be destabilizing, cause fragmentation, and just create too much resistance to any policy that aims at change. The current economic debate has become very lively and produced many valuable insights. Yet, if we test some of the most important propositions, it becomes clear that the divide between different schools is not so helpful.

	Change fixed capital formation (change 2000-2013)			Change (2000-2013)				Average (2000-2013)			
				Taxes				Taxes			
	Equipment	Intangible	Total	Total	Labour	LCI	Interest rate	Total	Labour	LCI	Interest rate
Belgium	7	111	42	1	0	45	-3	47	24	124	4
Denmark	20	104	22	-1	-2	44	-4	49	25	119	4
Germany	-4	30	7	-2	-2	28	-4	40	23	113	4
Ireland	-33	123	-28	-3	1	48	1	31	11	133	5
Greece	-20	80	-26	0	2	82	16	35	13	142	7
Spain	21	169	11	-1	1	50	0	35	17	131	5
France	17	52	45	1	1	40	-3	45	23	122	4
Italy	-3	15	10	3	3	36	0	42	21	119	5
Luxembourg	30	24	75	0	2	46	-4	39	16	125	4
Netherlands	8	28	6	-1	2	44	-3	39	20	126	4
Austria	28	80	31	0	1	40	-3	44	24	117	4
Portugal	-16	70	-30	1	2	37	5	35	12	124	6
Finland	16	67	38	-3	0	54	-4	44	23	130	4
Sweden	35	60	60	-8	-5	45	-4	48	28	125	4
UK	-39	4	-6	0	0	52	-4	37	14	132	4
Bulgaria	280	122	273	-4	-5	139	-2	30	11	165	5
Czech Rep.	62	152	80	1	0	90	-4	35	18	153	4
Estonia	200	403	205	2	-1	177		32	17	201	
Cyprus	59	562	12	5	4	55	-1	34	11	136	6
Latvia	77	153	138	-2	-2	229	-3	29	14	227	6
Lithuania	102	189	170	-3	-4	117	-3	30	14	164	6
Hungary	26	35	45	-1	-1	118	0	39	19	174	7
Malta	-2	615	19	6	2	44	-2	33	11	123	5
Poland	45	43	63	0	-1	98	-6	33	13	156	6
Romania	184	413	338	-2	-2	432		29	12	359	
Slovenia	32	23	12	0	-1	81	-3	38	20	152	5
Slovakia	234	231	142	-6	-3	109	-3	31	13	166	5
Correlations	Expected			-	-	-	-	-	-	-	-
	EU-27	Equipment		-0,3	-0,6	0,6	-0,2	-0,5	-0,3	0,6	0,2
		Intangible		0,4	0,1	0,4	0,0	-0,5	-0,5	0,4	0,1
		Total		-0,3	-0,6	0,8	-0,3	-0,5	-0,3	0,8	0,1
	EU-15	Equipment		-0,3	-0,3	-0,2	-0,5	**0,7**	**0,7**	-0,4	-0,5
		Intangible		-0,1	0,0	0,2	0,2	-0,1	-0,1	0,3	0,3
		Total		-0,2	-0,3	-0,2	-0,6	0,7	0,7	-0,4	-0,7

Table 8. **The relation between changes in fixed capital formation (i.e. investment) and the change/average of total taxes (share GDP), labour taxes (share GDP), labour cost index, and interest rates.** *Source:* Own calculations based on Eurostat, WDI, and ECB. *Note:* The change in FCF concerns the change between the FCF in 2013 against the FCF in 2000. Different calculations, for instance by taking the averages for 2000-2006 and 2007-2013 do not result in important differences in correlations. ***How to read this table:*** The first main column presents the change of investments in equipment, intangible assets like software, etc. The second and third main columns present the changes in and averages of taxes, labour costs and interest rates. A comparison between the first and the other main columns allows to test whether different forms of devaluation do indeed coincide with a greater willingness to invest.

A first option that has become more attractive is redistribution by taxing the rich. Many member states have either implemented or considered such policies. It is clear that inequality becomes politically untenable and recent studies also show that the wealth of some of the rich is not entirely the result of leadership in entrepreneurship and innovation. But the impact of taxing wealth is uncertain. Governments might explain such tax as justice but use the incomes opportunistically to serve their debt or to fill budgetary gaps. Even if we redistribute, the question still remains how exactly the money from the rich can be invested in a way that benefits economic strength in the long run. Wealth taxes also do not necessarily bring more benefits like good job opportunities to those at the bottom. So, the redistribution of wealth can only work if it entails a redistribution of opportunities, if it allows and incentivizes people at the bottom of the society to create value through a greater effort to participate, to train themselves, to become more ambitious as entrepreneurs, etc. Redistributing without such strategy could make the situation even more problematic.

A second option is internal devaluation. The reasoning is that if the labour costs per hour are reduced, by cutting salaries or making it easier to fire redundant workers, companies again have more space to invest and thus to boost productivity. The positive impact however is questionable.[11] For the whole EU, the correlation between the evolution of the labour composite index between 2000 and 2013 on the one hand and gross capital formation on the other is positive, whereas to support devaluation advocates, it should be negative. For the richer EU-15, as table 8 shows, there is only a very minor negative correlation. One interesting observation: Germany and Italy registered among the lowest CPI increases, i.e. very modest labour cost increases, but also registered among the lowest increases of fixed capital formation. With Sweden and France, for example, it was the opposite.

A third option is fiscal devaluation. This implies taxes on production and wages to decrease by raising taxes on VAT, for example, or just cutting government expenses. A review of the literature and two important recent studies for the European Commission and the OECD show that fiscal devaluation does not create long-term competitiveness gains and even have a pervert effect in a sense that they discourage more fundamental reforms that affect the performance of companies.[12] My own calculations confirm that the impact of fiscal moderation is not straightforward. Proponents of fiscal devaluations expect lower fiscal burdens on the economy to create a greater incentive for companies to invest, i.e. a negative correlation. At the EU-27 there is a relatively strong negative correlation, but among the EU-15 it is only very moderate (table 8). This goes for both labour and total taxes. Germany is again a case in point. Its fiscal burden decreased, but investment levels are very low. This was also true for Ireland, Spain, the Netherlands, and the UK.

A fourth option, related to fiscal devaluation, **is public sector dismantling and privatization**. This has been a preferred instrument to address large government budget deficits. Yet, it is not because the government offloads services like healthcare that the needs disappear. Privatizations mostly entail that households just spend more or less the same money to different suppliers. Research shows that privatization does not necessarily leads to lower prices, more quality, and higher productivity. Some of the gains of cutting jobs, for instance, are offset by losses as a consequence of fragmentation. What matters for quality and productivity, research shows, is not who organizes services, but how they are organized, how much is invested in training, incentives for strong performers, the ability of customers to compare providers, etc. This can be achieved both in private and public companies.[13]

Fifth comes what is probably the most popular policy these days: **printing money, being it in a slightly more sophisticated way, via quantitative easing**. This is another quick fix. It helps to ward off wrecking liquidity crises after bubble bursts and bailouts, but it cannot be a long-term solution. Without structural changes and productivity gains, quantitative easing does two things: it accelerates the formation of new bubbles and postpones the adjustment crisis. This is further complicated if the new money or bonds are bought by other countries and external debt increases. In case of the Eurozone, net external debt (bonds) has increased by 416 billion Euros since 2008.

The fact that Europe can so easily sell its bonds abroad leads to **a sixth element: external demand**. European leaders increasingly count on the growth of consumer markets in Asia and elsewhere to compensate for low demand at home. The problem is, however, that the trade surplus of Europe with the emerging markets remains very small and that those emerging markets first want to build their own industrial sector through exports – which means more competition with Europe.

A Seventh proposed solution concerns free trade agreements. Free trade agreements are supposed to lead to efficiency gains through specialization. Research shows, however, that the gains in terms of growth and jobs become less clear.[14] But there is a more fundamental problem. It is not always the most innovative and dynamic market that gains, because what becomes more and more decisive is the cost of energy and the cost of capital. Consider an FTA of two countries: one with very innovative companies but decides that it wants to curb global warming and another that stimulates the exploitation of shale gas and allows companies to borrow cheaper by forcing its citizens to save a lot or just owning the world's biggest reserve currency. In such context it will not be the smart innovator that wins. Liberalizing trade in a context where governments intervene in different ways can be risky.

These were seven measures related to the organization of the economy**. It is striking to see that none of the allegedly positive evolutions – tax moderation, labour cost moderation, even and productivity increases – had a clear positive and rewarding impact on the willingness to invest in infrastructure, equipment or intangible assets.**

There are four more issues related to specific sectors.

Many European governments have considered **an eight approach: industrial policy**, pursued to defend domestic industries or to get some industry back. Subsidies and more subtle support to an industrial sector that already often struggles with overcapacity can only be a waste – they will not generate the returns to compensate for the financial sacrifices.

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Euro Area	85	82	82	82	82	82	84	85	**82**	**72**	79	80	78	79	80
Germany	87	83	83	84	85	85	88	89	**85**	**73**	84	85	81	84	80
France	89	88	87	86	84	83	86	88	**84**	**77**	80	84	81	81	81
Italy	79	75	75	75	76	76	77	77	**75**	**65**	71	71	69	73	71

Table 9. **Current level of capacity utilization (percentage).** ***Source:*** **Eurostat.**

Ninth: Since the turn of the century, many member states were convinced that **a services-based economy** would be the future. This enthusiasm has cooled somewhat. Services cannot replace the secondary sector. First of all, only a small part of services are tradable. Second, goods remain far bigger in international trade so that strong service providers can still run big deficits on their trade balance. Third, many services are tied to industries and relocate with them. A tertiary economy is thus a very tricky economy.

	1980	1985	1990	1995	2000	2005	2010	2015
Services/total international trade	17	18	20	19	19	20	21	20

Table 10. **The share of services in global trade**. *Source:* Calculations based on UNCTAD Stats.

Tenth: technology. This is the most salient aspect of the economic debate. Almost all governments scramble to become technological leaders. But guess what, R&D intensity does hardly correlate with profitability. Looking at Europe's 1000 biggest spenders on R&D, the correlation is even negative (table 10). This is especially so in the pharmaceutical sector, the automotive industry, and industrial engineering. Investment in technological innovation does thus not always pay off. Much more important is branding and the ability to produce cheaply. The returns on innovation will probably be under more pressure as more and more countries aim at the same technology. Important to notice is that this creative destruction is thus not only a matter of the functioning of the market, but of government excitement and the allocation of public resources.

More philosophically: we are pushing to new products, but we do not consolidate at the bottom. We have the smartest phones, but we spend more and more time waiting in queues and traffic jams. More Europeans are connected on 4G these days than on an electricity grid that does not risk blackouts or a sewage system that does not leak. Progress does not always have to be a matter of technology.

Last come information technologies where one should remain sceptical. In 2008, Oracle analysts expected the IT sector to generate 1.5 million new jobs over the next five years. Only 360,000 were effectively created. The share of IT in the EU's employment remains only 1,3 per cent. IT does not create jobs for the masses and certainly not compensate for the jobs it destroys. Across different sectors, IT explains a lot of the EU's productivity gap with the US, but there are other elements at stake: declines in employment, organizational capital, training, and marketing, for instance.[15]

Chemicals	0,1
Aerospace & Defence	0,1
Construction & Materials	0,1
General Industrials	0,0
Software & Computer Services	-0,1
Electronic & Electrical Equipment	-0,1
Banks	-0,2
Technology Hardware & Equipment	-0,3
Industrial Engineering	-0,3
Automobiles & Parts	-0,3
Health Care Equipment & Services	-0,4
Pharmaceuticals & Biotechnology	-0,6

Table 11. **The correlation between R&D intensity and profitability for the largest companies in their sector** (N per sector is on average 38). *Source.* Calculations based on EU top 1000 companies.

Theoretically, the digitalization of production could allow us all to go on permanent holiday, but the shrinking size of labour in our economies means that wealth spreads less easily. In other words, many citizens will just not be able to afford a better life. The question also remains whether we want all things becoming virtual. Computerized work does not lead to greater satisfaction and using the computer for leisure comes with significant medical and social costs.[16] We are all born with a brains and hands that we want to use. The ability to do so, studies show, is having a huge impact on our satisfaction in life. People are physically and psychologically not made to become some kind of barnacle in a shell of apps.

It is not that IT has no merit and that we can go on spending on credit. But it is striking how the debates about economic policy have become debates about organization and distribution, but much less about the purpose of economy. This comes at a time, however, that a growing number of economists return to the following core questions: what is it that an economic stands for and what is the purpose of production in a technologically advanced society? That on its turn might explain why so many policies fail to appeal to the masses and politicians struggle to explain why is it that we have to make sacrifices to keep a certain economic system upright.

Identifying the strong performers

This paper thus far made three important points. Even if European citizens still attach importance to democracy, democracy is under pressure because of growing political distrust. A very important explanation for that distrust is Europe's dismal economic performance and its failure to bring opportunities to the masses. The effect of the most widely considered policy options – ranging from redistributions to quantitative easing – remains questionable.

At this juncture, one can go in two different directions: to try to make a more philosophical case for a better economy or *to show the way towards a stronger economic model by identifying current success stories.* This paper opts for the second. This section first identifies the countries with high political trust and then explains how they performed economically. The aim is not to come up with detailed conclusions, but to spot factors that can be of interest to other countries as well.

Let us first identify the strong political performers. The countries with the highest level of trust in the national government for the period 2003-2014 are: Sweden, Finland, Austria, Denmark, Germany, and Netherlands – some of Europe's richest.[17] In these countries, extreme right or radical Eurosceptic parties also tended to be small throughout the last three elections, representing about 13 per cent in Denmark (the Danish People's Party), about 8 per cent in Finland (True Finns – leaping to 19 per cent in 2011), 13 per cent in Sweden (Sweden Democrats), 12 per cent in the Netherlands (PVV), and 16 per cent in Austria (FPO, with a marked moderation after 2009).

What can then explain why citizens in these countries are politically more satisfied? Research has pointed at different factors, like stronger citizenship and a greater sense of community. But there also seem to be important economic factors at work.

Let us look at jobs. Austria, Germany, the Netherlands, the Czech Republic and Denmark have led the pack with low unemployment levels. Austria, the Netherlands, and Denmark had the lowest average level throughout the period 2004-2013, but Germany cut back its unemployment the most and together with Austria and the Czech Republic weathered the crisis better than the other three. Germany, Austria, The Netherlands, Denmark and the Czech Republic were most successful in limiting youth unemployment levels. Again, Germany registered the fastest drop un employment between 2004 and 2013, and it was, again alongside Austria and the Czech Republic, much less affected by the crisis than the other three.

Looking more specifically at the private sector, companies generated the largest increase in employment in Poland, Germany, and Belgium, Austria, and Sweden. Poland, however, was much more harmed by the crisis. Since the crisis, Denmark, Sweden, and the Netherlands lost heavily in manufacturing sector employment –

between 5 and 11 per cent – whereas Austria and Germany expanded employment in the manufacturing sector by 2 per cent.

A common critique is that many employees in countries like Germany cannot make ends meet. Indeed, average *In-work-at-risk-poverty-rates* remained significantly higher in Germany and **Austria**, but also in Sweden, than in the Czech Republic, Finland, Belgium, the Netherlands, and Denmark. *In-work-at-risk-poverty rates* in Finland, Belgium and the Netherlands decreased after the crisis, whereas they increased in the Czech Republic, Denmark, Germany, and Austria.

	Unemployment			**Youth unemployment**			**Private sector employment**			**In-work at-risk-of-poverty rate**	
	Average (2004-13)	Change (2008-13)		Average (2004-13)	Change (2008-13)		Change (2004-13)	Change (2008-13)		Average (2004-13)	Change (2008-13)
At	5	1	De	8	1	Pl	14	-1	Cz	4	1
Nl	5	4	Nl	9	-1	De	14	4	Fi	4	-1
Dk	6	4	At	11	3	Be	10	2	Be	5	0
UK	6	2	Dk	14	-1	At	8	3	Nl	5	0
Cz	7	3	Ee	18	1	Sw	8	4	Dk	5	1
Ro	7	2	Fi	19	-3	UK	6	4	Sl	5	1
De	8	-2	Cz	20	-7	SK	6	-1	Ir	6	-1

***Table 12.* Selected indicators of economic performance.** *Source:* Own calculations based on Eurostat.

In terms of net earnings, there were a large number of new member states that registered the fastest increase between 2004 and 2013, but looking at the leaders in other aspects of the labour market, the Czech Republic recorded the largest gains, followed by Sweden, Finland, the Netherlands, and a bit farther behind, Denmark. In Austria and especially Germany, these gains were more modest. Sweden and the Czech republic saw there wages the least affected by the crisis; Germany the most.

So, **five leaders in terms of employment assert themselves: Austria, Germany, Netherlands, Denmark, and the Czech Republic.** It is interesting to see how the crisis made the Netherlands pay a greater price in terms of unemployment, whereas Germany made a sacrifice in terms of poverty risk and salaries.

We can also evaluate *less material qualities of the labour market.* Here the general situation in Europe is problematic: only about 55 per cent of the people with a job think they get enough opportunities to show how capable they are; 25 to 31 per cent is not satisfied. The situation is most difficult in those sectors that expand fast: basic commercial services, retail, logistics, restaurants, and so forth. I would add to all this that a strong economy limits externalities – economic, social, intergenerational, and environmental ones. Europe is failing to do so. In the group of economic leaders the situation is different. The share of workers that believes to be able to show its capabilities is also very high in Denmark, Austria and the Netherlands. Germany and Sweden perform significantly less and the Czech Republic is nowhere to be seen.

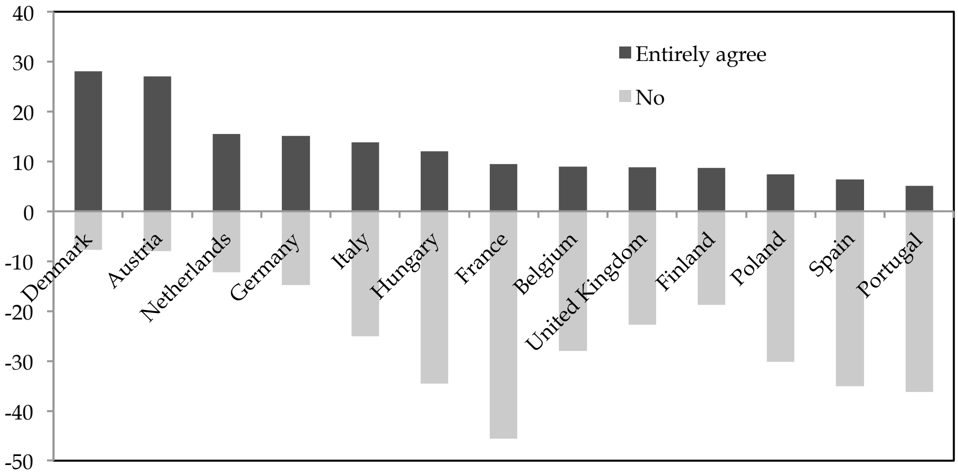

*Chart 1***. Job satisfaction**. Answer to the following question: "Chance to show how capable I am." (percentages for employed people, average N per country = 959). *Source:* Calculations based on ESS. Austria 2008 Data, others 2012.

Taking "quality" and "quantity" together, the Netherlands and Denmark emerge thus as the leaders of the European labour market.

Of particular interest is the situation of the economically weaker segments of our society. If one takes a broad definition and the median equalised income of the 60 per cent at the basis of our society (the three lowest income quintiles), the real income, so after calculating the impact of inflation, increased by 12 per cent between 2005 and 2013. But the country-by-country differences are huge. The real income dropped 17 per cent in the UK, and by 12 and 11 per cent in Spain and Ireland. The best performers of the countries that were identified as leaders of the labour market were the Czech Republic, Sweden, followed at a distance by Germany, and even further, by the Netherlands and Finland. In Austria, the income remained almost flat and in Denmark, it decreased by 5 per cent.

How about the economic fundamentals? As regards *labour productivity per hour worked*, the Czech Republic showed the largest gains between 2004 and 2013, followed by Austria, Germany, Denmark, and the Netherlands.

As regards the *investment in machinery, equipment, and intangible assets (fixed capital formation)*, which remains a very solid indicator of companies' confidence in the economic potential of a country, the Czech Republic leads, followed by Sweden, Austria, and Denmark. Investments in the Netherlands and Germany grew slower. Sweden, Austria, and Denmark also performed better between 2009 and 2014, whereas investments in the Czech republic, Netherlands and Germany dropped.

These countries also have a better balance between consumption and investment, mostly due to lower household consumption levels. The Netherlands deserves attention. Between 2004 and 2013, it registered one of the sharpest contractions of its household consumption in the entire EU, while its investment dropped too.

That leads us to the *current account*. These are all countries with a significant surplus on the balance of trade in goods and services. As a share of GDP, the Netherlands leads with an average annual surplus of 8.1 between 2004 and 2013, followed by Sweden, Germany, Denmark, Austria, and the Czech Republic. The Netherlands has the lowest share of manufactured goods in its export basket, whereas the share of mineral fuel has increased from 7 to 18 per cent and the share of the more broadly defined 'mineral fuels, lubricants and related materials' from 7 to 45 per cent.

This does not disqualify the Netherlands as an economic leader, but it does distort the picture and that leaves Austria and Denmark as probably the most intriguing leaders.

So what can we learn from these countries to enhance performance?

A first factor seems to be **education**. Countries like Austria and Denmark have very low skill mismatches and are at the top of labour market performance rankings.[18] This is largely the result of sustained investments in vocational education and apprenticeships. As much as 40 per cent of all young people in Austria choose an apprenticeship as their initial vocational training and another 40 per cent op for intermediate and higher-level vocational schools. Only 20 per cent decide in favour the general education system. Per student investments – financially and in terms of teachers – are high. Cooperation between the corporate sectors and schools is strong.[19] Research shows that students in vocational schools from Austria and Denmark have a significant positive impact on firms in terms of profit and productivity.[20] Moreover, in countries like Austria, Denmark, and Germany, vocational training leads to greater social engagement and participation in civil society, higher employment satisfaction, and even a better preparation for entry into higher education.[21]

The second factor is a good **mixture of small and larger firms**, manufacturers and service providers, old and young enterprises, strong performers in tradable services and non-tradable services. Its private sector is largely based on family-owned, medium-sized enterprises. This kind of enterprises is known for long-term ambition and great commitment to constantly adopt new technologies, improving productivity, and providing long-tenure jobs.

Austria and Denmark have a very good **entrepreneurial climate**, coming respectively at the fifth and second place (the Netherlands, Sweden, and Germany are ranked fourth, sixth, and eight). They are among the easiest countries to start up business, ranked fourth and fifth after the Netherlands, the Czech Republic and Estonia.[22] Perceptions of entrepreneurs are much better than in other European countries. Entrepreneurship also tends to be a more positive choice, driven by values like self-fulfilment, instead of a negative choice, related to unemployment.[23]

Countries like Austria and Denmark are **demanding societies**. Citizens attach great importance to creativity and innovative ideas (ranked second and fourth). Social values, like assisting others, are also very pronounced (ranked second and fifth) Citizens in Denmark and the Austria are the most demanding consumers when it comes to product durability.[24] For an aggregate indicator of consumer durability awareness, they rank second and fourth. They excel in high quality standards across the board, in industry, public services, but also in basic matters like housing, food, public spaces, and utilities.[25]

They also have strong public sectors. In terms of **governance quality** – captured in an aggregated indicator for the quality of regulation, governance effectiveness, and the rule of law – Denmark is ranked first, Austria sixth. We already mentioned education as an asset, but there are other indicators of strength. Their healthcare sector, which is public in both countries, is ranked second and tenth in the health consumer index and first and seventh in regard to patient rights and information.[26]

This does not mean that there are no vulnerabilities. Both Austria and Denmark depend heavily on exports on Germany and via Germany on exports to instable markets in Asia and elsewhere. Migration also weighs on domestic politics and creates strong social tensions. Income inequality in Austria and Denmark are also rising fast.

From a vicious circle to a virtuous circle – Making democracy thrive

The factors that explain the economic success of countries like Austria and Denmark are all the result of long-term developments in policy, society and even identity. *It is one matter to kick-start growth with fiscal stimulus, it is yet another matter to build a properly skilled, demanding and entrepreneurial society.* Deep structural socio-economic rejuvenation seems thus to be the way forward. These, on their term, should also allow politicians to give their citizens a sense of direction, an idea what the purpose is of painful corrections and sacrifices. Austerity without hope, we have seen, is detrimental to political stability. It could also create a vicious circle with spending cuts preventing investment in crucial sectors like education, which on its turn weakens the economy so that more spending cuts might be due.

Instead, financial and broader economic rebalancing, which is now more firmly put into Europe's economic governance, should be used to trigger a virtuous cycle. Surplus countries like Austria, Denmark, the Netherlands, Germany, and others should not just try to export their principles of frugality, but work harder to share their advantages in education, quality standards, etc. Their economic leadership within the EU should be more positive and constructive. ***Resilient economies, so much is clear, help sustain resilient democracies.***

What can be done?

The aim is not to paralyze the market. The aim is to lift it up to a higher level. Governments have to allow the market to reorganize itself in a way that it provides more quality and does so more sustainably. The end goal is to get stronger producers through smarter consumers. We have to stimulate entrepreneurialism, but we first have to address the lack of attractiveness of "real economy entrepreneurs" and allow citizens to understand why entrepreneurialism is so important for them and their society.

Here are a few avenues for reforms that we propose to build a competitive, sustainable and more enjoyable the European economy, reforms also that should restore citizens' confidence in the capacity of our democracy to perform.

1) Sound and credible economic governance[1], the prevention of investment bubbles, and adequate means to respond to setbacks. Europe must curb its structural deficits in government finances, in the balances of banks and in its current account (i.e. trade balance). Sound economic governance has to try to avoid that the next generations of Europeans end up with an ageing society and a large debt burden that has to be serviced with an economy that is less competitive and more dependent on imports of critical goods.

[1] See Task Force report to The Trilateral Commission (Europe) on ***Credible European Governance*** chaired by Jean-Claude Trichet and André Sapir, Rapporteur, May 2014

2) Governments should strive towards balance, but they should have the opportunity to submit **strategic investment plans** for scrutiny and approval to the European Commission. Strategic investment plants allow them to run a slightly larger government deficit to invest in critical infrastructure, energy efficiency, schools, etc. They will only be approved if the governments can demonstrate that the investments create enough returns to service debt and an additional surplus in terms of government income. Investment plans are for governments what business plans are for private firms.

3) We need a European **education pact**. Education policies have their roots in local culture, history, and social values. That *diversity must be maintained*. But it is in the interest of Europe to advance a collective plan that promotes more citizenship, consumer empowerment and entrepreneurship at school. We cannot expect a market to organize itself properly if its stakeholders are taught how to produce or to become intellectuals, if they are not taught how to make a judgement about value. This plan provides in financial support, a European standard of excellence for schools and in opportunities for outstanding teachers in schools without the standard to spend some time at a school such a school of excellence abroad.

4) We should create a **league of European shapers**, league of vocational schools that stimulate, inspire and train the builders of tomorrow. Europe should encourage governments to build attractive vocational school infrastructure by including it explicitly as an option for strategic investment plans and offering financial support. But applying governments should then also be able to show how this infrastructure makes their society stronger, how its will be set up together with entrepreneurs, how teachers will be stimulated, how parents will be involved and how students will be challenges to strive to excellence. To improve the status of practical jobs, Europe should finance competitions, awards, and even television that puts these jobs in a more positive light.

5) Europe's **higher education** policy should no longer aim to get as many students to university as possible. In the past decade, this has contributed in many countries to a skills mismatch. Like in Denmark, Austria, and Germany, students from vocational schools should be encouraged to further improve their skills in higher education, but this does not necessarily have to happen immediately after graduation from secondary school. Europe should also support opportunities outside universities to allow citizens to broaden their knowledge about subjects like history, philosophy, etc. Knowledge about these themes could make a society stronger and have to be part of the standard education curriculum, but citizens should not necessarily have to obtain a degree in, say, history, to learn about history. We should also consider Erasmus Grants not as a given, but as an award, for students who engage themselves more into voluntary work, additional training, and other initiatives.

6) National investment plans should be embedded in a **grand strategy for European rejuvenation**. Europe should identify a number of investment clusters that will form the pillars of tomorrow's economy. These should not be confined to industry and high tech:

i) **A first cluster could be urban rejuvenation**. A large number of European cities are in decay – in terms of housing quality, public infrastructure, heritage maintenance, etc. This undermines their attractiveness for investors, public morale and Europe's appeal to the rest of the world. Cities are the flagships of European societies. On the one hand, it is vital that success cities, mostly in the north, share their experience and inspire cities that perform less to draw up their own comprehensive rejuvenation plans. These plans should be about both hard and soft infrastructure – bricks and brains. On the other hand, one could consider long-term fiscally advantageous city bonds. This could be an opportunity to manage the transfers between surplus and deficit countries – instead of just sinking capital in real estate projects etc. – and in the long run also narrow the infrastructure gap.

ii) **A second cluster concerns public infrastructure** in general. Together with the member states, the European institutions should draw up plans for pan-European high-speed railways, cross-border smart energy networks, and even water management. Like with urban rejuvenation, one could consider a kind of bonds, but they could also be approved as strategic investment plans.

iii) **A third cluster concerns health care**. With an ageing population, the health care sector will inevitably expand. We should organize this sector in a way that it generates as many returns for the European society. That implies that we must do it ourselves and avoid that the sector generates yet another important drain of investment incomes on the current account. A strong healthcare sector can only exist in a strong society. Benefits must also flow back as broadly as possible to that society, in terms of affordable quality services, financial returns to bondholders, etc. One could consider a kind of **"bonds for care"** which families can buy, and whose interest can be reinvested in better healthcare insurance or just be added to the value of the bonds so that a financial reserve is created at the time of retirement. Whether that happens privately or publically or both, is of less importance. What matters are affordability, quality, sustainability, and innovation in terms of services, medicines, therapies, etc. Benchmarks are more important than ownership.

iv) **A fourth cluster concerns the secondary sector - industry and manufacturing**. Europe must retain its industry and reform it so that it becomes more competitive. Competitiveness does not only imply price. We want quality, not just in terms of end product, but also in terms of the process. We need to build companies that are more efficient, but also create more jobs that are varied, personally rewarding, and properly remunerated. We need to build companies that reduce externalities in terms of pollution, traffic, and limit. We need factories that show how dependence on imported raw materials can be reduced, how to produce in dignity.

7) These investments will not be possible without more ambitious **standards**. If we want our citizens, workers and employers produce in dignity and sustainably, that requires rules, in the same way that there are rules to drive a car safely from the one place to the other. More importantly, we have to embed these rules in our trade relations. If we ask our companies to respect standards, we should also expect importers to do the same. This is not protectionism. In fact, it allows other countries to enhance their own standards. It might put some brakes on the expansion of global trade, but there is no reason that more local production puts a break on growth as long as we compete globally with products and services that really make a difference in our lives.

8) As we reduce the divide between white and blue collar workers, we should now reduce the divide between workers and entrepreneurs. **Each worker should become an entrepreneur**. There should be decent base salaries, but also variable remuneration tied to inventiveness, excellence, etc. Many Scandinavian countries have experimented with this model, in both public and private company settings, and these highly rewarding experiences should be shared.

9) We should have a **European "*Tripadvisor* for plumbers"**. That is to say, that we should create a services market that is more transparent and rewards the best service providers. Today, we spend about a third of our income on plumbers, painters, carpenters, but we are hardly able to judge which whom we sign a contract.

10) We should engender **a fiscal shift from labour tax to environmental tax**, but again, these taxes should also be levied on imported goods and services. This makes standards enforceable and encourages companies to invest in people.

11) While economic concerns are usually more important than concerns about migration and minority groups, Europe's failure to integrate migrants and minority groups challenges its democracy in two ways: at times of economic uncertainty the **migration** issue is an attractive opportunity to populist parties to rally support, but it also prevents Europe from mobilizing a demographically important component of its society for its future growth. A major effort is needed to involve migrants as critical stakeholders in the advancing of both a resilient economy – and democracy. Table 13 presents some first indicators of this challenge, but, again, more research is needed.

		Migrants		**Muslim migrants**	
	Total	First generation	Second generation	First generation	Second generation
Unemployed, actively looking for a job	6	7	6	12	10
Unemployed, not actively looking for a job	3	3	3	5	3
Only lower education (<ISCED3)	29	26	21	48	45
Belonging to the poorest income quintile	26	29	18	32	23

***Table 13.* Selected indicators for the economic position of the migration groups in Europe and the total European society (percentages of three different groups).** *Source:* Own calculations based on ESS.

12) Lastly, **getting the political message right.**[27] The way moderate pro-European parties communicate European matters to the public, is absolutely key. Policymakers have to devote energy and time in communicating European integration as a firmly imbedded component of national interest and a means to preserve national values and assets.

This list is of course not exhaustive. What it seeks to do mostly is to contribute to a new economic narrative that allows Europe to thrive, citizens to regain confidence and to tackle threats to the environment in which our children and grandchildren will grow up. ***Rebalancing and sound finance remain key, but saving without vision is politically self-defeating.*** This paper started with an assessment of the challenges to European democracy. It concluded with some first ideas about we can make European democracy perform and thrive.

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