Growth and/or Austerity?

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1. Are high sovereign debt levels/shares the cause of the crisis? – no: in most countries, debt shares rose only after 2008 (saving banks and stimulus packages), Ireland and Spain had very low sovereign debt levels, but very high private debt (bubbles).

But now we have high sovereign debt levels. They require budget consolidation for debt reduction, but:

- Question: how much and how fast
- Question: which countries at which pace
- Question: growth packages and/or slower consolidation
- Question: how much political change is necessary to effect these and stabilize Eurozone

2. Since French/Greek elections (May 6) calls for a growth agenda become stronger and Hollande brings this to summits (together with others): G.-20 in Mexico, EU-Summit 28/29.6.

But. While everybody now talks about growth, what they really mean is very different, e.g.

a) Structural change necessary and sufficient

b) Structural change in labor and product markets, plus activation of existing EU money: 80 bn structural funds uncommitted (co-financing, projects?), EIB project bonds for TEN project finance, EIB capital increase of 10 bn

c) Macroeconomists: EU effective demand is missing (HH and enterprises holding back), thus total demand must be increased by government expenditures (temporary solution in order to jump-start economies)

d) Future EU budget: more growth orientation: “instead of agriculture, more R&D, education,”

e) Surplus countries (highly competitive and current balance surplus) can expand private demand by higher wages, leading to more consumption, and triggering investment, while deficit countries have no fiscal space and little private space, since part of their competitiveness problem is also wage competitiveness

To get out of the crisis, all these are needed, but they have different time dimensions. Crisis resolution necessary in short run (total demand stimulus), plus banking restructuring; must be folded into longer-term growth strategy. In order to promote growth, total demand (private plus public) needs to increase, confidence (of consumers and real investors/businesses – not financial markets) needs to strengthen in order to increase consumption and investment which then can take over from public demand.

Internal demand in Eurozone/EU would be strong enough to jumpstart economies, instead of relying on net exports (potential importers are also weakening).

But it is not only a lack-of-demand problem: the financial sector needs fixing too (see below).

3. What could a growth agenda contain?
   a) Existing EU Growth Initiatives
   - Lisbon Agenda, devised in 2000 to make Europe the most competitive and productive knowledge-based economy by 2010: not very successful
   - Europe 2020: growth strategy for smart, sustainable and inclusive growth, launched in March 2010, with specific targets in terms of employment, R&D expenditures, CO2 emission targets, etc.: underpinned by "European Semester" action plan where EU members devise their own strategies under EU flagship initiatives, submit them to EC, have them evaluated and actions proposed between March and May/June every year – monitored jointly with budgetary policies, thus better integrated than Lisbon

   b) What is the real situation: Industrial Policy missing: attention to post-crisis situation: short-termism and budget consolidation prevails; French proposal for F investment bank for export and innovation-oriented KMU (Austrian example of TOP-Aktion).

   - Many countries in the South have grave problems with job creation: on the one hand, economies are too little diversified (Greece, Portugal) and thus too vulnerable, on the other hand, they lack innovation: in all innovation indicators P, SP, I, GR are far behind. Thus they need to upgrade their education and training systems (apprentices), their vocational education institutions (e.g. technical schools at high school level), modernize their tertiary education systems. Many southern (deficit) countries have higher military than R&D expenditures (Greece (5:1), Portugal, Italy (4:3), France: In Sweden and Finland this ratio is 1:3). This indicates that positive spillovers from military to civilian innovation do not exist for these countries (do they produce military hardware themselves or import it? Their large trade deficit seems to point to the latter). In Greece during the crisis the share of manufacturing decreased from 11% (2000) to 7%, current account deficit is 15% of GDP; share of manufacturing in Portugal is 13%, in Spain 12% - in Sweden 21%, in Austria 19%, Germany 21%).

   - In many Southern countries, the share of "grey market" production is excessively high, thus not contributing to tax revenue and regulatory practices. Official firm creation is very low, access to finance for SME inadequate and access to business and technical information low. SME creation, simpler procedures, access to finance and advisory services needed.

- From the demand side, most countries have large unfilled need for environmental and energy investment, municipal infrastructure and modern business services. There may have been over-investment in "traditional" infrastructure (roads, etc.), but "green and social" demands are huge.

- It has become fashionable to do away with industrial policy: however, lateral promotion of higher value-added business ventures is necessary and does not come about without government intervention. A Europe-wide industrial policy, differentiated by country (group of countries) is required, based on realistic assessment of demographic, social, economic, environmental requirements. Rethinking of state-aid rules is necessary.

4. Crisis resolution requires several joint "unions" with the purpose to re-structure EU economic policy – which now is mainly geared towards budget consolidation.

a) Fiscal union: joint tax policy, joint budget policy, transfers; decision to slow down budget consolidation are more important than growth pact, until content of such a pact is clear; Eurobonds (limited to 60% or above 60%)

b) Financial union – banking union: joint banking resolution at EU/EZ level with plans which banks to rescue, which to close, which to shrink; joint supervision necessary: BANKS were the root of the crisis, this is where changes are necessary.
Northern Banks lent their surpluses to Southern Bank, interest down, - housing bubbles; Joint Deposit insurance for EZ!!!!

c) Monetary union: re-definition of ECB mandate to include financial sector stability, to establish "lender of last resort" function for banks and sovereigns – in the end to take over finance of sovereigns from private markets (ECB or ESM).

d) All this requires: Political union: transfer of sovereignty to EU fora or EZ fora; budget authority???
Restructuring of EU/EZ governance; more parliament, election of president

We all – including our policymakers - must realize that to just look at sovereign debt is the wrong strategy: it was private sector bubbles and the reckless lending of our banks which led to the crisis. There we must primarily look at the banks, at the current account imbalances, at the distributional developments, at the weak economic structure of some countries!

EU has gone through several "Growth Strategies": Lisbon Strategy (failed), Europe 2020 (better), but still economic governance and policy direction is dominated heavily by budget consolidation institutions, processes and measures. This is true both with respect to monitoring tools, coordination procedures and potential sanctions.

Crisis resolution requires on the economic side demand enhancement, growth investments for longer-term viability of high living standards and debt redemption and a restructured financial

system, geared towards financing crisis cum growth strategies. In the longer run, with ageing and shrinking populations, total GDP need not rise to maintain standards of living, but internal dynamics of a growth strategy need to be maintained to stay competitive at high value-added. Overall economic policy strategy needs to be coordinated at EU/Eurozone level, but have different emphases at country level.