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 ÖSTERREICHISCHES INSTITUT FÜR WIRTSCHAFTSFORSCHUNG
AUSTRIAN INSTITUTE OF ECONOMIC RESEARCH

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A-1030 VIENNA – AUSTRIA, ARSENAL, OBJEKT 20

Restarting growth in southern Europe in a period of fiscal consolidation

Karl Aiginger

OECD NERO Meeting, European Adjustment Session

Paris, 21st June, 2013

- The project WWWforEurope
- Status of Southern Europe
- Policy recommended by Troika and blind spots
- Elements of a strategy change
- Summary

Moving Europe towards a new path of growth and development

■ **The goals: Welfare, Wealth, Work**

- Europe needs to become more **dynamic, social and ecological**
- Scientific support for Europe 2020
- Towards a socio-ecological transition *

■ **The project: 7th Framework Programme**

- WIFO (Coordinator) plus 32 partners, 4 years
- Boards with a novel laureate, ex prime minister, Commissioner EU, OECD
- First tasks: European governance, problems of periphery *

⇒ **Homepage: <http://www.foreurope.eu/>**

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- The first task: Policy Brief on EU-Governance
- **The second task: Problems of the Periphery**
- Looking at success in catching up in 250 regions (31 resp. 7 successes)
- Aiginger–Huber–Firgo, Policy options for the development of peripheral regions and countries of Europe, WWWforEurope, **Policy Brief No 2**
(http://www.foreurope.eu/fileadmin/documents/pdf/Policybriefs/WWWforEurope_PB_no02_D504.1.pdf)
- Aiginger, K., A new strategy for the European periphery, **Policy Paper No 1**, 02/2013
(http://www.foreurope.eu/fileadmin/documents/pdf/PolicyPapers/WWWforEurope_Policy_Paper_001.pdf).

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WIFO ■ A bird's view on Southern Europe

- **Today:** Decreasing GDP, increasing unemployment and debt
- **Pre crisis period:** loss of competitiveness, external deficits, bubbles and inefficiencies
- **Long run:** bumpy catching up, structural weaknesses (Governance; negation of globalisation)

Regards: Greece, Spain, Portugal (P3); partly Ireland, Italy (South), Cyprus.

WIFO ■ Growth, Unemployment, Debt (P3)

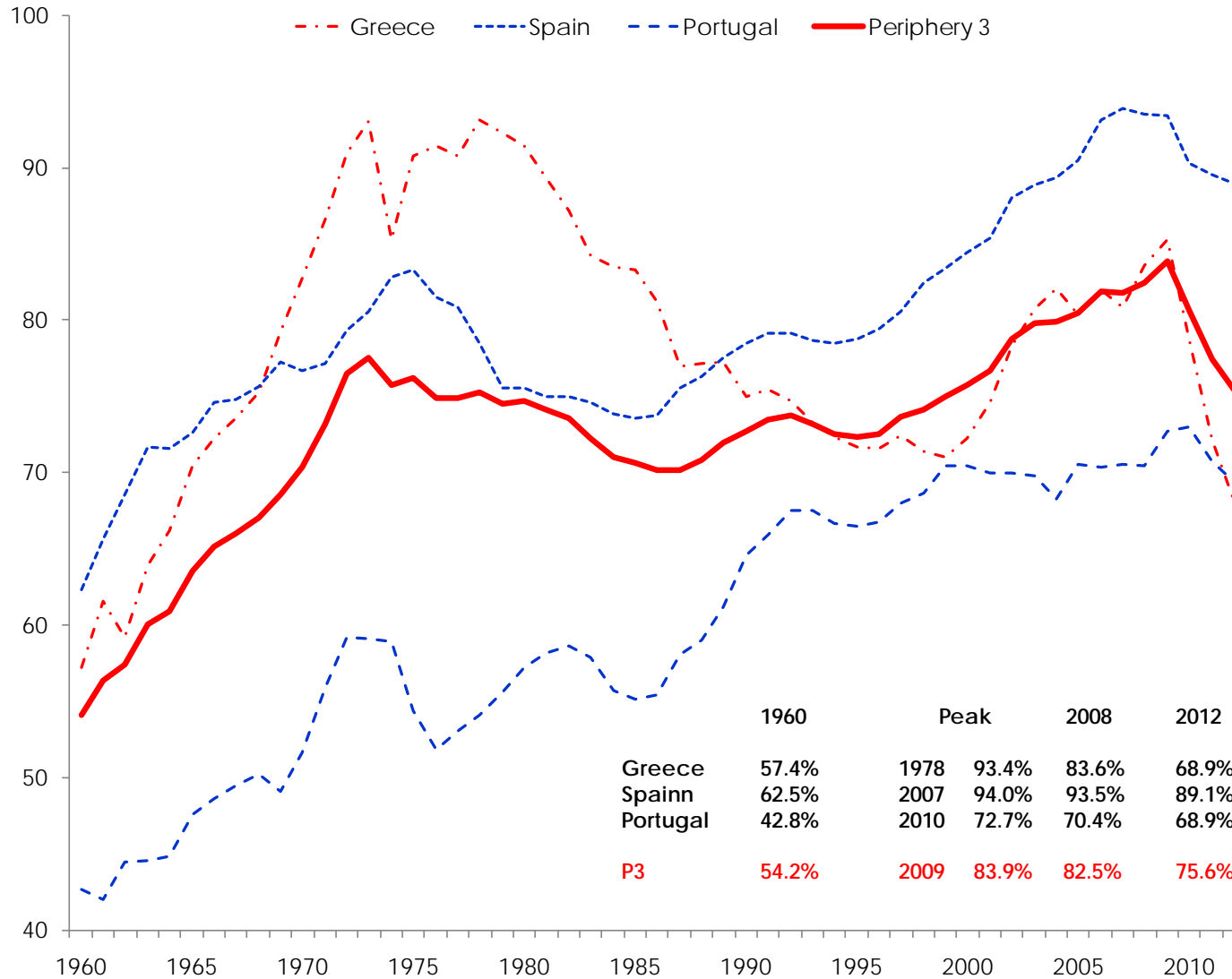
	2000	2008	2013
GDP ¹	2.7	2.6	-2.7
Unemployment rate	9.1	9.2	23.3
Deficit/GDP	-2.7	-6.0	-5.3
Debt/GDP	71.5	74.9	129.8

⇒ Deficit stabilised, economy shrinks, debt and employment rise.

¹ GDP: 1990/2000, 2000/2008, 2008/2013: average p.a.

S: Eurostat (AMECO).

Catching up stalled and reversed (EU 15 = 100)



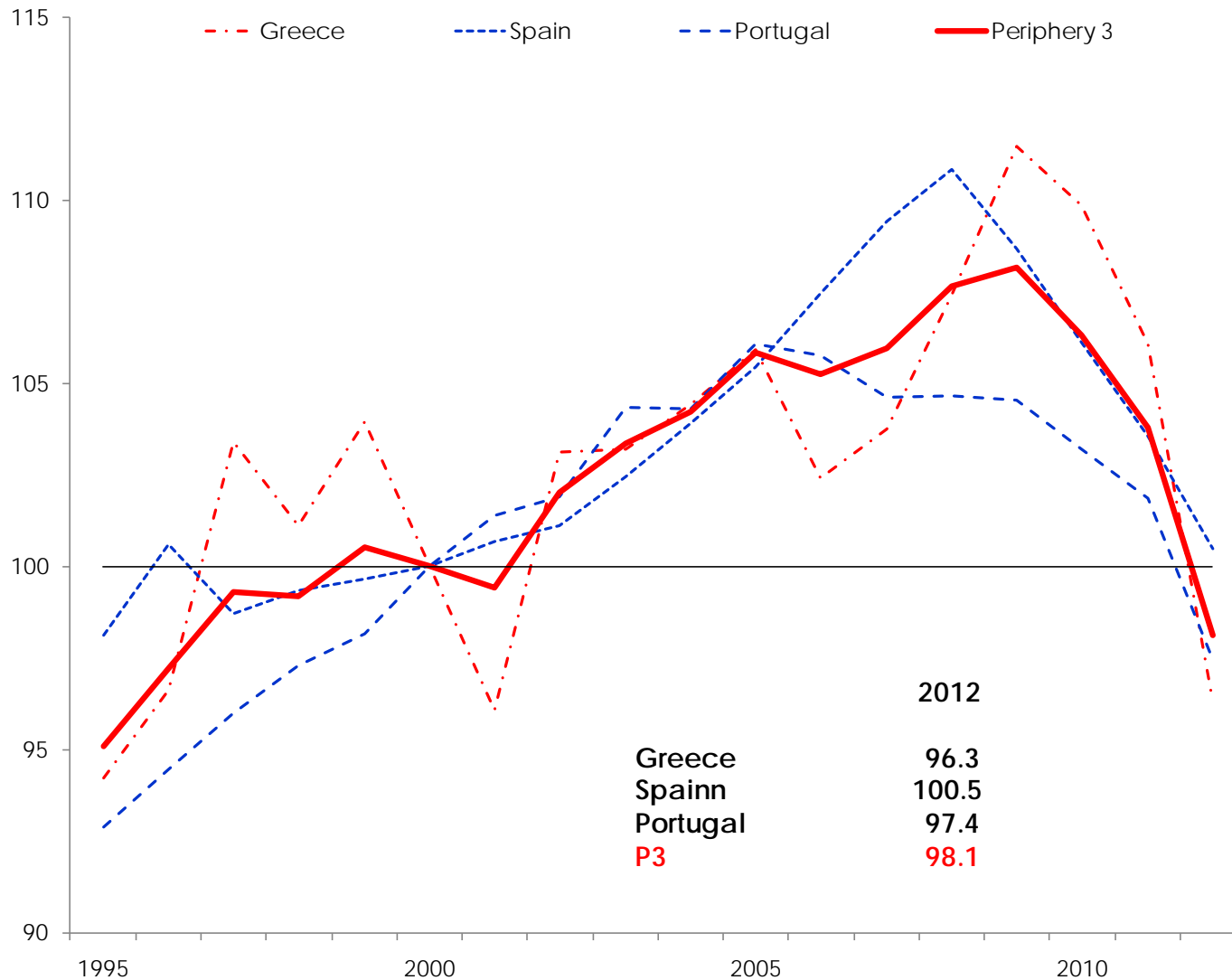
WIFO (Price) Competitiveness lost and regained!!!

(vs. unweighted EU-15)

	2000/2008		2008/2012	
	P3	EU 15	P3	EU 15
Growth p.a.				
Wages per capita	3.9	2.9	-0.4	1.7
Productivity	0.9	0.9	0.8	0.2
Unit labour costs	3.0	2.0	-1.1	1.2
Growth cumulative				
Wages per capita	36.1	25.8	-1.4	6.8
Productivity	7.4	7.7	3.1	0.8
Unit labour costs	26.4	17.5	-4.4	4.9
Difference ULC P3 - EU15		7.6		-8.9

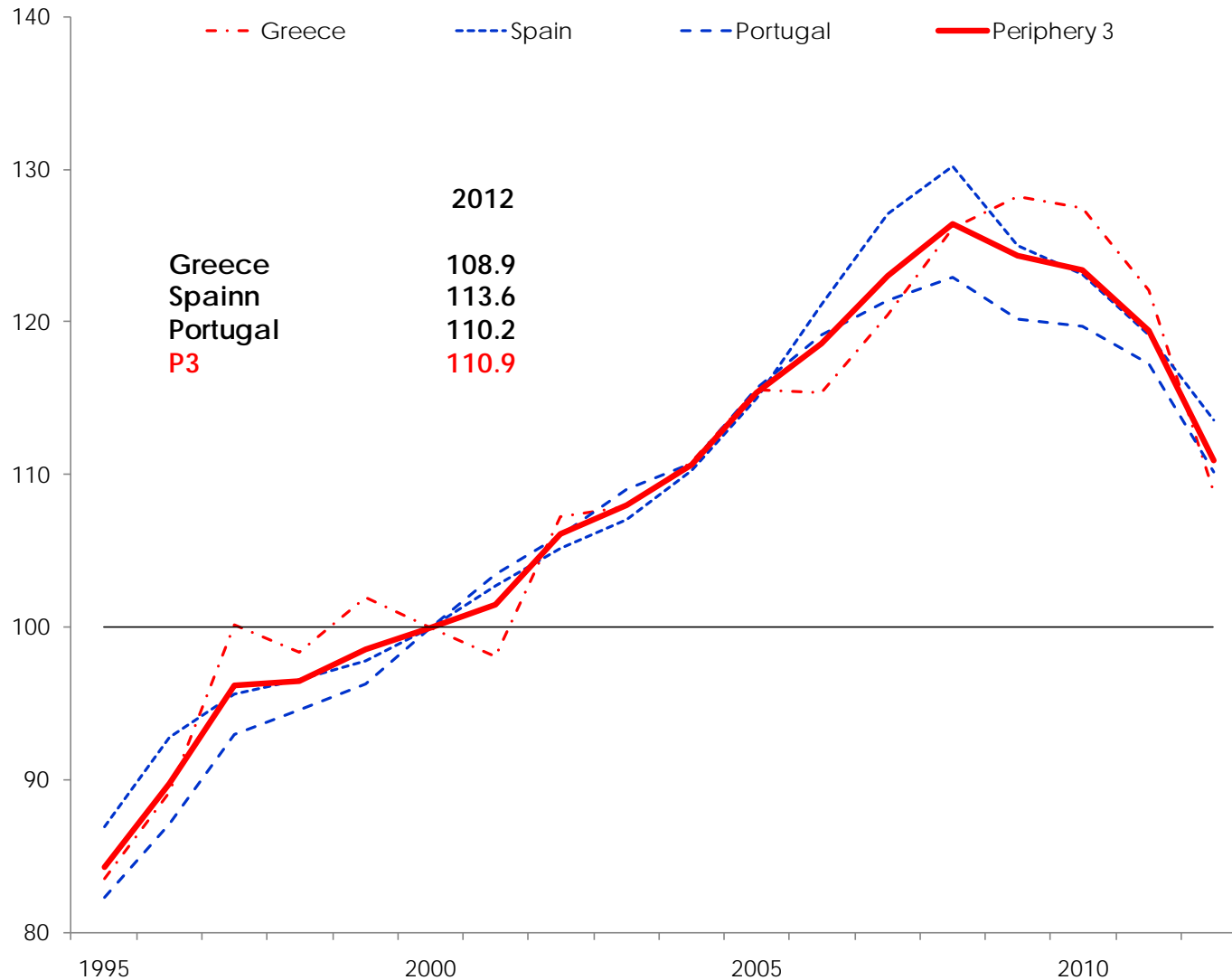
Unit labour cost down to position 2000, but...

P3 vs. unweighted average EU-15; 2000=100



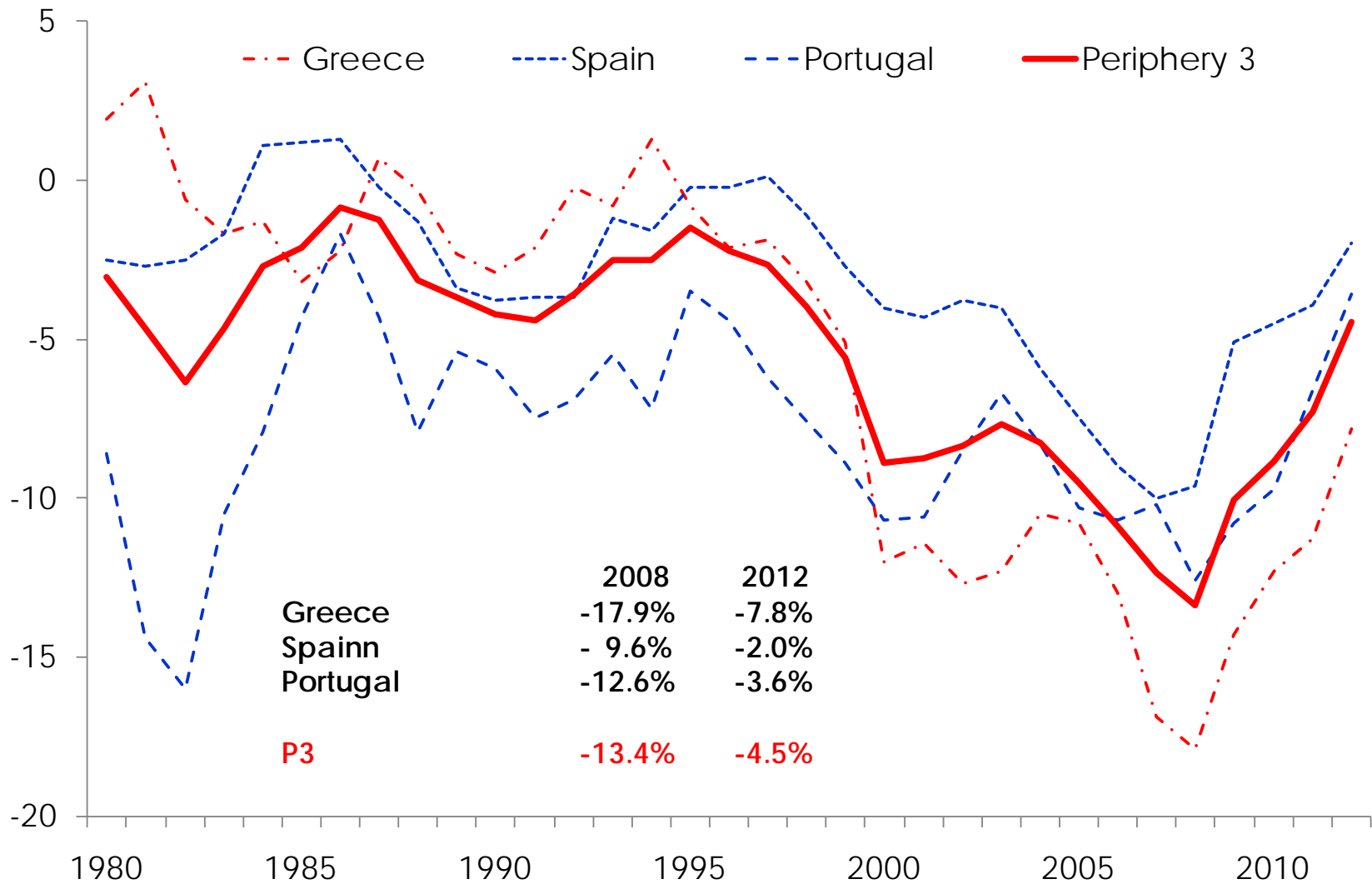
... not versus Germany (and unweighted EU-average)

P3 vs. Germany; 2000=100



- **Why** price competitiveness was lost:
 - Higher wage increase, **stagnant productivity**
 - The first fits for low cost catching up economies, the **second not**; productivity catch up should precede *
- **Correction up to 2012**: via wage decrease
- Extent of correction in unit labour costs (P3):
 - Vs. EU-15 (unweighted) more than technically needed **-2%**
 - Vs. EU-15 (weighted) **still** +4%
 - Vs. Germany **still** (but this should happen from both sides) **+11%**.

Current account deficit more than halved (partly cyclically)



„Path dependency“ of deficits

- But deficits were much smaller in 1995
- Some countries had years with surplus (GR)

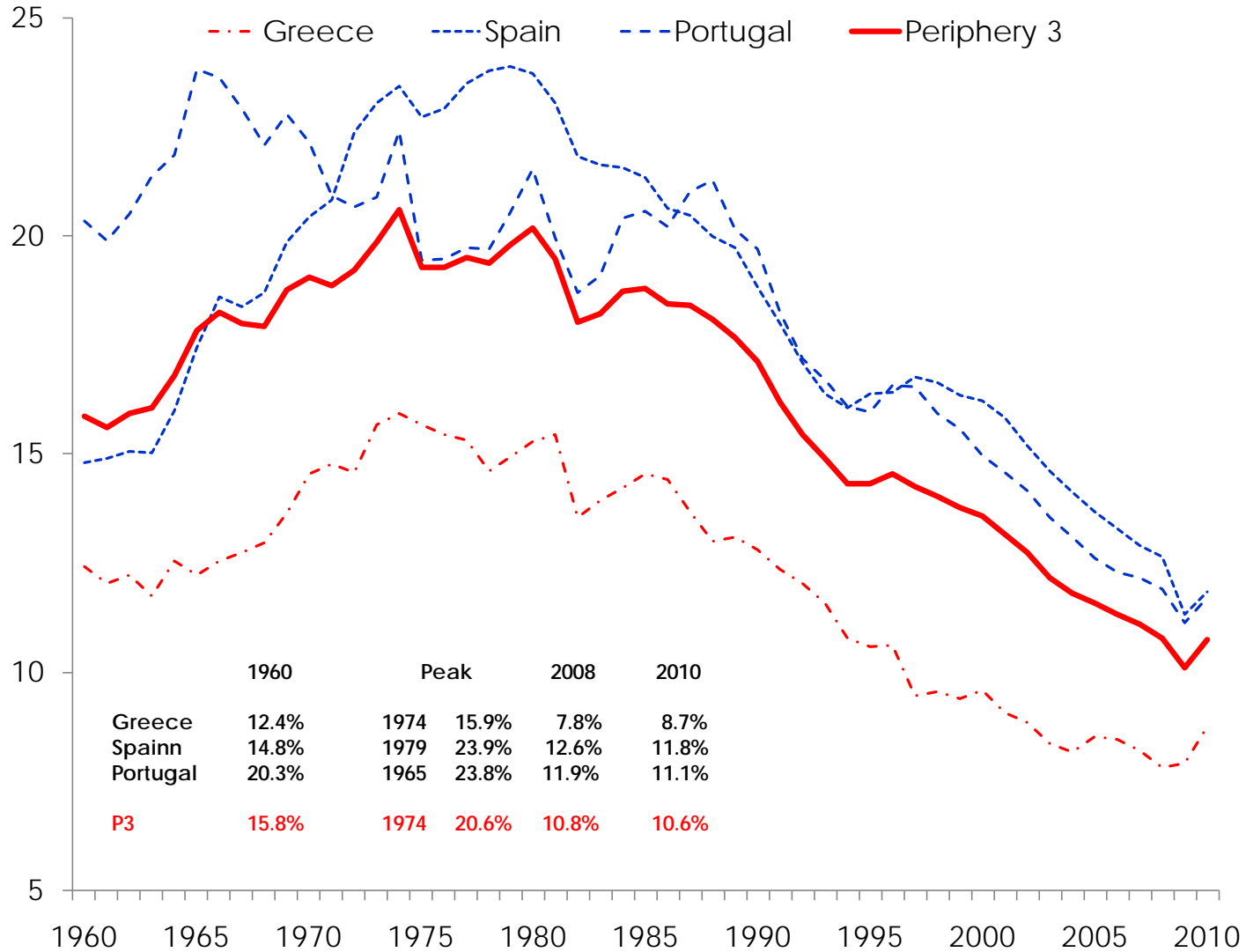
2008-2012: two thirds eliminated (**Greece 50%**)
from 13.4% to 4.5% for P3 (17.9% to 7.8%)

- Half comes from imports, half from exports
- More from **intra-EU-trade**, **less** from **extra-EU-trade**

⇒ **If economy recovers imports will grow**

⇒ **Balanced trade needs industrial base.**

Problem: low and rapidly declining share of manufacturing



A lost decade in tourism Exports (incomes) in % of GDP

	2000	2011
Greece	7.2	4.9
Spain	5.1	4.0
Portugal	4.5	4.7
Periphery 3 (P3)	5.4	4.2
EU 15	2.2	2.1

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- Low dynamics of **FDI** (in contrast to Eastern Europe)
 - Stable, slightly growing stocks, declining flows
 - Demand shift to **interest sensitive sectors** (construction, housing)
 - Large share of consumption, low export shares
 - Low **innovation** expenditure *
 - Tax administration/avoidance/corruption/monopolies
 - Negative attitude towards globalisation
 - High military spending (GR, PT, IT)
 - Poverty/unequal distribution of incomes and wealth.

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- “Umbrellas” for Greece, Portugal and Ireland;
specific support for banks in Spain, Cyprus
 - „Memoranda of Understanding” with Troika (IMF, EU, ECB)
 - Main focus budget issues; defined targets conditional for help
 - Internal devaluations: wages, pensions, expenditures, taxes
 - Soft targets for deregulation, Product/Labour markets, privatization
- ⇒ Similar for countries: assessed as unfair, oppressed
- ⇒ Active component missing
- ⇒ Economy shrinks, no long-run perspective.

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- Industrial policy, investment incentives (FDI), new firms (entry)
 - Cluster, innovation, lifelong learning, industrial zones
 - Low exports in dynamic market: neighbouring **and** distant
 - Inefficient retailing (imports of fruits)
 - High interest rates (specifically for SME) *
 - **Defining** future strengths and competitive advantages
 - Clean technologies: wind, solar; substitution of fossil imports
 - Employment for youth; fighting poverty, integrating migrants *
 - **Question of distribution, role of genders**
 - **Privileges of military, church, ship-owners; hierarchies.**

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Any reform strategy needs three agents cooperating

- Prime agent (driver): The country to be reformed
- Partner 1: Policy at higher level: European Commission
- Partner 2: Centre/high-income countries

⇒ The Greek society has a problem

⇒ And needs determination to solve it.

Remark: Greece as an example

Problems are similar but not identical.

1. Vision: where to be after the crisis: „Greece 2030“
2. How to raise productivity (no priority on wage restraint)
3. How to rebuild, competitive advantages, industrial policy
4. How to promote entry, new firms, growth of small firms
5. Attracting foreign direct investment (expatriats?)
6. Upgrading tourism : season length, health, culture etc.
7. Use of alternative energy, reduce high imports of fossil energy
8. Change attitude toward globalisation, openness as chance
9. Structural changes: education, innovation, regulation
10. Structure of expenditure, taxes, administration, gender policy.

- Larger share of structural funds, quick assignments
 - Cheap credits for SME in Southern Europe
 - Better focussing, less highways and airplanes, more business centres, new firms, software parks, knowledge transfer
 - Quantification of employment goals and active measures *
 - Knowledge transfer, incl. administration, lifelong learning
 - Low interest rates, bank union, Eurobonds, redemption fund *
- ⇒ EU-2020 goals important in consolidation period
- ⇒ Competitiveness & convergence (reform) contracts
- ⇒ Southern countries do not provide enough proposals.

WIFO ■ Complementary policy of high income - low deficit countries (agent 3)

- Stop policy of wage increase below productivity
- End policy of larger polarisation of incomes (which limits consumption and continue existence of low wage sector)
- Bolster demand: programs for clean technologies, sustainability
- Bolstering demand improves welfare in high-income countries (in their own interest, compatible with EU 2020 goals)
- Reduces amount of transfers to deficit countries (somewhat)

⇒ The issue: surplus country should excel in
Beyond GDP goals.

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WIFO ■ Three agents of reforms and their tasks

- Reforms must be developed (owned) by GR, P, Spain
 - Support long-run optimism und self esteem
 - Young people and females must be on board
 - Reform partnership with Greeks in the world
 - Europe must refocus and frontload help
 - Monitoring active components as close as deficits
 - High income-low debt countries have to invest in their own interest and reduce polarization at home
- ⇒ All countries go for socioeconomic transformation
- ⇒ Starting from EU2020; transformation as an opportunity.

- Southern Europe is surrounded by fast growing countries
 - New EU members on the Balkan, Black Sea Area, Northern Africa
 - Deep reforms in administration, in regulation, in transparency, attitude to globalisation and neighbours
 - Active components have to have the same priority as deficits
 - Expenditures can be cut in many areas without increasing poverty
 - New firms and FDI (plus public transport) instead of highways
 - Priority for young people, new business, openness, quality
- ⇒ “Change management” by government,
- ⇒ Reform partnership everywhere
- ⇒ S-Europe can become a hotspot in a prospering region.

Some pitfalls of current policy in Europe

- Asymmetry of macro imbalance procedure (MIP)
 - Austerity focus of country specific recommendations
 - Neglect of youth unemployment, increasing poverty
 - Perversion of FTT to a stamp duty
 - From energy efficiency to priority of low price
 - Subsidies for fossil energy still larger than for renewable
- ⇒ Instead of growth, employment, energy efficiency, CO2 reduction, resilience - based on innovation and entrepreneurship
- ⇒ Old concepts of price competitiveness (vs. US, China) are reemerging.

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- References
- Next projects
- Some controversial points

References on Governance and Economic Policy

- Aiginger, K., Huber, P., Firgo, M., Policy options for the development of peripheral regions and countries of Europe, WWWforEurope, Policy Brief No 2 (http://www.foreurope.eu/fileadmin/documents/pdf/Policybriefs/WWWforEurope_PB_no02_D504.1.pdf)
- Aiginger, K., Cramme, O., Ederer, S., Liddle, R., Thillaye, R., Reconciling the short and the long run: governance reforms to solve the crisis and beyond, European Policy Brief 1, WWWforEurope, September 2012.
- Aiginger, K., Schratzenstaller, M., "Consolidating the Budget under Difficult Conditions Ten Guidelines Viewed Against Europe's Beginning Consolidation Programmes", Intereconomics, Vol. 46, No. 1, 2011, pp. 36-42.
<http://www.intereconomics.eu/archiv/autor/356/>)
- Aiginger, K., Austerity should be complemented with a 'Social Pact', EurActiv, published 16 May 2013, <http://www.euractiv.com/priorities/karl-aiginger-austerity-compleme-interview-519651>)

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- Aiginger, K., The 'greening' of industrial policy, EurActiv, published 21 May 2013, <http://www.euractiv.com/sustainability/greening-industrial-policy-analysis-519874>
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- Area 1: Challenges for the European **Welfare State**
 - Area 2: The **Ecological** and Biophysical Dimension
 - Area 3: Drivers for Change: Innovation, **Industrial and Innovation Policy**
 - Area 4: **Governance** Structures and Institutions at the European Level
 - Area 5: The Role of **Regions** in the Envisaged Socio-ecological Transition
 - Area 6: Framing of the Project, **Integration and Synthesis.**

- **Competitiveness under New Perspectives**
- **Innovation governance across Europe**
- **Innovation for socio ecological transition**
- **Clusters for socio ecological transition**
- **Industrial policy for catching up countries**
- **Labor market and welfare reforms**
- **Modelling transition**
- **Feedback conference September 18-19th**

-
- Research agenda with "New Approaches" is overlapping
 - Any cooperation welcomed:
 - Interlinking webpages
 - Newsletters subscription
 - Workshops / Conferences
 - Sabbaticals
 - Cross refereeing
- ⇒ This afternoon could be a start for intensive cooperation between "New Approaches to Economic Challenges" and WWW for Europe.

- Catching up difficult and bumpy (250 regions)
- Out of regions in lower half (in productivity 1991)
 - Only 31 changed into upper half (2009)
 - Only 7 came from lowest quartile
- Only 16 regions of 250 managed to grow 2% above average continuously

⇒ **Regions are test labs for Currency Union**

⇒ **They share the problem not to be able to devalue.**

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- Determination and will to catch up
 - Institutions for change: agencies, social partners
 - Knowledge transfer, rule of law
 - Industrial base, services, clusters, change management
 - Education, Foreign Direct Investment, technology focus *
 - Long-run strategy, shared by society and opposition
 - Openness, education, innovation
 - Financial support from central region and government *
- ⇒ Low wage strategies do not work in the long run
- ⇒ The region provides the strategy, centre support.

- Greece needs new firms, new industry, quick start via FDI
- But location is not attractive: see rankings and facts
- What is necessary: some pecuniary incentives plus priority: transparent and quick processes, stability, rule of law
- All this is necessary for Greece in general
- But start and focus on new rules for some zones and projects
- EU competition authorities do not like special zones
- But if starting with administrative procedures they will not object similar “speed guarantees” as for Olympic sites.

-
- Scepticism as to their role in reforms
 - Employer's organizations favour monopolization, prevent entry
 - Trade unions defend privileges of insiders
 - Reform partnerships are feasible:
 - to change income curve
 - to offer wage restraint/time flexibility for employment guarantees
 - to offer bonuses in case of profits after period of restrained *
 - Are young people represented? Outsiders? Do they need a youth organization?
 - Youth think tank? Reform partnership "Young Greeks"?
 - Eco-partnerships? Waste management? Solar loading stations?

- Unemployment rate high, specifically youth
- But also experienced workers, if firm went bankrupt *
- Austria and Germany have shortage in several qualification
- Would be happy to take 100 – 200 Greeks (Germany 10x)
- Needs pre-screening in Greece to prevent disguised tourism
- The Austrian labour market service is happy to provide rules *
- This is a win-win for Greece and Austria, whether people
 - Stay 3 years or forever – experience, economic relations
 - There are lot of means available to support such an action.

-
- Exports to neighbours; GR 2.5% of GDP, EU average 15%
 - Exports to BRICs 0.4%, the same as 2000
 - EU average 1.9%, doubled since 2000
 - Greece does neither export to neighbours nor to BRICs
 - Globalisation: only 42% assess it as chance (least in EU)
 - Denmark 87%, EU average 56%
 - Other countries feeling threatened: FR, PT, RO
 - Military expenditures 2.5% of GDP, rank 2nd, EU 1.5% *

⇒ The strategy has to be developed by Greece.

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- Greece has highest youth unemployment rate
 - And no perspective to reduce it in the next 3-4 years *
 - Pensions are higher than active income
 - OECD: net replacement 110%, EU-15 74% *
 - Poverty rate rank 19, wage share rank 24
 - Wealth is de facto untaxed, no cadastre
 - Women better educated (94% vs. 85% in secondary education)
 - Male dominate on labour market (79% to 55%)
 - and in politics 94:6, EU 70:30.